LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 195/JERRY NEMORIN

Welcome to the Lend Academy Podcast, Episode No. 195. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of the LendIt Fintech Conference.

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Peter Renton: So welcome to a special LendIt Fintech edition of the Lend Academy podcast. We are here live at LendIt Fintech USA 2019 and I am joined by Jerry Nemorin from LendStreet, he is the CEO and Co-Founder of LendStreet.

Wecome to the podcast, Jerry.

Jerry Nemorin: Thank you for having me.

Peter: Okay, so let's just get started, we've known each other now for many years, you're a bit of a venture into the fintech space these days. Why don't you give us a little bit of background (Peter laughs)...give us a little bit of background about yourself and sort of how the arch of your career has gone.

Jerry: Well, personally, I'm originally from Haiti, I grew up in Haiti and moved to the States when I was very young and studied at the University of Florida, studied finance at the University of Florida and then did my MBA at the University of Virginia, the newly minted national champions. Finance was something for me, it was always a subject that I was really passionate about and interested in.

After the credit crisis, I was working at Bank of America Merrill Lynch in their Leveraged Financial Sponsors Group and the idea for LendStreet really stemmed from the things we were doing on Wall Street helping major businesses restructure their debt and giving them a path to being financially viable and sustainable. As a very early lender on Prosper, I thought the idea of creating a debt restructuring platform that not only allowed the consumer to get a pathway to financial health, but also give the creditor a way to recover more capital which didn't exist then.

I mean, you and I had this conversation before where, you know, we started off with Prosper and Lending Club focusing primarily on debt consolidation, but there were really no sophisticated debt restructuring platform that was focused on the consumers that when they experience a financial shock, how do you help them rebuild, how do you help them get back on path and that didn't exist at that time.

Peter: Right, right. So then, you know, you started this company and it was many years ago now and you're stuck at it which many wouldn't.....tell us how it's going because we first met, I think, it was like 2013 at a meet-up here in San Francisco and you know, you've stuck at it so tell us a little bit about those early days and how the journey has been.

Jerry: Yeah, you know, I think you're right, many wouldn't have stuck through it, but for me it's as personal as it is professional.

Peter: Right.

Jerry: I think most entrepreneurs will tell you, you don't do it, you don't take the risk of being an entrepreneur for the sake of really hitting it big as we know the odds are against you, right, nine out of ten companies will fail.

Peter: Right.

Jerry: But for me, this was a product that I believed really truly needs to exist. You know, it's easy for consumers when they're financially healthy, there are so many products out there that we're trying to give, you know....and, quite frankly, our industry have helped increase access, but we haven't had a product that actually think about the holistic health of the system, not just the consumer, but how we're impacting the financial system.

Are we adding more risk, are we, you know, are we making it safer, are we helping reduce the cost of capital broadly? So to me this was a product that my family could have used back in the days and so deeply believe that it needs to exist, no matter what I have to make sure that I gave myself a chance to see it through.

So starting off was really difficult. Imagine telling investors that you want to create a product that helps people in financial distress, who are delinquent, who are distressed and you're going to give them a loan so they can pay off their debt so it's just an oxymoron in many ways.

Peter: Right, right.

Jerry: You know, selling innovation is hard, right, selling innovation to people who cannot empathize with the problem is even harder and so our journey was much, much harder than most. We had to prove a lot more to make sure that the thesis that we had which is that consumers who are financially distressed, if you're able to right size their debt, get them into a payment plan that makes sense, they will perform and perform like they were prime or near-prime at that and that was always the thesis.

If you can match the capacity with the intent, you can make it happen so it took us a bit to get off because that was something that not most people would really identify with, but we're able to show the data, it came now to the numbers.

Peter: Right.

Jerry: We're able to show the data, prove out that, you know, there was a group of clients, if you take the winds of consumers are inherently good, they want to make payments, these are lives......

Peter: Sure.

Jerry: .....they're our lives, but if you take the notion that people are inherently good and they want to make good on their debt, that when they experience a financial shock it's a matter of bridging that capacity with the intent, that we'd create a product that truly, you know, make a significant impact in the lives of these individuals, but also create a product that helps creditors improve their recovery. Ideally, by improving the recovery for creditors, you ultimately make the system safer and you make the system less passive and that's been sort of the focus with LendStreet and that's what we've been trying to do.

Peter: Right. So early days, I want to go back, we talked about this a while ago and a couple of years ago, I think, but when you were talking about those early days you first raised money and you loaned that money out and you basically....I remember you said at that time, if I'm proven wrong and this doesn't work then I close up shop and go home. So you lent out that first cohort, so tell us a little bit that and how they performed.

Jerry: Yeah, so we raised capital, really friends and family, and just to prove out that at the end of the day the thesis was they would be paid. If they didn't pay within a structure that was market-based, not just that they'll be paying, but for me it had to be a market-based solution. So for the risk that, you know, that we were taking, that we were recovering a certain amount of capital and a profit, that would make sense to attract additional capital to scale because I don't think you can do real social impact without market-based solutions.

Peter: Sure.

Jerry: And so the first cohort we did and performed incredibly well, we actually supplied ourselves, we had less than 5% default from that first cohort, that scale certainly didn't hold up that way, but it was a metric. The thing that we were measuring is if we're able to lend to those consumers, will they repay, and that was a question we've got consistently, you know, through the process. Will they repay, will they repay their debt?

Our belief was that these are consumers, we call them recovering prime, so these are consumers who, historically, have been bad credit, experienced a financial shock and, you know, they've proven in the past their ability and willingness to pay. It's a matter of in this moment they can no longer make those same level of payments and so if we can restructure that debt and restructure the payment to what they can actually afford, will they be paid? That was the big pieces, that was the, you know, I'd like to believe it's the billion dollar thesis that I had (Peter laughs.)

Peter: Maybe one day.

Jerry: Maybe one day, right, but that thing just didn't play out, it played out where, you know, we had.....the default rates that we had were controlled enough, were low enough that we could create a product that could be scaled and could attract, you know, capital, given the rate of returns.

Peter: Yes, so you've got sort of mid-single digit to pulverize to a population that looks at first glance like they did subprime, definitely subprime.

Jerry: Yeah, that's exactly right.

Peter: So then, maybe I want to sort of talk a little bit about how your product works, but before we get to that maybe you could explain a little bit about the debt settlement industry. It certainly hasn't got a great reputation in some areas, some of it is, I think, earned, that reputation, but, obviously, there's good and bad players. Tell us a little bit about your approach to the debt settlement space.

Jerry: Yeah, so prior to starting LendStreet, I didn't have a consumer background, nor did I have a debt settlement background. The concept for LendStreet was based on a project that I worked on in banking where in 2008/2009, world was coming to an end and market was crashing and we covered private equity-owned companies so naturally, they are heavily indebted.

One of the companies we covered came to us and said, hey, you know, we'd like to figure out how do we take advantage of this market dislocation? We believe in our ability to be sustainable, to be viable going forward, but we think the market is in a different place and we'd like to take advantage of it. So the MD that I worked with at that time said, look, why don't you get capital from your private equity sponsor, take that capital, buy back your own debt and effectively, de-lever the company significantly, I think de-lever it by a turn or a turn and a half.

And so what that did for that company was that it lowered their debt, it lowered their interest servicing so it created cash flow for that company, made it more viable, more sustainable and, oh by the way, created equity, right, equity value for the private equity.

So it was a "win win win" idea and I watched that and I said, well, if we can do that for major businesses and as a lender on Prosper at that time, I was lending $25 at a pop at Prosper, I might be one of the few people who didn't lose money, didn't make any money, but I didn't lose any money (Peter laughs), this was 2008.

I thought, if you look at the loans that are being originated on Prosper, a lot of it was to consumers who were looking for debt consolidation and were 560/580 at that time, you know, 80% of the loans were at 580 at that time. And so I thought, if we could create a product, similar to what we just did for this major business which is a debt restructuring platform that focuses on helping consumers who have this delinquent debt, help them negotiate it with their creditors, give them the loan to pay off that debt so the creditor, at this point, is able to recover more capital, the consumer gets a new loan that can help them rebuild their credit and our investors get a rate of return that is market, that makes sense for the risk that they're taking. So that was sort of the aha moment, this can be a "win win win" business model.

Peter: Right.

Jerry: And so started doing research into what is out there, does this exist, who else is out there doing it, what are the options that are available to consumers when they face these financial difficulties. And so during my research, you know, I read about credit counseling, I read about debt settlement and I read about bankruptcy and this was 2008 and so prior to 2008, debt settlement was able to get paid their fee even when they hadn't delivered the service.

So, naturally, you have an industry that attracts a lot of people who necessarily didn't have the best intentions, in terms of serving the customer, right. And so debt settlement had a really, really bad....if you look back 2007/2006/2005 research on debt settlement, it had a really, really bad reputation. There are some reputable folks doing it, but, you know, like any other industry, it only takes one to spoil it.

Peter: Right, right.

Jerry: And so I thought, you know, debt settlement is a needed product. Let's be honest, consumers face financial difficulties, they need a solution that helps them get back on path and debt settlement allows them to do that without having to do the legal bankruptcy process.

Peter: Right.

Jerry: Unfortunately, though, it didn't have the scrupulous actors that was necessary to make this a significant industry and a significant business. So what does debt settlement do? The typical debt settlement.....in the past, they used to get their fees up front so they didn't have (inaudible) sent in to deliver the service. In 2008, the FTC passed a new regulation that they can only get paid when they deliver the service now.

And so the way the debt settlement model works is that consumers will enroll, they'll start making payments into a saving account so that they can eventually settle their debt. On average, it's about $25,000 to $30,000 of unsecured debt across six creditors and so they're making these monthly payments into the savings account so that they can save enough to eventually settle them one at a time.

Peter: Right.

Jerry: And so I thought, here you have a consumer who's demonstrated a willingness, because they could have easily just walked away from this debt, but demonstrated a willingness to pay and, oh by the way, you also have demonstrated the capacity to pay because they're making these monthly payments into these savings accounts.

I thought, if we want to solve this debt settlement issue which is a lack of trust amongst the creditors, a lack of trust to the consumers because the service was not necessarily being delivered and certainly a lack of trust among regulators. The only way you do that is to create a product that actually is a "win win win" value proposition across the board and so that gave rise to LendStreet.

Peter: So maybe talk us through an example of a customer you have, I mean, is it credit card debt they're doing, is it personal loan debts or is it a combo so tell us about that and then how the process works with you guys.

Jerry: Yeah, so it's typically a combination. Our average consumer will come in with about $30,000 of debt, $25,000 to $30,000. It's across multiple credit cards and some unsecured installment. The way the process will work is we partner with settlement companies. The customer would have been in their program, they've already made several payments, they will reach out to this customer and say, hey, you've been in our program, rather than, you know, make these monthly payments over 48 months and still getting collection calls and potentially lawsuit threats, because you've demonstrated the ability and willingness to pay, we can potentially get you a loan to pay off your debt, just to negotiate and to do all of them at once.

And so the customer then says, sure, you mean, I can go from being in this program for 48 months, getting collection calls, lawsuit threats and so forth to now getting a consolidation loan that is less than what I originally owed, but at an interest rate......our interest rates are 14.95 to 18.95...at an interest rate that is not....I think it's reflective of who they are, but it's not reflective of the credit score because, you know.......

Peter: Right.

Jerry:....it's less than (cross talking), 560 FICO, they're in the subprime and so they would expect 22 to 30% interest rate so we're pricing them where we believe they are as an individual, not where they are as a credit score person.

Peter: Right.

Jerry: So that's the loan product. So the consumer submits an application, we underwrite them, we approve them, the settlement companies go out and do the negotiation, we fund the settlement and the customer now has one loan, all of their accounts are settled, the delinquent ones are settled, we pay it off and they're making one payment to us, we report to the bureaus so it helps them rebuild their credit and so forth.

Peter: So when they come to you, has the debt been already negotiated (cross talking).

Jerry: No, it's delinquent at that time, it's delinquent, it's not negotiated yet so we have to do an estimation of what that settlement will be and we're providing them a loan, a line of credit that allows then to go out and do the negotiation and draw on it.

Peter: Okay, so one of the knocks you will hear in the industry is that some of the platforms, the Lending Clubs and Prospers and Marlettes, whatever, they don't want their debts to be settled....they want their debts to paid in full, they don't want it to be settled down. What are your conversations like when you talk to those....to organizations like that, how does that go, what do you tell them?

Jerry: I'm no different, I want my debt to be paid (laughs) because we're lending, right, so for me, we're taking risk in lending to these consumers. So, similarly, we make sure we're looking for consumers that truly have a hardship and what I think the industry....we've had these conversations for months with folks in the industry is, I'm not here to help anyone defraud the creditors.

Peter: Right.

Jerry: I don't believe that's the right solution. In our average, each guy, right, when you look at our customers, some of our customers who have 75% DTI. These are consumers.....yeah, they can't live on that, there is no question about it, they can't, it's not sustainable. And so, you know, the way....obviously whenever you lend you're going to have delinquencies, you're going to have defaults.

Unfortunately, what we've seen in the past, and I'm not saying that....you know, they don't have good reasons to be mad about the settlement companies and things like that, but I think there's a belief that some companies are particularly targeting their customers. I don't know if that's the case, I think what happened is customers who are going into consolidation loans were really trying to outrun a situation.

Peter: Right.

Jerry: Right, the problem is that trying to outrun a situation did not necessarily resolve that situation.

Peter: No, it just delays it.

Jerry: It just delays it.

Peter: Right.

Jerry: And that's what we were seeing. These consumers, you know, with 50,60,75 DTI, you know, they get a loan, either they pay off that original credit card or they don't, right, but even if they pay it off they now have access to this credit card where they go back and swipe.

Peter: Right.

Jerry: And, unfortunately, for the majority, I mean, our customers are middle income so these aren't the high earners or anything of that nature. So I do agree with the industry that there has to be a come upon agreement that says, these are the parameters. If the consumers look like this and they come to you, let's work out a way that'll work to make sure that this customer gets back on path......

Peter: Right.

Jerry: ....and vice versa. I think for settlement companies, if this customer looks this, we're not going to service them because, you know, they have the means, they have the ability to pay......

Peter: Right.

Jerry: .....you know, they don't need our service, right. And I think that's where both industries need to acknowledge, the need for each other and the need to balance the service that each one of them provide such that it's a healthy and viable ecosystem.

Peter: Right, right, now that makes sense. So maybe you could tell us a little bit about what happens when, you know, your customers come into your program and I presume they continue to make payments on the loan, what happens to their credit score?

Jerry: Yeah, so what we're seeing now is that consumers who have been in our program, typically their credit scores improve by 80 points within 12 months and over 100 points within 18 months and that's largely....my belief is that that's largely due to the fact that we're able to clean up their credit. So first and foremost, they no longer have the delinquencies showing up in their credit report; secondly, they have a lower amount of debt.

We've been able to restructure their debt such that their DTI's now are below the 70's, it's now closer to a 45/50% and so we've made them better customers, better credit profile and that’s what's allowed them to become.....and they're making monthly payments and those payments are being reported back to the bureaus which we know is a key component of credit scores.

So I think that's why we see the benefit and one anecdotal thing too, what we're seeing is these are consumers again on average 50 plus years old and so a good chunk of them have homes so they'll go out and refi their homes, take capital, pay off our loan and for us, that's an exciting moment. We were able to take this customer who was on the point of financial distress, help them rebuild their credit and now they're making savvy financial decisions to improve their financial health long term.

Peter: You mentioned your pricing, you said like 14.95 to 18.95, so how do you decide who gets what price? Is there a risk-based pricing component to this or not?

Jerry: There isn't, we're flat fee, we're state-by-state so some of that is driven by state regulation. We have to be mindful of APR caps in certain states, origination caps in certain states and so forth.

Peter: So, basically, someone comes into your program it's a binary decision, you either get a loan… (cross talking)

Jerry: That's right.

Peter: Okay, okay, that makes sense. So then what is your revenue model then? Are you taking origination fee, are you taking, you know, a fee on the backend, how do you get paid?

Jerry: Yeah, it's a combination. You know, we get a portion of the debt settlement fee for helping accelerate their revenue because normally they would have monetized that customer over 36/48/60 months and we're helping accelerate that to 6 to 9 months. So in some ways, if you think about it, it's almost factoring their fees and we're taking the dropout, delinquency default rate, you know, default risk.

Peter: So you're taking on the risk?

Jerry: We're taking the default risk so, you know, they give us a portion of their fee as a result of providing that service. We get an origination fee for the consumer and on loans that are on our balance sheet, we get a sliver of the entry spread and those that we sell we get a sliver of the servicing fee.

Peter: Right, right, okay. Okay then, so give us a sense of the scale you're at today, how many loans are you doing?

Jerry: Well, first, I think this is an industry where we're talking about the 71 million consumers and $680 Billion of distressed that are in the US so what we've done is not even remotely close to scale. I wouldn't even call it scale, I don't even think about......we are not even a pin drop in this problem because when we think about it, the thing that I'm most proud of is our entry into the space have created multiple new companies that are doing similar things to us.

Unfortunately, we have more competitors than we would like, but that's business. Whenever there's a good product, good service, you know, a need for it, there's going to be competitors. We're excited about the fact that what we've seen is settlement entities have grown, the debt settlement space itself has grown significantly.

We're starting to see delinquencies rise in the credit card space so we know that means there's going to be a significant amount of defaults and delinquencies so we've been building ourselves for scale, for true scale. I think what we've done today has been great and we’ve made an impact, but we're not even close to what I would call real scale.

Peter: Right, right. I know you raised a Series A last year and also significant debt capital from really some of the marquee names in the financial health space so tell us a little bit about who's backing you and about that process.

Jerry: Yeah, you know, our Mission is to deliver financial health and our Vision is to create a just financial system so we want to be the catalyst, we want to be the.....you know, the way I think about it, we want to be the lab that creates the solutions that help consumers get access to products that were previously inaccessible.

We want to create solutions that help consumers improve their financial health, get them back on path, we want to be, in a way, the think tank where we can come up with the better solutions, where there's non-transparency, we want to improve transparency; where there's predatory pricing, we want to eliminate the predatory pricing, or not eliminate, but at least create a better product that gives the consumer a different choice.

Peter: Right.

Jerry: And so as a result, we've been able to, you know, attract some of the more mission-aligned, but also mindful of the need for market-based solutions to attack these problems. So we have Prudential as one of our investors, we have Radicle Impact, Candide which is a combination of some of the Pritzker family funding, we've got CFSI which is a big backer of ours, we're part of the JP Morgan Chase/CFSI Fin Lab.

So, you know, yeah, we've been fortunate enough that people who are recognizing that what we're doing is adding significant value not only to the consumers, but also creating real value economically that this is a viable business and deserves to be funded and given a path to scale.

Peter: Right, right. So we're almost out of time, but maybe just a couple of more questions before you go. So are you open to outside investors, or just using your funding line that you've got, or......

Jerry: Yeah, we're using what we have, but we're in the business of renting money (laughs). Unfortunately, you're always raising when you're in our business so you're always talking to more folks, you're always creating a pipeline, you're always making sure you know what's out there, what the pricing is and then what are the opportunities going forward. I mean, it wouldn't be prudent of me to not have those conversations and always be talking to various investors because as we scale, we need more access to more capital because that is effectively our product.

Peter: Right, right. Okay so then give us a sort of look down the road, where are you hoping to go like 12 months/24 months down the road, what are hoping the future holds for LendStreet?

Jerry: Yeah, 12 months, I'm hoping we do several things. One is that we finally get the lenders to recognize the need for such a product and the ability for our product to provide a quicker recovery, a much better recovery than the typical process which is charge off the debt, package it together and sell it off. So, ideally, we get a few major creditors to be partners such that we can help restructure the consumers who are currently in a delinquency mode. So that's one piece.

On the consumer side, you know, while we created a product that's incredibly consumer-friendly, we haven't done nearly enough to create the engagement that we want and to create the impact that we want which is ultimately being able to take the consumer from a point of financial distress and giving them a path to being financially secure and not ever be needing our solution. So we need to do a whole lot more work in that area to create better engagement, better tools, better solutions for the consumers.

And then, lastly, I think, you know, what we've been doing for the last few years has been building for scale and so now to actually go out and scale this business in the way that we know we can and knowing the needs that's out there,

Peter: Right. Okay, on that note, we'll have to leave it there. Thank you very much, Jerry, it was great to have you on the show.

Jerry: Likewise, thank you, thanks for having me. Are you open for questions?

Peter: Sure. (cross talking)

Jerry: Anybody who'd like to ask questions, just raise your hand, please.

Question 1: Jerry, congrats for building a fantastic business, it's doing good for consumers so congratulations. But you're in the industry, obviously, that's kind of have somewhat of a sullied reputation, you're one of the sort of shining stars there.

Talk to us a little bit about sort of your strategy or techniques or ways that you envision down the road helping giving buoyancy to the industry and maybe engaging the regulators to, you know, bring to light some of the positives that you're doing so people can see exactly that the model that you have is really designed to help consumers, you know, and do some good in the industry.

Jerry: Absolutely. So the question is, you know, obviously we've built something that's been impactful, but how do you both engage regulators to make sure that they understand what you've built and how it's impacting the consumers as well as building a broader, you know, rent amongst consumers or, you know, people in the industry to understand our business, understand what we're doing.

You know, I think it comes down to one thing. First and foremost is creating a product that actually delivers a service at a price point that makes sense and that's been our focus. First and foremost, our product has to be good and we've done that. It's consumer-friendly and at the heart of what we've done and everything we're doing is the consumers and that's all we think about.

How does it impact their cash flow, how does it make sure that they're actually getting better. And so I think, because that's been part of our DNA from day one, it's allowed us to have many conversations with the CFPB, it's allowed us to have conversations amongst the regulators and we're open book because we're very much aligned with their vision of a better financial system that service the broader population.

And so we've been able to have those conversations and continue to have those conversations, but to your point, you know, we have to do a better job as an organization to start tooting our own horn a little bit, we don't do that as well and really get our story out there and let people know what we're doing and how we're doing it and the impact we’re having among consumers.

Peter: Okay, thank you very much. Thanks again, Jerry.

Jerry: Thank you, thanks, Peter.

Peter: See you.

(closing music)