LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 101-RAUL VAZQUEZ

Welcome to the Lend Academy Podcast Episode No. 101. This is your host, Peter Renton, Founder of Lend Academy and one of the Co-Founders of LendIt.

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Peter Renton: Today on the show, I am delighted to welcome Raul Vazquez, he is the CEO of Oportun. Now Oportun are a fascinating company, they are a lender to the underserved and they have been around now for more than a decade and they have done billions of dollars in loans to this community. So we get in some depth into their business model, how they're able to do this, the different marketing channels they use, the different ways they're able to score these people who for the most part do not have a credit score. We also talk about the work Raul is doing at the CFPB and their perspective on their kind of business and we also talk a little bit about what they are planning for the future. Hope you enjoy the show!

Welcome to the podcast, Raul.

Raul Vazquez: Thank you.

Peter: So let's just give the listeners a little bit of background about yourself. You have had a very interesting career, it seems to date, so why don't you tell the listeners a little bit about what you did before you came to Oportun.

Raul: Okay, I'm happy to do that. I'm actually an industrial engineer by training so I've had the good fortune to work in several industries. The first job that I had outside of college was actually in a manufacturing environment working on surgical drapes and kits. I then had a chance to work in management consulting and really enjoyed those two opportunities because one was at the shop floor level, the other was working on strategy for very large companies; everything from evaluating markets in Africa for suitability for investment to working with divisions of large corporations on profitability of their different product lines. So it was a great chance to see kind of smaller problems and to be very close to them and then work on big corporate initiatives.

Around that time the whole dot com race if you will started here in the Bay area so I went ahead and jumped in in 1998 and that gave me a chance to work at technology led organizations that were growing quickly; everything from the company that invented online auctions to a company that worked on B2B marketplaces. So had a chance to work in a variety of different firms; everything from technology for database indexing to advertising technologies, marketing campaigns.

And then in 2002, I had a chance to join Walmart.com and spent nine years there growing my career at Walmart.com being the CEO there for several years and I had the chance to manage a third of the stores here in the US for Walmart and my last role there was in global e-commerce. That was before I decided to join Oportun which was five years ago.

Peter: Okay, so it's a bit of a jump, I'm guessing from Walmart to Oportun. What was behind that decision?

Raul: There were a couple of things that had led me to make that decision. Number one, I left Walmart because I had two young children at the time and I was really spending a lot of time on the road and I really wanted to spend more time with my family so I realized a change was going to be necessary. Once I decided that I was going to make a change there were three things that I felt I've been able to achieve at Walmart and that were very gratifying to me and I wanted those three things in my next professional opportunity. The first was an opportunity for me to provide for my family. Not only do I enjoy working, but I need to work.

Peter: (laughs) Right.

Raul: That first one was important. The second one was a chance to learn and to grow as a professional and I'll get to that in a little bit, but that was one of the things that was really appealing about Oportun.

And then the third was a real feeling that I was helping others, a chance to give back. And I felt like all three of those things had been present in my nine years at Walmart and as a consequence I really wanted to make sure that the next opportunity would have those as well and it was absolutely true here at Oportun and continues to be the case. Not only do I get to provide for my family, but I learned a tremendous amount in terms of financial services because this was an industry that was new to me and suddenly our mission and the fact that we're a mission-driven company means that we are giving back, that we are helping others and we are strengthening communities so really these five years at Oportun has been fantastic.

Peter: Okay, so then why don't we dig in a little bit into Oportun because not everybody knows you guys. So tell us exactly what you guys do and who you serve.

Raul: Okay, we're a mission-driven organization and the way we talk about our mission is that we provide affordable loans that help people with little or no credit history establish credit and build a better future so that's really what we're focused on. In terms of those people with little or no credit, as you probably know, in December of last year the CFPB estimated that there are 45 million adults here in the US with little or no credit history so that's about 20% of the US adult population here in the US.

And if you're one of those people, your options are limited if you need to borrow money to fix your car, if you need to pay a deposit on your new apartment or if you need to get through a medical emergency or even if you've got an opportunity to make some extra money on the weekend and say you need to buy some tools or some other small investment to be able to take advantage of that opportunity. All of those things are difficult if you're one of those 45 million people with little or no credit history.

So what we've done here at Oportun is we have dedicated ourselves to using advanced data analytics and technology so we could score those people that are considered unscoreable by the traditional financial services institutions. Once we figured out a way to score them, we then focused on creating a product that was responsible, that was affordable and that would have fixed payments that would work within the individual budgets of our consumers. So in a nutshell, that's what we do.

Peter: Okay, so then your core market then is the underserved, shall we say. What percentage of the people, for example, that are customers of yours that don't have a credit file? Do you know that number roughly?

Raul: We do. The way we think about it is not having a FICO score so about half of customers when they show up to deal with us the first time don't have a credit score and as a consequence the alternatives that they do have are very, very expensive. This is one of the areas where we really focus on from a mission perspective is really providing those low cost, affordable loans to those consumers.

One of the things that we feel really good about is we commissioned some work with CFSI because we feel like they really understand this space, they really understand the consumer, they had done work as part of the Financial Diaries and we asked them if they would be willing to figure out how do our costs compare to the alternatives that our customers usually have available. So they asked us for some data, they combined that with the data that they've been able to collect and what they were able to determine was that the alternatives to our loans in the markets we serve are on average four times more expensive than the cost of our loan. And when it compares to payday, it's actually about seven times more expensive than the cost of our loans.

So that's again one of the things that we feel great about because now in the ten years that we've been lending, we've made about 2 million loans, we've lent about $3.5 billion and with that work from CFSI estimates is that not only have we lent those $3.5 billion, but we've saved our consumers about $1 billion in interest and fees.

Peter: Right, so if I do the math on that, that means about an average of $1,750, is that the average loan?

Raul: That's about right. It's grown over time as we continue to invest in technology, but that's about right for the average. The range is everything from a $300 starter loan, if you will, to a $7,000 loan, that tends to be the amount lent to the customer that's dealt with us more and as we come to understand the behavior that they have with our loans...one of the things that we do is we tend to tend to start with a smaller amount and because that customer isn't known to us, the rate tends to be a bit higher. Then if the customer comes back, we drop the rate because we think it makes sense to reward customers with great behavior with the loan, and we make more capital available to them if our underwriting determines that it is possible to give them more capital.

Peter: Right, so then what is the range of loan terms like are these 3 month loans, 6 month, a year, what are you offering?

Raul: The minimum term is six months,

Peter: Okay.

Raul: And so we think one of the things that is really important when you're dealing with someone that say on average makes about $36,000 is to recognize that they need enough time to be able to pay the loan back. So we have a minimum term of six months, but there are no pre-payment penalties so if our customer gets extra hours and is able to pay back the loan faster, we're absolutely okay with that.

We built a business where our interests are completely aligned with the consumers. Our best and most profitable loan is a loan that is never delinquent, where there are never any extra fees, no late fees or anything else and where the loan is either paid back on time or early. So we tried to design the system where that happens and part of that is the term so a minimum of six months and it can go up to 35 months, but no pre-payment penalties, fixed rates, fixed payments and no balloon payment at the end either.

Peter: Okay, okay, so these are fully amortizing loans then?

Raul: That's correct.

Peter: Okay, so let's just take a typical loan. It might be say a $2,000 loan that someone wants to pay off over one year and I presume you're doing like risk-based pricing, but what are the range of interest rates there?

Raul: What we really try to do is not so much risk-based pricing, what we do is we tie our pricing to the size of the loan.

Peter: Okay.

Raul: What our algorithm really tries to do, and this is what we honed now over ten years, is to understand the person's income. That's one of the things that we verify to understand their expenses and then to try to get a sense of okay, based on that cash flow, based on where the person lives, based on everything that we understand about them, what do we think is the right amount of capital, what's the right amount of time and then based on that and the experience that we have with the customer, then it comes up with pricing.

So the average interest rate right now across all of our portfolio is about 33% and as I mentioned earlier, it's higher for the first time loan and then it starts to drop, especially between the first and the second loan it's a pretty big drop so that way the customer again sees the benefits of that good behavior. We feel that by also lowering the loan amount, the customer is more likely to choose us.

Peter: Right.

Raul: We think that’s important because one of the things I did not mention earlier is we also build credit scores for people, we establish credit scores for them.

Peter: Right, I was going to ask that. So you're reporting this to the bureaus, I presume, are you?

Raul: Yes, we do. So after about six or seven months, that half of customers that came to us without a credit score now will have a credit score visible to a lot of other institutions which from a mission perspective we feel that can be a success if someone works with us and then decides to work with someone else. But from a business perspective, we think that if a customer loves our service, loves the loan, appreciates the lower rate that is provided and the additional capital and they choose to stay with us, that can also be a success.

Peter: Right, right, got it. So how do you find these people? I presume they're not responding to a direct mail piece or even going to a website, how are you finding your customers?

Raul: It has been one of these things that we really had to work on figuring out. When I first joined the company, I remember someone that I was talking to about the firm that lovingly referred to the customer we serve as a financial ghost. They're not in the bureaus and therefore can be very hard to find. One of the things that we think has helped us a lot is we have decided that we should provide physical locations where we can serve the consumer or we can explain our products and where we can also take cash payments.

So today we lend in eight states, six of those states have physical locations, they are typically in these low and moderate income communities. Right now, we have about 237 locations in six states, we know how to run those profitably, we are dedicated to providing an omni-channel experience so basically giving consumers a choice of how they want to deal with us. So we're happy if they deal with us in a physical location, if they want to call us over the phone and talk to someone or if they want to just go ahead and use their mobile device the way that all of us do now in dealing with different service providers. We're happy to serve a consumer in any of those channels and in fact, let them start in one channel and finish in another one.

Peter: Interesting, so are you finding the mobile uptick like the rest of...you know, the online lenders are noticing that there's more and more mobile uptick. Is the same thing happening in your business?

Raul: It is happening and what we still see is there are consumers that just want to deal with us in person. When I talk about this, the person I envision doing that is someone like my mom. My mom is a sociable person, she likes interacting with other people and given the choice, my mom would rather deal with someone in person. We know in different focus groups that some of our customers say, I really enjoyed that physical interaction the first time, but now that I understand your process, what I like to do is I like to start the re-application process with someone talking to them over the phone and then I'll go into the location to make my payments or to get a question answered.

Now we know kind of along the lines of what you're asking about, there are some consumers that never want to talk to someone. You know, I think of my friends that way, some of my cousins where what they would do is just deal with us as a company over their mobile device, they want to do an e-signature, they want to have the loan deposited straight into their bank account. We can do all of those things and we're happy to provide all of them because from our perspective when you're focused on a certain 45 million people, you're going to have large quantities of people in each of those camps and then you're going to have people that want to do a combination of all of those channels.

Peter: Your physical locations, are these inside grocery stores, are they stand alone in shopping malls, I mean, what do you have as far as a template for your physical locations?

Raul: They're both, so the way to think about it is think of it as a small retail space that is meant to be a node on a network. We're a very much a technology-enabled company, we've always been. That's how you make this business profitable on a loan that is on average, as you pointed out earlier, $1,800 to $2,000. So what the physical location is meant to do is it's meant to provide service to a customer, answer any questions that the customer has, gather data which is really the primary purpose of that location and then that data through the platform that we built gets combined with other data that we collect gets fed into the underwriting engine and then the engine makes a decision and communicates it back to our employee in the retail location.

There is no one in the company that has the title of underwriter; all of it for us is centralized through our engine so it's 100% automated, no exceptions and really what that location does is it collects that information and it provides service including potentially taking payments. But that's really what that format does so we're very comfortable either doing that in the small space in a grocery store or as our presence gets larger in a market we can go ahead and open stand alone locations where we can serve more customers.

Peter: Okay, so I want to dig into the underwriting system you have. You say it's completely automated, you're basically providing loans for people that…you're not pulling data from Experian or Equifax or TransUnion, I imagine you are in some cases, but in many cases you're not. Maybe you could just give the listeners a little bit of color about your underwriting system, particularly when it comes to data. I mean, how are you able to successfully underwrite these customers that just don't have much of a footprint?

Raul: That's been one of the biggest challenges and it's an area where we continue to invest a lot. Like all of the other firms that I'm sure you've talked to as part of these podcasts, we hired data scientists, statisticians, mathematicians, we've got a team of engineers focused only on the risk engine working with those individuals that I just described and what we've been able to do over these ten years is to create a proprietary cash flow based ability to pay framework.

We start by verifying income, we estimate how much cash a borrower might have after paying their expenses each month and then we conduct a sophisticated assessment of credit worthiness and we do that by leveraging a diverse set of data sources which are fed into the proprietary risk scoring model in combination with that income and the estimate of expenses. You know, some of the information that we look at are things like how long someone has lived in a particular location, what their job is, how long they've had that job, how long they've had the same cellphone number and certainly a lot of other factors.

But at a high level, we're trying to figure out both the person's ability to pay and their willingness to pay and that is really one of the biggest challenges that we've had to solve in this business is trying to figure out what are the right thresholds, how do we evaluate those consumers. It's something that we feel very good about what we've built to be able to score those unscoreables. But it's an area that we're constantly reinvesting in with the goal really of having a major upgrade to our risk engine about every 12 to 18 months.

Peter: Okay, I'm curious about fraud detection, I mean, if you've got a 100% automated system you've got to have sophisticated fraud detection or else you're really going to be out of business fairly quickly, I imagine, because you're giving away free money. It's tough to be giving it away without having these deep credit files that people have. Tell us a little bit about the anti-fraud measures that you have.

Raul: That's been a really large focus area for us as we push harder and harder into mobile. In a physical environment there is still the ability for people to show up and to want to commit fraud, but one of the things that I've learned having worked in both physical businesses, online businesses and then businesses that try to do both is the instant that you're not dealing with someone in person to your point, Peter there is a higher likelihood of fraud so as we push into mobile which we did thoughtfully and carefully because as you pointed out we're handing out money and they're all unsecured loans so we don't have an asset if someone decides not to pay us back.

So given the characteristics of our product, we did focus a lot on making sure that we could match the capabilities that we have in risk with capabilities in fraud detection and fraud mitigation. That scenario where now we have a dedicated group of people working on that in the same way that we've got people dedicated to risk. We are working with different service providers, we're trying to understand all the data that's out there and in particular for our customer, one of the things that we've learned is we have to work even harder to find data signals that would be different than the signals that are available for a prime or super prime customer.

So that is another big investment area now for us and one where we will innovate at probably even a faster pace than the one for risk since the individuals out there trying perpetrate fraud are also people that are out there innovating pretty quickly.

Peter: Right, okay, so you've been certified as a CDFI, a Community Development Financial Institution, can you explain what that means, what advantages you get from that certification?

Raul: I'd be happy to. We've been certified a CDFI since 2009 and what that stands for is it means we are a Community Development Financial Institution. It is a certification that is provided by the Department of Treasury and as a mission-driven organization one of the things that we really like about that particular certification is we feel that it recognizes our goals of increasing economic opportunity for our clients, of promoting community development and of serving low income or underserved communities.

For example, when I've met with the heads of the CDFI Fund one of the things that they really appreciated about our mission-driven organization is the fact that…in one of the meetings I was able to share with them the fact that we would hit the milestone of having provided $2 billion to these low and moderate income communities. These are communities that a lot of times have been the victims of redlining in the past, where there aren't a lot of physical locations to serve individuals that aren't really experienced in these products and where banks, unfortunately, are in many cases having to pull back from a physical presence.

We're building physical presences and we're lending billions and billions of dollars in those areas. So being able to share with the CDFI Fund the $2 billion milestone, the $3 billion milestone and hopefully soon, the $4 Billion milestone...those are all things that we believe help us continue to keep our certification and they are yet another indication of the fact that our mission is making a difference in the lives of people.

Peter: Sure, so I want to switch gears a little bit and talk about the other side of the business and that is the funding of these loans. I know you're not a marketplace but can you give us a sense of how you're funding it. I just read in the last couple of days there's a securitization coming, is that the main funding mechanism, I mean, how are you actually providing the capital?

Raul: That is one of the ways. There are three principal ways that we get the funding that we need to be able to keep growing at a high rate and to be able to keep helping our consumers. One of the ways that we secure funding is by borrowing under a secured line of credit that's provided by several large banks and it's something that's worked well for us in the past.

The second is that we have been issuing investment grade securitization bonds and as you pointed out, we recently announced that we're starting to work on our newest securitization and that's a program that we have had success with for several years now and it is a key part of how we grow.

The last part, the third part, is we sell a portion of our loans directly to investors and it's not a large portion. It moves between 10% to 15%, but we thought it was important to be able to develop that source of funding too so that the capital markets would see that this was a valuable asset and that there were individuals out there or organizations out there that would want to own the asset. So for us, we feel that diversification is a key element to being able to grow at a predictable rate and to be able to grow at a high rate so that's really how we get the funding we need for our loans.

Peter: Right, right, okay. So then I know that you're on the advisory board of the CFPB so you obviously have close communication with them. I'm curious because you have a company that offers loans at rates that just...you know, the sound bites you hear from some people in

Congress are certainly pretty negative about the kind of rates that you charge, I know the CFPB has come down hard on the payday lending industry. So I'm just curious about...firstly, obviously you have a close relation with the CFPB, what's that relationship like and what does your work on the advisory board entail?

Raul: We're very grateful for the opportunity to be on the CFPB's Consumer Advisory Board. I'm also the Chair on the Federal Reserve's Community Advisory Council and I think we're the only for-profit firm on that Community Advisory Council. In both cases what we feel has happened is that both of those organizations have really put in the work to understand what is it that's happening at the community level and how do our products compare to those other products that, as you pointed out, tend to generate an allergic reaction from certain individuals.

I think both in the Community Advisory Council's case at the Fed and in the CFPB's Consumer Advisory Board, they realize that we are a mission-driven organization that has created credit scores now for hundreds of thousands of people and have helped about a million people solve problems in their lives or be able to open up new doors through our loans.

So our gratitude first comes from the fact that those two groups have looked beyond the easy sound bites and have looked beyond how things look at a distance and really put in the work to understand how do our products compare to those other products that are generally available to our customers. And that's also why we really like that work by CFSI because we feel CFSI also really understands the reality at a community level so I'll start with that.

What's been very rewarding for us on both of those councils has been to hear from other organizations, other non-profits or other for-profit organizations, in the case of the CFPB Consumer Advisory Board, and to hear what is it that they see at a community level, what do they see consumers reacting positively to, what are the things that they're seeing maybe from organizations that don't have the best outcomes in mind for the consumer, what are the things that they're seeing at that community level that are worrisome to them and what are the problems that they're trying to solve and how is it that those organizations on those two councils are trying to solve those things.

So being in the room and hearing likeminded organizations generally has been really, really helpful. At the same time, hearing the Fed or the CFPB talk about what is top of mind for them, how are they trying to shape markets, whether it's regulatory markets or financial markets, has been helpful too.

Going back to your specific question on the CFPB, it's been things like they're focused on the use of alternative data, they're focused on third party collections, certainly the small dollar lending, the prepaid card rules. All of those things has been fantastic to be in the room to hear the questions that the CFPB has been asking and then to hear the responses from other organizations.

Peter: Okay, we're almost out of time, I just have a couple more quick questions. I know you're a private company, but is there anything you can share like are you profitable, I mean, how far along towards profitability are you? Is there anything you can share on that metric?

Raul: We are profitable, we've been cash flow profitable now for about four years.

Peter: Okay.

Raul: We felt that as a mission-driven organization one of the things we really needed was a solid financial foundation. So if you want to be able to serve 45 million people and I mentioned we've served about a million, one of the things that felt we needed was our own profit engine that would allow us to grow at a high rate so that we could serve as many customers as possible, as quickly as possible. So we really committed to being a disciplined but lean organization so that we could hit cash flow profitability and we've been cash flow profitable now for about four years.

As a high growth lender, another challenge was reaching full GAAP profitability which as you know one of the challenges from a GAAP perspective is not only do you have to recognize your current losses, but you also have to estimate and provision for the future losses that are in your portfolio, but we feel very good about the fact that we've been fully GAAP profitable now for over two years.

So we feel like we have that foundation now that allows us to invest in new channels like mobile, that allows us to invest in expanding our footprint by going to additional states and we've announced two new states which we entered mobile first this year. Those states were Missouri and New Mexico and we think all of that really comes back to that foundation of profitability that we have.

Peter: So does that mean there is going to be an IPO coming down the track sometime soon?

Raul: We really think about it more in terms of how do we get the funding that we need to keep growing. I mentioned to you earlier the mechanisms that we use today, those three elements that continue to serve us well.

Peter: Right.

Raul: If and when an IPO makes sense, it will be more of a question of how do you secure access to that equity that you need as well as a lender or that we do since we're not a marketplace lender, we do put our own capital when we make loans so if and when an IPO makes sense it will really be about how do you have access to that stable source of funding as opposed to any other driver for that kind of a step.

Peter: Right, okay, last question. So what are some of the interesting things that you're working on now that may come down the road at Oportun in the future?

Raul: The things that we're really focused on right now are number one, just further development of our mobile capabilities. As you asked earlier, you asked are we seeing customers respond positively to this new capability that we're offering as an organization and the answer is yes. We feel that right now we need to invest even more to provide a great experience to our consumer. Our Net Promoter Score as a company is about a 81 right now so we have very high degrees of customer satisfaction and we're seeing comparable scores in mobile, but we believe that there's still a lot of work that we can do to provide an even better experience. So that's one of our big areas of focus.

The second is really thinking about how is it that we can serve customers in states where we're not in today so we're hoping to expand to potentially two other states this year, but we're always thinking about what's the next state that we can go into to try to bring our affordable, responsible loans.

And then one thing I'm spending time thinking about now is what are additional products that we might be able to offer our customers. So that's from a strategy perspective, something that I'm spending a lot of time thinking about, both in terms of what products might our current customer base really like, but what are products that these other 45 million people that we're trying to serve...what products might they like to have access to from Oportun.

Peter: Okay, well on that note we'll have to leave it there. I really appreciate you coming on the show today, Raul.

Raul: Thank you so much for the opportunity. It was really nice talking to you.

Peter: Okay, see you.

Raul: Bye.

Peter: For those of you who were at LendIt this past March, you will have noticed that we had a financial inclusion track for the first time, something that I feel personally pretty passionate about. I feel like the online lending industry, the fintech industry should be doing more to really expand access to credit and this is exactly what Oportun is doing. As he said 100% automated underwriting decisions. That's only possible through really great use of technology and data science.

I feel like if we are going to expand access to the underserved, which I think people want to be able to expand access, they just don't know how to do it in a profitable way. Well I feel like the way you do it is through the application and technology and I think Oportun is a great case study in this example. And I hope and expect that we will see more companies out there who are really focusing on these markets that are...you know, they're much more difficult to underwrite than sort of the mainstream consumer.

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

(closing music)