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As Big Banks Balk, Upstarts Attract Deserving but Underserved Borrowers

FirstAgain, Virgin Money Rely on Word-of-Mouth and Online Marketing

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LOS ANGELES (AdAge.com) -- Many surveying the consumer-loan landscape see nothing but slag heaps of defaulting subprime mortgages and frozen lines of credit all the way to the horizon. But two upstarts with decidedly fresh marketing and lending approaches are seeing the image crisis at more-established banks as an opportunity.


Richard Branson: Look what a loan did for him.
Photo Credit: Gamma

Virgin Money and FirstAgain are thriving by serving a suddenly burgeoning market of deserving but underserved borrowers. Even their corporate monikers set Virgin Money (unblemished by the subprime debauchery!) and FirstAgain (putting the customer first once more!) apart from the behemoths.

As traditional lenders endure what FirstAgain co-founder Gary Miller referred to as "a deer-in-headlights moment," his venture has grown with almost no marketing.

FirstAgain focuses only on ultrareliable "superprime" borrowers who want unsecured loans of up to $100,000 to buy anything they like -- a horse, a timeshare, a Bentley, even 60 bottles of Châteaux Margaux.

It got another $30 million capital infusion in February from Arsenal Capital Partners but still markets itself using only a handful of ads on sites such as Bankrate.com and partnerships with sites such as LendingTree.

Seemingly risky bet

"How do you market sliced bread?" Mr. Miller asked, adding: "Our customers are very research-intensive, and so they find us. We're really a direct-marketing company."

FirstAgain's success all the more remarkable given that consumer delinquencies on auto, credit-card and home-equity loans are at their highest levels since 1992, per the latest American Banking Association report on credit. James Chessen, the ABA's chief economist, attributed the rising tide of red ink largely to auto-loan delinquencies, which account for about two-thirds of all closed-end consumer installment loans.

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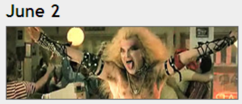

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As Automotive News noted recently, that's led some small regional banks to stop making loans through auto dealers altogether.

The result: Many otherwise credit-worthy consumers have been forced to buy cheaper models or used cars, and when such consumers can get loans, they're frequently saddled with bigger down payments, higher rates and shorter loan durations.

FirstAgain's Miller knows a thing or two about auto loans: In 1997 he created online auto financier PeopleFirst.com, which became the nation's largest by lending directly to people with excellent credit. When Mr. Miller and co-founder Dave Zeller sold their business to Capital One in 2001 for $200 million, PeopleFirst had one of the lowest default rates in the business.

Lower default rates

"We just didn't want to be in a collection-intensive business," Mr. Miller said. "It's not what we enjoy doing. And because we don't need to worry about repayment, all of our focus is on developing a great customer experience."

FirstAgain surpassed $100 million in unsecured-loan originations in April. But "unsecured" is not the same as "insecure." PeopleFirst's and FirstAgain's default rates hover at one-tenth of 1%, compared with the industry average of 3% to 4%, Mr. Miller said.

The seemingly risky bet to offer unsecured loans, even to high-quality borrowers, came from a paperwork snafu during Mr. Miller's days at PeopleFirst. Borrowers were supposed to receive the titles to their new cars upon paying off their auto loans. But Mr. Miller discovered that PeopleFirst had never gotten the titles to hundreds of cars from the borrowers in the first place -- meaning that at any point along the way, the customers could have cashed their blank PeopleFirst checks and sold the cars that served as collateral.

That hadn't happened once, so Mr. Miller realized "these kinds of [superprime] loans just don't need to be secured."

Of course, not all consumers are lucky enough to have credit scores worthy of such largess, especially would-be borrowers who've suddenly found themselves unable to tap home-equity loans (as thousands of Countrywide and Indymac bank customers did over the winter). According to the Center for Economic and Policy Research, the American housing market will lose $6 trillion in home values this year.

Not as seen on TV

The best sources of funding for those credit-worthy and even less-than-credit-worthy cash-strapped folks may be family and friends -- with an assist from Virgin Money. If you haven't heard about Virgin yet, it might be because you've been watching too much TV.

"We're a new company and a new category, but you're not going to media-buy your way to critical mass," said Virgin Money Chief Marketing Officer Sarah Dekin.

Virgin Money, like FirstAgain, is relying largely on word-of-mouth, Ms. Dekin said, as well as online search optimization and blogs. (Its loans are typically two to three percentage points lower than what banks charge, so word travels fast.) Massive advertising campaigns are not in Virgin Money's future.

Virgin is not a lender but serves as a go-between for borrowers and lenders who know each other well. It makes its money from documenting the loans, reporting to tax authorities, administering payments, reporting to credit bureaus and restructuring payments between lenders as necessary.

'Everybody wins'
U.K. billionaire Richard Branson acquired Waltham, Mass.-based CircleLending in October 2007 (just a year after FirstAgain was founded) and relaunched it in the U.S. as Virgin Money. As Mr. Branson notes on the company's website, "When I first started out in the record business and was struggling to get by, my Aunt Joyce was kind enough to give me a small loan. That loan kept the Virgin Records recording studio afloat."

"Most of our borrowers have other alternatives," Ms. Dekin said, "but they realize that as borrowers [they] get a better rate of return, and as lenders, they will get a better interest rate. People go, 'Everybody wins, so why not keep it in the family?'"

By employing what could be called guiltonomics, Virgin Money is betting that a borrower's desire to be able to look Aunt Joyce or Uncle Bob in the eye -- and a commensurate wish to not run afoul of credit bureaus -- will serve it well.


FirstAgain co-founder Gary Miller

So far, so good: Virgin Money grew 21% in fiscal year 2007 and on April 29 surpassed $300 million in total loan volume. Its default rate is 3.8% across all its loan products, well within the range of mainstream commercial lenders serving auto and personal loans. That drops to a paltry 2.5% among its mortgages.

Moreover, its default rate has so far not been driven upward by a fast-deteriorating housing market -- despite the fact that, again according to the Center for Economic and Policy Research, the average homeowner will lose $85,000 on the value of his or her home this year.

College loans
The plunging values of homes and financial stocks (the S&P 500 financial components are down 13% this year alone; the S&P Case-Schiller housing-price index is similarly down 12.7%) coupled with college-tuition costs also makes for a potentially brisk education business at Virgin Money. The company just started offering Virgin Money student loans last month, and they're fast becoming popular with boomers who are nearing retirement but still have kids headed to or in college, Ms. Dekin said.

"They're getting to the point when they'd be putting their 401(k) into fixed income anyway," she said, "so lending money for college to their kids gets them a higher interest rate with no tax consequences, and their kids get tuition at a lower rate than they would at other [commercial] borrowers."

Given that almost 70 private and nonprofit education lenders have ceased offering government-insured loans through the Federal Family Education Loan Program, there's little need to advertise. Frantic students and parents are online looking for lenders, and search-engine-optimization efforts of FirstAgain and Virgin mean they won't stay unknowns for long.

"The credit crunch has created an environment where people are talking about borrowing money," Ms. Dekin said. "We're just happy to be part of the conversation."

FIRSTAGAIN

WHO THEY'RE AFTER: The "superprime" borrower -- i.e., if you'd sooner eat cat food in a rented room than not pay your bills on time, give

VIRGIN MONEY

WHO THEY'RE AFTER: Anybody, really -- it's not their money. But this is most attractive for those who'd otherwise qualify for a loan but at a higher them a call.

HOW THEY DO WHAT THEY DO: Since less money goes to chasing down financial basket cases who default on their loans, more money goes to improving the customer experience.

TAGLINE: "Rewarding you for excellent credit."

rate.

HOW THEY DO WHAT THEY DO: Shame and guilt, the twin pillars of modern family life, with an assist from credit-reporting agencies. From the website: "Loans with relatives? ... We took that awkward thing and made it easy."

TAGLINE: "Go fund yourself."