deBanked

January/February 2018

Minority-owned Businesses Present Opportunities for Online Lenders
By Cheryl Winokur Munk

Banks, Alternative Funders Continue to Compete for Small Businesses
By Ed McKinley

I Got Funded, Again
By Sean Murray


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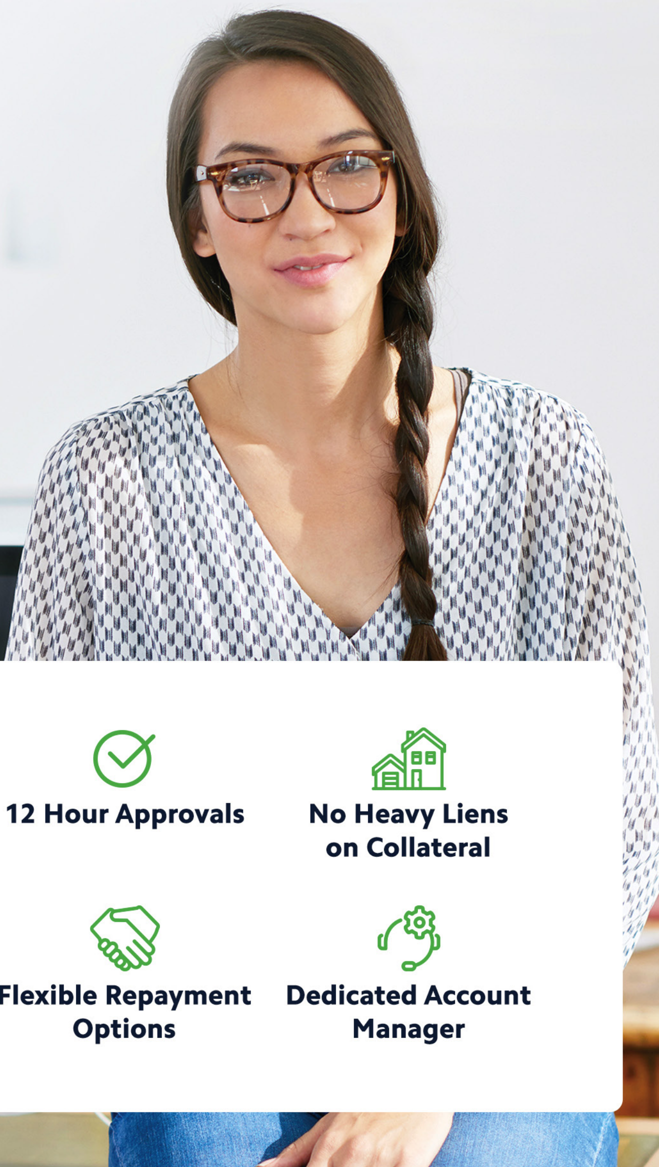

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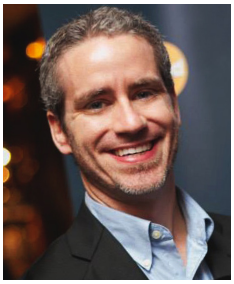
Letter From the Editor



BY
SEAN MURRAY

A new year, a new issue, and there's more happening than ever before.

First and foremost, deBanked's team is growing. And in order to make that possible, we left the luxury confines of Wall Street and Manhattan for the seductive grit of Downtown Brooklyn. But we're excited about our new home, The Clocktower Building, as it's known on Gold Street, was built in 1916 and is the birthplace of Etsy, a publicly traded e-commerce business. More precisely, our individual office suite previously served as the Brooklyn re-election campaign headquarters for NYC Mayor Bill de Blasio. I imagine the signage people had an easy time updating the building records from de Blasio to deBanked. Brooklyn is also where we're hosting our first conference, Broker Fair 2018 in May. In this way and others, it seems we are right where we need to be.

If you joined us in South Beach on January 25th for our cocktail networking event, you'll know that we can put together a spectacular crowd for an excellent time (See photos: http://dbnk.news/1s). You may also recall that it was completely booked to full capacity weeks in advance. ISOs, Brokers, to guarantee yourself a spot at Broker Fair, make sure you register before it's too late at https://brokerfair.org/pages/register/. There are only a limited amount of tickets that we can sell and our event is something you won't want to miss.

There's a whole lot more going on, of course, which is why you'll want to turn the page. In this issue, we delve into the competition between banks and alternative funders, the opportunities online lenders present to minority owned businesses, and a first-hand account of what it's like to be a merchant paying off a loan via a credit card processing split.

Also included is an update on the Madden decision, the 3-year old court ruling that continues to lurk in the shadows as a threat to non-bank finance. Meanwhile, we've got the scoop on the LendItFintech Conference through an interview with co-founder Peter Renton. Renton explains why cryptocurrency is broadening the fintech horizon while offering advice to online lenders about the best path forward.

That's all for now. I'll let the stories and pictures do the talking from here. Thanks for reading.

–Sean Murray

MINORITY-OWNED BUSINESSES PRESENT OPPORTUNITIES FOR ONLINE LENDERS

by CHERYL WINOKUR MUNK

Research consistently shows that minority-owned businesses have a harder time accessing capital than other business.

Online financing has the potential to change this.

Most of the online funding process is based on objective factors such as your business type and revenue. When you apply for funds online, it's harder to discern things like the color of your skin or your ethnicity—factors which research shows can sometimes play into the face-to-face lending process, even though it's illegal and immoral. What's more, applying for funds online eliminates the stigma that keeps many minority-owned businesses from walking into a bank to apply for a loan, according to industry participants.

"Many minorities are hesitant to go into a bank," says Louis Green, interim president of The National Minority Supplier Development Council, which provides business development opportunities for certified minority-owned businesses. He says the growth of online lending platforms will potentially open more doors for minority-owned businesses to get much-needed capital to operate and expand.

"The beauty of things on the Internet is that it has the ability to take away discriminatory issues," says Green, who is also the chief executive of Supplier Success LLC, a Detroit-based business that offers online business financing solutions.

Certainly, minority-owned small businesses are a large and growing market. There were 8 million minority-owned firms in the U.S. as of 2012, according to U.S. Census Bureau data. Minority-owned firms represented 28.8% of all U.S. firms in 2012.

Historically, however, minority-owned businesses have had trouble getting access to credit for a host of reasons, and recent research suggests the problems persist.

A report published in November by the Federal Reserve Banks of Cleveland and Atlanta examines the results of an annual survey of small business owners. The report found that while many minority small businesses were profitable, a significant majority faced financial challenges, experienced funding gaps and relied on personal finances.

Some of the trouble obtaining financing may have discriminatory underpinnings. For instance, a recent working paper by researchers at Utah State University, Brigham Young University and Rutgers University, among others, suggests that minorities were more highly scrutinized for loans than other applicants. For instance, African American "mystery shoppers" underwent a higher level of scrutiny and received a lower level of assistance than their less-creditworthy Caucasian counterparts, according to the study.

Also, African American testers were asked significantly more often about their marital status and their spouse's employment. This "marks another and even illegal differential experience for these minority entrepreneurial consumers compared with the Caucasian shoppers," the study finds.

To be sure, other factors are also likely to blame. For instance, the average credit score of a minority small-business owner is 707, which is 15 points lower than the overall average for small-business owners in the U.S., according to a 2016 study by credit bureau Experian.

Even so, the bias issue remains a stark possibility in at least some cases. A 2010 report by the Minority Business Development Agency (MBDA) offers data to show that minority-owned firms are less likely to receive bank loans than non-minority-owned firms. Among all minority firms, 7.2 percent received a business loan from a bank compared with 12.0 percent of non-minority firms, according to the report. High sales minority-owned firms were more likely to receive bank loans with 23.3 percent receiving this source of startup capital. By contrast, 29.2 percent of high sales non-minority firms received bank loans, the data shows.

To be sure, it's very difficult to prove discrimination when a bank loan is denied. A few years ago, a mortgage banker who asked not to be named, says he suspected discrimination when an Asian couple he worked with was denied a small bank loan. While he didn't have rock solid proof, he felt the bank's stated reasoning for turning down the loan was unjustified and he tried going to bat for the couple. His efforts were rebuffed, however, and the loan was denied.

Based on the size of the loan and the couple's finances, the banker says the loan would have easily been approved by an online provider that was looking only at objective factors. "They see the numbers they've been given and calculate risk and make decisions based purely on numbers," he says.

Indeed, this is where online lending has already shown significant potential. Alicia Robb, a research fellow at the Atlanta Federal Reserve who co-authored the November report by the Cleveland and Atlanta Federal Reserves, says when controlling for credit score and other business-related factors, the data shows that minority businesses have a better shot at getting loans approved online than they do at a large or small bank.

Industry participants say the online funding process can be a boon for minority business owners because it strips subjective reasoning out of the decision-making process. Instead of presenting themselves, applicants are presenting what their business looks like financially, and funders are

making highly automated decisions based on the information provided.

"Humans make terrible decisions. The more you can eliminate human bias in the process the better," says Kathryn Petralia, co-founder and president of Kabbage. She says 95 percent of the online lender's customers have an entirely automated experience, which includes validating their identity using digital processes. "We never see a picture of them or know anything about their ethnicity or demography," she says.

Even funders who do ask for photo identification say that doesn't happen until after applicants have been approved. And even then, it's just to "make sure that the person you are funding is actually the person you are funding and no one is trying to defraud you," says Isaac D. Stern, chief executive of Yellowstone Capital LLC, a MCA funder in Jersey City, N.J. "Online financing is colorblind. It doesn't matter if [you're] white or Hispanic or black," he says.

Dean Sioukas, chief executive of Magilla Loans, an online search engine that matches prospective borrowers and lenders, has hope that the anonymity of the online funding process could eventually make the off-line process more equitable for all applicants. After accepting a number of solid proposals from viable lending opportunities—without knowing any personal information about the applicant—his hope is that whatever biases a loan officer may previously have had will dissipate, he says. Funding decisions should only be made on objective criteria, he says. "The rest has no place in the process."

While in theory online lending should improve access to funds for minority-owned businesses, several industry observers say barriers remain.

One major challenge is getting the news out to minority business owners, many of whom don't know about the online funding opportunities that exist, says Lyneir Richardson, executive director of The Center for Urban Entrepreneurship and Economic Development, a research and practitioner-oriented center at Rutgers Business School in Newark, N.J.

He suggests online lenders and funders need to do a better job of connecting with minority-owned businesses and explaining what they have to offer.

He works with about 300 entrepreneurs, 70 percent of whom are minority-owned businesses. He's held this position for 10 years, but says he's never been approached by an online lending company to market its services, speak at one of his events, provide funding advice to business owners or in any other capacity.

"There is an opportunity for online small business lenders to market and make known, particularly to minority business owners, that they have viable, market rate lending products that can help them grow," he says.

One caveat is that rates online are often higher than traditional bank loans, so there is a trade-off for minority-owned businesses, says Brett Barkley, a senior research analyst in the community development department at the Federal Reserve Bank of Cleveland, who co-authored the November report.

Other research from the Federal Reserve shows that satisfaction levels were lowest at nonbank online lenders for both minority- and nonminority-owned firms compared with borrower satisfaction levels at small banks and large banks, he says. The satisfaction levels seem to be related to higher interest rates and "lack of transparency," he adds. While the study doesn't define the latter term, the findings could "point to confusion regarding the actual terms of the loan," Barkley says.

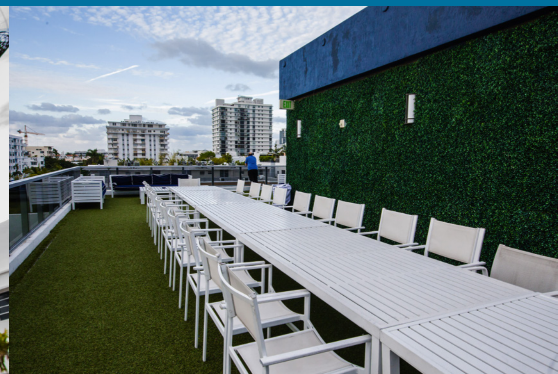
Some online firms have taken steps to make pricing more transparent by using the SMART Box disclosure agreement, a comparison tool developed by the online lending industry to help small businesses more fully understand their financing options. There are currently three different versions of the SMART Box disclosure –for term loans, lines of credit, and merchant cash advances.

This "is a really important metric," says Petralia of Kabbage, which offers the tool to customers.

Green, the interim president of NMSDC, says that helping its 12,000 minority-owned business members gain access to capital is a major goal for the organization. While online financing is still a largely "untapped resource" for minority businesses, it makes borrowing money easier and more appealing. "It holds great promise for minority-owned businesses, but I think the reality hasn't met that promise yet," he says.

deBanked CONNECT *Miami*

JANUARY 25, 2018



Thank you to everyone that joined deBanked's cocktail networking event in South Beach. We had a great mix of ISOs, funders, and lenders, nearly 200 people in all at The Gale (See photos: http://dbnk.news/1s). The event was booked to capacity weeks in advance and we exceeded our initial attendance goals.

There is no doubt that South Florida is an integral part of the small business financing industry and we intend to return in the future.

Thank you again to the companies that sponsored the event: Everest Business Funding, National Funding, Grand Capital Funding, Knight Capital funding, NISO, and Venture Credit Solutions.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BANKS, ALTERNATIVE FUNDERS CONTINUE TO COMPETE FOR SMALL BUSINESSES

By *ED MCKINLEY*

The alternative small-business finance industry owes its very existence to banks' reluctance to lend money to mom-and-pop shopkeepers, tradespeople and restaurateurs, but bankers' tight fists may be loosening. Small-business owners are reporting better results when they apply for bank loans.

In fact, small entrepreneurs succeeded in landing bank loans 37 percent of the time in the fourth quarter of 2017, up from 29 percent a year earlier, according to the 1,341 merchants surveyed for the most recent quarterly Private Capital Access Index report provided by Dun & Bradstreet and Pepperdine University's Graziadio School of Business and Management.

"That's a big change. It's outside the margin of error and outside normal statistical variation," Craig R. Everett, assistant professor of finance at Pepperdine and director of the Graziadio and Dun & Bradstreet Private Capital Markets Project, tells deBanked. He's comparing the shift to patterns established in the nearly six years the quarterly index has pegged small-business trends.

But the effects of bankers' increased willingness to lend to small businesses may prove a bit muted in the alternative funding industry. That's partly because Pepperdine and Dun & Bradstreet define small businesses as having up to $5 million in annual revenue. Alt funders often deal with much smaller enterprises that could still fail to capture the attention of bank loan officers, says Noah Grayson, managing director of South End Capital in Encino, Calif. "If you're making $5 million in gross revenue, that's a pretty robust business," he says of his clients.

Then there are the borrowers whose companies seem small in that they employ just a few people but might rake in $5 million on a single contract – like contractors who specialize in heavy construction equipment or have a presence in the aviation business – but aren't profitable enough to qualify for bank loans, says Gene Ayzenberg, CEO of PledgeCap, a company with offices on Long Island and in Manhattan that specializes in business and personal loans secured by collateral.

Besides, lots of alternative lenders don't regard gross revenue as the measure of a business. "I would look at what kind of resources and infrastructure the business has to define what is small and medium-sized," says David Obstfeld, CEO of New York-based SOS Capital. Many alt lenders cite the importance of net over gross.

The size of prospective borrowers aside, banks are probably lending to small merchants more often these days because small businesses are becoming more profitable in today's relatively healthy business climate and thus stand a better chance of qualifying for credit, Everett says. The recent reduction in corporate taxes will also improve profits and make small businesses more credit-worthy, he says.

The change in bank lending volume seems tied to those financial gains and doesn't appear to be linked to any shift in policy among bankers, Everett notes. But new policies at the Small Business Administration could prompt the banking community to view small-business loans more favorably, according to Grayson. The SBA is increasing the percentage it guarantees for some loans

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Ready to Pull the Trigger? 1-800-781-1085 | www.silverbulletleads.com and reducing the amount required for a down payment on some loans, he notes. That could make life more difficult for some alternative lenders because most of the small-business loans made by major banks, like Wells Fargo and Chase, are SBA loans, he says. The SBA did not provide details regarding the changes by press time.

Regardless of what's making banks loosen their grip on the purse strings, merchants are feeling more optimistic – or at least less gloomy – about obtaining bank loans in the near term, the study by Pepperdine and Dunn & Bradstreet indicates. In the fourth quarter of last year, 55 percent of small-business owners predicted difficulty in raising financing in the next six months, down from 61 percent a year earlier, the survey shows.

"That's an improvement, but I still think it's an alarmingly high number," Ayzenberg says of those findings. "Before they even start worrying about how their operations are going and how good their product is, one in two businesses is already worrying that their bank is not going to be able to fulfill their needs. They shouldn't have to have those fears."

So, banks are becoming a bit more likely to loan to small businesses but still aren't throwing open the flood gates to create a flood of funding. That's true of banks that qualify as large and those classified as small.

American banks tend to be either small community institutions or huge national concerns that are swallowing up the remaining mid-sized regional banks, observers agree. Between 80 and 90 banks control assets of $10 billion or more and thus qualify as large, while thousands of small banks have more limited resources, says David O'Connell, an Aite Group senior analyst.

Large and small banks exhibit about the same degree of ambivalence toward small-business loans. Banks can mitigate the downside of the loans because they have funds to hire staffs and buy technology to analyze risk, O'Connell says. Executives at small banks can avoid potential problems with small-business loans because they're often dealing with prospective borrowers who were their high school or college classmates, he notes.

Whether banks are large or small, they have their reasons to deny loans to small businesses. Perhaps foremost among the rationales for denying loans to small businesses is the cost of underwriting, says O'Connell. Banks simply can't make enough money on the loans to pay the cost of processing them, he says, adding that, "It's a long-standing problem." For example, a bank can make a profit by loaning $2 million at prime plus 2 percent, but can't cover the underwriting costs of an $80,000 loan that also earns prime plus 2 percent. The underwriting costs would be the same in both cases, he notes.

Banks became even more ambivalent about loaning to small businesses after the Great Recession struck in 2008, O'Connell continues. They didn't want to repeat the mistakes of the freewheeling period that preceded the economic catastrophe. About the same time, private equity and hedge funds began madding more capital available to alternative lenders, he says. Meanwhile, technology and alternative data sets helped the alternative industry understand risk and reduce underwriting costs, he maintains.

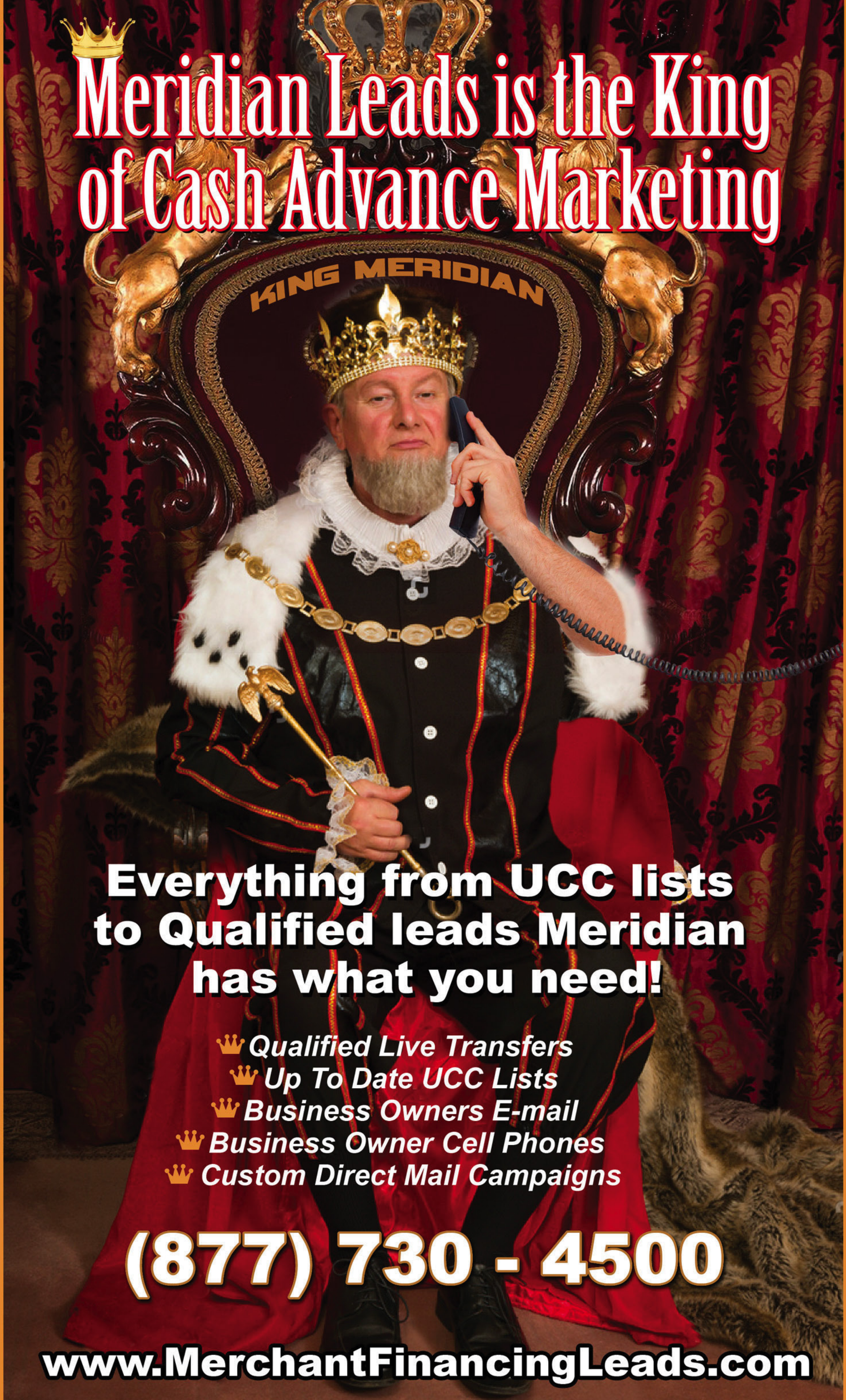
Banks also find it more expensive to loan to small businesses these days because the Dodd-Frank Act has increased compliance costs, Everett points out. "Red tape and reserve requirements for the banks have all increased under Dodd-Frank, so making loans to small businesses is less cost-effective than it was before." Banks now need upwards of $1 billion in assets under management to remain viable, and they feel compelled to expand their staffs to follow all the new rules for lending, he says.

What's more, bankers still exercise extreme caution when it comes to extending credit to small businesses because stores or restaurants often fail and then the business or the owner defaults on the loan, Everett says. That's why banks often require business-loan applicants to demonstrate two years of profitability to qualify for credit, he notes. Higher interest can mitigate that risk, but state usury laws often cap rates at 36 percent or less, Everett notes.

State usury laws don't apply to factoring or merchant cash advances, and that enables alternative funders to charge more for the use of funds, Everett says. "If it's not called a loan and what the customer is paying is not called interest, then it's not subject to state usury laws," he says.

Obstfeld puts it this way: "It would be great to be in a business where nobody defaults. The rates we charge at SOS Capital are necessary to cover our losses and be profitable at the same time."

The high cost of obtaining funds in the alternative market could eventually prompt the federal government to intervene with regulation but that probably won't happen anytime soon, Everett predicts. O'Connell agrees, noting that in the current political climate the government has little appetite for new restrictions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Because alternative funders have greater flexibility than banks in how much they can charge for access to credit, banks have sometimes formed referral relationships with alt funders to hand off small-business borrowers. "That looks good on paper and makes great headlines, but it's harder to do in real life," O'Connell maintains, because the bank loses control of the customer experience. If the alt funder doesn't manage customers' expectations effectively, the bank might have to take the blame – at least in some consumers' minds, he contends. He's surveyed bankers and found them feeling "really mixed" about such partnerships.

The impact of such partnerships hasn't been as great as some anticipated. "We were quite nervous when we heard that JPMorgan would be using OnDeck's platform," recalls Obstfeld. "However, it's been quite some time that they've been doing that and it hasn't seemed to make a dent – at all – in alternative lending."

But alternative funders can provide borrowers with advantages that banks can't match. Some alternative lenders can approve a client's application in a few hours and wire funds to the recipient the same day, Grayson says. Steve Hauptman, chief operating officer at SOS Capital, notes that banks can require weeks or even months to respond to an application.

That's why SOS Capital customers sometimes obtain funding from the company as a bridge to keep operating while they're waiting for an SBA bank loan or to take advantage of an opportunity that requires a quick response, Obstfeld says.

The advantages of the alternative funding industry don't end there. SBA bank loans require more paperwork than is needed for a merchant cash advance, which can slow the process even further as the client assembles the documentation, Obstfeld notes.

In addition, banks can simply seem slow to respond to the needs of the market. "Banks are banks – they're never going to be able to do the things we can do," says Obstfeld. "If one product becomes an issue, we can pivot and create a new product tomorrow. It takes banks years to get approval for something new."

Then there are cards. Besides an increase in banks' willingness to lend to small businesses, merchants are finding it easier to obtain business credit cards, the index provided by Pepperdine and Dun & Bradstreet finds. In the fourth quarter of last year, 65 percent of survey respondents applied successfully for cards, compared with 51 percent in the corresponding period a year earlier.

Easier access to credit cards might not make merchants less likely to apply for loans, Everett says. "Usually, credit cards are a backup plan," he notes. "They're the poor man's line of credit. It's a very high interest rate." Most businesses would prefer to open a line of credit from a bank with a lower interest rate. Many cardholders use cards only for travel expenses or to ease short-term cash-flow issues, he says.

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even for those who are adept at online searches, says Grayson of South End Capital. In addition, many business credit cards carry a low spending limit. A business might qualify for a $5,000 credit limit on the card but could receive a $50,000 loan, he adds. "A card generally doesn't fill their needs," he declares.

Others have a slightly different view of business cards. "Once you get approved, it's easy money," Obstfeld says of business credit cards. However, cards can't finance some of the actions that cash from merchant cash advances can cover, such as buying out a partner or opening a second location, he notes.

Moreover, the fact that competitors exist – whether they're banks, card issuers or other alternative lenders – doesn't necessarily threaten existing alt funders, according to Hauptman. Remember that banks and alternative lenders aren't offering the same products, he says. Those products, such as bank loans, factoring and merchant cash advances, each have advantages and disadvantages, which prompt merchants to pursue the vehicles that are right for them, he says.

Having banks and nonbanks in the mix can even prove complementary, too. Pumping more funds into the small-business economy from any source can result in a healthier environment that offers more opportunities for all, Ayzenberg says.

The real danger resides not so much from direct competition but rather from failing to keep pace with the alternative lending industry's introduction of new products, falling behind in the quest to speed up the decision-making process granting funding or neglecting to obtain technology that eases the application process, Grayson says.

In one recent development, some alternative lenders aren't reviewing credit histories, he notes. Instead they look just at deposits and can extend credit based just on that, Grayson notes. That's somewhat like a merchant cash advance, but it's offered at single-digit

rates and on favorable terms, he says. "A lot of lenders are making it very simple for borrowers to get money now," he continues, concluding that alt funding firms that can't afford to make such improvements probably can't remain in business.

Though some players will inevitably disappear, the alternative small-business funding industry in general seems likely to survive so long as banks remain reticent about lending to small businesses – the situation that gave rise to the alternative industry in the first place.

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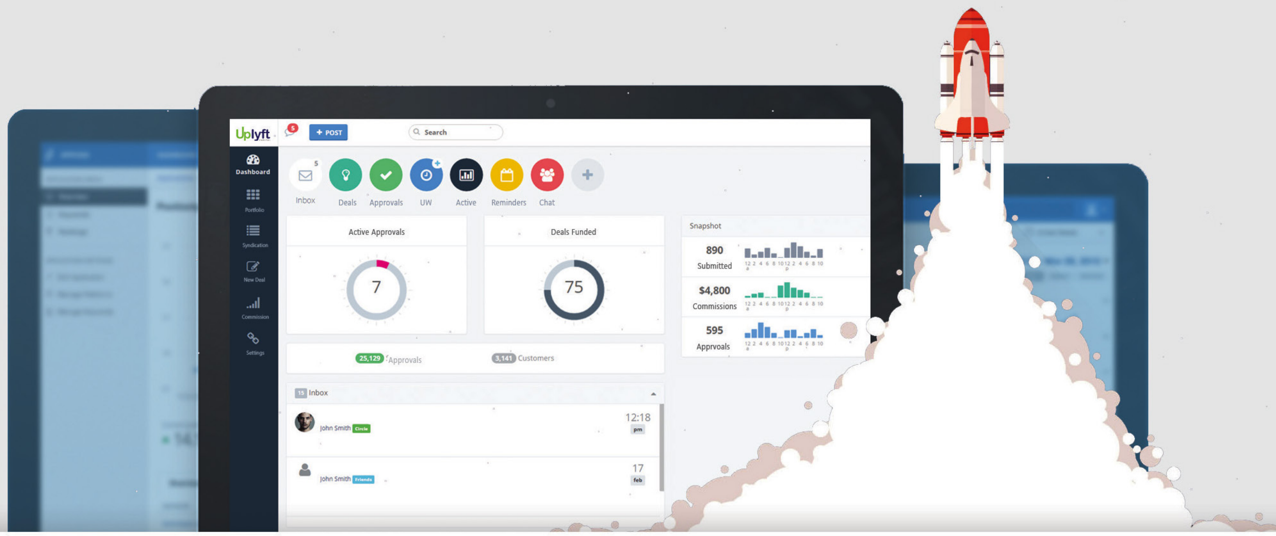

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INDUSTRY *NEWS*

11/30/17 - ForwardLine appointed Steve Carlson as its new CEO. Co-founder Craig Coleman advanced to Board Vice Chairman

12/4/17 - Funding Circle surpassed £3B in loans originated since inception

- Former CFPB Director Richard Cordray announced that he would be running for Governor of Ohio

12/5/17 - Bitcoin surpassed $12,000

12/6/17 - IOU Financial surpassed $500M in loans originated since inception

- Bitcoin surpassed $13,000

- Bitcoin surpassed $14,000

12/7/17 - BFS Capital surpassed $1.7B in financing originated since inception

- BoeFly surpassed $6B in financing activity through their platform since inception

- Bitcoin surpassed $15,000

- Bitcoin surpassed $16,000

- Bitcoin surpassed $17,000

12/8/17 - Yellowstone Capital surpassed $2B in deals originated since inception

12/10/17 - Bitcoin futures began trading on the Chicago Board Options Exchange

12/11/17 - Affirm raised $200M in a new round of funding, increasing their valuation to $1.75B

12/12/17 - OnDeck hired two new SVPs, Kelly Merrill for Finance and Erich Wust for Portfolio Management

- Prosper appointed Claire Huang to Board of Directors

- A judge dismissed the New York Department of Financial Services' lawsuit against the US Comptroller of the Currency over its proposal to offer a special fintech charter.

12/13/17 - Ethereum surpassed $700

12/14/17 - Santander Bank announced first-ever Lending Center in Brooklyn, a community-focused approach to mortgages, personal and business loans

- Finn & Co, Inc. announced the formation of two new equity/debt private equity funds, one of which is earmarked for merchant cash advance investments

- Reliant Funding founder and CEO Adam Stettner was accepted into the Forbes Finance Council

12/15/17 - BFS Capital named former BankUnited executive, Mary Harris, as Chief Marketing Officer

12/16/17 - Funding Circle surpassed €100M lending milestone in Germany

- Bitcoin surpassed $18,000

12/19/17 - Tennessee State officials announced that Avant would be bringing 200 new jobs to Blount County

- Bitcoin Cash arrived on Coinbase

12/21/17 - Bitcoin crashed to as low as $13,300 on the day

12/22/17 - Bitcoin dipped below $11,000 on the day

12/26/17 - Uber agreed to sell its US auto-leasing business to Fair.com

12/28/17 - OnDeck added a BlackRock managed fund to its platform of financing partners

12/29/17 - Ripple surpassed Ethereum as the second largest cryptocurrency

1/1/18 - Funding Circle was reported to be preparing for a £1B London IPO

1/2/18 - Law firms Ballard Spahr and Lindquist & Vennum announced a merger

- Report revealed that Peter Thiel had been buying massive amounts of Bitcoin

- Simply Funding announced Kiara Gaddy as Director of Business Development

1/3/18 - Prosper Marketplace appointed former Bank of America exec Justine Metz as Head of Marketing

- The S&P 500 reached a new record of 2,700

- Bitcoin celebrated its 9th birthday

- Money360 surpassed $500M in commercial real estate loans since inception

1/4/18 - INTRUST Bank and Funding Circle announced a strategic partnership, where INTRUST Bank will originate US small business loans through Funding Circle

- Ethereum surpassed $1,000

- Ripple co-founder and CEO Chris Larsen became one of the world's richest men due to the incredible rise of the company's cryptocurrency XRP. Its per unit value had risen from 25 cents to $3.16 over the course of just 3 weeks

1/5/18 - Payday lending kingpin Scott Tucker was sentenced to more than 16 years in prison after being found guilty of federal truth in lending and racketeering laws

- The legislative proposal for an online lending task force in New York was amended to replace the task force with the Department of Financial Services. The State banking regulator itself would therefore be tasked with studying online lending

1/9/18 - JP Morgan Chase CEO Jamie Dimon reportedly said that he regrets calling Bitcoin a fraud

1/10/18 - YieldStreet Inc., a company that specializes in loans to real-estate projects, raised $113M in debt and equity

- Community Bank invested an additional $2M in Lendistry's CRA Loan Fund

1/11/18 - Chase announced a partnership with AutoFi, a fintech company that helps customers select and finance vehicles through their automotive dealers' website. Chase is the first national bank on the platform

- LendingPoint acquired LoanHero, a point-of-sale finance company

- Marlette Funding named Mark Elbaum as CFO. Elbaum is the former CFO of Merrill Lynch, Bank of America's Wealth Management business.

1/12/18 - Goldman Sachs was reported to be expanding into home improvement loans

1/16/18 - BlueVine named Ana Sirbu as CFO. Sirbu was formerly the company's vice president of finance and capital markets

- Ripple (XRP) was down more than 40% YTD

1/17/18 - The Funding Circle SME Income Fund entered into a £50M deal with CitiBank to make loans to UK small businesses through the Funding Circle platform

1/18/18 - CFPB Acting Director Mick Mulvaney made waves by requesting zero funding from the Federal Reserve in the second quarter

- Fundation Group, LLC closed a new subordinated debt facility with Waterfall Asset Management. No terms were disclosed

- Varo Money raised $45M for mobile banking without fees in a round led by Warburg Pincus and The Rise Fund

1/19/18 - Rocket Mortgage by Quicken Loans announced a partnership with Esports Powerhouse '100 Thieves'

1/22/18 - Fundbox Launched Fuse, a new credit-integration service

- BB&T earmarked $50M for emerging digital technology

- Bitcoin company Coinbase revealed revenue of $1B in 2017

- UK-based RateSetter announced that they will be winding down their unsecured business lending business and focusing solely on property-backed and asset-backed lending

1/23/18 - SoFi appointed Anthony Noto as new CEO. Noto was previously the COO of Twitter

1/24/18 - Payments company Stripe announced that they will no longer process Bitcoin payments

- StreetShares secured a $23M Series B round

- CFPB opened up their RFI on civil investigative demands, as part of Acting Director Mick Mulvaney's campaign to best direct the agency's efforts

1/25/18 - Breakout Capital announced FactorAdvantage, a product for factoring and invoice financing companies

- Square acquired a 32-year-old restaurant delivery company, Entrees On-Trays, to take advantage of relationships the company has formed with local restaurants

- MetaBank and Liberty Lending, LLC partnered up to originate personal loans

1/29/18 - Elevate appointed Brian Biglin as Chief Credit Officer. Biglin was previously the Chief Risk Officer of loanDepot

1/30/18 - Goldman Sachs acquired Final, a credit card startup

- BlueVine announced the opening of a new Jersey City office and doubled the maximum size of their invoice factoring product up to $5M

- Facebook announced that they would ban cryptocurrency ads

- The SEC secured an emergency asset freeze over AriseBank, a purported decentralized bank that was engaging in unregistered securities sales through an Initial Coin Offering

1/31/18 - The U.S. Court of Appeals for the District of Columbia Circuit ruled that the CFPB's structure was indeed constitutional, overturning the previous ruling in PHH Corporation v CFPB that it was unconstitutional

- SoFi laid off 5% of its staff

- IOU Financial partnered with CDE Solutions, a POS solutions provider

2/1/18 - eBay announced that PayPal would no longer be its default payments platform

- Coinbase announced that credit card purchases were now being recognized as cash advances by credit card issuers

2/2/18 - Credit card issuers begin banning bitcoin purchases entirely

- Amy Johnson named COO of dv01. Johnson was previously the Global Head of Credit Execution at Intercontinental Exchange

2/3/18 - Bitcoin dipped below $8,000

THE MADDEN DECISION, THREE YEARS LATER

By *PAUL SWEENEY*

At first, reversing the 2015 *Madden v. Midland Funding* court decision, which continues to vex the country's financial system and which is having a negative impact on the financial technology industry, seemed like a fairly reasonable expectation.

The controversial ruling by the Second Circuit Court of Appeals in New York, which also covers the states of Connecticut and Vermont, had humble roots. Saliha Madden, a New Yorker, had contracted for a credit card offered by Bank of America that charged a 27% interest rate, which was both allowable under Delaware law and in force in her home state.

But when Madden defaulted on her payments and the debt was eventually transferred to Midland Funding, one of the country's largest purchasers of unpaid debts, she sued on behalf of herself and others. Madden's claim under the Fair Debt Collection Practices Act was that the debt was illegal for two reasons: the 27% interest rate was in violation of New York State's 16% civil usury rate and 25% criminal usury rate; and Midland, a debt-collection agency, did not have the same rights as a bank to override New York's state usury laws.

In 2013, Madden lost at the district court level but, two years later, she won on appeal. Extension of the National Bank Act's usury-rate preemption to third party debt-buyers like Midland, the Second Circuit Court ruled, would be an "overly broad" interpretation of the statute.

For the banking industry, the *Madden* decision – which after all involved Bank of America -- meant that they would be constrained from selling off their debt to non-bank second parties in just three states. But for the financial technology industry, says Todd Baker, a senior fellow Harvard's Kennedy School of Government and a principal at Broadmoor Consulting, it was especially troubling.

"The ability to 'export' interest rates is critical to the current securitization market and to the practice that some banks have embraced as lenders of record for fintechs that want to operate in all 50 states," Baker told deBanked *in an e-mail interview.*

A 2016 study by a trio of law professors at Columbia, Stanford and Fordham found other consequences of *Madden*. They determined that "hundreds of loans (were) issued to borrowers with FICO scores below 640 in Connecticut and New York in the first half of 2015, but no such loans after July 2015." In another finding, they reported: "Not only did lenders make smaller loans in these states post-*Madden*, but they also declined to issue loans to the higher-risk borrowers most likely to borrow above usury rates."

With only three states observing the "Madden Rule," the general assumption in business, financial and legal circles was that the Supreme Court would likely overturn *Madden* and harmonize the law. Brightening prospects for a *Madden* reversal by the Supremes: not only were all segments of the powerful financial industry behind that effort but the Obama Administration's Solicitor General supported the

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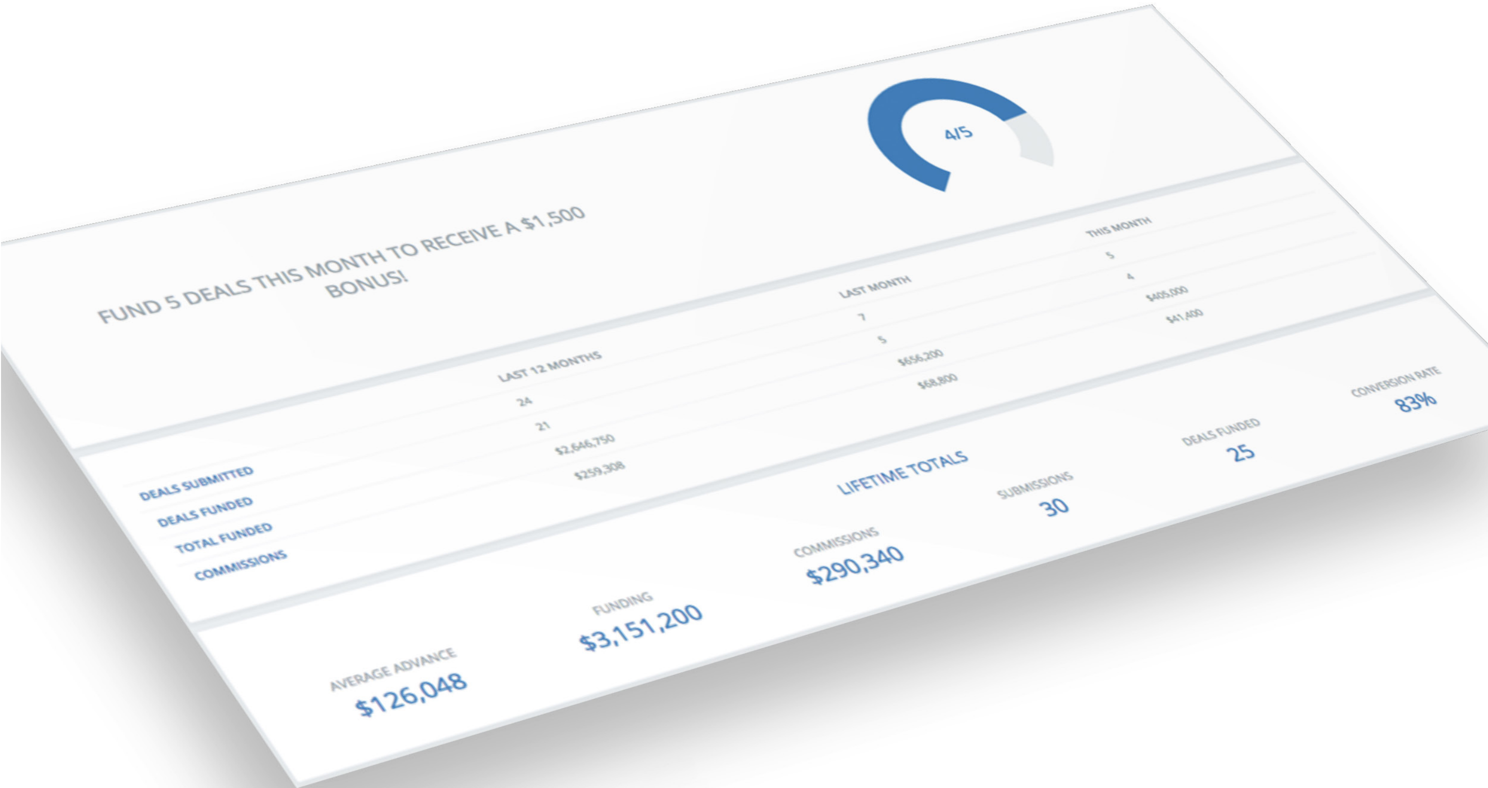

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anti-*Madden* petitioners (but complicating matters, the SG recommended against the High Court's hearing the case until it was fully resolved in lower courts).

Despite all the heavyweight backing, however, the High Court announced in June, 2016, that it would decline to hear *Madden*.

That decision was especially disheartening for members of the financial technology community. "The Supreme Court has upheld the doctrine of 'valid when made' for a long time," a glum Scott Stewart, chief executive of the Innovative Lending Platform Association – a Washington, D.C.-based trade group representing small-business lenders including Kabbbage, OnDeck, and Breakout Capital — told *deBanked*.

Even so, the setback was not regarded as fatal. Congress appeared poised to ride to the lending industry's rescue. Indeed, there was rare bipartisan support on Capitol Hill for the Protecting Consumers' Access to Credit Act of 2017 -- better known as the "Madden fix."

Introduced in the House by Patrick McHenry, a North Carolina Republican, and in the Senate by Mark Warner, Democrat of Virginia, the proposed legislation would add the following language to the National Bank Act. *"A loan that is valid when made as to its maximum rate of interest...shall remain valid with respect to such rate regardless of whether the loan is subsequently sold, assigned, or otherwise transferred to a third party, and may be enforced by such third party notwithstanding any State law to the contrary."*

Just before Thanksgiving, the House Financial Services Committee approved the Madden fix by 42-17, with nine Democrats joining the Republican majority, including some members of the Congressional Black Caucus. Notes ILPA's Stewart: "We were seeing broad-based support."

But the optimism has been short-lived. The Madden fix was not included in a package of financial legislation recently approved by the Senate Banking Committee, headed by Sen. Mike Crapo, Republican of Idaho. Moreover, observes Stewart: "Senator Warner appears to have gotten cold feet."

What happened? Last fall, a coast-to-coast alliance of 202 consumer groups and community organizations came out squarely against the McHenry-Warner bill. Denouncing the bill in a strongly worded public letter, the groups -- ranging from grassroots councils like the West Virginia Citizen Action Group and the Indiana Institute for Working Families to Washington fixtures like Consumer Action and Consumer Federation of America – declared: "Reversing the Second Circuit's decision, as this bill seeks to do, would make it easier for payday lenders, debt buyers, online lenders, fintech companies, and other companies to use 'rent-a-bank' arrangements to charge high rates on loans."

The letter also charged that, if enacted, the McHenry-Warner bill "could open the floodgates to a wide range of predatory actors to make loans at 300% annual interest or higher." And the group's letter asserted that "the bill is a massive attack on state consumer protection laws."

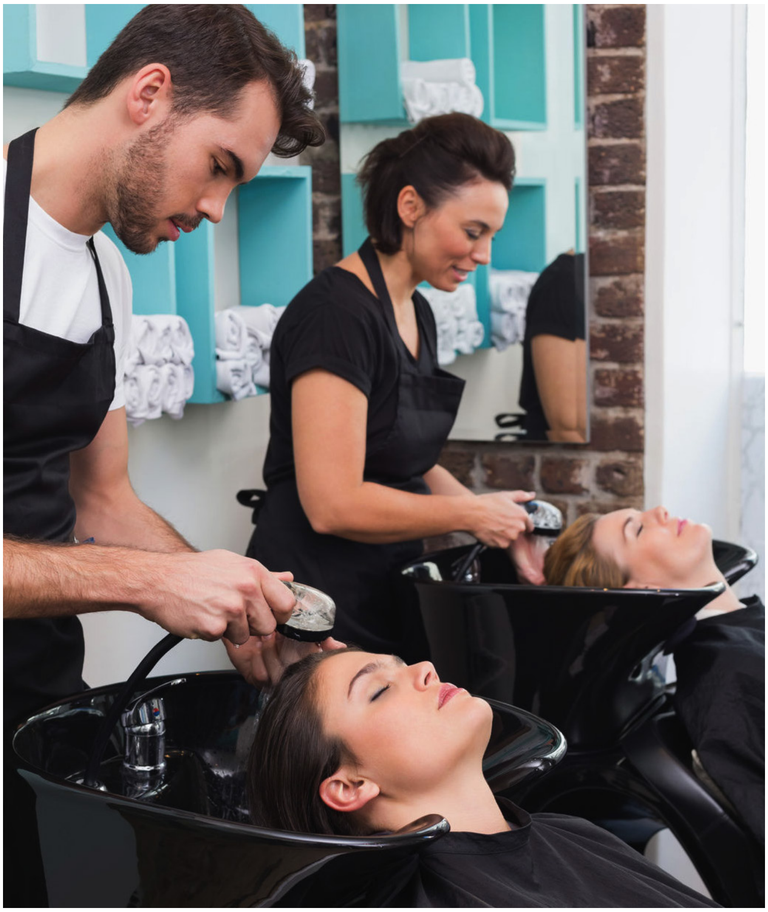
Lauren Saunders, an attorney with the National Consumer Law Center in Washington, a signatory to the letter and spokesperson for the alliance, told deBanked that "our main concern is that interest-rate caps are the No. 1 protection against predatory lending and, for the most part, they only exist at the state level."

But in their study on *Madden*, the Stanford-Columbia-Fordham legal scholars report that the strength of state usury laws has largely been sapped since the 1970s. "Despite their pervasiveness," write law professors Colleen Honigsberg, Robert J. Jackson, Jr., and Richard Squire, "usury laws have very little effect on modern American lending markets. The reason is that federal law preempts state usury limits, rendering these caps inoperable for most loans."

While the battle over the Madden fix has all the earmarks of a classic consumers-versus-industry kerfuffle, the fintechs and their allies are making the argument that they are being unfairly lumped in with payday lenders. "Online lending, generally at interest rates below 36%, is a far cry from predatory lending at rates in the hundreds of percent that use observable rent-a-charter techniques and that result in debt-traps for borrowers," insists Cornelius Hurley, a Boston University law professor and executive director of the Online Lending Policy Institute. Because of fintechs, he adds: "A lot of people who wouldn't otherwise qualify in the existing system are getting credit."

A 2016 Philadelphia Federal Reserve Bank study reports that traditional sources of funding for small businesses are gradually exiting that market. In 1997, small banks under $1 billion in assets –which are "the traditional go-to source of small business credit," Fed researchers note -- had 14 percent of their assets in small business loans. By 2016, that figure had dipped to about 11 percent.

The Joint Small Business Credit Survey Report conducted by the Federal Reserve in 2015 determined that the inability to gain access to credit "has been an important obstacle for smaller, younger, less profitable, and minority-owned businesses." It looked at credit applications from very small businesses that depend on contractors -- not employees – and discovered that only 29 percent of applicants received the full amount of their requested loan while 30 percent received only partial funding. The borrowers who "were not fully funded through the traditional channel have increasingly turned to online alternative lenders," the Fed study reported.



The ILPA's Stewart gives this example: A woman who owns a two-person hair-braiding shop in St. Louis and wants to borrow $20,000 to expand but has "a terrible credit score of 640 because she's had cancer in the family," will find the odds stacked against her when seeking a loan from a traditional financial institution.

But a fintech lender like Kabbage or CAN Capital will not only make the loan, but often deliver the money in just a few days, compared with the weeks or even months of delivery time taken by a typical bank. "She'll pay 40% APR or $2,100 (in interest) over six months," Stewart explains. "She's saying, 'I'll make that bet on myself' and add two additional chairs, which will give her $40,000-$50,000 or more in new revenues."

In yet another analysis by the Philadelphia Fed published in 2017, researchers concluded that one prominent financial technology platform "played a role in filling the credit gap" for consumer loans. In examining data supplied by Lending Club, the researchers reported that, save for the first few years of its existence, the fintech's "activities have been mainly in the areas in which there has been a decline in bank branches....More than 75 percent of newly originated loans in 2014 and 2015 were in the areas where bank branches declined in the local market."

Meanwhile, there is palpable fear in the fintech world that, without a Madden fix, their business model is vulnerable. Those worries were exacerbated last year when the attorney general of Colorado cited *Madden* in alleging violations of Colorado's Uniform Consumer Credit Code in separate complaints against Marlette Funding LLC and Avant of Colorado LLC. According to an analysis by Pepper Hamilton, a Philadelphia-headquartered law firm, "the respective complaints filed against Marlette and Avant allege facts that are clearly distinguishable from the facts considered by the Second Circuit in *Madden*.

"Yet those differences did not prevent the Colorado attorney general from citing *Madden* for the broad-based proposition that a non-bank that receives the assignment of a loan from a bank can never rely on federal preemption of state usury laws 'because banks cannot validly assign such rights to non-banks.'"

Should the Federal court accept the reasoning of *Madden*, Pepper Hamilton's analysis declares, such a ruling "could have severe adverse consequences for the marketplace and the online lending industry and for the banking industry generally...."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I GOT FUNDED, AGAIN

By *SEAN MURRAY*

One year after I received a 12-month loan from Square on fixed monthly ACH, I logged onto my dashboard to renew. I was pre-approved to do it all over again, the screen indicated, but the monthly ACH payment option had disappeared. In its place, Square offered to withhold a fixed percentage of my credit card sales going forward until the balance was paid in full.

Known as a "split," diverting a percentage of the card payment proceeds to a financial company is straight out of the merchant cash advance playbook. Square, however, structures their transactions as loans. That means that regardless of how my sales ebb and flow, I must pay off my balance in full in 18 months.

I was okay with that. I had to be. It was that time of year when working capital is very important, the holidays. Not to mention, deBanked was in the process of moving, again. If you recall in December of 2016, we moved to a slightly larger office in the same building on Wall Street. In December of 2017, however, we moved from Manhattan to Brooklyn, a locale I intend to remain in for a long time.

But this loan had no monthly payment, just a 15.75% split. Others may refer to this as the holdback, withhold, or specified percentage. Square's application process this time around was slightly more rigorous than a year ago, a few more buttons, a couple more disclosures, and even a notice that a review could take between 1-3 days. I was still approved the same day however and had funds the next. There were no hidden fees or closing costs.

Six days after being funded, I ran a charge, Square took their split, and I netted the difference minus the interchange fees. I noticed, but in a way I didn't. I didn't have to worry about how much the monthly payment would be and when. The loan was being repaid all by itself. That was how I processed it psychologically anyway, as I imagine many other small business owners have as well.

And the feeling of relief from impending monthly payments is not entirely mental. Seven weeks later, I was already 17% paid off. That's real progress, especially with a 65-week window remaining to pay off in full.

Had the same transaction been structured as a merchant cash advance, the timeframe would've been unlimited. But hey, I guess sometimes you can't have it all. It was a 1.10 factor rate, decent by industry standards, certainly not the most expensive, but not the least expensive either. It was fast, it was helpful, and best of all, it was free from the burden of fixed monthly payments.

I got funded again and loved it. What are you still waiting for?

Editors Note: deBanked did not collaborate with Square in the writing of this editorial. To be frank, Square did not even contact us after I published my first experience with their product one year ago (See article: http://dbnk.news/1u). It is unclear if they are even aware that I wrote anything at all. Square is not an advertiser nor have they sponsored any of our events. I did not attempt to interview them for this write-up or tip them off that I would be writing anything. To my knowledge, we did not receive any special benefit or pricing. deBanked chose Square for funding in part to avoid the conflict of writing a review of a paying advertiser or sponsor.

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A DIALOGUE WITH PETER RENTON: CRYPTOCURRENCY AND BEYOND

By *CHERYL WINOKUR MUNK*

DeBanked Magazine recently caught up with Peter Renton, founder of Lend Academy, a leading educational resource for the marketplace industry. Through his writing, podcasts and video courses, he's been helping multitudes of people better understand the industry since 2010. Renton is also the co-founder of LendIt, one of the world's largest fintech conventions, which recently branched out beyond its marketplace lending focus to include other types of fintech. The flagship U.S. conference will take place April 9 through April 11 in San Francisco. The following is an edited transcript of our discussions.

DEBANKED: Why did you decide to rebrand LendIt as LendItFintech?

RENTON: The main reason is that we have moved beyond the online lending space. While it's still the core of what we do, it's not all of what we do anymore. Many of the large online lenders have also moved beyond online lending. Lending is part of financial services, but our attendees want to know what else is important. Our attendees also want to look at other opportunities for expansion. They want to know how other areas of fintech are going to affect their business—topics such as blockchain and digital banking. LendItFintech tells people that lending is what we focus on, but it also makes clear that we're about more than lending.

DEBANKED: In addition to your marketplace lending investments, you entered into the cryptocurrency space back in early 2015. Tell us what you're doing now with respect to cryptocurrency?

RENTON: This was not something that I spent much time thinking about back then. At the time, I expected bitcoin to never amount to anything. But I'm interested in financial innovation and I decided to give it a go. I never thought in my wildest dreams that it would get to $10,000. (Editor's note: In 2017, bitcoin climbed to nearly $20,000; in early February it fell below $8,000 for the first time since Nov. 2017) I opened up a Coinbase account with $2,000, which got me 10 bitcoins. I have since sold a portion of it gradually as the price of bitcoin went up, and I diversified into a handful of other coins as well. I have recently moved a significant portion of my investment into a privately managed cryptocurrency fund, and I still maintain my Coinbase account too.

DEBANKED: How are things different now than when you first entered the digital currency market?

RENTON: In January 2015, I created my bitcoin account and I don't think I ever logged in over the next 18 months, or if I did, it was maybe just once or twice. No one was talking about bitcoin back then. It was still on the fringe of fintech. Sure, there were some people focused on it, but it wasn't part of mainstream media coverage. Then, all of a sudden, it became hot because people love get-rich-quick schemes and hearing about people who hit the big time from nothing. These stories really fuel people's imagination. Then suddenly bitcoin became one of the biggest phenomena of 2017; no one would have predicted a few years ago that would happen.

DEBANKED: What are the biggest risks you see with cryptocurrency today and how can investors best overcome these challenges?

RENTON: Many people are buying purely on speculation with no thought that bitcoin could go down in price. You hear of people buying bitcoin on their credit card and paying 20 percent interest on that purchase. It's insane. I feel that cryptocurrencies are here to stay, but I don't like that they have these massive 20 percent to 30 percent swings in a day. The speculators have helped drive the price up, but they've also driven the volatility up and that's been a bad thing.

DEBANKED: Do you think cryptocurrency will ever dethrone cash? If so, what will it take to get to that point?

RENTON: I feel that some kind of digital currency is inevitable—but whether it's a Federal Reserve-backed

currency or something else remains to be seen. I have an 11-year-old and a 9-year-old and I am confident that at some point in their lifetime there will be no such thing as cash. In China, for example, there are some places where you can't even use cash. You can go to a street vendor and buy a piece of fruit with your phone. Certainly in the U.S. we're not there yet, but I think China shows where we are going to be. Cryptocurrency is only one type of digital cash, and it's hard to say how it will ultimately fit into the larger picture. To dethrone cash as we know it today, cryptocurrency needs to be a quick and efficient way of transacting, and right now it's not quick and it's not cheap.

That said, I believe there will be some kind of digital currency in the future. It will take a long time for the Federal Reserve to say cash is no longer legal tender, but I expect we'll see some kind of digital currency in the next 10 years for sure.

DEBANKED: How do you think regulation will change the cryptocurrency landscape? Is it inevitable and, more importantly, do you think regulation of cryptocurrency is necessary to take it beyond the level it is today?

RENTON: Right now bitcoin is not systemically important. At a market cap of around $156 billion in early February, if something happens and it completely crashes, it won't make a dent on the U.S. or world economy. But if bitcoin continues to rise and reaches a market cap of say $16 trillion, and then it falls to zero, that would reverberate around the world. The largest economies that have the most bitcoin would be the most impacted.

At some point governments will step in with regulation. It's already happening in places like China and South Korea and there are rumors of other governments taking action. I don't think the largest governments will allow their economy to be at the whim of speculators.

DEBANKED: How do you feel about the SEC stepping into regulate ICOs? Is this necessary to protect investors?

RENTON: There are certainly some ICOs that are complete scams while others are obviously violating securities laws. But many ICOs have strong legal teams supporting them and are doing it right now. The SEC should absolutely clamp down on those doing the wrong thing, but my hope is that they don't overreact and throw the baby out with the bathwater.

DEBANKED: What about online lending? The industry has gone through a lot of changes in its relatively short history. How do you expect to see the competitive landscape change in the next year or so? What about farther out?

RENTON: The online lending space has gone through a lot of changes in its short history. I feel like the biggest trend we're seeing right now is banks launching their own platforms. Take Goldman Sachs with the Marcus online lending platform, for example. More than anything else that has happened in the history of online lending that is among the most telling for the future, I think. Goldman has gone all in with this effort, and that move woke up all the large banks. Top banks like PNC and Barclays are also launching their own initiatives instead of partnering with others, which was surprising to me. I would have thought there would be more partnerships. There are still some, but several banks have decided to do it themselves rather than partnering. Smaller banks, however, that want to get into the space, will likely partner because they can't afford to do it themselves. While we have seen a few partnerships develop, I expect we will see many more over the next couple of years.

DEBANKED: What do you see as the biggest risks for online lenders today? How can they best overcome these challenges?

RENTON: As an industry, we have to focus on profitability. Profitability comes down primarily to two things. First, you have to get your cost of acquisition down. Some of the companies that failed recently were never able to get their costs of acquisition down to a manageable level. Underwriting is the second piece. Particularly if you're a balance sheet lender and you're not underwriting well, you can't make money. The pullback in the industry in 2016 occurred because many of the major platforms got a little too

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aggressive in their underwriting. Investors are still paying for some of those mistakes.

Successful companies are ones that have figured out how to profitably acquire customers and how to underwrite effectively. Most of them have learned their lesson, but in business companies sometimes have short memories. We need to keep a close eye on it.

DEBANKED: What advice do you have for alternative lenders and funders?

RENTON: In addition to paying careful attention to profitability and underwriting, another important piece is having diversified funding sources. You want to make sure that you don't have one big bank or some other source providing 90 percent of your funding. You should really have different kinds of lending sources. Some loans you can fund through a marketplace, some loans you can fund through your balance sheet. It's good when you're not reliant on one particular way of funding your loans.

DEBANKED: How is regulation likely to impact the online lending industry?

RENTON: Having support in Congress for the online lending space is important. Congress hasn't devoted a lot of attention to it in the past few years, but it's starting to. The Madden decision—which has the potential to lead to significant nationwide changes in consumer and commercial lending by non-bank entities—has created uncertainty in the industry. In states affected by the decision (Connecticut, New York and Vermont) already there has been less access to credit. I'm hopeful that Congress moves ahead with legislation to override the Madden decision that's having such an impact in the Second Circuit states. People are worried that it could expand nationwide and Congress needs to act so there's clarification. There's too much uncertainty right now.

DEBANKED: Several platforms have closed their doors in the past year or so. Do you expect to see this trend continue?

RENTON: There are companies out there still trying to raise money and struggling to do so. That's a healthy thing for an industry. You want the strong players to survive and thrive and for the weaker ones to go away.

DEBANKED: How big do you think an online lender has to be to thrive?

RENTON: There's no doubt that scale is important. If you're a small player, you have to have some kind of niche in order to acquire customers. If you have that, you have the ability to compete. Even with that sometimes, it's going to be difficult. It's a pretty complex business. You need to have a lot of staff for compliance and operations and that can be expensive. When you have high fixed costs, you have to have scale to be able to make a profit. That said, I think there's room for more than just the ultra-large players in the online lending space. I think there will be plenty of opportunity for strong, well-positioned medium-sized players to compete.

DEBANKED: What about M&A in the industry?

RENTON: Valuations at many of the large platforms are way down from where they were several years ago. As long as valuations stay depressed, I think we could see a big acquisition of a major platform this year. Some of these platforms have millions of customers. Having the ability to pick up such a large number of customers instantly through an acquisition could be compelling for the right buyer, such as a large bank.

DEBANKED: Is this a good time or a bad time to be an online lender in your opinion?

RENTON: It is still a good time to be an online lender. We are expanding access to credit and making the world a better place. I have never been more excited about the industry than I am today.

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