PODCAST TRANSCRIPTION SESSION 51: SASHA ORLOFF

Welcome to the Lend Academy Podcast, Episode No. 51. This is your host, Peter Renton, Founder of Lend Academy.

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Peter Renton: Today on the show, we have someone who's a little bit different, he runs a different kind of company. Sasha Orloff is the CEO and Co-Founder of LendUp. LendUp are a short-term lender, what are called sometimes payday lenders, but they are doing something very different to most payday lenders. They are focused very much on a "win-win" for the borrower and the lender. They want to be able to help these people who have an emergency need or short-term need to help them build their credit and not sort of send them down into a debt spiral that really doesn't help anybody. They're a fascinating company, they obviously are tackling a challenging sector of the market, but they're doing so successfully and it's a fascinating story. Hope you enjoy the show.

Welcome to the podcast, Sasha

Sasha Orloff: Thanks, great to be here.

Peter: Okay, so let's just get started by giving the listeners a background about yourself and how your background kind of led you to start LendUp.

Sasha: Well, I'll tell you the slightly longer version because it's a little more fun. LendUp really came about out of years and years and years of frustration at most of my jobs involving financial services or financial technology. So I've worked at Citibank, the World Bank, the Grameen Bank, who won the the Nobel Peace Prize…whose founder won the Nobel Peace Prize, I've worked for some start-ups, one that was bought by AT&T for some transaction processing capabilities, one that was bought by Intuit for some bill payment capabilities.

All of my life, I would come home and I would complain around Thanksgiving...that I was always struggling to do as good as job as I could in my various sort of financial services roles. My younger brother was at home and he's been a software developer his whole life and he comes home and every time I am complaining he goes...oh, you have a software problem. I was at Citigroup and I would say...I can't evaluate all this data I want to make effective lending decisions and Jake would say...oh, that's a software problem and then I'd go over to the finance team and I would say...I can't combine all of these datasets together and do some really accurate forecasting. He's like...oh, you have a software problem and then I would go...I can't test all these marketing messages and conversion and funnel analytics. He said...oh, you have a software problem. So after years and years of complaining, he said...why don't we just build better software for the banking world.

And so to give you a little context about Jake, the other Co-Founder and my younger brother, he started at Yahoo when he was 16 years old as the 80th employee, as a developer. He worked there for quite a long time rebuilding search, video, photos, classifieds, auctions, etc. He's 29, he was recruited out to work on Zynga to build a centralized infrastructure team and became CTO of Platform at Zynga and so sort of qualified, but, you know, it's always hard to listen to your younger brother.

Peter: Right.

Sasha: So the long winded answer is I kept complaining that I had a software problem to do everything that I wanted to do in financial services, especially in consumer lending and so one day, we were down in South Park in San Francisco and he said...why don't we just do something about it and then a light went off and then...so we started LendUp.

Peter: Okay, it sounds like...before that you spent some time...why don't you tell everybody...I saw a video of you one time talking about...was it in Mexico or Honduras, where were you that you spent...you went down for a short time, you ended up extending it for years.

Sasha: Yeah, so I was working for a fintech start-up here in the late 90's in the Bay Area and I read a book called "Banker to the Poor" written by a guy named Muhammad Yunus who founded the Grameen Bank in Bangladesh and pioneered this idea of microcredit, sort of helping poor people in rural areas start businesses so that they could feed their families. It was so inspiring, almost like too good to be true that they would have a 98.5% repayment rate after billions of dollars lent and so I wanted to get involved. It moved me to the point that I give everybody, all our new hires, that book…still to this day here at LendUp.

So I called up and got ahold of the Grameen Foundation in DC which was tasked with replicating Grameen around the world and they were starting a technology company. They wanted to build open source software so free software to give away to banks around the world to start microcredit banks, small loans to poor people in rural areas and they said...well, we want to move to Honduras and you can go for a 6-month internship and I said, sure, where is Honduras? (laughs) They said it's in Central America. I said, great, I grew up part of my life by the border of Mexico, learned some degree of Spanish or so I thought.

So I moved to Honduras and stayed there for what was supposed to be six months, I ended up staying for almost three years creating training programs for these small banks, most of them non-profits, all throughout Southern Mexico, Central America, South America and we were giving away free software and actually giving them loan capital to try this idea of microcredit as an anti-poverty alleviation tool and it was like just mind blowing inspiring which was why I stayed down there for so long.

Peter: That's a interesting background to what you're doing now. I can hear that you're very passionate about it so why don't we segue now into explaining what LendUp does and what you saw that was broken that made you decide to start it.

Sasha: So when I was...prior to starting LendUp, I was a fintech investor, a venture capitalist and I was looking at all of these themes that were changing in the United States and I wasn't really seeing enough companies doing and bringing technology and better financial services to the underserved markets as much as I wanted to, especially around credit.

So we started LendUp and the concept of LendUp is we're using modern day technology focused on a mobile phone for access and reach to create safe credit products for people that banks and credit unions won't approve or can't approve for whatever reason. So the entire concept is to deliver access to credit, we believe access to credit is incredibly important and incredibly powerful, we do it in a very safe and transparent way directly over mobile phone, as fast as possible, embedding education into the product so that we're teaching people about how credit scores work, savings, budgeting, how their behavior affects their life and providing them the opportunity to build credit. One of our missions as a company is to try and improve everybody's credit score.

The reason is when I was at Citi, we funded a study from the Aspen Institute. What we showed predominantly with a wonderful non-profit named Justine Petersen in St. Louis was that the average family will pay $250,000 more over the course of their life because they have a low FICO score.

Peter: Wow!

Sasha: This will affect their borrowing cost for credit, insurance, jobs, their apartment and it was actually faster to preserve more household wealth in families by helping somebody raise their FICO score as opposed to trying to get them a raise at their job if they worked for minimum wage and that just…between my work at Grameen and the study with Aspen Institute and Justine Petersen was just…it made me think. We had to create better financial opportunities for the people that banks won't deal with to help them raise their FICO score so they can then get access to the traditional banking products that can help them get ahead in life.

Peter: So then who are we talking about exactly? Are we talking about immigrants, are we talking about people who have gone through a bankruptcy or just someone who is not very financially savvy. I mean, can you give us…I mean, obviously, it's not just one profile, but can you give us an example of some of the kinds of borrowers who come to LendUp.

Sasha: Yeah, so the biggest misconception is that payday lending or short term lending or sub-prime cards are these immigrants that come over. This couldn't be further from the truth. It is the average working class American person. Our profile and demographic fits into usually two main categories.

One of the 26 million people in the United States who have zero credit history and because they just don't happen to have any credit reporting relationships on the major credit bureaus, they have no FICO score and they have no traditional credit score so they can't get access. So that's one bucket, what we call no file or thin file people and these are just people that have worked in cash most of their life or young people that are just starting off in life.

The second main category are people that have low FICO scores. So they've had access to credit and they've had some incidents in the past and they just simply are either…had a bankruptcy, had a medical emergency, something that set it over the edge or people that just abuse credit the wrong way, have declared bankruptcy, had some write-offs in the past so their FICO scores are below 680 which is typically the lowest that most banks will go, which is over half of the United States today. So the average is actually…the highest predominant demographic is a working class mother working one to two jobs with two children and has a low FICO score or no FICO score at all.

Peter: Okay, that makes sense. So explain your offering a little bit…I mean, so these really are microcredit loans. I mean, you're not talking of thousands of dollars here. What is your offering, what's the loan terms, what's the dollar volume typically that people take?

Sasha: Yeah, so every state has their own specific laws, but on average across the United States, the average first time loan is around $200 for about a month. We allow people to borrow between $100 and $1,000 for between a week and a year. One of the things we do differently is we give the borrower the choice. So whatever the law allows, we give them the ability to pay in as many payments as they want, borrow exactly the amount they need, they can choose their repayment date or they can choose their first repayment date and split it into multiple payments. So we try to use technology to build a safe transparent experience in which the borrower controls the entire experience.

Peter: Right, okay, then so how do you find these people? I mean, if they've got a thin file you're not kind of…obviously, you've got channels, but explain exactly how someone's going to find out about Lendup.

Sasha: Right, this is one of the main challenges of a emergency credit business. How do you find somebody that is kind of off the record, they don't have a major bureau file and they have an emergency and you have to be top of mind in that moment that they have an emergency and need money…so it's to fix their car or to pay their utility bill or their phone bill so their phone doesn't get disconnected and that's a challenge, right? It's not as easy as refinancing existing loans which are on the bureaus so you're competing on price…send a mail piece out or something to somebody who has existing credit to refinance them.

That's one of the things I almost get jealous about the Lending Clubs and the SoFis of the world is you're refinancing people's debt, it's kind of easy to find them. So ours is a little bit different. You know, frankly, one of the biggest channels we have is word of mouth and when you create…our product is just better than the competitor's in every way, it's cheaper, it's faster, it's more convenient, it provides the opportunity to build credit and we're very flexible because the same technology we custom built for our own product we expose to users. We let them do everything they want, there's no debt traps so there's no way to get in trouble with our products.

It turns out if you're just better in a population that has very few options, they tell their friends about it. And we see this really interesting thing where once somebody finds us in a neighborhood, if you do this like time series over a map, you can just see it kind of spreading which has been great. It sort of reinforces that a really good product that actually focuses on solving the customers' needs can win, but we also do all the traditional stuff, TV, radio, mail, online advertising, stuff like that.

Peter: Right, okay, so then I want to talk about….you mentioned different states have different rules and we all know about the usury caps…you know, any kind of short term loan, APRs kind of…it's not a very good measure because you might only be paying $20 in interest, but your APR is over 100%. So what are the laws that govern short term lending? They must be different, I imagine, from the rest of lending.

Sasha: Yes, there's two different types of laws traditionally in most states, well, at least in 35 states. The first one is the General State Usury Law for an unsecured or secured long term loan and each state has those measures…in all 50 states. Thirty five states allow some form of short term loan and it's not considered an APR usury fee because it is a fixed fee associated with it and because it's a short term loan what happens is it's a fixed fee so in California, the maximum is 15% of the face dollar value of a check.

Peter: Okay.

Sasha: And so when you multiply out a two-week or a one month loan times either 12 or 24, the APR looks really high, but it's not part of the usury laws because it's actually a fixed fee so it's a fee-based product in most states and the fee is defined outside of the usury law because it's a fixed fee for a short term, not an annualized loan that would have an APR associated with it for usury cap.

Peter: Right, so then just on that point, obviously, you've probably heard this argument so many times, but I just would want to hear your response. Many people say that the APRs are…you go on to your website and actually display the APRs which is nice and oftentimes, they're over 100, 200, even 300% so what is your response to people who say that's too high.

Sasha: Yeah, so the first thing is because it's a short term loan almost all of our customers, and I know this because we survey them and then we survey other people's customers, what they care about is the dollar amount. They're managing their short term cash flow, but a good way to compare different types of structures together if you can is to look at APRs so we displayed both right on our home page. It's not hidden, you can see it, you don't have to enter in any personal information and that's just part of our value of transparency.

So, while none of our customers which we surveyed have ever been able to tell us what an APR stands for or what an APR formula is. They understand dollars and cents, but we put them on there. So, listen, it is an expensive form of credit and it's because we are dealing with high risk people that no bank would ever work with, We carefully underwrite each consumer, but we're concerned with the false negatives as much as the false positives. So what's important here is to have a transparent product so how ever people want to think about it, they can see it in the form that works for them. That's why we have dollar amounts larger because that's what people care about most, but we put APRs there.

The most important thing about what we do differently is we don't let that turn into multiple loans with rollovers and refinancings. So what you see in that dollar amount is what you get when you pay for it. We don't have any of these weird tricks where people can end up paying more in interest or fees than they can in principal. That's the difference so what we're showing you is the maximum price, not the minimum price which is sort of the most traditional thing.

And then for people that need to borrow again and again, they move up our product which is called the LendUp Ladder and their APR can automatically go down. Even If they were to get that same structure loan again and again and again and they did that for a full year at a competitor, that would actually be an APR because it would be a full year where our interest rates automatically go down over time for borrowers that pay on time, take our credit education, stuff like that.

Peter: Okay so what about the borrowers that can't pay on time or they thought they'd be able to, but something else came up and at the end of the month they just don't have the money. What do you do then?

Sasha: Yeah, so this is one of the key differences in showing the maximum price as opposed to a minimum price. That's it, that's all the borrower pays. If they can't make their payment on time then we call them up or they log in and they see the ability to break it into as many payments as they want to fit within their budget that they can afford. So if they can't pay the full amount, they can split it into two payments or they can split it into three payments. They can do that alongside our customer service, they can do that by themselves by logging into the website.

They can pay via cash, via check, via debit card, via pre-paid card, via their bank account. So we give everybody as much flexibility to do exactly what they need to be successful and part of this is to train people about the responsibility of making on time payments because that's the largest factor in somebody's FICO score. So our entry level loan is like training wheels, but it's just very safe because we've structured our product so we only make money when somebody pays us back, not when they get into trouble so we don't make any more money, no accruing interest, no rollover fees, that's it. What you see is what you pay and as many times as you need.

Peter: Okay, okay, so then how do you decide...obviously, I imagine, not everybody gets a loan or do they, I mean, that's the question. How do you decide, what's your underwriting process, let's start off there, I want to talk about your default rates as well. Let's talk about your underwriting process.

Sasha: So what we do is we look at minor credit bureaus, small specialty bureaus that look at payment records on cellphones, on utility bills, on rental payments, on whatever we can find that shows a steady, positive history of repayment behavior. So we underwrite those people by using different data and people that have a bad credit score, we can supplement it with other data, but really what we do is instead of just looking at the 10 to 15 variable list, we just use the entire dataset and there's a lot more value in there.

For instance, when we were at the bank, when I was underwriting at the bank...if somebody had a bankruptcy, they were basically locked out for seven years. Well, bankruptcy isn't always necessarily a bad thing. If you had a bankruptcy because you were using credit the wrong way and you were just maxing out lines and borrowing more and more and more, that's different than somebody that had a foreclosure on their home or somebody that had a medical emergency. So by not just taking one binary variable and making that a yes or a no, but using that as a factor in a long list of decision criteria then there's actually a lot of valuable information in there that can give us confidence to be able to underwrite.

Peter: So you use data wherever you can find it. You use the major bureaus, do you use like alternative data like social data, anything like that that's non-financial?

Sasha: No, we don't. As a start-up, there's only so many things that you have time and capacity and money to focus on and while I think that there is incredible signal in some alternative data, we just simply don't do it. We only use FCRA (Fair Credit Reporting Act) compliant data. I think that is a battle that I hope somebody wins to unlock this ability to use other data, but that's not our battle.

Peter: Right, okay. So then tell us about the LendUp Ladder and how borrowers...I mean, they can build up their credit you said by paying on time, educate themselves…watching videos, how does that work?

Sasha: The LendUp Ladder is really...we first talked about a very safe product and our goal is to solve somebody's problem, that's why they need emergency credit. Get them the money they need in a safe way, solve their problem and let them get on with their life. The problem though is over 50% of America today is living paycheck to paycheck and doesn't have access to traditional banking products so over half of our country is subprime, meaning they don't have access to most traditional banking loans.

So the LendUp Ladder is how we work with repeat customers. We give them a chance to de-risk themselves through positive repayment, through taking our education courses, sharing more information, things that help them de-risk themselves and just like how you and I would pay our credit card on time and we would earn access to a higher line at a lower rate, same thing with the LendUp Ladder. Customers can earn access to more money for longer periods of time at lower rates. At the top two levels we have gold, silver, platinum and prime, they can report to the major credit bureaus and this is how they can improve their credit score and gain access to more and more products either with LendUp or beyond LendUp.

Peter: So you're not reporting to the bureaus at the bottom two. What's the reason for that?

Sasha: There's twofold; one is the bureaus don't want that data.

Peter: Okay.

Sasha: The second is it's almost like a training wheels program where in the United States, which is different than other countries, it's very easy to have your credit score lowered. It’s a logarithmic sort of scale, but your score can go down much easier than it can go up. And so what we don't want to do is create a behavior or create a customer that has the ability to lower their score really, really fast. So we always think about silver and gold, the sort of training wheels program to get people used to the structure, make sure that they can understand how their behavior is affecting their credit score. That's where education and our notifications and our gamification come in and then we turn them into credit reporting relationships with a high degree of success.

Peter: Yeah, let's talk about success. I want to get some sense of the performance of these loans and kind of the losses that you receive from your borrowers. Can you tell us a little bit about that?

Sasha: Right, so we measure success in two ways. The first is financial success. We're not a non-profit, we're a venture-backed start-up and we have to build profitable growth with good fundamentals, otherwise, we would never be able to raise…continually raise venture capital and debt capital. So we think about both the approval rate, the loss rate, the marketing cost, the operational cost through net present value and what that tells us is whether we are growing profitably or we're growing unprofitably and by every state and by every channel we hold ourselves accountable to profitable growth.

So we have better than a nine-month payback in all channels and all states overall across our company and we are growing in a profitable way which is exciting to see and exciting to hear. Else we wouldn't be able to continually lower interest rates from about half of market to about a 20th of market. We're giving loans to customers that banks should be giving loans to at 19 to 29% APR. If we weren't showing good performance through our product and our gamification and education, we would be losing money and we wouldn’t continue to be able to get hundreds of millions of dollars from both equity and debt. Venture capitalists...they would come in and they wouldn't give us money if we went out trying to fundraise.

Peter: Right.

Sasha: The other way in which we measure success is through the building of our credit scores of our consumers. We did a study with TransUnion against other customers by similar credit score bands and by people that took out other loans and what we saw was LendUp customers have a higher likelihood of having a credit score increase, they have a higher likelihood of having a material credit score increase and they have a lower likelihood of having their scores go down and go down materially.

Peter: Okay, so that sounds good. I want to talk a little bit about something you just touched on there, about who is funding your loans. I know when we chatted a month or so ago, you said you just hired a capital markets guy, so I guess…who is funding your loans today and what are your plans? Are you looking to start a marketplace, what are your plans there?

Sasha: Yes, we hired a capital markets guy and it's time as our business is building and growing so fast. We've been growing 15% new customers month on month for almost three years so we're getting to a substantial size even though our loan sizes are between $100 and $1,000 and between a week and a year.

So we're funded now with Victory Park Capital, great, huge dedicated specialty financed lender located in Chicago and they've been very supportive and very aggressive, but as this grows we just have to diversify our funding sources over time. It's too much of a material risk to the business. So we're looking at exploring what different types of funding mechanisms can be, one in which we still get to participate in the loans because we want to make sure we're aligned with the right incentives and we give debt providers the ability to make a healthy return based upon their risk level across our different types of products.

So we're exploring what that could look like, but given how short durations some of these loans are, whole loan sales I think is going to be a challenge, if not impossible. Maybe you can help us here. We'd love to structure something in which we can offer the ability to invest in our loan pool in a way that provides a great return for investors in a diversified suite and so we're exploring this stuff right now and we should follow up on how best to do this given your expertise.

Peter: Sounds good, sounds good, we'll talk about that offline. So before I let you go, I want to talk about your new product. I mean, I was at Money20/20 recently where you launched the L Card and I wonder if you could share a little bit about what that is. It seems like an ambitious endeavor at first glance (laughs). Why don't you tell us a little bit about that.

Sasha: The L Card is the proof of concept of our new company called LendUp Card Services and what we're trying to do is bring a lot of the principles from our loan product, mainly control and transparency, to the credit card industry. We built it because we saw that credit cards were not entirely working for the customers we wanted to serve and we knew we could change that so we announced with FIS that we're giving customers for the first time access to the authorization stream, meaning that customers with our credit cards can now control a lot more over how and when and where their cards are used. They are better able to protect themselves from fraud and at the same time, it just adds another layer to our LendUp Ladder where we can let people borrow at a lower and lower and lower cost.

So we can literally take borrowers now that banks have never and would never be able to work with because of their lack of or bad credit history and progress them through the LendUp Ladder. Now if they pay back their balance in full at the end of the month, they have a zero dollar borrowing cost. So imagine taking somebody from the APRs of the market between 400% and 1000% APR and bringing them down to a borrowing cost of zero dollars month to month. That was just something that we felt was really important and needed in the market and we had to build it.

Peter: So this is going to be available only to your existing customers, is that correct?

Sasha: No, this will be available to people along the way. The concept of the LendUp Ladder was to first help customers who only have access to this horrible financial product called a payday loan and give them the ability to continually de-risk themselves over time and as they de-risk themselves we share back the profit with the customer by lowering their interest rates.

This was just a natural extension, but the next iteration of LendUp, as you start thinking about it, doesn't mean that it's only available for LendUp customers, but for customers that are only looking for an alternative to payday loans. They should be able to start at different levels of the LendUp Ladder directly and that's what we're starting to test now and that's where we're starting to get to. So the L Card will be available to the general public, but we're just still finalizing some of the rough edges. We want to have a really good sense of control and foundation and make sure that it really works with the consumers before just trying to build it up and build it as fast as possible.

Peter: Right, okay, that's fascinating. So, I guess, last question, you seem like you've got your core constituency here which is really pretty unique in our industry where most people are either going after the prime or even the mid-prime kind of borrower, is this where you want to focus? Are you intending to go up the LendUp Ladder all the way to compete with like a Lending Club or are you firmly entrenched in sort of the more subprime arena?

Sasha: I think that we're definitely squarely focused on the consumers that banks cannot or will not work with. That's where our software works really well, that's where our underwriting works really well, that's the customer that we really know and we see a lot of opportunity there to build out a suite of products specifically focused on this customer and our goal is to get them to be able to be a Lending Club customer or a bank customer. The fortunate thing is it's over half of this country, it's a huge market so getting people to better and better rates over time so they can get access, that would be a huge win. We're not going to move upmarket, we'll stay squarely in that subprime, near-prime market. That's where we think we have the biggest opportunity.

Peter: Okay, well best of luck. You've done a great job, so far, Sasha, and I think it's a fascinating story. I appreciate you coming on the show.

Sasha: Yeah, thank you for having me.

Peter: Okay, see you.

Sasha: Bye.

Peter: There is a segment of the population that has been horrifically underserved, there's no other way to put it and I think it's great that a company like LendUp is coming in and serving them in a way that's a positive for everybody. I wish them all the best. They have a great idea, a great product, they appear to doing quite well. As I said, it's a very ambitious project, their L Card, but you can see, you can hear it in Sasha's voice that he is very passionate about what he does. He's passionate about this company and he is going to build a company that is going to be one of the leaders, if not the leader, in the subprime market and I certainly wish him all the best.

On that note, I hope you enjoyed the show. If you have any comments or questions, feel free to contact me peter@lendacademy.com. Also would love to get a review, if you haven't done so already on iTunes or Stitcher. I read all of the reviews and love to get the feedback. Anyway, on that note, thank you very much for listening. I will catch you next time.

Bye.

(closing music)