LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 186 / SUSAN EHRLICH

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Peter Renton: Today on the show, I am delighted to welcome Susan Ehrlich, she is the CEO of Earnest. Now Earnest is an interesting company, they are one of the largest student loan refinancing companies. In fact, Susan shares in the show that they're now number two, as far as loan volume goes, and they also do personal loans, they've been around for many years.

They were bought by Navient, the large student loan servicing company back in 2017 so we wanted to talk a little bit about that, talk about how much she interfaces with Navient; we talk about the student loan crisis and what Susan thinks about that. We obviously talk about the products that they offer, their approach to underwriting, acquisition channels and cross-selling and much more. It was a fascinating interview, I hope you enjoy the show.

Welcome to the podcast, Susan!

Susan Ehrlich: Thank you, thanks for having me.

Peter: Sure, so I like to get these things started by giving the listeners a little bit of background about yourself. You've had an interesting career to date and why don't you share some of the highlights with the listeners.

Susan: Yeah, of course. You know, I think my career so far has really had three chapters. I began my career in traditional banking and then I shifted over to retail and most recently, I'm now in the financial technology space. So I really feel like I've been a part of that transformation that both banking and retail have been impacted by from bricks and mortar to digital.

My career started with Citibank in New York City, followed by Providian in San Francisco. These were kind of the "go go" days of credit card marketing where credit cards were democratizing access to credit, credit scores were race and gender blind and we were able to expand access to credit for people who hadn't had that before. I really loved the left brain/right brain aspects of direct marketing, that combination of the analytical underwriting and pricing and the qualitative marketing and communication.

In the second part of my career, I moved over to retail finance, chose the exact wrong time to be doing that. It was in the midst of the financial crisis so you had retailers losing sales as the economy was tanking and banks pulling back on credit so it was an insanely tough place to be. I was working with Sears and Kmart at the time and we actually dipped into an old playbook and brought back layaway and Christmas club and installment loans at point of sale and turned layaway from kind of a consumer accommodation that we used to do ad hoc in store into a billion dollar business for Sears and Kmart in the middle of the financial crisis.

From there, I kind of shifted from...I took that brick and mortar retail to online retail step and moved over to Amazon, spent about a year and a half there and with that Amazon tech experience in my background moved over to fintech and spent some time at Lending Club, at Simple, before now joining Earnest.

Peter: Sure, so then what was it that...why did you take the job at Earnest? I'm curious to sort of get your perspective on why, moving to Earnest.

Susan: Sure, that's a great question. You know, because before Earnest I was at Simple, I was learning a new craft as the chief financial officer at Simple, a role I had not held previously at any company I'd worked for before. I was enjoying the foodie culture in Portland and perfectly comfortable when I was contacted by a recruiter about the opportunity at Earnest. I had known Earnest already, I had met the founders, we had on and off talked about partnering opportunities and so when I was approached about the opportunity I knew more about the company than most people would.

I was very impressed with the underwriting, with the brand they had built and the customer experience they had created. I'd also been following the explosion in the student debt market, I was an advisor to Gradifi and I really believed in the mission that Earnest was focused on to help clients get a better deal. But I'd also be remiss if I didn't say that the opportunity to lead a company as CEO and the chance to move to one of my favorite cities, San Francisco, were also draws, for sure.

Peter: Right, right. So let's talk a little bit about Earnest and the product suite that you have. I mean, I know that Earnest began refinancing student loans, but what is the mix of products today?

Susan: Yeah, you know, interestingly, Earnest launched its first product with a personal loan in 2014.

Peter: I didn't know that.

Susan: Yeah, it was Louis and Ben, the founders, used Boston as a test market since there was a high concentration of young professionals. They were really focused initially on super prime personal loan and it wasn't until the following year, in 2015, when the company raised their Series A that they announced the launch of student loan refinancing.

Peter: Okay.

Susan: So it was actually the second product that the company had and along the way we've tested additional areas. We have a handful of auto loans, we were in the mortgage business last year, we've now exited that space. We're focused today in installment lending with a strong focus on students. We are continuing to evolve our student loan refi product and we're adding a student loan in 2019.

Peter: Okay, okay, so for existing students not graduates.

Susan: Correct, that's right.

Peter: Got it, got it. So, you know, most people know…I'll just to refresh everybody's memory that Navient, the very large student loan servicer, acquired Earnest in 2017 so you've obviously come along after the acquisition. I'm curious about...obviously, you were comfortable with the structure of the company taking the job as CEO, but is Earnest really…is it hands-off when it comes to Navient or how much do you actually interface with the mother ship, shall we say?

Susan: Yeah, you know, this past year has been one where we've really tried to explore a bit how that relationship should work. We are a wholly-owned subsidiary so we operate fairly independently, we maintain our own brand, identity and marketing and you can see that in how we go to market and we staff and train our own employees, our own client happiness team, our own credit, product and engineering teams. Where we've most benefitted from the acquisition and the integration with Navient has really been with respect to access to capital.

You know, in Earnest's old days, as with many fintechs, that steady access to capital is a huge challenge and it causes a lot of volatility in how companies operate. And so now that we've got that steady source and supply that Navient helps to provide us, we've really been able to grow from 5th to 2nd, in terms of market volume, in student loan refi and just continue on a very steady growth path which has been great.

Peter: Okay.

Susan: I think in return, you know, in terms of...that's kind of what Navient has provided for us. I think, in return, we've really helped to showcase for them how to take a more user-centered approach to product design and to thinking about the client. We run a usability lab as part of Earnest's standard business as usual operations. It's run by our product, design and customer research teams and it's been the most frequently visited part of Earnest from Navient. So I think that it's early days, but I think that…you know, we look forward to continuing to impact their thinking about client and client experience and we thank them for their assistance in helping us access the capital markets.

Peter: Okay, so I want to step back for a second and just talk about student loans. Obviously, this is a big part of what you guys do and much has been written about the student loan crisis. I'm not sure what the exact number these days, $1.5 trillion outstanding, I know that defaults are going up. When you look at this country today and the student loan massive debt that many, many young people are taking on early in their lives, what do you think is needed to really end the crisis or to change things up?

Susan: Yeah, it's definitely a challenge of our time and I don't think there's anyone in the country who wouldn't agree it's an issue for our younger generation where the burden is falling most heavily. You know, when I look at the big picture, I kind of break this into two parts. There's originations, the new student loans that customers are taking on and then there's the existing loans and I think, you know, as a nation, we're starting to rethink the origination part.

I think there are times when student loans are appropriate, but there are clearly degrees where it's not worth taking a huge loan for and I think people are beginning to look at the cost benefit of education in a more sensible way and I think that's a good thing. Personally, and to be clear, I'm speaking not for Earnest or for Navient, but I actually think universities should have more skin in the game than they do today. I think, you know, from my experience here at Earnest, I can see that graduation rates are a key determinant in whether a student loan gets repaid.

Peter: Sure.

Susan: And if a student is getting accepted by a school and they're taking out a loan for their tuition and fees, but they don't graduate with a degree, that's commonly the reason they are unable to repay the loan so I personally think universities and colleges should take more responsibility for that. They should be willing to guarantee a student loan. I think that, you know, taking a page out of my retailer history and playbook, I think that would really be standing behind their students and would be a money back guarantee. I think it would be a real game changer and I'd like to see colleges and universities considering that.

Peter: Yeah, I couldn't agree more. I feel like we're going to move to that direction, something has to give. I mean, the top schools are going to continue to attract many, many students...as you say, not all of them are going to graduate and if you're going to Harvard and you're paying whatever it is, $60,000/$70,000 a year, you're there for two years and you don't graduate, you drop out, something happens, I mean, that's a really bad outcome for that person potentially.

I feel like we've got so much data now available, look at the data that we use in credit, in personal loans, small business loans, what have you, there is so much data available and yet I feel like the universities...we should be using the data. There is information on graduation rates, but I'd like to see it, what is the graduation rate by major, what is the starting salary by major…

Susan: Agreed.

Peter: …all of that sort of information should be available so when kids go off to college, they are armed with full knowledge of what they're getting into….

Susan: I agree.

Peter: …and I love the idea of having universities actually guarantee the loan, at least a portion of it. That would change everything I think overnight…I think it would.

Susan: And I think it's, you know, a guarantee always sits in the background, right, it doesn't have to be activated...

Peter: Sure.

Susan: ...unless you're in a situation where something has turned out not the way you expected. So I think it would be very easy to implement, easy for a university to do, but I do agree with you. I think more transparency and information so that a student, with their parents, can make a better decision up front and I think a university really standing behind their commitment to graduate that student would be a very important signal to send. In an era where universities are going to continue to compete more and more for students, I think that could be a really powerful message to send.

Peter: Sure. Moving along, you know, you operate obviously in a very competitive market, the online lending space is much more competitive today than it was five years ago and I'm curious about...maybe we can take the student loan product and the personal loan product, I mean, they're obviously two quite different markets, how do you differentiate yourself with the other student loan refinancing companies and the other personal loan providers?

Susan: Yeah, you know, in the product categories that we're competing, they're largely driven by price, but we are differentiating in a couple of regards. The first is we focus on a very high touch, very human interaction. Our in-house customer service team we call, client happiness, and we're very committed to making sure that we're...folks have contact with us, it is very intuitive, it's very clear they're getting the information that they need to make the decisions that they need to. We're also very committed to leveraging technology to create a digital experience that makes it very easy and intuitive for a customer to understand our product and for our client happiness team members to service that client when they need it.

And I'm really proud of the fact that we are the only lender that offers precision pricing. This is something that's in our student loan refinance product and what precision pricing is it enables a client to set the exact monthly payment they want. In student loan refinance, it's more traditional for the lenders to force clients to choose from a few options, a 5-year term, a 10-year term. At Earnest, by using precision pricing and working back from what the client is looking for, we let the client set the monthly payment amount that they want to pay, the exact amount to the penny.

From that, we work back to what the loan term and price for that loan would be and the result of that is, you know, you may not have a 10-year loan, you may have an 11-year loan, but it's going to enable you to pay exactly the thousand dollars a month that you want to be paying to pay back your loan and we're going to set that interest rate at the lowest possible rate that matches that monthly payment. So the client gets the exact amount they're looking for, it reduces for Navient and our securitization and investors any pre-payment risks so it's a win-win and we're the exclusive provider of that and we get a lot of good positive customer feedback for it.

Peter: Interesting, it makes sense. There's no reason why the term of the loan shouldn't be an output rather than an input. I know Marcus did this when they launched in personal loans, that was one of their unique offerings. They did it in the personal loan space and I feel like….because so many people, they know they can afford whatever it is, $500 a month, $700 a month, and that's what they can afford. Obviously, they want to pay the least amount over time, but if you give them something that's $900 a month and they can only afford $500 a month, yet it's the lowest rate, that's still not going to be a good outcome. So I think that's what makes the most sense.

Susan: I agree, in this day and age too, you know, I think banks worked back from what did the market want, what were investors interested in and so they map to 5-year, 10-year, 15-year. In this day and age, you can generate the loan agreement real time and, again, by being able to give clients exactly what they're looking for, you know, they're comfortable with and committed to making that payment consistently. It puts control in the client's hands and it ultimately creates a better experience for everybody.

Peter: So right now, that's just in your student loan refinancing product, it's not in the personal loan?

Susan: It is, that's correct.

Peter: Okay, so are you doing like...for the personal loans, are you doing a lot of cross-selling with personal loans, are customers coming from other channels? Maybe let's firstly answer how much are you doing cross-selling with your large student loan database?

Susan: You know, cross-sell hasn't really been an emphasis for us now just because we're seeing more opportunity with organic growth and we really are putting a very heavy emphasis on student loan refinance. We've just seen more opportunity in the market there for us and we're going to stay committed there and I think we'll be, as I mentioned doubling down on both student loan refinance and looking at in-school student loans in 2019.

Peter: Okay, so then how are you finding your customers, what are the main channels that you're using?

Susan: A wide range of channels as all lenders typically do, but you know, our main and defensible channel is really word-of-mouth and existing client referrals which has allowed us to compete really effectively and to reach the number two market position in 2018 without a 9-figure marketing budget so we're really pleased and proud with that result.

Peter: Right, okay. And then so let's talk about underwriting for a little bit. I'm curious about what your approach is here, the technology you use, the data sources you're using. Can you give us a little bit of color on that?

Susan: Yeah, I think, you know certainly in the early days of fintech there was a lot of talk about new data sources and new credit models and I think from our experience it turns out that it's perhaps not as complicated as people thought. You know, the most important indicator is income and beyond that debt to income so that's really where we've been focused on how we evaluate free cash flow and to help make sure that we're putting customers in loans that they can afford and with precision pricing payments that they can comfortably repay.

You know, a big part of our process has been making it simpler and faster for us to get the information we need to confirm income and validate that and move people through as automated a process as we can. The faster we can get them to a credit decision, the more quickly they can begin saving money.

Peter: Right, right, okay. So something else, I'm looking at your LinkedIn profile, I'm curious about...you were very much involved with the Center for Financial Services Innovation, it looks like you were Chairman of the Board there for many years and we've had Jennifer Tescher on the show here, I'm curious about how your time there, how that sort of informs what you're doing at Earnest because obviously the CFSI is very much about financial inclusion and building, creating products that are win-win and helpful for the underserved and what not. Tell us a little bit about your time there and how it applies to your time at Earnest.

Susan: Yeah, absolutely. I'm really pleased and proud of the work that Jen and the team at CFSI have had over time. You know, I, like Jen am very committed to a mission of inclusion and making a meaningful difference in people's financial lives and, you know, I think that really played a part in my coming to Earnest seeing an opportunity to take what the company was doing and really extend further the reach and opportunity in the area of student loan refinance.

I'll give you an example, when I got to Earnest this past summer in July, we had a group of MBA students who were interning with Earnest and one of the projects that we had asked them to take on was to calculate how much we've saved our clients since the company got started five years ago.

At that point we had refinanced about $3 billion of student loans and when we calculated the savings, we had generated just over $400 million in total interest expense saved and that's a consumer benefit that was not available before the advent of student loan refi and talk about a disruptive force for good, an opportunity to improve consumer health which is very much the focus that CFSI has these days.

So on an individual level, that client who's refinancing, shortening their loan term, speeding up their pay down is saving $31,000 over the life of their loan. That's a life changing amount of money and something that we're really proud to play our part in helping to improve consumer financial health. If you have the opportunity to refinance, you should take advantage of it.

There's meaningful money that can be saved up toward buying a house, paying for a car, taking a vacation, you know, it's life changing.

Peter: Right, I completely agree. It's like getting a tax cut in some ways where you suddenly have more money every month and given how much burden so many people are under and anything that you can do to ease that burden is certainly worthwhile, a worthwhile cause.

Susan: Sure. In the Bay Area, $31,000 might not add up to a lot of money, but it's a down payment on a house, it's the price of a car. I think it changes the trajectory of people's lives and we're just proud to be able to play a part in that and put the client at the center of what we're doing. We're very mission-driven.

Peter: So do you think that...I imagine most graduates now...obviously, student loan refinancing didn't exist ten years ago, you know, for many reasons, but do you think that most or what percentage of graduates do you think now...like some of these graduates obviously have federal student loans. I know I've had one of my colleagues here at work has got a very low interest rate and tried to refinance and it just wasn't worth it, but those that have private student loans. Some of them are, 8, 10, 12%, do you think...what percentage of them are still out there, do you think, that have not been refinanced?

Susan: Yeah, there's...you know, as you mentioned earlier, the volume of existing student loans that are out there is in the order of $1.5 trillion. We've made a dent in that universe, we're a little up over $4 billion in student loans refinanced. Obviously, SoFi is a bigger player in this category than we are, but collectively, you know, we've only made a tiny dent in the opportunity that's there. Variable rate loans will continue to see rates increased on those as rates rise and continue to rise so I think, you know, students will continue to graduate with student debt to be paid back.

And so, I think, we expect to continue to see the market remain sizable and growing into the near future and anything that we can do to help improve the financial circumstances for our clients by looking into and refinancing is worth doing. It's very easy to come online and do a rate check to see what the benefit can be, it's a 2-minute exercise and I think anybody who has graduated from school and has a job should do themselves the favor of just checking and making sure there isn't a better deal out there.

Peter: Right, right, for sure. So I want to talk a little bit about the funding of these loans. I'm particularly interested in the context of what you said earlier where you have these loan terms that are an output rather than an input to closing a deal. So how are you funding these loans, is it all on balance sheet, are you doing securitizations, what is the mechanism you're using?

Susan: Yeah, we're leveraging the access that we have now through Navient to a strong balance sheet and so we fund our loans on balance sheet and then on a periodic basis, we're executing asset-backed securitizations to improve our liquidity and reduce the balance sheet stress.

Peter: So how does it work when you've got all these sort of like 11-year loan terms? Are you sort of packaging them all up into one group that is all the same loan term or how is it working?

Susan: Yeah, you know, as they structure the securitizations, it's going to be a mix of payments and repayment terms and schedules and so that's just in the pool and factored into the cash flows.

Peter: Right, right. Okay, so we're just about out of time, but last question. We're recording this in early January of 2019, and I'm curious about what your….as you're looking ahead to this year, what are you most excited about for Earnest in 2019?

Susan: Yeah, thanks for the opportunity to share. So first off, we're very excited about the new product launch that will be coming in the first half of this year so please stay tuned for that. We're also looking forward to getting bi-weekly payments back as an option in our student loan refi business. We think that's going to be another key differentiator.

And you know, we're certainly actively hiring so we're looking for key members of our teams in the area of engineering, product, marketing and risk so if there are listeners out there who are interested in and intrigued by what they've heard, I'd love to hear from them. And you know, we're looking forward to just continuing to do what we've been doing and proving to be really good at which is helping clients save money by refinancing their student loans.

Peter: Okay, well on that note, we will have to end it there. I very much appreciate you coming on the show today, Susan.

Susan: Thanks so much, Peter, appreciate you having me.

Peter: Okay, see you.

Susan: Bye now.

Peter: One of these days, I would like to think that the total outstanding student loan balance will start to fall. It's been going up, I remember when it crossed $1 trillion, it wasn't that long ago and now it's up around the $1.5 trillion mark and I would like to think that one day it will actually go back down below $1 trillion. Certainly companies like Earnest are helping to make these loans more affordable for people after they graduate and even when they're in school.

I also think that the idea that Susan had about having schools guarantee some of these loans, I think that's super interesting and one thing that we're going to be covering at LendIt in April. I think this whole idea about schools having skin in the game, really having some sort of incentive in the outcomes beyond just, oh look at our graduation rates or whatever. I feel like this is where we can really move the needle and I feel like going to school in ten years time is going to be very different. The application process will be very different to what it is like today as I think more of this sort of results-based orientation for students will certainly take center stage.

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

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