LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 189 / JASON GROSS

Welcome to the Lend Academy Podcast, Episode No. 189. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of the LendIt Fintech conference.

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Today's episode is sponsored by LendIt Fintech USA 2019, the world's leading event in financial services innovation. It's going to be happening April 8th through 9th, at Moscone West in San Francisco. We're going to be covering digital banking, blockchain, financial health and of course, online lending, as well as other areas of fintech. There will be over 5,000 attendees, over 250 sponsors and registration is now open. Just go to lendit.com to register.

Peter Renton: Today on the show, I'm delighted to welcome Jason Gross, he is the CEO and Co-Founder of Petal. So many people have heard of Petal, they have not been around very long, but they have certainly been out there in the fintech airspace, shall we say. They are a credit card company, but trying to do something a little bit different, a credit card company for the underserved, for those people who really are rejected by the mainstream companies and what they've done is not just create like a secured credit card or a very, very low credit limit type card.

This is a card that really has a lot of the same features as a premium card, but it is targeted at the underserved. It's a fascinating challenge that they've undertaken here and it was a fascinating conversation. I hope you enjoy the show.

Welcome to the podcast, Jason!

Jason Gross: Hey, thanks for having me, Peter.

Peter: My pleasure. So I like to get these things started by giving the listeners a little bit of background about yourself, if you could just tell us what you've done in your career to date.

Jason: Sure, and so I'm the CEO and one of the Co-Founders of Petal, originally trained as a lawyer. I went to Harvard Law School, I met two of my co-founders while we were in school, we stayed in touch and ended up working together years later. Began my career working at a big law firm, corporate law, essentially as a Wall Street lawyer, my clients were all financial companies and financial institutions.

Over the course of my career, transitioned from the legal side of things to the business side and also transitioned from big Wall Street financial services to tech and then from tech back around to financial technology. Over the course of my career I’ve had the opportunity to, first on the legal side, work with some of the fastest growing, most successful technology companies and venture capital funds.

On the financial services side, I've had the chance to work with some of the largest, most successful institutions in the world. That experience, and the breadth of that experience has been really helpful in my current role leading Petal.

Peter: Right okay. So then what was it that led you...where did you get the idea from, how did the process begin that led you to starting Petal?

Jason: Sure, everything began for us with a personal experience of one of our co-founders. So I mentioned that the founding team goes back quite a ways, we all knew each other in grad school. I was studying law at Harvard and my co-founder was at MIT at the time doing a masters and he stayed on to get a PhD in machine learning and data science. He has an international background, moved to the States for college and when he crossed over into the United States he was not able to bring his financial record with him so he was starting over from a financial perspective and was unable to qualify for many US mainstream financial products.

He did not have a credit history so when he applied for a credit card, he was declined and that lack of a credit history impacted him in other ways as well. He had trouble signing a residential lease because landlords were checking credit, he had trouble setting up a cell phone plan that wasn't prepaid. It's a frustrating experience that many folks who've crossed borders have run into. That got us talking about credit scoring, the data that is involved with credit scoring and sort of how that legacy infrastructure works and we were having a conversation right around the time that regulators and academics were starting to really shine a light on the contours of credit access in the United States.

When I think the light bulb really went off for us was the realization that the poor experience that our co-founder had in attempting to access financial services, notwithstanding his educational background, his financial resources, etc., was not unique to him, but instead was the experience of tens of millions of US consumers basically on a daily basis.

The research that I'm referring to in part is the CFPB's research on credit invisibles and thin file consumers. As you know, there are tens of millions of adults in the United States with no credit score or with a thin credit file such that their credit score is not reliable.

Peter: Right, right, so you started Petal. Why don't we actually take a step back and tell us what is it you guys do, what's your core product, how does it work and how is it different to what else is out there?

Jason: Sure, happy to. So we have one product today, it is a Visa-branded credit card, unsecured credit card product. There's really three things that make our product unique from what else is in the market and what has existed up until this point.

The first has a lot to do with addressing the problem that I was just describing, that is what we call cash flow underwriting. We are providing a credit card product that in terms of interest rate and credit limit and fee structure is the kind of product that previously was only available to people who had built significant credit history. What we do is incorporate the data that describes the rest of a consumer's financial picture that's not captured in a credit report. We incorporate data like income, monthly expenses, trends in volatility and that information to essentially appropriately underwrite customers that today can't be well understood by the traditional system. So that's number one and it allows us to offer people essentially more credit for less money.

Number two, we offer a user experience that is designed for a modern consumer, for digitally native consumers, and it takes into account the fact that so many of our users are seeking to establish and build credit in a safe and responsible manner. So there we offer a mobile app that is built around financial success and responsible use of credit. We embed financial education, we help folks to make the financial decisions in the use of the product that benefit them and help them to succeed financially.

We do not encourage people to borrow more money than they should, we do not encourage people to spend more money than they should, we make more transparent the cost of interest and sort of the workings of a credit card in a way that I think really is a different, more modern approach to the product.

Finally, I would say, number three, we're building a different sort of financial company that puts the customers' best interests first and that means that we are seeking to partner with our customers over the long term. It means that we want folks to make the decisions that are right for them, and that are right for them financially. It's one of the reasons why we don't charge any fees and one of the reasons why the product is as transparent as it is. You know, the business model there is really based on this recognition that today customers are looking for a financial company that has their best interest in mind. If they're able to find that kind of a provider, we think that they'll stick with us over the long term.

Peter: Right, right, got it. Okay, so then can you talk a little bit more about that person. Who is the typical customer? You obviously talked about the immigrants who have come here, obviously you're dealing more with the thin file/no file type crowd, but are these people who are really professionals who’ve come here or are they...why don't you give us a little bit of a profile.

Jason: Yea, well the thing about the thin file/no file crowd is that we were all once members.

Peter: Right.

Jason: Everyone is born credit invisible and from the industry's perspective, subprime. So we find today that our product is a really good fit for folks that are seeking to establish and build their credit so oftentimes, we're the first credit card in someone's wallet. We also are a really good fit as the second or third card as well. So we have folks who were previously only able to qualify for a secured card for instance, and they are able to upgrade from that secured card to use our product.

I mentioned that the underwriting allows us to extend more credit so we're able to give people credit lines that are significantly higher than what they would get from similar introductory credit products. So we see a lot of young people, we see a lot of immigrants and more and more we're tracking interest from consumers that are outside of the category that I just described. People that have been attracted to us more because of the product and because of the brand.

Peter: Right, so they're attracted to you because of sort of the usability, is that what you're saying?

Jason: That's right, yeah, I think that people are looking for that sort of simple, modern intuitive user experience, you know, the same way that we're seeing customers flock to neo banks, to some of the mobile first stock trading platforms, Robinhood for example...I think these people are looking for a similar experience in the credit card space.

Peter: Right, that makes sense, that makes sense. So, you know, I want to dig in a little bit into the underwriting piece. You've touched on it already, but I want to sort of get a much clearer picture if I can, and then...is your primary tool to sort of dig into the borrower's bank account so you can really get a sense of cash flow, or is there a multitude of things? I mean, how are you approaching underwriting?

Jason: Sure, this is an area, in general, where I think in the industry there's been far more sizzle than there has been steak. People talk about, you know, artificial intelligence and machine learning, they talk about very exotic data sources, but when you get down to what actually is in use in the market, practices tend to be fairly consistent. At the end of the day, 99% of all the lenders that are out there are using information that they get from the major credit bureaus or from the potential customer in the application form.

We actually are reliant on a whole new set of data which is the digital financial record of the consumer and we use machine learning and we use sort of the latest methods of analyzing that information, but what's most important is that the inputs to our model are vastly different from what the rest of the industry is looking for. So we're an application built on top of essentially open banking rails.

We asked ourselves, in a world where the whole financial picture of a customer is machine readable, is digital, is easily transferred by the customer, how does it make sense that we're looking only at essentially the liabilities side of a customer's balance sheet? We're looking at the amount that they owe and the amount that they have owed historically without a clear view into the assets or into the cash flows and the income of the prospective borrower.

Our perspective on this is before we start getting into the exotic world of alternative data and before we start mining someone's social media or, you know, making judgments based on someone's cell phone battery, we should begin by just developing the capabilities required to understand their financial position, revolutionary concept, right. Anyone who's been in lending for a long time who has seen judgmental underwriting or who has looked at the underwriting of larger products, you know, understands that at the core of the information you're looking for really is a question of income, stability in income and willingness to pay. By allowing customers to share with us that holistic financial picture, we can really measure those things in a way that hasn't been done before.

Peter: Right, so when you say you're allowing your customers to share, so are you saying like they connect their bank account, do they connect their Robinhood account, I mean, what are the sort of things they're connecting?

Jason: That's exactly right. So folks are connecting their primary accounts so checking accounts, savings accounts. If they have liquid assets in other places as well, they can connect those sources of information also and that allows us to gain this more holistic picture. Of course, you know, when you apply for a mortgage, you turn over bank statements as well; the big difference here is in automation.

The average cost to underwrite a mortgage in the United States is something like $8,000 and obviously in the credit card market you can't spend $8,000 underwriting every single application and so really the innovation here is that the system is fully automated. That customers connect their bank accounts, customers send us their credit information as well and we algorithmically analyze that information and make a decision on the spot so we're able to tell customers from a credit perspective whether they are pre-approved in just a matter of seconds.

Peter: Okay, and so then you could tell that but then are you doing like risk-based pricing at all because you're going to obviously have people who...I'm sure there are people you deny, there's people that you approve, but they really only just made the grade and then there are going to be others you easily approve, what is your approach to pricing on your card?

Jason: Sure, so when we thought about designing a product that was appropriate for this huge segment of potential customers, it was really important for us to build something that had some flexibility baked in. And again, everyone begins credit invisible and thin file, right, we know that out of that potential group of customers we will have very high income folks with the ability to afford a very large credit limit, we know that we'll have lower income folks and everything in between.

So our pricing ranges pretty dramatically, you know, we try to match up credit lines, for instance, that are appropriately tailored to someone's financial position. You don't want to give them too much and you don't want to give them too little, sort of a Goldilocks situation.

So credit lines for us range from $500 on the low end to $10,000 on the high end and the average is around $3,000 which, you know, if you compare that to other introductory credit card products, 10X, what you tend to see then APR's, again, risk-based, range from 14 which is pretty low in the credit card market up to 25/26 which is where most introductory cards start.

And then finally, the last piece which is not risk-based is that we don't charge our customers any fees at all. By having such a wide spectrum of pricing, we're able to one, get the most leverage out of the sophisticated work that we're doing on the underwriting side and two, we're able to serve a wider range of customers.

Peter: Interesting, it's always surprising to me how so many credit card companies don't operate a wide band of pricing for their products so that makes sense. So then what about...how are you approaching fraud, obviously there's going to be some bad actors out there who are going to try and get this card, what's your approach, how are you fighting it?

Jason: Yeah, so this is something that, you know, everyone participating in the industry is facing. We're fortunate in that some of the best fraud fighting tools are available even to new companies so we're working with partners that are really at the cutting edge of digital identity mapping, transaction pattern monitoring, etc. We can kind of tap into the same technologies that are being used by the largest issuers in the market to make sure that we're keeping our customers safe and that we're also protecting our company against fraud.

One thing that we have going for us is that we are looking at more data at the application phase and so we have more opportunities to get wind of something that doesn't look right.

Peter: Okay, so then I'm curious about how you are finding your customers today. You're obviously on the app stores, where are you...do you require people to download the app and tell us what the main channels are for acquiring customers.

Jason: Yeah, so to date the largest channel for us has been organic and word-of-mouth. We had 100,000 people sign up for a waitlist when they heard about the product and we've done only very limited advertising to date. So I think that first, the product being unique, the technology being something that's new to the market has gotten the attention of the media and we've been fortunate that a number of widely read outlets have told our story so I think a lot of customers have heard about us from those sources.

We are available in the App Store, we have apps on both IOS and Android, we've been doing some digital advertising now and over the course of the next year, we've planned to engage in multi-channel advertising to get the word out about the program even further so that customers will be able to find us in a variety of different sources, but we expect that word-of-mouth to really continue.

One of the things we've been very proud of is our NPS score with our early customers and even though we've only been out in the market for a short period of time and there's still a lot that we want to develop in terms of features and perks and functionality that we offer through the product, we've been able to achieve a NPS scores in the mid-70's. And of course, NPS, for those that are not familiar, is that question that company's ask that says, how likely are you to recommend this product or service to a friend or a family member.

You know, the average in credit cards I think is in single digits. The average in financial services is something like around 30. In the mid-70's, we're up there with really some of the most loved brands like Apple and others, so that is a good measure of word-of-mouth potential so we've been very proud of being able to achieve that.

Peter: Right, right. So then I'm curious...you said you've only been out for a few months, when did you actually launch your first credit card?

Jason: So as it turns out, building a nationwide credit card program from the ground up is harder than it sounds.

Peter: (laughs) It sounds hard, actually.

Jason: (laughs) Yeah, it's one of the things where if I had known back then what would go into this, I don't know if I would have made all of the same decisions.

Peter: Right.

Jason: I joke a little bit, but even though we're a small company, you know, we're doing just about everything that the largest credit card issuers in the market are doing, from the marketing and advertising to underwriting and decisioning through the whole customer journey and customer support, all the way to the end of the life cycle, collections and everything in between. So to stand up that whole platform and to do it in partnership with WebBank and with Visa certainly takes some time in the development phase.

So brief history of the company, we've put together the very early team, you know, the first ten people at the beginning of 2017 and end of 2016. Spent 2017 building up a platform and developing the software, etc. towards the end of that year began to issue our first credit cards.

So we did that in a beta program, first just operational and then kind of expanding in terms of robustness of the data and then finally in the middle of 2018, we had finished the end-to-end testing of the program, etc. and we were able to start issuing our first credit cards to customers.

Peter: So have you gone through the 100,000 people on your list and does everybody have one who wants one?

Jason: So everybody on the list has the opportunity to apply.

Peter: Right.

Jason: So we are now publicly available, you can go to the website at petalcard.com and you can apply for the product right now.

Peter: Okay, so obviously you've got a few months of history behind you, you must have...the great thing about a credit card is that you get a pretty quick window into your credit performance. So what can you say, I know it has only been a few months, but what can you say so far about the performance of your portfolio?

Jason: Yeah, you know, even with a credit card it does take some time to really measure your performance. You know, you tend to see defaults on credit card loans later in the customer life cycle, year two, year three, etc. but there are a number of attributes that we can begin to look at like utilization of the credit line for instance.

So far, we're feeling really good about our approach and I think that it has to do with the fact that we are not relying on an untested, exotic data set but that we're talking about people's income, their savings, their monthly expenses. So one of the things we're most excited about is if you look at the population of folks who have come to us and qualified for the card with no prior experience of credit, the truly credit invisible segment, we're seeing performance from that segment that mirrors the performance that we see from folks who have applied with prime credit scores, that’s in terms of their utilization, in terms of their enrollment in autopay which is another indication of folks that have the ability to easily pay their obligations.

We really think that we've been able to uncover a good segment of customers that we've been calling the invisible prime. You know, that from a traditional scoring perspective appear extremely high risk, but actually if you dig in a little bit further to the data you find that they are folks that are going to have a 750+ credit score, they just haven't had the opportunity to build it yet.

Peter: Right, right, that makes sense. So then is your business model like a traditional credit card company, you're making money off the interest? Is there any other way you're generating income?

Jason: Interchange is really important in the credit card business.

Peter: Sure.

Jason: A lot of our income comes from the merchant fees as well, but those are the two primary sources, interchange and interest revenue.

Peter: Yeah, sure. So then how are you getting the money to fund these credit lines with these cards, like who has jumped in early to be part of the funding sources?

Jason: Sure, so our primary funding sources are Jefferies, the international investment bank and Silicon Valley Bank to date but we are set up from a legal perspective in a manner that's very similar to a marketplace lender where we work with a bank to originate the loans, or in our case to originate the receivables and then those receivables are financed on the back end so we have these investors, Jefferies and Silicon Valley Bank for instance that essentially finance the receivables.

As we grow, we are planning to work with the sorts of investors that are interested in that asset class and sort of larger and larger institutions so eventually, we're set up in a manner that will allow us to securitize just like any large credit company might do.

Peter: Right. Okay, so I downloaded your app before this interview and when you actually load it up it says...”a credit card with a conscience.” So obviously that's sort of something that you're promoting, what do you mean by that? Tell us a little bit more about sort of the thinking behind having that come up every time someone opens up your app.

Jason: Sure, so when we started working on this product, we realized very quickly that when it comes to the new to credit audience, the problem is not just that people have trouble qualifying and when they do qualify they don't get enough credit or their APR is too high. We also found that the needs and expectations of these consumers are not being well met by the traditional options.

I think that in the credit card space, generally, you have a lot of focus and attention on the most premium customers, sort of that tier of customers that have super prime credit scores and are looking for travel rewards and paying large annual fees, a lot of the marketing dollars and the thought and effort from the big institutions goes to fighting over those customers.

At the same time, if you look at the tens of millions of customers that are newer to their credit journey, the products don't seem particularly thoughtful from our perspective. You see very little in terms of financial education, you see very little in the user experience that is tailored to the needs of that customer.

Really what people are looking for is the of kind simple, modern, transparent experience that they've come to expect from service providers across other facets of their life. I think that this trend towards greater transparency and towards wanting to do business with companies that will act in the customers' best interest. This is a trend that is playing out on a very large scale and it's just starting to take root in financial services.

So a lot of introductory credit cards are larded with fees, have very high interest rates and don't help even a brand new customer who is brand new to credit to understand how to use the product responsibly. Almost everyone has either personally experienced or knows someone who has experienced the process of getting a first credit card and using it like it's Monopoly money and running up a whole bunch of debt inadvertently so we're trying to design a product that takes a totally different approach to that relationship.

We know that our customer group in particular would benefit from a product that's easier to use, that helps you to make more informed financial decisions so we're, like I said earlier, working to help our customers to financially succeed and not the alternative, we don't want folks to pay unnecessary fees, we don't want people to run up debt that they can't pay back. We want, instead, for people to make the right financial decisions and set off successfully on their financial journey. That's what we mean by "credit with a conscience."

Peter: Right, got it. Okay, we're almost out of time, but just a couple more questions. You've chosen an endeavor, you mentioned that already, it's not easy starting a credit card company, you don't get a bunch of…it's not like a hot thing to go and start a credit card company like it might be a neo bank these days, but...so I'm curious now looking back...I mean, you've obviously overcome a great deal of hurdles and your alive and you've got a real business now, what's the biggest challenge now for you guys as you're starting to grow your company?

Jason: Yeah, you know, I think that for us, we're starting to face the challenges of the scaling phase of the development of our business so we've been able to successfully develop the product, get a product to market that users are really responding to, that users like, that fills an unmet need in the market, but we now have to go from the small company and small program that we have today to a program that can support tens of thousands, if not hundreds of thousands or millions of customers.

So we are dramatically increasing our head count, we are over 60 people today. At this time last year, we were about 16, so really growing in terms of our own capabilities and I think along with that we'll be looking to get the word out about the program and to really grow with our customers and make sure that we continue to deliver a product that is really useful and valuable to them over the long term.

Peter: Okay, so then last question then, in 2019, we're still here at the beginning of 2019, what will success look like for you? What are your goals for this year?

Jason: We've set goals in a pretty ambitious manner. This year we are looking to expand our customer base by about 10X, we are looking to significantly increase the features and functionality that we offer to our customers and we're looking to really establish ourselves as a legitimate alternative to the mainstream options in our category.

So today when you think about getting a first credit card, you ask someone on the street who might send you to Capital One or might send you to Bank of America. By this time next year, we think it would be amazing if folks added Petal to that conversation as something that people can check out and, you know, a real alternative to what's previously existed in the category.

You know, if you look at the growth of marketplace lending in the personal loan category ten years ago, almost entirely dominated by the banks, in terms of online lending very little activity. Over the last decade, you know, we've seen the online marketplace lenders take something like 35% of that overall market share.

In the credit card category, I think where the personal lending, marketplace lending was ten years ago where there was huge consolidation in credit cards…I think the top four or five issuers had 90% of the market, all the products that are in the market come from a traditional bank.

But over the last year, there's been something like $300 million invested in new technology focused startup credit cards so I think that, you know, we're in the early days, but we're going to see a similar transformation in this category just like we're seeing in terms of the checking and neo bank, just like we're seeing in wealth management and stock trading and like we have seen in some of the other lending categories. We're very keen to be part of it on the ground floor.

Peter: Okay, well best of luck with that, Jason, I really appreciate you coming on the show today.

Jason: Thanks so much. Great chatting with you.

Peter: Okay, see you.

Jason: Alright, take care.

Peter: It is interesting to me that most of the innovation that is happening in the credit card space is really happening at the prime end of the spectrum. You've got all of these different reward cards, I see new ones coming out all the time that are really targeted for the premium customers, but in the subprime space, or in the non-prime space, shall we say, there's a few secured credit cards and there's certainly a handful of fintech companies trying to attack this problem, but there isn't sort of this surge of innovation that you've seen in other areas of fintech.

So it will be interesting to see if Jason is right and it's going to become the next frontier of fintech. They certainly have...you know, they've got some big goals and they've got an interesting approach, and I wish them all the best. It will be fascinating to watch them as they progress.

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

Today's episode was sponsored by LendIt Fintech USA 2019, the world's leading event in financial services innovation. It's happening April 8th through 9th, at Moscone West in San Francisco. It's going to be the largest fintech event held in the Bay Area in 2019. We'll be covering online lending, blockchain, digital banking and much more. You can find out all about it and register at lendit.com.

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