FINTECH ONE-ON-ONE PODCAST – AL CRAWFORD

Welcome to the Fintech One-on-One Podcast, this is Peter Renton, Chairman & Co-Founder of Fintech Nexus.

I've been doing these shows since 2013 which makes this the longest-running one-on-one interview show in all of fintech, thank you for joining me on this journey. If you like this podcast, you should check out our sister shows, PitchIt, the Fintech Startups Podcast with Todd Anderson and Fintech Coffee Break with Isabelle Castro or you can listen to everything we produce by subscribing to the Fintech Nexus podcast channel.

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Peter Renton: I interviewed Al Crawford who is the CEO & Co-Founder of BHG. I interviewed him at Fintech Nexus USA in New York City back in May and the title of this session was "Lessons Learned During the Difficult Times" because what is unique about BHG is that they've been around 22 years, so they've seen the round-up in the previous crisis, we actually talk about that, what lessons were learned there. We talk about some of the actions they've taken during this challenging time, we talk specifically about credit because this was in our credit and underwriting track, so we spent quite a bit of time talking about credit and Al provides a lot of insight on how to navigate these difficult times. It was a fascinating discussion; hope you enjoy the show.

Peter Renton: Al, good to see you.

Al Crawford: Good to see you, Peter.

Peter: Congratulations on the award that you just won.

Al: Very exciting, it was a surprise but after 22 years in the business, it was a welcome surprise so thank you and really appreciate it.

Peter: Okay. So, why don't we just kick it off with a little bit of background, tell us a little bit about what BHG, the different verticals you're operating and why you started the company all those years ago.

Al: Sure, thank you. We've been in business for about 22 years, my partner, Eric, is out here and another individual, wanted to bring a real interesting business loan to small business owners. So, we came up with the idea of a $100,000 loan that was fully funded and not at a discount that we would move very, very quickly on and that was pretty much unsecured and that we would really look at the borrower and the borrower's credit worthiness to make a decision whether or not the person would pay us back which was obviously the most important thing.

We also built a bank network on the back side, we had relationships with many community banks and so we had an idea of originating high quality loans with business owners for say $100,000 small ticket, give them a term that went out at approximately seven years which was just a random date that we chose, 84 months, and we would fund it and we would then sell it to our bank group which was very small. Day 1 back in 2001, it was only five banks at that time that were working with us. So, it was a pretty simple concept we'd originate for small businesses, we would then package it, we would underwrite it, fund it and then sell it to a bank group on the back side that we knew. Started very, very small, $25,000 in capital and today, we're about $550 Million in capital and we started $25,000 in assets, today, we're about $4.4 Billion in assets so that kind of growth.

Peter: That's quite a story. So then, what verticals do you operate in today?

Al: We operate with the consumer and basically a very small average size $50,000 debt consolidation loan, we go out as far as ten years on term, we've continued to offer our small business loan. One of the things we learned along the way was there's a lot of entrepreneurs in the United States and so we have a lot of different W2 employees that have had a dream, had an idea, strong credit, strong income, and we've done a $100,000 kind of startup entrepreneurial loan for them has been one of our signature loans over the years too, it's a really interesting vertical.

Peter: Okay. So, let's just talk about your loan marketplace for a minute. Why don't you describe it and what makes it unique?

Al: I think we've got probably one of the most diverse marketplace funding facilities in the world, I'd go as far as saying. We have 1,500 banks on any given day that come to our marketplace, come to either our live auction or a silent auction, a direct placement, a number of different ways they can buy the paper from us, and they compete for the paper. We put anywhere from $10 to $20 Million a day on that auction platform to give everybody an idea. In April and May, in each month, we had 400 unique banks buy loans during that time period. And I would consider those time periods as some of the tougher time periods I've seen in the last 20 years with what's gone on in the deposit world as well as what's gone on with, you know, banks getting really punished not for credit problems but just for duration problems.

Peter: That's great to see post SVB getting that sort of volume. So, I want to talk about the last 12 months, you know, there's been certainly a bit of a downturn with the consumers, there's been a lot of inflation that's been impacting the consumer, how are you adjusting your credit box and what are you learning from your borrowers, I guess, in real-time?

Al: Great question, Peter. I think we're learning a lot from our borrowers; I think during times like 2021, back side of 2022, everybody pays. I think all your models work, I think you can have a model that says, I'm going to lend to just this type of person in Northern California and this person's going to pay me back and the person probably will pay you back in times like 2021/2022. As we roll to 2023, we're learning a lot about mistakes that we made with our models.

So, in my opinion, if you can grind through and you're like 2023, potentially 2024 and learn just a tremendous amount of information on where your models are maybe priced wrong, maybe where your credit was too aggressive, you put that into the models now and as you come out of these years your models are much, much more specific for performance. So, we're doing a lot of data research, we're looking at why we lost, where we lost, we're adjusting different risk rates, probably, I'd say, we've lost about 18% of our volume by design for our riskier risk rate, and we're not originating that right now. You know, we went blanket on some of our deeper risk rates and now, we've come back and said, this portion is still paying very, very well so we might add that back in.

Peter: Okay. So, you are one of the very few fintech lenders that was around during the previous financial crisis, talking 2008/2009, what are some of the lessons that you took from then? Obviously, the company wasn't as big in scale as it is today, but still you were out there in the market, what was that time like and what lessons did you learn that is helpful now?

Al: During times like 2008/2009, a little bit 2023, you can't have enough margin on a deal, you stress it two or three times, all of a sudden you realize there are certain risk rates that are stressing at five times. And so, hopefully, you have deep reserves on balance sheet, you have strong cash position and I think your funding sources have got to be deep and diverse because you have to plan on losing some of those funding sources. And we've had tremendous participation over the last, throughout 2023/2022 but we still have lenders who probably aren't buying from us for some reason or another, maybe their liquidity situation, their deposit situation so I think you have to expect that, you have to be prepared for that, we learned through 2008.

And I think we're well poised for 2023, our reserves are at record highs, our credit is performing, we're not beyond what we thought we would stress at by any means and I think those are some of the important things. And I think you need to stay close to your staff, very close to your key leaders and one of the things I've never been a big proponent, it hurts me at times, it hurts me a little bit with Wall Street at times, it hurts me with some of the bigger banks is we grind in times like these so we take week by week, honestly day by day, month by month and I hate forecasting now, let's say to 2025 right now. There's just so many unknowns out there that my message to the team is do what we do well, do it every single day, and just grind through these times and get through them. Is one of the biggest things I learned from the 2008/2009/2010 market.

Peter: Right. So, it sounds like as you say, banks are still lending, they're still on your platform but I'd be curious to know about how they have adjusted. You said you've taken a lot of the volume of the riskiest loans off, but are banks now, the banks that may have been interested in moderate risk, are they adjusting their credit boxes to say you know what, we're only taking prime consumers right now.

Al: They have. One of the, again, the positive things about times like this is that the competition tends to go to the sidelines for various reasons and we don't. We're tracked to originate to $370 Million this month yet our lead flow is at record highs, we're seeing 70,000 leads a month right now through our digital marketing and our other marketing channels, our direct mail so our selection process is enabled to really take the best of the best. We did probably $430 Million, I think it was in October of 2022, so we're at $370 right now and you're $50 Million dollars less and you're seeing more lead flow than we've ever seen in the history of the company and what that equates is you get to in and select some very, very strong credits.

We're passing those credits along to the banks, the banks 100%, Peter, are looking for stronger credits, they're looking for, you know, stuff that they feel is going to get them home and we're able to deliver that right now given the lead flow, given what we're funding and giving that our FICO scores, our score which is internal, have never been higher, they're at record highs with the fundings we're doing.

So, we're able to meet that desire to do a stronger credit at the bank level. And another thing I'll say is one thing the banks are demanding, they're demanding more rate, they're following Fed Funds like everybody else so if Fed Funds have gone up 500 basis points, we've had to adjust. You know, we did an ABS for $500 Million at 1.67 in early or late 2021, I told everybody, you'll never see a rate like this again, we should take $2 Billion if we can from the market. (Peter laughs) And we went to market literally the week of the SVB failure and we were at 7.50. So, you know, Wall Street's re-priced, the banks have re-priced and we've been re-priced on the front end too.

Peter: You got that deal done, right?

Al: We got the deal done. We priced SVB at…it was taken over on Friday and we priced the following Friday, so it was a turbulent mark, but it was about $280 Million approximately that we sold in that period which I was happy to be able to do.

Peter: Right, right, yes, for sure, that is actually impressive. And so, maybe we should talk a little bit about how you kind of have built your credit team because I'm sure in the audience there's a lot of people working in credit teams would love to get sort of some insight into how a company like BHG, you know, how you've created and how you run the credit team.

Al: It's a great question, Peter. It's interesting because it ebbs and flows, we have 90 underwriters on staff, some of them have been with us for over 15 years, we have 50 data engineers who drive the credit team. So, the credit team isn't, I would say, making decisions on their own per se, they're really driven by the data and they're driven by the data engineers who are tweaking the models that we talked about a little bit of go every day. But if you talked to me two years ago, we were really driving towards trying to have no friction and just be technology all the way through.

Today, again, you ebb and flow, we're ebbing a little bit where, you know, there's a lot of stacking that's come at fintechs, you know, we're targeted by borrowers who have no intention of paying. And so, we've added a 30-member fraud team in the last three years which is probably second to none and we really have to look at what can we do to prevent that from happening to us. And there's some manual processes in the underwriting scenario that you can do that I think slows that down tremendously. Requiring bank statements, looking further into the credit than just a flow pass through scoring model that we might have been really interested in, you know, when you go back two years ago. So, right now, we run heavily on technology, but we also use credit officers, especially in that area where the applicant looks like it may be a little bit interesting, we may want to do a little bit more digging to make sure that it is somebody that's not going look to just use us for a stacking opportunity.

Peter: Right, right, interesting. So, can we put the Slido QR code on the screen so people can ask questions. There we go, thank you very much. If you have a question for Al, you can scan that code and it will take you into a place to ask questions. Then maybe we can talk…I just want to dig in a little bit more if we could about the………you said you're getting record borrowers coming to your platform today so demand is there. Is that across the board, the demand that you're getting, and what are these borrowers looking to do for the most part?

Al: It's a record demand, it is across the board which is great news, we're seeing probably the best credits we've ever seen in the history of the company and I'm guaranteeing we're seeing volume of the worst credit stack that we've ever seen (Peter laughs) so it's heavily across the board, as I said, the good news is we're seeing some, you know, super credits, I think very much what they've always loved, consolidate debt. Your small businesses may be looking to take down a little extra capital as the environment gets a little scarier when you turn on CNBC and you see the regional banks last week get hit then you see them come back which was awesome.

You know, I think the CPI figure today was encouraging down for yet another month. Fed looking like they're pausing here for five or six months would be super, but I still think the consumer's seeing all that too and they're just looking to take a little bit of a safety capital for themselves, make sure they have a little backup to cover their debt. The business owners want a little bit in the coffee jar to basically have for down the road in case it gets all dicier so we're hearing that a lot as people are coming in because…and, again, we have people that are looking to extend their term, maybe their payments are a little bit tough on an adjustable that they had, or other debt that they had.

We go out 12 years so it's a very, very affordable payment out at the 12-year mark and, you know, our pre-payments, penalties are pretty minimal so they can go out there, they can borrow the money. The rate may be a little bit higher than what they are hoping for, but again in times like this they have the ability to pay if off if things don't get as bleak as some of the different announcers make of it.

Peter: Right, right. So, let's just get to one of the audience questions here, how do you prevent loan stacking and what are some of the signals that you track from manual underwriting?

Al: Great question. One of the things that the analysts have come up with is if you're not in our universe of let's say purchase data borrowers and you come in digitally, your risk jumps three to four/five times, crazy. So, needless to say, we're cross referencing anybody that comes in digitally to see if they're in our universe of what we purchased with specific credit desires in mind we're looking to market to them.

In that situation, we would look for additional information, we would look for potential checking account information, we would have a live underwriter on with them and we would be probably digging much deeper into what their current situation looks like and also looking to get a snapshot of their let's say last 12 months use of money, you know, how much do you have coming in, how much do you have going out, does it look like you're just supporting a higher FICO when really all you're planning to do is borrow as much as you can from every fintech and then just dump. And so, those are some of the processes we would use to identify that type of borrower.

Peter: Right, right, okay. Maybe we'll just take one more question here, so any pieces of data your underwriting team uses that you would consider unique?

Al: Probably, probably (both laugh).

Peter: You don't want to share, do you? (laughing)

Al: Probably a much better question for Juan Carlos Ortigosa who's our Chief Revenue Officer and runs our data engineers, we look at a lot of traditional data and I think we just score it and weight it a little bit differently and like I said to start the session off, not always accurately. You know, you find out in times like this that we've scored this, we thought this was dependable and it's really not performing like we thought it was going to so we may want to weight that differently in the future when we're enduring what we're enduring in 2023.

Peter: Right, right. So, last question then, you know, you've touched on it, but I'd love to get you to tackle it directly, what is the key for a lender to survive during turbulent times like we have now?

Al: I think cash, cash is king, I think you have to have….I think reserves are very important. We're at the highest percentage reserve we've ever been at, we honestly, historically over the last six months, have in reserve about 135% of our 12-month trailing loss so we're well above our methodology going into this. Again, I just don't think you can have enough in reserves when you're in turbulent times like this.

And I think when we talk about key funding sources…we've got tremendous operating lines, about $850 Million led by BMO, we have relationships with big PEs, we do go to the ABS and then we have our bank network of 1,555 banks that we sell to every day. You will have ebb and flows with those sources, those varying sources but somebody, thank God, has always been there for us and so I think it's important to have those diverse funding sources in times like this.

Peter: Yeah, that is good advice. Well, Al Crawford, CEO of BHG, thank you so much for joining us here today. Give him a hand. (applause)

Al: Thank you, Peter, appreciate it.

Peter: Well I hope you enjoyed the show, thank you so much for listening. Please go ahead and give the show a review on the podcast platform of your choice and go tell your friends and colleagues about it.

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

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