PODCAST TRANSCRIPTION SESSION NO. 237–SCOTT SANBORN

Welcome to the Lend Academy Podcast, Episode No. 237, this is your host, Peter Renton, Founder of Lend Academy and Co-Founder of the LendIt Fintech Conference.

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Peter Renton: Today on the show, I am delighted to welcome back Scott Sanborn, he is the CEO of Lending Club, a company that I am sure every listener knows quite well. They've been in the news a lot lately with their acquisition of Radius Bank. So, I wanted to get Scott back on the show to go in depth about this acquisition, why they went and did it, how it all came together, you know, some of the background to it.

We talk about all the different products that Radius Bank offers and how that's going to fit in with Lending Club going forward, talking about some of the banking offerings, the Banking-as-a-Service pieces. We talk about Scott's vision for what this new marketplace bank will look like and that was super interesting, and we talk about the timeline they've set forward, and, finally, how the industry really should think about LendingClub going forward. It was a fascinating interview, I hope you enjoy the show.

Welcome back to the podcast, Scott!

Scott Sanborn: Thanks, Peter, good to be here.

Peter: Likewise. Let's just....before we get to the big news that you're going to devote most of this podcast to, I want to just maybe take a step back and give the listeners a little bit of an update on the core parts of your business, how's that been going?

Scott: Yeah. So, our core business is doing great, we're executing very well against the plan we laid out at our Investor Day back in December of 2017. You know, we've regained market leadership and actually gained share throughout last year, put ourselves, most importantly, on the path to sustainable profit in Q4. We achieved gap profitability, just barely, but an important milestone on the last ....and the first time we've hit that since I became CEO, and a very important pre-requisite to becoming a bank.

We also achieved record customer satisfaction last year and are building a really important foundation for a lasting relationship and a lifetime relationship with the customer that our recent announcement that's perfectly in tune.

Peter: Right, right, okay. So, we're recording this...it's February 25th today, it's a week since you made the big news, I'm curious.....before we dig into it, what's been the mood like inside the company over the last week.

Scott: It's been electric, people are extremely excited about the future we're building and have this.....you know, we've obviously been public since after our Q1 earnings of last year about our intentions, and so it's now real and especially the technology and marketing folks who are really, really looking forward to taking in a new front that we can innovate on behalf of the customers.

After every earnings call, I do the Ask Scott Anything Session which is kind of a open mic forum where people can ask questions and let's just say, it was a packed house, we went overtime because people were really enthusiastic and everybody, of course, is eager to know how they can help and when we could get started.

Peter: Right, I'm sure it's good to be back on offense again in a big way, so that's great. So then, let's just maybe start with why did you decide to do an acquisition, not just Radius Bank, why did you decide to do an acquisition instead of pursuing a charter yourself?

Scott: Yeah. So, as you know, there's two paths here. One is the normal application and the other is through acquisition, and, you know, we had always preferred the acquisition path because it de-risks execution and it accelerates your accretion, right, and so what I mean by that, de-risking execution, you can imagine, with the regulators, we clearly have a lot of experience on the lending side of the house, right.

We've been doing this first loan since 2007, we're doing it at scale with over $55 Billion in loans issued to date, but we don't have experience on the deposit side of the house, so....and we don't have the systems, the processes, the people to manage that. And that makes, you know, kind of validating for regulators that you're going to be a responsible steward of those capabilities more challenging, right. As you know, there's only one fintech that's made it through that process and it's been three and a half years, so we view this as really significantly accelerating the path and de-risking the path.

The other piece of that acceleration is that it's earning acceleration, right, because by acquiring a bank you're acquiring a book of deposits, right. In the case of Radius, over a billion dollars in deposits and you're acquiring a book of loans that are already earning net interest income. So, that helps, you know, I'm not an expert on bank accounting, but, as you know, as you build a loan portfolio, especially under CECL, you need to take all of the loss reserves up front, right, so that the GAAP financial picture early on is one of the more challenging and when you do an acquisition path, you're much more quickly accretive.

So, with that, it's always been our goal..... we were scouted, but, you know, finding the right partner is the challenge. There's more than 6,000 banks in the US, and, you know, you get both practical and strategic consideration, you know, practically somebody we can afford to buy that's for sale, that's willing to sell to a non-regulated institution which, you know, bears thinking about, right, because there's more risk in the transaction there for them, and, certainly, timeline, at the very least, and it's not bringing legacy infrastructure to the table. And then there's the strategic side, right, is there are cultural fits here and do they have, you know, the online deposit taking capabilities versus, you know, some kind of a branch infrastructure that obviously wouldn't fit.

Peter: Right.

Scott: So, you know, finding the right partner was critical.

Peter: Right. So then, when did you actually first start talking to Radius Bank about this?

Scott: Yeah, actually, over the summer, late summer, we started talking to them and the initial call was really about a partnership. We were evaluating partners...that's always been part of our vision to add a transaction account for our customers, and, you know, prior to having a charter, we were looking at ways of developing one in partnership.

And so, our first conversation with them was to explore that idea and the CEO was on the phone, I was on the phone and, you know, I would say five minutes into the conversation, after they gave the intro to their company, gave the intro to our company, we both clearly had a wow, should we be talking about something deeper here because it was so clear that we had separately built at scale, the two sides of a bank balance sheet, right, and we had built deposit at scale and they had built online deposit taking at scale. Putting those two things together is a one + one = three.

Peter: Right. So, it's fair to say that you really....obviously, there are not many banks quite like Radius Bank in this country. You know, I had Mike Butler on my show just a couple of months ago and I've really been impressed by them. So, suffice to say, you took off the table then this sort of going to buy like a one-branch community bank. It would have been a lot cheaper to go and buy a one-branch bank to get.......... a banking license in some small town in the middle of America, but it sounds like you took that off the table pretty quickly.

Scott: Yeah, it goes back to that question of what are we looking for, right? We're looking for somebody who's got the ability to take online deposits at scale, and who would be excited about, you know, being part of Lending Club and building, a major brand in business and that's what Radius brought under Mike's leadership. They, several years ago, went through the process of closing down their branches and investing in their online capabilities and that's been where all their focus has been, just like all our focus has been on, you know, building out our lending capabilities.

Peter: Sure. So, when you look at Radius, it’s business, they obviously have a much broader kind of product suite. From what you've just talked about, I mean, they have this sort of Banking-as-a-Service part of their business. You know, I know that they've got NerdWallet, they're doing savings accounts for NerdWallet, they're doing bank accounts for Brex. These are sort of pretty unrelated type offerings than what Lending Club has today, I mean, how do you feel about that part of their business. Is this something you want to adopt and grow, or not?

Scott: Yeah. So, we are very excited about what they've built and on the partnership side of their business, yeah, they're bringing over a billion dollars in deposits and just like in lending, having a diversified portfolio is important. Same thing is true in deposits, so these partnerships are an important part of their diversified deposit portfolio and, you know, once we get through the nuts and bolts of the integration, we can provide them real exciting potential for future growth and the ability for us to potentially provide some other services to those partners.

Peter: Okay, what about......

Scott: Peter, that's why we're being...whenever we talk about this, we say we're going to be a marketplace bank, right, this is all part of that. It just differentiates us from what people think of as the traditional banking model.

Peter: Right. So, maybe just expand on that a little bit. When you say a marketplace bank, do you mean like....obviously, you've got the marketplace lending operation which I think everyone gets, but do you mean having a marketplace...like Radius Bank has a marketplace where products that they don't offer directly they have referral type programs....I mean, maybe you could just spend a minute just teasing out your vision of what a marketplace bank actually will look like.

Scott: Yeah. So, there's a couple of aspects to it. One is, again, you know, on the lending side of the house, we believe the marketplace model has some really critical strategic advantages for the customer and by extension, for the company, which is, you know, we're able to serve a very broad range of customers, right. That goes beyond what a traditional bank would do by virtue of the fact that, you know, there's a segment of customers that don't comfortably sit on a typical bank balance sheet due to their risk profile, but there are plenty of buyers for that asset.

And so, by being able to cover both high quality, let's call it traditional bank customers, as well as still creditworthy, but higher risk customer segments that will enable us to say, yes to more...makes our marketing much more efficient and really kind of drives the overall business model, so that's on the lending side. The other concept of the marketplace on the lending side is we don't need to build every product ourselves. You know, we will have a customer relationship which will soon be enhanced by not only being able to extend credit in the form of unsecured lending, or auto re-finance, but also the ability to offer them a transaction and/or savings account.

So, we've got that, then we'll have significant data on our customers who will understand their cash flow, understand their credit history, understand their behavioral patterns and can we identify other opportunities for these customers to save, regardless of whether or not we manufacture those products, right. So, if I see rates has gone down and I know somebody re-financed two years ago when rates were higher, shouldn't I prompt them that they can save off of their mortgage and can I, with their permission, provide them a pre-approved offer from a partner who we know will deliver on the experience.

So, that's all part of vision for us of a marketplace bank is, you know, investing in areas that are strategic for us to really own the experience, but then integrating and partnering with others to add value to the customer and not feel like we need to build it ourselves.

Peter: It reminds me, actually, of your LendIt keynote, your first keynote as CEO back in 2017, where....I still remember this distinctly where you sort of teased sort of the audience about becoming sort of the Amazon....I think you used the Amazon analogy directly, saying the Amazon of financial services, I mean, is that really what .....sounds like that’s what you're talking about here.

Scott: It is, and, you know, we are making progress towards that vision. As you know, last year, we integrated with several partners on the small business side to do just this, right, which is we’re working with Opportunity Fund and Funding Circle to enable customers who are coming to us organically, right, just because they know the brand and potentially have experience with the brand as a consumer, or also might just have heard of us through, you know, you, or other places in the media, or word of mouth. We are enabling them to get connected to, you know, credit at a fair and transparent process and these aren't products...it's not a product that we are manufacturing, so we are already building towards that vision.

Peter: Right. And then, what about the products that Radius is manufacturing? Like when I talked with Mike, he mentioned equipment finance, SBA loans, like would you continue those kinds of products as in having them manufactured in-house?

Scott: Yeah. As I mentioned before, kind of having a diverse portfolio in lending is a good thing than bringing a portfolio of loans while at a significantly smaller scale, obviously, than what Lending Club is producing is part of that enables this deal to pay for itself within two years. Certain of those portfolios, we think we can even turbo charge, for example, the SBA loans, make perfect sense as part of our current portfolio where people are coming to us looking for small business loans and we’re working with partners. The SBA product would be something that we could click right into that.

Peter: Right, right, that makes sense, that makes sense. So then, if we fast forward....you said 12 to 15 months you said on the earnings call, if we fast forward 15 months...I mean, when this is all said and done, what are you most excited about offering. I mean, what can we expect to see first as you kind of integrate, what new products?

Scott: So, the number one thing we are really excited to get to work on is a uniquely Lending Club checking account, transaction account for the customers. Right now, as you know, we help people pay less when they're borrowing money. What we want to do is help them earn more when saving and really create an integrated experience that goes after, you know, some of the fundamentally broken things in the current banking experience, right.

For example, a significant percentage of Lending Club customers today get hit with overdraft fees and the average customer that gets hit with an overdraft fee actually gets hit with it three, or four times in a year. I think you know how those things work, they're not considered loans. If they were, they would be at usurious interest rates that you're paying. You write a $30 check and you pay a $35 overdraft fee.

We look at that and say, well, can't we use the tools available to us today, both a combination of artificial intelligence to do some predictive modeling on a batch of consumers and say, hey, you've got some bills coming up, your account's getting low, you've got to be thoughtful about the payments that are due at this time, and if the customer doesn't have a choice extending fair and reasonable credit seamlessly as part of the actual integrated account experience for them.

So, that's something we are super excited to go after, it really gives us a reason to have a mobile experience, to have an experience that's high engagement, our customers want this from us. You know, we did a survey of our customer base and 90% of them said that they would consider a Lending Club account and 36% of them said, you know, I'd just do it. (Peter laughs)

I think you know we rolled out late last year in beta a credit health tool for customers and we're seeing really high adoption of that as well. You know, people are saying they tried Lending Club, we've helped them save money and this idea that we can, you know, kind of have a product and have a business where the interests of the customers are aligned with the interest of the company and when we win, they win. It's something that is super exciting for everybody here.

Peter: Interesting. So, another question I was going to ask about is the financial health piece. You've been pushing that message for some time now and so, sounds like what you're saying is that the new products that you launched as a result of this merger….. are you going to have new....this financial health is going to be the backbone of the ....you know, the thing that ties it all together, I take it, is that how you're thinking about it?

Scott: Yeah, that's right. We're going to make this a really integrated experience and you can think about a couple of things we've been talking about for a while all coming together. One is, you know, really investing in this idea of club membership that once you come to us the first time and, you know, we have underwritten you and you've successfully paid off a loan, how do we make any subsequent experience you have with us in lending really, really seamless.

So, last year, we got to a one quick offer for you when you come back, so no need to fill out another application, and, you know, have a fee like a stranger, we treat you like a member of the club. This year, we're going get to a one click-loan by using the data that we have to enable really, really.....you know, our goal is to make it as easy to get an unsecured personal loan as it is to swipe your credit card, but, obviously, we'll be giving you a superior product at a lower fixed rate versus a card, so that'll be one aspect though.

The second is continuing to invest in this credit health tool that helps people understand where they are and how the actions they're taking are most directly affecting their eligibility and their cost of credit, something we internally call "do this, get that." So, we're building this experience where we're tracking all your cards, we're tracking your credit and we can tell you, hey, the problem is your utilization is getting high because you're putting it all in this one card. You either need to raise the limit on that card, or, you know, spread it out amongst your cards. Those kinds of things that'll help you manage your credit, specifically your cost of credit, and your eligibility.

And then, the third is going to be a new tool available to us which is being able to help you manage your cash flow, and, actually, manage your spending so that we can help you save more in your checking and savings account. That'll be the new front, and so the goal is to have all of these three, upon approval, come together into a really unified experience.

Peter: So, does that mean you would offer a Lending Club credit card at some point?

Scott: I don't see that on the near term horizon. I do think there is a way to offer a credit card that is on brand for Lending Club, right, where you are being rewarded for your good behavior, but that is not something we're focused on near term right now.

Our near term focus is these kind of three pillars that I just talked about, and, obviously, bank readiness, just making sure we are ready to really hit the ground running such as post-approval, we have the ability to issue our own loans, gather our own deposits, deploy a sub-set of those deposits into loans and really take the customer experience to the next level.

Peter: You know, I read recently you crossed, I think, three million borrowers now, so you've got a very large customer base there, but I actually want to talk about the individual investor. Obviously, the numbers are much less than that, obviously, I'm one of those, I've been an individual investor now for, boy, coming up to 11 years very soon, but...... (laughs)

Scott: Thank you, Peter.

Peter: (laughs) You're welcome. So, what are the future plans for that sort of sub-set of the Lending Club, membership, shall we say.

Scott: Yeah. I mean, we view kind of the retail investor as sort of the, you know, pinnacle of a successful journey for the customer, right. If you come to us to get savings off of your cost of debt, you open a Lending Club checking account, we help you actually generate real savings in the form of your own kind of cushion so that you don't need to turn to debt if there is an interruption in your cash flow, or an unexpected expense. And then, from there, the ability to pay it forward and to support other American consumers who, you know, we're where you were however many years ago, and also earn a compelling return.

So, we think as part of our overall part of the customer journey, the retail investor is an important part of it. We look forward to being able to evolve that experience under the bank charter frame. I mean, I think you can imagine a world where you've got a Lending Club retail investor account and it's lent to a card and you could set up how much you want to invest, how much you want to keep in cash and, you know, you have the ability to use that at ATMs. That would be an example of something that we could do in the future.

Peter: Right. So, from what you're saying, obviously, you're filing….. the self-managed individual investors are becoming a smaller percentage as you grow, but it sounds like you're still committed to maintaining and potentially improving the offerings there.

Scott: Yes, this will give us new opportunities to do that.

Peter: Right, okay, I look forward to that. Okay, so then, you've got this timeline that you've laid out there, I'm curious about what are some of the near term targets that you are looking to hit to make sure that you maintain...obviously, you've been talking to regulators, I imagine, for a long time, but what are some of the things that are coming up on that timeline?

Scott: Yeah. So, correct, we've been engaged with the regulators for more than a year now and the important thing is we now feel like we're at a place where we're ready for this next stage. You know, if you go back a year, one of the ....I'll share with you, the question was, okay, does Lending Club know how to manage credit, check. Is Lending Club profitable, hmm that was an X year ago, we're now profitable, that's a check.

So, one of the things we need to do now is maintain profitability, that'll be a key thing and that's a core focus of us this year is maintaining that. And next is, does Lending Club know how to manage deposits? Now, with the acquisition of Radius, the answer to that is again a check. And so, the process we need to go through now is essentially, you know, get regulatory feedback on all of our cross board; people, processes, tools, systems, our business plan, all of those.

You know, process that feedback from the regulators, revise and remediate anything that they've identified on our behalf, incorporate that and then, you know, eventually submit a formal....and that will be a public application that will come later in the process, you know, that's the mission of the formal application. The formal application will be something that, you know, will indicate that we're kind of through the process of remediation.

Peter: I imagine it's fair to say that you had conversations with the regulators before you came and made this public announcement. I mean, what were those conversations like?

Scott: You know, the conversations have been incredibly constructive, really constructive and, you know, we're trying to do something that hasn't been done before. It's not every day that a company doing $12 Billion in loans acquires a directly supervised institution. So, the conversations have been okay; what do we need to do to essentially get the regulators comfortable with the frameworks that we have in place and how do we need to ready ourselves for the process we're about to go through, but they've been very constructive and very frequent. You know, we're feeling a high degree of engagement on the part of the regulators and we're looking forward to working with them collaboratively as we go through this process.

Peter: Right, right. I mean, it is good....I was listening to a podcast on the weekend with Jo Ann Barefoot, she had Jelena McWilliams on, the Head of the FDIC, and I just was struck by how much she wants to promote innovation and new ways of doing things, and…doing away with a lot of the sacred cows at the FDIC that ....when I was listening to that and thinking about what you guys are doing, I feel optimistic.

I imagine you did too about the fact that the regulators are not throwing up hurdles against you. I know that Varo, obviously, had a really long time before they were able to get approval, complete approval there. But, I imagine even the OCC tried with the Fintech Charter, that's sort of in limbo now, but maybe you can maybe give us your sense too that the regulators really want to say yes, whereas before, I feel like they wanted to say no.

Scott: I think there is a recognition that, you know, there is a lot of benefit that a company like Lending Club brings to the system, right. We have been demonstrated in some studies by the Federal Reserve that we're making credit more affordable, we're making credit more accessible, we've reached a scale at which.....you know, it makes sense for us to be directly supervised and as a result of that scale and the unique aspect of our model in which we're partnering with so many banks, we've built so much of the systems and processes and have hired so many of the people that you would expect to see in a bank that it just makes sense.

And I think that desire....you're not only hearing the top where the tone is being set, but we feel that throughout the whole organization. That said, it is an awesome responsibility that, you know, comes with a bank charter. So, you know, real work needs to be done to validate that an organization is prepared for the responsibility that they're about to be granted. So, there is real work that needs to be done and not everyone is going to be ready. You know, I look to .....I think we are really uniquely positioned given the length of time we've been in business to scale. We're operating in the nature of our banking relationships that has required us to build out these capabilities.

You know, I think when you look in other markets, there are certainly some interesting models. You've probably seen what Singapore did with these bank charters that kind of have levels of charter that they grant and they're trying to make it possible for new entrants to come in and gradually move up, in terms of the capabilities they get, and also the leeway they have to operate. I think there's some interesting models there...I think lacking that, you know, for most companies, it is a difficult path to get down and there are only a few companies, I think, that are ready to do that and I do believe we're one of them.

Peter: Sure, okay we're just about out of time, but one question before I let you go. We look at Lending Club's position in the industry and you've had a leadership position and a very clearly defined leadership position for many years, but this move is something that is going to reposition yourselves. Maybe you can share with the audience how the fintech industry should really think about Lending Club going forward.

Scott: Yeah. I mean, we will continue to stand apart, you know, we're going to have a new peer set that we're amongst, but we're not going to, you know, we're not going to look like they do, we're going to be faster growing, high margin and, again, have a business model in which the success of the company is really aligned with the success of the customer. We're looking forward to bringing that same, you know, innovation and customer-centric product development to the deposit, checking and transaction side of the house that we brought to the lending side of the house.

Peter: Okay, we'll have to leave it there. Good luck with everything, Scott, I'm sure it's going to be a fascinating journey over the next 12 to 15 months and we'll be all be paying attention. Thanks for coming on the show, and best of luck!

Scott: Alright, thanks, Peter, and watch the space.

Peter: Indeed, okay, see you.

You know, I have to admit when I first heard the rumors that Lending Club was acquiring a bank, I didn't immediately think of Radius Bank. I clearly should have because I feel like they really are a great fit. I'm excited for Lending Club and what it means, I think, for fintech. This is the first of its kind, having someone who has really become an established lender, in fact, the largest personal loan lender in the country.

Going down that route before becoming a bank has never been done before, it's going to be super interesting to see how it all plays out. I think this is not going to be the last of this kind of acquisition that we'll see in this industry, but, I think, everyone is going to be watching closely to see how the acquisition goes, how the regulatory approvals go and what comes out of it. As Scott said, it's an exciting time, there's a lot of things that they can do with this.

Anyway on that note, before I sign off, you'll be able to hear more about this at LendIt Fintech USA where Scott Sanborn will be a keynote speaker on our opening morning.

Anyway, thank you very much for listening and I'll catch you next time. Bye.

Today's episode was sponsored by LendIt Fintech USA, the world's largest fintech event dedicated to lending and digital banking. It's happening on May 13th and 14th, 2020, at the Javits Center in New York City. Lending and banking are converging and LendIt Fintech immerses you in the most important trends of the day. Meet the people who matter, learn from the experts and get business done. LendIt Fintech, lending and banking connected. Go to lendit.com/usa to register.

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