LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 80: ANDREW GRAHAM

Welcome to the Lend Academy Podcast, Episode No. 80. This is your host, Peter Renton, Founder of Lend Academy.

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Peter Renton: Today on the show, I am delighted to welcome Andrew Graham. He is the CEO and Co-Founder at Borrowell. They are a marketplace lending platform based in Toronto, Canada. They are north of the border here and they've been around for a couple for years. I wanted to get Andrew on the show to talk a little bit about his company, talk about some of the unique things about the Canadian market, some of the unique approaches they are taking particularly when it comes to borrower acquisition and also, we delve into some depth about a recent partnership they announced with a large Canadian bank. Hope you enjoy the show!

Welcome to the podcast, Andrew.

Andrew Graham: My pleasure, good to be here.

Peter: So let's just get started with giving the listeners a little bit of background about yourself and what you did before you started Borrowell.

Andrew: Sure, I worked for a Canadian bank running the insurance division and I did that for a number of years and saw how profitable the credit card division was. Every quarter we'd work as hard as we could in insurance and be soundly beaten when it came to profitability by the credit card division. So that was sort of what gave me an insight that there was something interesting going on in unsecured consumer credit here in Canada, like there has been in many other parts of the world.

Peter: Okay, so was that the impetus for starting Borrowell? I mean, what was the trigger that got you over the edge and decided you wanted to found a new company?

Andrew: Well, Canada is an interesting market in a number of ways. We have a very concentrated banking system; the top six banks in Canada control close to 90% of assets, much more concentrated than the US, for example. And as I was sitting in my job sort of looking out on the industry and seeing how profitable credit card businesses were in this system and then...going to LendIt in the early days and looking at how the online lending industry was evolving in other markets, it really struck me as sort of strange that there wasn't any activity really in online lending in Canada at a time when it was growing by leaps and bounds in other markets.

As mentioned, you know, the Canadian bank industry is very concentrated and there's a bunch of dynamics that make it an even more attractive market for unsecured consumer credit. Interest rates on credit cards are almost universally...in Canada, 19.9% or higher. I have read one study that sort of said, you know, interest rates in credit cards are about 400 basis points higher on average than in the US, and yet, default rates across the cycle and across almost any part of the credit spectrum have been lower traditionally in Canada, including in 2008. Losses were lower on average across portfolios here than in the US so there's some fundamental dynamics that make Canada, we think, a very attractive market for this kind of product and it was striking that there was no one doing this when I and my co-founders sort of first started looking at this in 2012/2013.

Peter: So can you just tell us a little bit about the Canadian system, let's talk about banking. You talked about the six big banks, do these banks all offer personal loan products or did they offer and they stopped, how's the banking system...what's it like in Canada?

Andrew: We have a very stable banking system, we had no significant...really no banks of any kind go bust during the financial crisis, but the corollary of that is that it's a very profitable banking system so a statistic we like to use a lot is if you lined up all the world's banking systems by aggregate profitability, not on a per capita basis, but just by aggregate profitability, Canada comes fourth. So there's more banking profit generated in Canada than in the UK, for example, or in Germany, countries that you think of as being very well developed when it comes to banking. There's a lot more profit generated, about 2X on a per capita basis what banking profit is in the US so we have a very stable, but fundamentally a very expensive banking system here in Canada.

Certain kinds of products are readily available, for example, lines of credit are increasingly available. Whereas banks have really de-emphasized personal loans at the expense of lines and lines are much easier to get, of course if you have an asset to secure them against like a house so getting an unsecured line is a challenge, especially if you don't have a relationship with the bank previously, it involves many visits to the branch, etc. typically. So when we were looking at the market, it was not common to get a loan first of all and certainly, it was not possible to do it online.

Peter: Right. so then did the financial crisis impact what banks were offering? Like, you know, in the US banks that had a personal loan offering for the most part, they removed those from their offerings and on small business they tightened it dramatically as well because of the crisis. Did the same thing happen in Canada?

Andrew: Yeah, I'm not sure if the pullback was quite as stark. I think there just wasn't the availability even before the crisis of personal loans so the pullback may not have been as stark, but we sort of ended up in a similar place.

Peter: Right, right, so let's just talk about Borrowell for a bit. Tell us a bit about your company, what kind of loans you do, what are the terms of loans, what do you offer?

Andrew: So we're focused on prime consumers, meaning people with credit scores above 660 and we offer, I would say, sort of a fairly standard prime consumer loan product which is a personal loan with three-year terms and five-year terms. We do between $1,000 and $35,000 and our rates range from about 5.5% up into the mid 20's.

Peter: Okay, so that's pretty similar to what many of the US platforms offer. Then as far as the borrowers themselves, you said prime consumers, but what are they using it for? Is it debt consolidation primarily of credit cards, I mean, what are the kinds of borrowers that you're attracting?

Andrew: Debt consolidation is certainly a large share of our origination volume because we've certainly been active targeting those consumers. We skew higher than many other platforms in the prime space in our market so our average FICO across our portfolio and it's roughly equivalent to sort of what a US FICO would be, is about 740 so that's quite a high sort of average FICO. So we've been able to attract, I think, a very high quality group of borrowers and average loan size for us is about $12,000/$13,000.

Peter: Okay, so how are you finding these borrowers? Are you finding these people online, are you doing a lot of direct mail, how do you attract them?

Andrew: It's really a combination of different channels. We started out, I think more focused on online channels and we've had a particularly strong relationship with Facebook. They've been very helpful and supportive of what we're doing. I think the channel though that we're most excited about is a proprietary channel that we launched back in June. Before we came along there was nobody in Canada offering credit scores for free, it just wasn't a thing here. There was certainly no one offering them on a mass basis so we became the first company to do that. We partnered with Equifax back in June and we now offer credit scores for free and we've had tremendous response to that in just a sort of...four months since launching.

We've had about 130,000 people now sign up for that program so really, really good response. I think there was sort of a pent up demand and that gives us an opportunity to advertise our loan products to people who are appropriate for it. So that's become a very important channel for us and one that we're excited about. I mean, it also in some ways eliminates the challenge that comes from targeting people who are actively searching for loans. I mean, that channel allows us to avoid that by targeting people that are there to get a better education about their credit score and I think we know that a big lesson from certainly the US experience is that channel matters a lot when it comes to assessing credit quality.

Peter: For sure, a Google Adwords person is very, very different compared to someone who's coming from Credit Karma or even a direct mail piece where you know what their credit score is and you know what kind of borrower they are. It's fascinating that Canada didn't have that because it's been around in the US for many, many years, but it's curious to me because there are so many parallels between Canada and Australia. We have a very similar banking system, they are extraordinarily profitable. The leading company in Australia has also gone and created a free credit score system…SocietyOne, they did that.

So you've got this proprietary channel, that's fantastic. Let's just talk about the underwriting piece…firstly, before we go there, when you're giving people their free credit score and you've partnered with Equifax that means you have a very solid credit picture of all those 130,000 people that have signed up for that, is that fair to say?

Andrew: Yeah, absolutely, it's a way for us to get to know customers better and not only, of course, at a point in time, but over time so we're very excited to use ongoing credit data rather than just point in time credit data to feed into our pricing models and so forth. We think there's actually a lot of synergy when you combine the model of sort of credit monitoring and lending, we think there's some natural synergy there.

Peter: For sure, and I think they are going to be a high quality borrower too if someone is really interested in monitoring their credit. They're going to be less likely to not pay their bill because they care about their credit clearly. So let's just talk about underwriting for a little bit. Tell us how you built your underwriting model and how you're refining it, what your approach is.

Andrew: Yeah, I would say we have sort of a two-part process. We, first of all, have a number of tools that help us assess fraud risk. You know, as I'm sure many of your listeners know and can relate with, fraud in the online channel is always a risk and something that we have to be very careful with. So we have a series of tools we use to assess fraud risk and that's a part of our business where we did a lot of development in the past couple of years and we're really excited about where we've landed. Of course, the war is never over, there's always very smart people on the other side trying to figure out ways to defraud you so that's a fight that's never finally won.

Peter: Of course.

Andrew: And then a totally separate decision for us is then the credit decision. We take, frankly, a more traditional approach to credit risk assessment, we think information from the file, much more than just score, but we think information from the file is really the best information there is for assessing when it comes to our prime borrowers. We do supplement it somewhat with other factors, with other variables. As I mentioned, channel matters a lot, we believe, but fundamentally, we're not looking at the number of Facebook friends that you have when deciding what interest rate you get or whether you qualify for a loan. We leave the more social, exotic stuff for fraud and focus on, really I would say traditional credit underwriting for pricing and for loan approvals.

Peter: So do you have people who have worked in the banks, maybe for the credit card divisions or whatever that are really helping to create this or how have you gone about creating it?

Andrew: Yeah so one of my co-founders is a gentleman by the name of Scott Laitinen and Scott worked at the bank where I was previously. He was Chief Risk Officer there and managed a large credit card portfolio, multi billion dollar credit card portfolio, for a number of years including through the financial crisis so he was Chief Risk Officer of a credit card portfolio through 2008, 2009, 2010 so really saw first hand what happens to unsecured loan portfolios through a crisis like that…25+ years of banking experience so a really important person in the foundation of the company.

So we believe it's sort of back to our approach of we believe sort of in fundamental understanding of credit and we believe there is in some ways no substitute for experience. Scott works closely with our analytics team which contains people who don't have 25 years of experience, but have a lot of experience with latest statistical techniques and we think that's a great combination. I think when you can put someone very, very experienced or a team of people very experienced together with folks who are very quantitatively adept, you come up with a great solution and a great approach to credit risk.

Peter: You've been operating for some time now, I mean, how have the defaults been trending, what can you share about that?

Andrew: Yeah, we've been lending for just under two years so we like to joke that it's too early to declare victory (Peter laughs), but it wouldn't have been too early to blow ourselves up and I am very happy to say that we haven't…everything is so far, trending within expectations, within the tolerances of our models. But, again, we're cautious to sound any note of victory because it still is early and we know that as these portfolios season, a lot a lot of that seasoning happens after 12 months so we're cautiously optimistic, but keeping a very careful eye on things.

Peter: Right, right, okay. Let's switch on to the other side of the equation here and talk about the funding of these loans. Who are some of the investors and could you just tell us some of the people or organizations funding these loans?

Andrew: Yeah, sure. We were proud to have gone to market in partnership with a large Canadian bank, a bank called Equitable Bank, which right from the beginning was a partner of ours. They were a participant in our first equity raise and were one of the first organizations putting funds on our platform to loan. They've really been a perfect partner, they don't have a credit card portfolio themselves so there's no conflict with an unsecured portfolio there, but they have a ton of experience with credit underwriting.

They focus largely in the mortgage space, but have a deep understanding of consumer credit risk, certainly in the Canadian context, and were an important partner working with Scott, our Chief Risk Officer in building out our initial credit models and asking the hard questions and sort of validating that they made sense according to certainly their deep experience. So they have been funding loans on our platform from the beginning and have really been a superb partner for us.

We have another Canadian bank, a larger Canadian bank, not public yet which one that is, but we do have a Canadian bank on our platform, another one funding loans.

And then we have a series of family offices and other sort of high net worth individuals. The true sort of peer to peer model is still challenging in Canada from a regulatory perspective. It may be somewhere we go eventually, but it's certainly not where we started. We wanted to make sure that this business was very easy for…fit in squarely, I guess I should say, with sort of existing regulation.

Peter: Right, I mean, do you still have the concept of accredited investors there where...are you open...you say you have family offices, but are you open to individual investors or is it all institutional and who are you open for?

Andrew: I mean at this point we're focused on institutions which we would include large family offices in that group.

Peter: Sure.

Andrew: We're not sort of publicly advertising in any sense for new loan capital investors. Because there aren't as many people doing this in Canada, I think we offer a fairly unique channel to the asset class, to unsecured consumer credit and we've spent a lot of time with organizations in Canada and also organizations in the US and have actually had very good reception from a number of debt funders in the US to what we're doing. I think for US institutions getting geographic diversity into Canada is attractive so we've been really pleased with the interest that we've seen.

Peter: Did you have any fallout this year because we had the capital markets pullback earlier this year, we had the Lending Club episode. Did you have any fallback in your business?

Andrew: I don't think it made things easier (Peter laughs) in any sense, but on the other hand, this is still a fairly nascent asset class in Canada, it's earlier and there's still a lot of growth I think in interest. That may have been tempered a little bit, but we're just at a very different stage, an earlier stage in this market and so there's still a lot of interest in it. So it didn't help, but has not been fatal or hasn't stopped us on-boarding new investors, for example.

Peter: Right, right. Speaking of investors, what is the return expectations across your platform? Obviously, you've got different rates going from just under 6% to over 20%. What's the return expectations that you provide your investors?

Andrew: We guide our investors to 7% to 8% after losses and after fees. We're currently doing better than that, but again, it's early and we're not…too early to sort of say that higher numbers will be consistent, but that's what we're aiming to return our investors.

Peter: And then with fees, are you doing a similar sort of model? Do you have an origination fee and a servicing fee on the investor side, or how are you generating revenue?

Andrew: Yeah, that's exactly right. We have an origination fee that gets charged to the borrower, we have a servicing fee for the investor and increasingly, with our free credit score platform we're experimenting with and believe that there's some long term value that we can create for our members showing third party products. So the reality is that there are a lot of people who don't want, don't need loans, but may well need a mortgage or may well will need other kinds of credit products and we think by presenting very targeted offers to them, we can create value and that's something that we're focused on as well. So we're diversifying our sources of our revenue, but remain sort of focused on providing consumers with the right credit solutions.

Peter: Interesting, interesting, that's great because you've got a major asset there with 130,000+. I'm sure you're getting many, many in every single day, many new people and it's nice to be able to monetize that beyond just the very small percentage that would want an unsecured personal loan.

Anyway, I want to talk about this partnership that I read about recently. I know we emailed back and forth about this a little bit. I know that CIBC, one of the largest banks in Canada, you've got them now as one of your partners, it seems like a bit of a coup from my perspective, why don't you first explain who is CIBC and how did you end up getting on their radar?

Andrew: Yeah, so CIBC is one of the five largest banks in Canada and really a very large bank in the North American context. They have about 11 million customers and are a significant player here, have been around for a very long time and I think increasingly, the new CEO who took over there relatively recently have been increasingly focused on the power of digital and the power of technology to better serve customers and I think they've been very sort of forward thinking about the value of partnership in some instances as a faster and better way to get new ideas and new products to market. So our partnership with them is very much in line with that.

We are out in market now with a really exciting product, it's a version of our three and five-year term loans co-branded so this isn't a white label, this is a co-branded offering and from the beginning we were both really excited about that approach. We think it sends a great signal to the consumer and so it’s a way for their customers to access three and five-year term loans using the easy online approach that we built here so it leverages our technology and our processes and makes life, we think, better for their consumers.

Peter: So I've got to ask you, okay, you're a two-year old company and you’re doing business with a large publicly traded bank in Canada that has 11 million customers and clearly is a behemoth compared to you, how do you convince them that they need you?

Andrew: I really give their senior management a lot of credit for that, I mean, I think they ultimately decided that a partnership like this was in their best interest. That's something they wanted to pursue and right from the beginning have been really determined to get it done and to get it done in a way that was effective and positive for both parties. And you're right, there are cultural differences between a bank with 11 million customers and a two-year old platform like ours (Peter and Andrew laugh), but I think in the end it wasn't always easy. We've been able to get some of the best from both approaches.

We've become a lot smarter about underwriting by spending a lot of time with their credit team, sort of showing them our approach and saying...this is how we do things, what do you think, and having them sort of challenge us. That's helped us. We've gone through all the sorts of tests and audits that you'd expect that we'd have to go through given the sort of tight coupling so we've had so many different penetration tests of our IT system, a whole bunch of other kinds of audits on our controls and these are things I just don't think many platforms at our early stage would do, but as painful as some of them have been, I think we're a stronger company for it.

Peter: Sure.

Andrew: Without sort of being immodest, I hope we've taught them a couple of things about our approach to development and being agile and moving quickly and iterating quickly to improve the consumer experience. Our belief is, and certainly from everything they've said, that it's been a positive so far for both sides.

Peter: Do they have a large credit card portfolio, I mean, I imagine they must have if they've got 11 million customers. Answer that question and if so, then how are they getting around that fact with the cannibalization piece or do you think they really are such different products that it's not going to cannibalize?

Andrew: I can tell you they are very much a large credit card issuer in Canada, one of the largest. I don't want to speak too much for them, but I can say that I think they recognize that the world is changing and financial services is changing and cannibalization can be a risk for incumbents, but in some ways there's a bigger risk for incumbents across many industries and that's being behind change rather than in front of it. So I think they're taking a perspective of better to lead and understand what's going on versus not.

Peter: I presume this is just an offering they're making to their existing customers or if I went on to CIBC's website and I look for personal loan, would I see this offering?

Andrew: We're taking a very sort of startup technical approach here in that we're starting with a limited base of customers and then rolling out to a larger group as appropriate so it's not available today if you went on to their website. You would be eligible for this if you were part of a select group essentially of their customers today.

Peter: Okay, so did you create a special underwriting box just for CIBC that's really tailored to their needs or did you iterate on your own underwriting model and it's using a standard model?

Andrew: You know, without wanting to give too much away I can tell you there was great contribution from both sides so it's not exactly the same product that we have, there's no origination fee for example, but it certainly took input from both sides to build it and we're excited about what we've built together.

Peter: So this is purely just…if there's no origination fee I mean, I'm imagining...are they putting capital on your platform as well or is this just purely like a software as a service type deal?

Andrew: I think we both view it as a partnership. The fact that our brand is on it as well, I think, is an indication of that so we view ourselves as much more than just a software vendor, for example. I mean, we view it as a partnership when we speak to consumers…as part of this program, they see the co-branding and the financial setup is supportive of that.

Peter: Okay, are you looking for more deals like this? I mean, there's five other banks that are in Canada...it's not like America where there really are hundreds or thousands of banks, hundreds of mid-sized banks...I mean, is this something that you want to shop around to others or is this something you're focused on just for this one entity?

Andrew: You know, I think it's early days for us with this partnership. We started life as a pure consumer play and I think we're very excited about how that part of our business is growing, particularly with the free credit score offering as well as with the growth in loan volume that we're seeing every month. So we remain very excited about the opportunity to be part of consumers' wallets here and eventually in other markets as well, perhaps, but we're also very excited about this partnership and I think there's real synergies back and forth.

We're going to get smarter, faster on underwriting by working with CIBC and we're going to be able to continue to evolve that product because of what we're doing in our direct channel as well. I think it's a bit early for us to say how much of our focus shifts to partnerships. I think we're very excited about this partnership and happy to talk again in six months or so and give you an update.

Peter: Sure, so then let's just look into...I mean, look forward to 2017, you've got this partnership in place, the rest of your business is growing steadily, what's next? Are you trying to just focus on your core business, are you looking for new business lines? As you look to 2017, what are some of your goals?

Andrew: I think 2016 has really been about creating a platform for growth so it's been about proving out that our underwriting, so far, is working well, knock on wood, with our core lending business, improving our understanding of channels for that business, lowering our cost of acquisition for that business. It's been about launching a new channel in terms of a free credit score and then it's been about building this partnership with CIBC and I think 2017 is about continuing to build on that base.

We think there's absolutely room for additional product innovation in this market, we think there's absolutely opportunities in other markets, but we've got a lot on our plate right now. We've got three different initiatives that all intertwine and all support each other, but nevertheless all ones that we need to kind of continue to nurture and grow and that's going to keep us busy through certainly the first part of 2017.

Peter: So we're not going to see you here in the US except for maybe at a LendIt conference, we're not going to see you here in the US anytime soon then?

Andrew: Well, never say never, but probably not in Q1 of 2017. (laughs)

Peter: (laughs) Right, well on that note I'll have to let you go. I really appreciate your time today, Andrew.

Andrew: It's my pleasure being on the podcast. Certainly one I've listened to many times.

Peter: Great, thanks, see you.

Andrew: Thanks, bye.

Peter: Canadian Imperial Bank of Commerce, that's what CIBC stands for, they are, as Andrew said, a large Canadian bank. They have a $29 billion market cap, they have over 40,000 employees and they decided to partner with a fintech startup to really help them offer loans online to their customers because they realize it's not their core competency.

The way I look at it is this, lending is moving online, it's an unstoppable trend, every bank will be impacted by this. If you're offering consumer loans, small business loans, even real estate eventually, you are going to have to offer an online product and some of the more forward thinking banks are making moves into this area right now, but we still have barely scratched the surface.

I think 2017 is going to be the year of the bank partnership, I think we're going to see dozens of these kinds of relationships get established. I applaud Andrew and his team at Borrowell for really taking initiative here and signing a deal early with a very large bank north of the border. We are going to see many more of these, I think, in the US in 2017.

Anyway on that note, I will sign off. I very much appreciate your listening and I'll catch you next time. Bye.

(closing music)