LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 181 / JAMES GARVEY

Happy New Year, everybody and welcome to the Lend Academy Podcast, Episode No. 181. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of LendIt Fintech.

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Peter Renton: Today on the show, I am delighted to welcome James Garvey, he is the CEO and Co-Founder of Self Lender. Now Self Lender is a fascinating company, they are doing something really unique in the lending space insofar as they've created a product that helps people with no credit score, or poor credit score, helps them build their credit fairly quickly and fairly painlessly. They do this through a unique product that they've partnered with a bank to produce. We go into the mechanics of this in some detail.

We also go into really who their target market is and the needs of this market, we talk about how they're able to find customers. We talk about the stats behind the increases in the credit score from their customer base, we talk about the future products that they're coming out with and we talk about what the future holds. It was a fascinating interview, hope you enjoy the show.

Peter Renton: Welcome to the podcast, James!

James Garvey: Great to be here, Peter.

Peter: Okay, so I'd like to get this thing started by giving the listeners a little bit of context, a little bit of background about yourself and what you did before you started Self Lender.

James: Yeah, so I'm a software engineer by trade and I spent most of my career working in online direct marketing. I've had two companies that I've started and co-founded and then ended up selling and both helped large companies and are now at scale. So, you know, I come from the space from a totally different angle.

Peter: Interesting, so then what was the idea, what was the germination of Self Lender?

James: So I got married and my wife and I, we decided to take a couple of months off and we were in Argentina and I thought I'd set up my credit card on auto pay. Two months into my billing cycle, I realized that I made a mistake and that wasn't scalable on auto pay and I hurt my credit score. I was trying to understand how this credit really worked, you know, how does it actually work in the U.S. I'm not from a financial services background so I just started digging in, doing research and the more I read, the more I realized that I know nothing about payments or credit bureaus or anything, and that's when I discovered it hurt so many people that either don't have a credit score or are below credit score.

So I'm trying to understand how do people solve this problem today and what I'd find out is secured credit cards are, you know, typically the way that somebody's going to solve that problem if they can't get approved for a normal credit card. So, you know, you go to a big bank, you deposit $500 and they give you a credit card that's secured by this money and that the challenge is number one, you have to have that $500 which is a hard problem that lots of people have and number two, if you need that money back then you have to close down the credit card.

So it's a complicated problem and there's really not a lot of good solutions for building credit for people that are either new to credit or people that are rebuilding and so I saw some credit unions doing something interesting. Some of the credit unions that I looked at are....when you walk in the credit union, you make a $500 deposit, you can make your $500 loan that's backed by the deposit.

Now that's not going to solve the first challenge of coming up with the money, but it does solve the problem of, okay, while you've got these installments, you have a start date, you've a stop date, you have equal payments...that makes sense, but the problem with that model is you have to have the money.

So the idea for Self Lender was what if I could partner with a bank and basically make you a loan where you have to put the money into a brand new CD, so it's basically like a small $500 loan, a 12-month installment loan at roughly 10 to 12% interest, where that money goes into a $500, 12-month CD that pays you a tenth of a percent of interest. So the idea is that we're lending you money, you have to save it and the beautiful thing is your start date or stop date, that equal payment, it feels really like a savings plan that builds credit and not like a CD-secured installment loan which is really difficult to save.

Peter: Right, right, I get it. So let's just dig into the process there for a second. So someone comes along to Self Lender's website and I see build credit while you save, and you get started and you basically choose how much or whatever. You said you create a CD, a savings product so someone says.....let's just take that example, so the $500 example you just gave, what do you actually do? That money is deposited with a bank account before anything else happens? Tell us about the sequence of events.

James: Yeah, so what happens is behind the scene we have a couple of bank partners and the action is number one, we're going to lend you $500 as a 12-month installment loan and the lender is our bank partner, they're the true lenders, and then the money of the loan proceeds are immediately deposited into a freshly created FDIC-insured CD in the customer's name. So in the loan documents there's Truth in Lending and Truth in Savings, it's from our bank partner to the customer.

So Self Lender is the technology arm, Self Lender is the servicer and we are also the system of record so we're behind the scene, there isn't a Fiserv behind the scene, we actually build our own core processor.

Peter: Okay, so then someone comes along, the $500...the bank loans them the money, but they don't send them the money, they open up a CD in their name and so then the person is paying back monthly. Are they paying back the bank monthly, how does that work?

James: Yeah, that's right. So what's happening is the customer is making a payment on a fixed schedule that they agree upon when they get started and those payments are being serviced by Self Lender. So Self Lender behind the scenes ....you know, we are creating the (inaudible) file that gets uploaded to the (inaudible) reserve. We don't move the money, but we do move the data and so the money is being pulled from the customer's account either through ACH or through a debit card.

What happens is as the customer repays the loan, they're paying down the loan, but yet the CD is slightly growing over time and so at the end the customer has paid off the entire loan and then simultaneously, the CD a unlocks and then the customer gets the money either via ACH or through check.

Peter: Okay, at the end of the loan term is there a rollover or can they choose to take the money back? What happens after the period's over?

James: So when we first got started, you know, we created the experience to really have a start date and stop date and it really is like you pay it off, you get the money, end of story. That's how it is today and it's not a great experience that way and so that's going to be changing in the future, but as of today, you get the money, congratulations, your credit score is probably up and we give the customers their credit score on a monthly basis so they can actually track that over time. So they are getting some education stuff, but they're not getting the other financial products other than our flagship product.

Peter: Okay, so I'm curious...you said you've got a couple of bank partners. I imagine this is somewhat of a creative idea that....it’s not like everyone else is doing this, you're the first one that I've seen that has this approach so how did those conversations go? How are you able to get those banks on board?

James: Yeah, I'll tell you it was really hard. (Peter laughs) When I got started, I met with 60 banks.

Peter: 60, six zero?

James: 60, yeah, six zero, and it was really tough because if you don't speak the language that they want to hear, nobody's going to take you seriously. And so when we first got started, I found a tiny bank based in Austin, Texas that was willing to work with us and so what I did was, my wife and I....from San Francisco to Austin so we could be physically close to the bank as we're building everything out, and it was incredibly valuable for us. It would have been a lot harder if we hadn't done that.

So once you get your first bank partner, it's a lot easier to get the second and third and fourth and so on, but the first one was extremely tough. In our case, as you said, like there's no capital at risk here, but you do have operational risk, strategic risk, compliance risk, reputational risk, you know, it keeps going on and on.

So one of the things that we did early on, which is kind of rare for most startups, is we became SSAE 16 SOC 1 compliant which is called SAS-70. It's a set of controls that allows you to prove to third parties that you do what you say you will do; yes you have encryption, yes you did background checks, you have a written process and procedure for banks, that kind of thing and that was really helpful as we were getting started. If we hadn't done that I think it would have been really tough

Peter: Okay, okay. So then let's talk about the customers that come to you. You've starting to get some traction and I'm curious to know like who are these people? Are these all millennials, are they immigrants, like I presume many of them either have no credit score or obviously have a low credit score, but tell us a little bit more about the people who are coming.

James: Yeah, so today, most of our customers are people that are rebuilding, you know, only a fraction of them are people that are establishing credit for the first time. We have customers in all 50 states, we have concentration around the normal states that you'd expect and what we've seen is about 70% of our customers are typically below 35, so we have a lot of younger people that have either established credit or are trying to rebuild with Self Lender.

What we've also seen, which is kind of interesting, is based on the Facebook data that we have, we're estimating 70% of our customers are women. We have a lot of customers that are African American and Latino background as well so it's a really fascinating customer mix and what's great about what we're doing is we didn't have a chief marketing officer, we didn't have a marketing team until about six months ago.

So we have just naturally been able to attract a really great pool of customers that are all over the U.S. The thing that's fascinating is, you know, our customers, most of them are not prime customers, but they don't have a subprime mindset, you know, they're coming to Self Lender, they're making their payments and they're doing this in order to build credit and save money which is kind of an interesting thing because you have to match with some self selection going on here.

Peter: Right, I was thinking that because the mere fact that they've landed on your website means that they're interested in building their credit score. They're not just a random person who may or may not care about their credit score.

James: Exactly.

Peter: So then on that, do you....I presume you say you do AML and anti-fraud checks and what have you, but can anyone sign up? Do you do any underwriting on the individuals who are signing up?

James: Yeah, so prior to the customer being able to apply, they have to go through the normal knowledge-based authentication, ask us the questions about their (inaudible) wallets, KYC, AML, but after that, you have to be 18, you have to have a social security number which means you're either a citizen, a US resident or a non-resident alien. The one piece of underwriting we do though is our bank partners have wanted to do check systems and so the check systems underwriting that we do is ....have you committed fraud, basically; have you been reported as committing fraud, so it's a very low percentage of people that are rejected. The very, very vast majority of applications are approved.

Peter: It's good to hear. You're one of the very few people we have had on here that can say that because obviously most lenders reject a large percentage. So then you said you've only been marketing for six months or so, but how have you been finding these customers, I mean, have you just relied on word-of-mouth and PR, tell us a little bit about the strategy to build your customer base?

James: We've relied mostly on word-of-mouth so we do all of our customer service in-house, we track net promoter score on a very, very regular basis and typically on that net promoter score on a weekly basis is in the 75 range so it's really high and that's the net promoter score, but between -100/+100 just to clarify. The customers have been really good at telling their friends about it and primarily because if you're trying to build credit and you get rejected, it sucks, and there's not that many options out there. I think that's why the word-of-mouth has been so popular.

Peter: But you wouldn't get repeat customers right, as you said most people, they take their money, I mean, do you get many people going through the whole thing again?

James: Yeah, we have some, you know, the repeat rate is not very high and it's about 15% so it's something that we understand. This is the problem with our model because we have to be able to graduate the customer into another product, something that can keep them longer term so, yeah.

Peter: Right, right, okay. And what stats can you provide about how much is this actually really making a difference? Say it's a 12-month term and the person comes in with like a 500 credit score, how much difference do you make? What do they end up after the end of the 12-months with?

James: Yeah, so the one thing I want to say first is the data is reported as it happens so when a customer stops paying, as an example...you know, the payments are being reported to the credit bureaus as delinquent and so we do have customers that are delinquent as well as people paying on time so when customers are paying on time and they're paying their other bills on time, the way we're able to track that is we give our customers credit monitoring for free.

So when there's new delinquency, new bankruptcy, new public record, you know, we're able to track that and so that's one of the reasons why we can say, well, if you use Self Lender and you pay Self Lender on time and you pay your other bills on time, we're seeing an average impact of zero to 670, if you're starting from no score. If you're starting from a low score, we've seen about 45-point improvement and that's typically in the 6 to 12-month time frame. But just to say it out loud, I'm telling you this on your podcast, you can look on our website, we don't market it that way, because there's some compliance challenges in doing that.

Peter: Sure.

James: We don't want to be deceptive. At the end of the day, if you pay your bills on time and you're paying the bill that's reported to the credit bureaus, well, you're probably going to have a better credit score at some point, like it's a pretty simple concept there.

Peter: Right. So then it's interesting to me that people would be delinquent because they've got cash waiting for them at the end of the cycle so can you share what sort of percentage you're getting that are delinquent?

James: Yeah, it's about 7%.

Peter: Okay.

James: So it's not super high. One of the things we do is we have auto pay, you can make your payments anytime, make one-time payments and so we do have about 60 notifications that happen over the customers' lifetime. You know, at scale, you're going to have people that sign up and they make mistakes. It happens.

Peter: Sure, I know. That's lower than I expected it would be, to be honest, because when you're dealing with a population.....if they were taking out from some of the subprime lenders, they have delinquency rates in the 20's, 25% or even more in some instances so that's really more of a .....not a prime consumer delinquency, but like a mid-prime, near-prime consumer. I think that's not a bad effort really. So then what's your business model, how are you actually making money?

James: Yeah, the way we're making money is firstly, we had to raise a bunch of venture capital so that we could build all this tech behind the scenes. You know, most banks are paying their software vendors about $100 a year in software to originate and service checking accounts, just from the software standpoint, not for marketing. That's really expensive, like if you're a bank you'd rather have one customer with a million dollars than a thousand with a thousand dollars any day, so we built our own tech underneath that originates and services these CD-secured loans.

Our cost to service is extremely low and our business model is pretty simple. These CD-secured loans on the loan side, is about a 10 to 12% interest rate and what we do is we work with our bank partners and we do a revenue share. So what that means is the customer has to actually

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pay for us to make money or for a banks to make money so it's kind of a cool and fair arrangement where we all win; the customer wins, banks win, Self Lender wins.

Peter: Interesting, okay. So then I'm curious about...I read an article about you guys recently that talked about...you're going to be launching a credit card in 2019. So it's a natural product, I guess, but also is one that is fraught with more challenges, so tell us a little bit about what you're planning there and how that's going to work.

James: Yeah, so what we're going to launch is a credit card that's being secured by part of the customer's deposit. So, basically, you join Self Lender and after say six months, you've been paying $50 a month and your CD is worth $500, but your loan balance is about half of that so you've got at least $250 of equity in your account is the way to think about it. So the cool thing about what we're doing is we can give the customer a credit card where the credit limit is being secured by a piece of their collateral so it's a natural graduation.

The customer wants...they've asked for it and it gives them some access to real liquidity that's in their hands that they can use and we also have this relationship with the customer such that they have now a revolving relationship with us. If we do it right, we keep the customer engaged for the next decade. Now there are limits on this, of course, it is a secured credit card, but once we've built a pretty robust secured credit card program, we just have to raise more capital and bring in some super intelligent people to help us on that side of the business.

But, you know, we can build a big business even without unsecured credit and that's what we're really excited about. Our customers...many of them are not going to be able to be eligible for an unsecured credit card within the first year and so they are eligible for this product and that's really why we're graduating them into secured credit cards.

Peter: Okay, so in that situation too I can see that they're making their payments on their Self Lender loan and their equity is increasing each time so their credit limit can easily increase. So, I guess, then at the end of the 12-month/6-month, whatever it is, at the end of the time period where they would typically get back that money, is that being held then at the bank and they say, right, you did $500 and now you've paid that all back, you've got your credit card, you've got your $500 credit limit, tell me a little bit about what are the plans once they've finished up their term?

James: Yeah, so we're using all the same tech behind the scenes and it gives us the ability to say, okay, we're going to do a secured credit card that has a minimum $100 line of credit. So if the customer wants to reduce that credit line, they can and still keep the card open. So that's one of the core features that our card has and so that flexibility is what our customers have asked for and we think that's going to be the really cool feature that they want, but it's going to take us years to be able to figure out, okay, well, how do you think of those secured cards and turn them into unsecured. You know, it's a lot more complicated than what we're doing today because there's no credit risk.

Peter: Right, right. So they can take a portion of the money back and keep the portion that will then be used so they can have a line of credit.

James: That's right.

Peter: Okay, so than I'm curious...one other thing I read recently about you guys was around CRA, the Community Reinvestment Act, and how banks are…banks have requirements where they have to be CRA compliant, they have to be loaning money to underprivileged or to parts of society that are not very well served and it seems like you have a core customer base that falls...I would imagine completely within that community.

James: That's right.

Peter: I've heard you're talking with banks about this, I mean, how are going to sort of use your unique community because you have probably a very unique customer base in many ways, how are you going to use that to help banks meet their CRA requirements?

James: Yeah, this is the thing to understand. So our customers are low to moderate income, they are absolutely the kind of customers that will qualify for CRA credit. The challenge for banks though is many, many banks have a very small serviceable geographic region and I think that's one of the reasons why the CRA, the people in Congress are talking about, or at least American Banker, are they're talking about reforming CRA.

I think it'd be great if it could have a much larger distribution, but our customers are exactly right, you hit it the nail on the head here, these are people that are underserved, people that are low to moderate income and should absolutely be able to qualify for that. Now we've worked with one bank in a very small area to give them some data reports that we presume were offloaded to their regulators for CRA.

We haven't heard back on the status of that, but we assume that they should be able to get the credit. At the end of the day though, the regulators have their own discretion on how that should be administered so we hope that there's going to be some exciting changes in CRA in 2019 and hopefully we can play a small part in that.

Peter: Yeah, it seems to me everyone agrees that the CRA was written in the 70's, didn't even imagine the Internet would exist.

James: Correct.

Peter: So it's in desperate need of updating and I think there's general agreement that it should be updated, just how exactly it's going to be updated, we'll wait and see on that. Anyway, we're almost out of time, but I wanted to get a couple of more questions in here. I am curious about the scale you're at. When did you write your first Self Lender loan and how many have you done, what scale are you at today?

James: Yeah, the first one was about three years ago and I always put a caveat...you know, from the first year of the business, we only did about a thousand customers. You know, we were trying to make sure that everything is correct, you know, when you're computing interest, when you're computing fees, you're responsible for a lot of the stuff behind the scenes we were talking about, banks want to be confident that we are doing what we say we're doing. So we are doing today about ...I will say, in 2018, we've originated over $100 million of these secured loans and we're doing about half a million dollars today of new originations. So our expectation is in 2019, we will, at least, double that number so that would be about $200 million and $250 million. In total, though, we've originated about $150 million.

Peter: Okay, okay. So that equates then to well into the six figures, as far as number of customers, I imagine, right?

James: Yeah, about 200,000 customers.

Peter: 200,000, okay, okay, cool. Okay, so then we've touched on this and this is my last question, we touched on it to some extent. There's a lot of ways you can take this, but I'm very curious to get, what is your vision for the future of Self Lender? What do you want to be in ten years time?

James: Yeah, yeah. So, you know, Capital One got started doing secured credit cards and what I want for Self Lender is to become the on ramp for responsible credit. We want to be able to be the biggest player and just affordable credit for people that are everyday Americans. We're not going to serve the best customers in the market, we're not going to serve the worst. We're going to serve just no class Americans that just need affordable and responsible credit. In ten years, we're going to have a company that's got a lot of customers and hopefully, we'll IPO at some point, that's my boyhood dream. (Peter and James laugh). We'll see.

Peter: Okay, on that note we'll leave it there. Good luck with that, James, it's certainly a noble cause that you have there, wish you all the best. Thanks for coming on the show.

James: Thanks, Peter.

Peter: See you.

James: Bye.

Peter: What I love about Self Lender is that they solve the Catch 22 that many people starting out struggle with where to be able to obtain credit you need decent credit. It's a chicken and egg problem, whereas what Self Lender does is they solve that directly and they solve it in a way that's creative and that really helps the consumer.

It's really a "win win" for everybody involved and I think whether they get to national scale like James hopes, I really don't know, but what I do know is that services like this are desperately needed. We need people to be able to get started in a responsible way and rebuild their credit in a responsible way and I think the service that Self Lender provides really does help do that. It does a lot to help promote financial inclusion in this country.

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

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