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A Look Ahead

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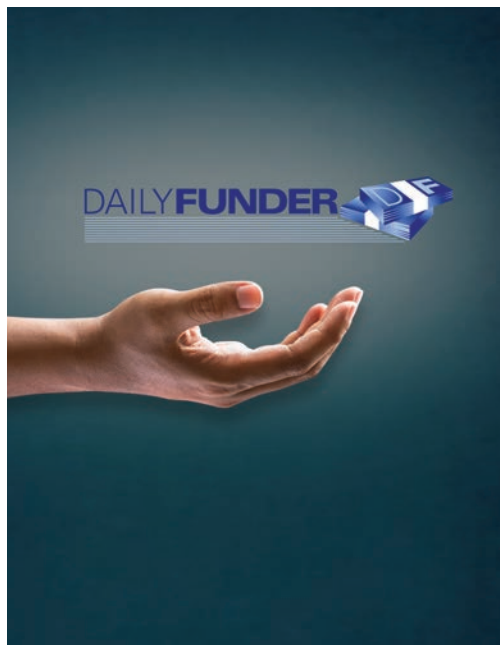
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Letter From the Editor

**BY
SEAN MURRAY**

We usually report on acquisitions taking place around the industry but this time I am in the unusual circumstance of being the acquirer in a major industry deal. Very recently, we took over 100% of DailyFunder, a highly trafficked website that serves as a vital message board for small business finance professionals. If you read deBanked, it's possible you came across DailyFunder at some point in your business career. I had always been a partner in that site since it launched in 2012 and only just recently had the opportunity to take it over entirely. In this issue, I answer questions about what DailyFunder is and what the takeover means. Eight years ago, its potential reach was limited by the small size of the industry. As the industry as grown, so too has DailyFunder.

Such a trajectory calls to mind another industry that seemed limited at first but is now experiencing epic growth, cannabis. What's happening with it and who's financing the businesses within it? We dive into that and more in this issue of deBanked.

—Sean Murray

In January 2020, Raharney Capital, LLC, the company that owns deBanked Magazine, acquired the other 50% stake in Daily Funder, LLC to bring its total ownership interest in the company to 100%. Below is a Q&A interview with Raharney Capital, LLC president and deBanked Chief Editor Sean Murray to answer questions about the acquisition.

Q: You've just acquired DailyFunder, can you explain what it is?

(Sean Murray)

A: Sure, DailyFunder was primarily an online forum or chat board for folks that worked in the merchant cash advance industry but it has evolved over time to include a wider range of professionals and small business finance discussion.

Q: And you were part of this website originally to some extent, correct? What is the connection for those that don't know?

A: Yes, I co-founded the website in 2012, which is crazy to think was 8 years ago already. My company owned 50% of DailyFunder since inception. The DailyFunder forum was a side project to my primary business, deBanked, which I launched in 2010 (originally as Merchant Processing Resource). What's changed is that we now own 100% of DailyFunder.

Q: The DailyFunder has a lot of posts and members on it, what was the inspiration for the website all the way back in 2012? Could you see it growing to be as popular as it is?

A: The DailyFunder forum works because it serves a distinct purpose and fills a necessary void. The idea of a forum specifically for merchant cash advance discussion actually wasn't even a very original idea in 2012 because there already was a website for that kind of thing called MCAForums.com. I had been an active member of the MCAForums since January 2009 and found it quite useful despite there being parts of it that I thought could use improvement. I envisioned DailyFunder to be a better version of MCAForums, not really something similar to deBanked. MCAForums was semi-popular but the industry was very small back then. I think part of the surge in users on DailyFunder and popularity directly ties into how large that market has grown in the last decade.

Q: So the original MCAForums was very influential then on your individual vision for DailyFunder?

A: Definitely. I actually tried to convince the owner of MCAForums to sell it to me personally in 2011 but that conversation never went anywhere. There were a number of other people on that forum who also thought

it could be better and they were one of the first users on DailyFunder when it launched. For a time, people were using both DailyFunder and the MCAForums and then gradually MCAForums disappeared. DailyFunder had a huge advantage because I was able to use deBanked (then Merchant Processing Resource) to advertise DailyFunder for free. It worked extremely well. It certainly helped establish it.

Q: So you originally wanted DailyFunder to be a better MCA-focused forum?

A: That's exactly it. By the time DailyFunder launched I already had my hands full with deBanked. My personal vision for DailyFunder in the beginning was really a better MCA chat board. There was a short time when DailyFunder experimented with producing its own content as I'm sure some of the old timers who've been around awhile recall, but it created a paradox for the brand. Was DailyFunder a platform or a publisher? It's actually something Facebook and a lot of other social networks have struggled with. Either you are in control of the content or the users are. It's difficult to try and have it both ways. DailyFunder had been founded as a platform for discussion and the reason it is still popular today is because it stayed true to that mission. The users create and drive the content. That's who DailyFunder is. New users still sign up for the forum every single day and there's almost 130,000 posts on there. It's amazing!

Q: So when the DailyFunder forum launched, how did you balance that with deBanked's forum, did you discontinue the deBanked forum that had been operating for years already?

A: No, that's the thing, the two websites don't compete with each other. Unlike DailyFunder, deBanked is a publisher. It started off that way. It has a forum but it doesn't drive the site or the brand. The deBanked forum gets a lot of traffic, but it's just an add-on to our publishing business. We're in control of the content and our users

are consumers of it. Some folks might enjoy both sites or prefer one versus the other, depends on what they're looking for I suppose. I have been asked, of course, if DailyFunder will be absorbed into deBanked now that we've acquired the entirety of it, and the answer is 'no,' why would we? DailyFunder is good at being what it is. It's got its own following and fans and none of it conflicts with what deBanked is doing and has in store. I can't really even picture combining the two and I suspect users of both would prefer that not happen either. The two companies will be united under common ownership but that's about it.

Q: So DailyFunder 2020 and beyond, what are the plans?

A: We have some plans to improve the site's underlying infrastructure, utility, and content moderation procedures that I believe will enhance the community it fosters. It could certainly use some work in a variety of areas. I recognize that the culture has changed on it over time and the product discussion has moved beyond merchant cash advances as the b2b finance marketplace has evolved. Whatever we can do to make it a more valuable and enjoyable experience, we will try to do. We're going to ponder the same questions that I pondered in 2012, how can this forum be better for people who are involved in dealmaking day-to-day?

Q: How about you, do you miss the day-to-day dealmaking that inspired DailyFunder in the first place?

A: You know what's funny, someone told me recently that I'm not even genuinely part of the industry that our platforms cater to. I think it was supposed to be an insult but I totally respect that diss because to an extent they're right, I haven't called a merchant about funding in like a decade! My experience on the frontlines spans from 2006 - 2011, first as a very senior underwriter and then later as a sales rep for two different ISOs. There's a certain nostalgia for the times I spent sitting in a windowless room with some great friends cold calling on a straight commission,

no-base no-draw comp plan. It was harder back then (It could take days, weeks, or months to convert a merchant's processing account), there was no stacking, and no ACH payment products, so the road to six figures-a-year glory was a lot tougher. Then again there was a lot less competition. I've always considered my time doing that type of sales as a very valuable learning experience because it was so challenging.

The way I even got into it was that I was the Director of Underwriting for Merchant Cash and Capital (which later became Bizfi) in 2008 before I transitioned to becoming a broker because I thought the financial opportunity of uncapped commissions would be exponentially greater than being a salaryman. Terrible timing! Lehman Brothers collapsed the week after I started and all the funders started getting their lines pulled. Nobody wanted to fund anything and I had given up comfort and stability in exchange for a straight commission job. There's a learning curve with selling these kind of products to begin with and it didn't help that anything I managed to get submitted was being instantly declined. The first two months I earned a whopping zero dollars. I remember I had the opportunity to go running back to my cushy salary in underwriting but I had to decide right there and then or else the spot would be filled by a really smart up-and-comer. It was a defining moment because I couldn't ever see myself going back. I stuck with the commission lifestyle and over time managed to do pretty well for myself. I remember the first time I got a check for around 10 grand, it was a huge rush. All of this sealed my interest in becoming an entrepreneur. I learned that I could turn nothing into something and that I had the stomach and mindset for risk-taking.

But the question was, do I miss the day-to-day dealmaking? Not in the sense that I have an itch to hop on a phone and try to pitch someone on why \$30,000 would be great for their business, but I do miss the camaraderie of the sales rooms. I like to think that what I do now is an advanced version of my past experience as a lot of our customers and readers are salespeople themselves. Try pitching salespeople in the financial services business. It's HARD!

Q: You reminisce of the old days, but how old were you when you started everything?

A: I'm 36 now but I started in the industry when I was 23, almost right out of college. I launched deBanked at 27 and co-founded DailyFunder at 29. I'm not really that old but It's weird to think that some of today's up and coming salespeople that I've met at the conferences we put on were in like 5th grade when I first got into this industry. '06 wasn't that long ago and it was well into the era of the Internet but one of my good friends who helped get me that first underwriting job wasn't even given a computer at work for the first half a year or so he worked there. He was literally pricing MCA deals with a pencil and loose leaf paper. I remember when he was showing me the ropes, he gave me a spiral notebook to do the math on every file. When he eventually built an excel spreadsheet with all of the formulas built in, it totally changed the game and made the process incredibly more efficient. EVERYONE in the industry wanted a copy of it! It sounds ridiculous now.

Q: Lastly, where will DailyFunder fit into your ecosystem of news, resources, and conferences?

A: DailyFunder is a unique addition to what we have already built and what we've been planning. It gets a lot of visitors and has engaged users. Is it going to be a huge revenue generator? I don't know. It goes back to what I was saying before, the mission will be to create a great forum for those involved in day-to-day dealmaking. How can we provide a platform that enables those in the industry to make more money? That's the way I look at it. I think if we can provide that type of value, success will follow.

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By **BRENDAN GARRETT**

deBanked CONNECT **MIAMI**

Two blocks back from where the waves were washing up on Miami Beach, attendees flocked into the halls of the Loews Miami Beach Hotel. A mix of brokers, funders, lawyers, and anyone else attracted to alternative finance made up the crowd of the 2020 outing of deBanked Connect Miami.

They had come for the speakers and talks, the networking opportunities, and, of course, the

weather; the first of these being a mix of topics and characters from across the industry. But before the talks could properly kick off, deBanked's President and Founder Sean Murray took to the stage to welcome attendees and announced the publication's latest news: the utility of www.seekingfin.com and the administration of two large social media groups, Merchant Cash Advance on Facebook and Merchant Cash Advance Resource on LinkedIn.





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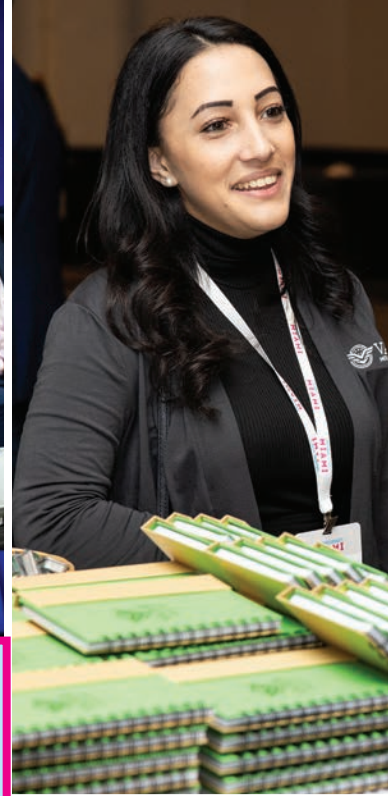
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Following on from Murray's introduction, Brian Holloway, former Patriots Offensive Lineman, opened the show with an impassioned speech alongside his son on how to translate your passions and determination into sales maximization, citing the mantra of "Let's move as the champions move." A collection of industry figures including United Capital Source's Jared Weitz, Elevate's Heather Francis, and alternative finance veteran David Goldin discussed the challenges and changes that businesses are likely to face when making money in 2020 – including what to be aware of when considering syndication and how to build a book. And closing the show were Gunes Kulaligil from Methodical Management alongside Hans Thomas of 10X Capital, who broke down how to accurately value yourself and your company's worth.



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Running throughout these talks, just off from the general session room, the sponsors hall was abuzz with deals and networking. With business cards exchanged, rumors swapped, and trends discussed, the hall served for the day as a focal point for the industry.

And as the sun set on South Beach, the speakers wrapped up and the sponsors wound down their tables. The audience billowed out into the courtyard, where the lasting Miami heat accompanied food, cocktails, and conversation, as deBanked Connect Miami closed for another year.



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2020 AND BEYOND— A LOOK AHEAD

By CHERYL WINOKUR MUNK

W

ith the doors to 2019 firmly closed, alternative financing industry executives are excited about the new decade and the prospects that lie ahead. There are new products to showcase, new competitors to contend with and new customers to pursue as alternative financing continues to gain traction.

(cont'd)



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Executives reading the tea leaves are overwhelmingly bullish on the alternative financing industry—and for good reasons. In 2019, merchant cash advances and daily payment small business loan products alone exceeded more than \$20 billion a year in originations, *deBanked*'s reporting shows.

Confidence in the industry is only slightly curtailed by certain regulatory, political, competitive and economic unknowns lurking in the background—adding an element of intrigue to what could be an exciting new year.

Here, then, are a few things to look out for in 2020 and beyond.

REGULATORY DEVELOPMENTS

There are a number of different items that could be on the regulatory agenda this year, both on the state and federal level. Major areas to watch include:

Broker licensing. There's a movement afoot to crack down on rogue brokers by instituting licensing requirements. New York, for example, has proposed legislation that would cover small business lenders, merchant cash advance companies, factors, and leasing companies for transactions under \$500,000. California has a licensing law in place, but it only pertains to loans, says Steve Denis, executive director of the Small Business Finance Association. Many funders are generally in favor of broader licensing requirements, citing perceived benefits to brokers, funders, customers and the industry overall. The devil, of course, will be in the details.

Interest rate caps. Congress is weighing legislation that would set a national interest rate cap of 36%, including fees, for most personal loans, in an effort to stamp out predatory lending practices. A fair number of states already have enacted interest rate caps for consumer loans, with California recently joining the pack, but thus far there has been no national standard. While it is too early to tell the bill's fate, proponents say it will provide needed protections against gouging, while critics, such as Lend Academy's Peter Renton, contend it will have the "opposite impact on the consumers it seeks to protect."

Loan information and rate disclosures. There continues to be ample debate around exactly what firms should be required to disclose to customers and what metrics are most appropriate for consumers and businesses to use when comparing offerings. This year could be the

one in which multiple states move ahead with efforts to clamp down on disclosures so borrowers can more easily compare offerings, industry watchers say. Notably, a recent Federal Reserve study on non-bank small business finance providers indicates that the likelihood of approval and speed are more important than cost in motivating borrowers, though this may not defer policymakers from moving ahead with disclosure requirements.

If these types of requirements go forward, Jared Weitz, chief executive of United Capital generally expects to see commissions take a hit. "This will drive commission down for the industry, but some companies may not be as impacted, depending on their product mix, cost per lead and cost per acquisition and overall company structure," he says.

Madden aftermath. The FDIC and OCC recently proposed rules to counteract the negative effects of the 2015 *Madden v. Midland Funding LLC* case, which wreaked havoc in the consumer and business loan markets in New York, Connecticut, and Vermont. "These proposals would clarify that the loan continues to be 'valid' even after it is sold to a nonbank, meaning that the nonbank can collect the rates and fees as initially contracted by the bank," says Catherine Brennan, partner in the Hanover, Maryland office of law firm Hudson Cook. With the comments due at the end of January, "2020 is going to be a very important year for bank and nonbank partnerships," she says.

Possible changes to the accredited investor definition. In December 2019, the Securities and Exchange Commission voted to propose amendments to the accredited investor definition. Some industry players see expanding the definition as a positive step, but are hesitant to crack open the champagne just yet since nothing's been finalized. "I would like to see it broadened even further than they are proposed right now," says Brett Crosby, co-founder and chief operating officer at PeerStreet, a platform for investing in real estate-backed loans. The proposals "are a step in the right direction, but I'm not sure they go far enough," he says.

Precisely how various regulatory initiatives will play out in 2020 remains to be seen. Some states, for example, may decide to be more aggressive with respect to policy-making, while others might take more of a wait-and-see approach.



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“I think states are still piecing together exactly what they want to accomplish. There are too many missing pieces to the puzzle,” says Chad Otar, founder and chief executive at Lending Valley Inc.

As different initiatives work their way through the legislative process, funders are hoping for consistency rather than a patchwork of metrics applied unevenly by different states. The latter could have significant repercussions for firms that do business in multiple states and could eventually cause some of them to pare back operations, industry watchers say.

“While we commend the state-level activity, we hope that there will be uniformity across the country when it comes to legislation to avoid confusion and create consistency” for borrowers, says Darren Schulman, president of 6th Avenue Capital.

into underwriting risk. Some industries and companies may be more susceptible to this risk, and funders have to plan accordingly in their projections. It’s not a reason to make wholesale underwriting changes, but it’s something to be mindful of, says Heather Francis, chief executive of Elevate Funding in Gainesville, Florida. “Any election year is going to be a little bit volatile in terms of how you operate your business,” she says.

COMPETITION

The competitive landscape continues to shift for alternative lenders and funders, with technology giants such as PayPal, Amazon and Square now counted among the largest small business funders in the marketplace. This is a notable shift from several years ago when their footprint had not yet made a dent.



ELECTION UNCERTAINTY

The outcome of this year’s presidential election could have a profound effect on the regulatory climate for alternative lenders. Alternative financing and fintech charters could move higher on the docket if there’s a shift in the top brass (which, of course, could bring a new Treasury Secretary and/or CFPB head) or if the Senate flips to Democratic control.

If a White House changing of the guard does occur, the impact could be even more profound depending on which Democratic candidate secures the top spot. It’s all speculation now, but alternative financiers will likely be sticking to the election polls like glue in an attempt to gain more clarity.

Election-year uncertainty also needs to be factored

This growth is expected to continue driving competition in 2020. Larger companies with strong technology have a competitive advantage in making loans and cash advances because they already have the customer and information about the customer, says industry attorney Paul Rianda, who heads a law firm in Irvine, Calif.

It’s also harder for merchants to default because these companies are providing them payment processing services and paying them on a daily or monthly basis. This is in contrast to an MCA provider that’s using ACH to take payments out of the merchant’s bank account, which can be blocked by the merchant at any time. “Because of that lower risk factor, they’re able to give a better deal to merchants,” Rianda says.



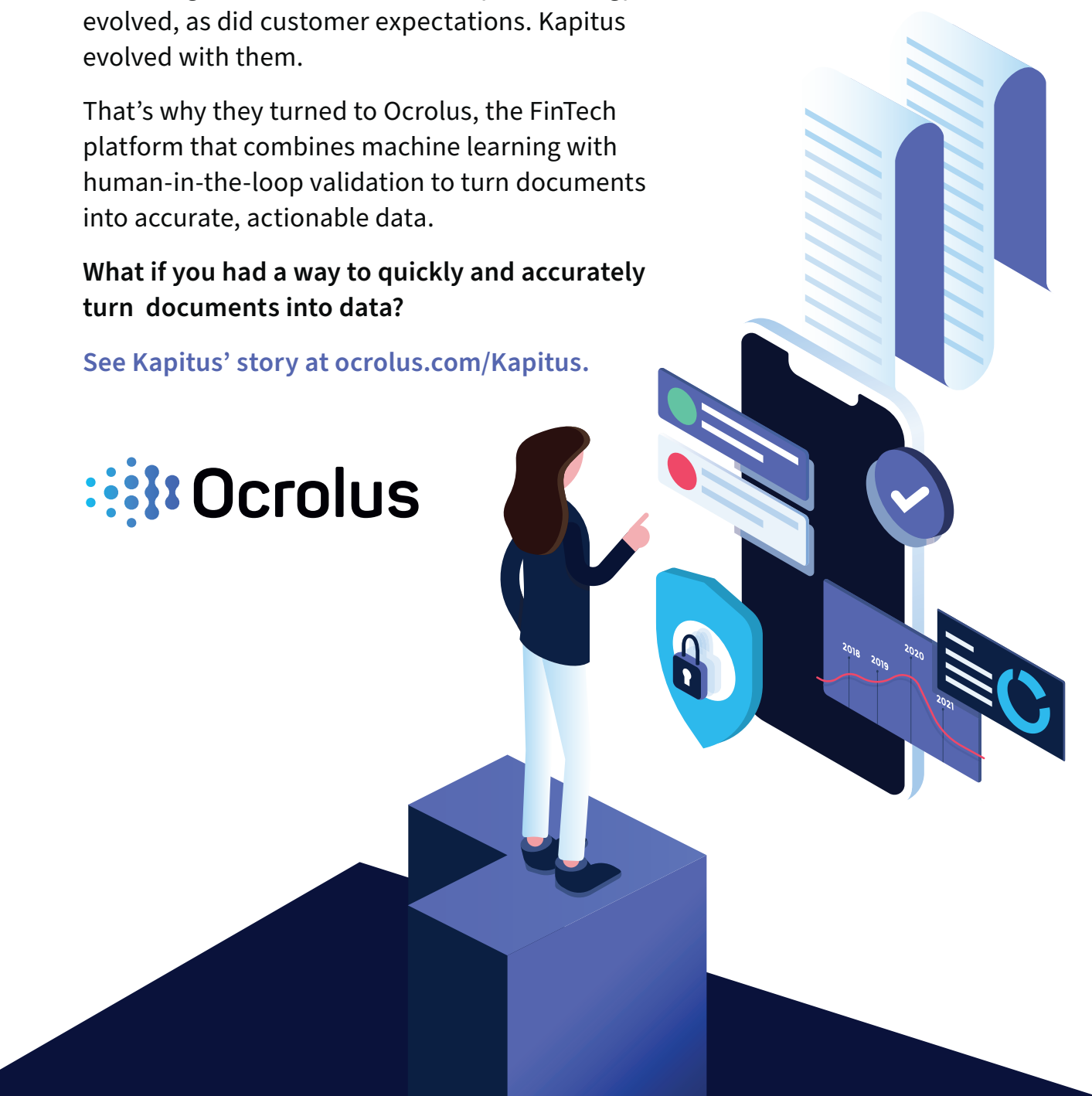
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Increased competition has been driving rates down, especially for merchants with strong credit, which means high-quality merchants are getting especially good deals—at much less expensive rates than a business credit card could offer, says Nathan Abadi, president of Excel Capital Management. “The prime market is expanding tremendously,” he says.

Certain funders are willing to go out two years now on first positions, he says, which was never done before.

Even for non-prime clients, funders are getting more creative in how they structure deals. For instance, funders are offering longer terms—12 to 15 months—on a second position or nine to 12 months on a third position, he says. “People would think you were out of your mind to do that a year ago,” he says.

Because there’s so much money funneling into the industry, competition is more fierce, but firms still have to be smart about how they do business, Abadi says. Meanwhile, heightened competition means it’s a brokers market, says Weitz of United Capital. A lot of lenders and funders have similar rates and terms, so it comes down to which firms have the best relationship with brokers. “Brokers are going to send the deals to whoever is treating their files the best and giving them the best pricing,” he says.

PROFITABILITY, ACCESS TO CAPITAL AND BUSINESS-RELATED SHIFTS

Executives are confident that despite increased competition from deep-pocket players, there’s enough business to go around. But for firms that want to excel in 2020, there’s work to be done.

Funders in 2020 should focus on profitability and access to capital—the most important factors for firms that want to grow, says David Goldin, principal at Lender Capital Partners and president and chief executive of Capify. This year could also be one in which funders more seriously consider consolidation. There hasn’t been a lot in the industry as of yet, but Goldin predicts it’s only a matter of time.

“A lot of MCA providers could benefit from economies of scale. I think the day is coming,” he says.

He also says 2020 should be a year when firms try new things to distinguish themselves. He contends there are too many copycats in the industry. Most firms acquire leads the same way and aren’t doing enough to differentiate. To stand out, funders should start

specializing and become known for certain industries, “instead of trying to be all things to all businesses,” he says.

Some alternative financing companies might consider expanding their business models to become more of a one-stop shop—following in the footsteps of Intuit, Square and others that have shown the concept to be sound.

Sam Taussig, global head of policy at Kabbage, predicts that alternative funding platforms will increasingly shift toward providing more unified services so the customer doesn’t have to leave the environment to do banking and other types of financial transactions. It’s a direction Kabbage is going by expanding into payment processing as part of its new suite of cash-flow management solutions for small businesses.

“Customers have seen and experienced how seamless and simple and easy it is to work with some of the nontraditional funders,” he says. “Small businesses want holistic solutions—they prefer to work with one provider as opposed to multiple ones,” he says.

OPEN BANKING

This year could be a “pivotal” year for open banking in the U.S., says Taussig of Kabbage. “This issue will come to the forefront, and I think we will have more clarity about how customers can permission their data, to whom and when,” he says.

Open banking refers to the use of open APIs (application program interfaces) that enable third-party developers to build applications and services around a financial institution. The U.K. was a forerunner in implementing open banking, and the movement has been making inroads in other countries as well, which is helping U.S. regulators warm up to the idea. “Open banking is going to be a lively debate in Washington in 2020. It’ll be about finding the balance between policymakers and customers and banks,” Taussig says.

THE FUNDING ENVIRONMENT

While there has been some chatter about a looming recession and there are various regulatory and competitive headwinds facing the industry, funding and lending executives are mostly optimistic for the year ahead.

“If December 2019 is an early indicator of 2020, we’re off to a good start. I think it’s going to be a great year for our industry,” says Abadi of Excel Capital.

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HOW HOT IS THE LEGAL CANNABIS INDUSTRY?

By PAUL SWEENEY

One gauge of the commercial excitement over legal weed, medical marijuana and cannabis's byproducts could be witnessed at the Las Vegas Convention Center in early December where the Marijuana Business Conference & Expo was overflowing with 31,523 attendees.

Appealing to that audience—roughly the population of Juneau, Alaska—were more than 1,300 exhibitors who hailed from 79 different countries and touted products and services as varied as advancements in crop cultivation, medicinal breakthroughs, and innovative consumer products like marijuana-laden pastry.

That's some 30% more than the 1,000 vendors who packed into the Central Hall in 2018 and about double the 678 who were showing off their wares in the smaller North Hall two years ago, reports Chris Day, vice president for external relations at Denver-based Marijuana Business Daily, which follows the cannabis industry and sponsored the Las Vegas trade show.

"In December, 2019," Day declares, "we did not have to turn people away because we expanded. We had enough room for exhibitors but we needed both halls." Unable to resist a boast, he adds: "We've been the fastest-growing trade show in the country three years running."

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One face in the December crowd was seasoned financial broker Scott Jordan, the Denver-based managing director of the Alternative Finance Network. He was occupying a booth accompanied by two attractive female models in fetching T-shirts emblazoned with the message: “How much would you borrow at zero percent?”

The young ladies’ arresting appearance and the message worked to the extent that “it got people talking,” Jordan says. As for the zero-interest rate, it’s not exactly free money. “I’ve got a product that puts together a line of credit,” he explains, “and after they receive the line of credit, it charges them a fee.”

As a broker, Jordan does the spade work of poring through a cannabis business’s financial statements and business model before he tees up a deal—typically between \$250,000 and \$750,000—to “a cadre” of 35 lenders in 10 states. He’ll ascertain whether the best funding option should be structured as equipment leasing, a working-capital loan, a revolving line of credit, project financing, or a real estate loan.

One recent cannabis deal that Jordan midwived involved a “post-revenue, pre-profitability” manufacturing and processing company headquartered in Colorado. The financing, which closed in April, 2019, involved a pair of four-year term loans: one for \$400,000 to refinance existing machinery, and a second for an additional \$500,000 to acquire new laboratory equipment. Both credits carried interest rates in the “mid-teens,” he says, and were secured by the equipment.

Once the debt financing was in place, the manufacturing operation was “fully functioning,” Jordan reports, paving the way for the company to raise \$30 million in venture capital financing. Jordan argues that “even if they pay a 10-20 percent interest rate, it’s better to preserve equity and finance through a normal type of loan. If you need an extraction machine or packaging equipment,” he adds, “why give up equity if you can finance it through debt?”

Jordan’s reasoning appears to sit well with clients and funders alike. Since 2014, he has brokered 85 transactions worth \$33 million. He reckons that two out of three deals that he takes to funders meet with success. “My best year was 2015 because there were only a few competitors and I was the only guy on the block,” he says.

As the country steadily decriminalizes and legalizes pot, however, early market entrants like Jordan no longer have the cannabis business all to themselves. Thirteen states have legalized recreational marijuana for adults. These include California, Colorado, Oregon, Washington and Nevada in the West; Illinois and Michigan in the Midwest; and Massachusetts, Vermont and Maine in the East. Hawaii and Alaska permit it and, if you’re over 21, you can legally grow, smoke or ingest weed in the District

of Columbia, but it cannot be sold commercially.

An additional 24 states have approved medical marijuana. While research on cannabis’s medicinal properties remains thin—largely because of objections by federal law enforcement—it is being prescribed for a range of maladies, including cancer, glaucoma, epilepsy, Crohn’s Disease, multiple sclerosis, nausea, and pain. “[The marijuana plant contains more than 100 different chemicals called cannabinoids,” according to WebMD. “Each one has a different effect on the body. Delta-9-tetrahydrocannabinol (THC) and cannabidiol (CBD) are the main chemicals used in medicine. THC also produces the ‘high’ people feel when they smoke marijuana or eat foods containing it.”]

Industry data assembled by MJBizDaily reflects both the broad acceptance of legal cannabis use and its increasing commercial popularity. U.S. revenues from legal weed and its byproducts are expected to clear \$16.4 billion this year, a 40% growth rate over the \$11.75 billion in estimated revenues for 2019. The legal cannabis industry now employs about 200,000 persons in the U.S., about the same number as flight attendants (120,000) and veterinarians (80,000) combined.

For more evidence that the cannabis market is hot look no further than the state of Illinois, where recreational marijuana went on sale Jan. 1, 2020. The Prairie State’s governor also pardoned some 11,000 citizens with criminal records for possession and the sale of low levels of marijuana.

“We’re showing that sales were close to \$3.2 million on the first day of 2020,” says MJBiz’s Day. “Illinois is the big story right now,” he adds. “Anytime a new state opens up in the market, you’re seeing enormous pent-up demand and enthusiasm.”

Even as the cannabis industry takes giant strides toward public acceptance, the plant continues to face hostility from the U.S. federal government, which has criminalized its use for 80 years. Marijuana remains classified by the Drug Enforcement Agency as a Schedule 1 drug, keeping company with heroin, LSD and Ecstasy.

That designation has also made it hard for the cannabis industry to engage in simple financial transactions, much less obtain financing. “Despite the majority of states’ having adopted cannabis regimes of some kind, federal law prevents banks from banking cannabis businesses,” Joanne Sherwood, president and chief executive at Citywide Banks, a \$2.3 billion-asset bank headquartered in Denver, testified to Congress last summer.

“The Controlled Substances Act,” added Sherwood, who is chair of the Colorado Bankers Association, “classifies cannabis as an illegal drug and prohibits its use for any purpose. For banks, that means that any person

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or business that derives revenue from a cannabis firm is violating federal law and consequently putting their own access to banking services at risk.”

And despite the herculean efforts by the cannabis industry to soften its image, obtaining financing from traditional sources like pension funds, insurance companies and university endowments remains a daunting proposition as well, says David Traylor, senior managing director at Golden Eagle Partners. His four-person, boutique investment fund, which makes equity investments in up-and-coming cannabis companies, relies on wealthy individuals and family offices for the bulk of its funds.

“Capital is hard to come by for this industry,” Traylor says. “From day one, most venture capitalists have been staying out of it. It’s still illegal in many states

and their limited partners are endowments like Harvard and Yale, which see marijuana as the antithesis of education.”

Sarah Sanger, chief financial officer at Oak Investment Funds, a real estate investment firm based in Oakland, says: “There’s a great deal of economic activity in California but it’s stymied by the lack of financing and difficulty with changing regulations. It provides an opportunity for really expensive debt from private investors willing to do due diligence.”

That absence of establishment financing has opened up a plethora of opportunities for alternative funders, and not just in agriculture and plant cultivation. While agriculture represents the bedrock of the industry—there is no downstream product, of course, without the cannabis leaf—growing and harvesting cannabis is just one stage of the industry’s life cycle.

MJBiz’s Day notes, for example, that the legal cannabis industry is regulated for safety, so growers must show that “the flower has no molds or contaminants.” That means that crops are subject to rigorous testing and decontamination, which requires both materials and expertise. To process the leaf and develop “infused products” by extracting cannabis-based oils entails the purchase and deployment of costly

technology. Packaging and labeling along with tracking systems that, Day says, “are stricter than in other places” are also key components of the farm-to-market supply chain.

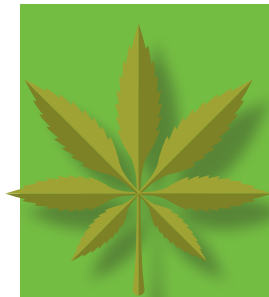
Meanwhile, in an ongoing effort to appeal to a fresh cohort of customers, Jordan notes, the cannabis industry continues to develop innovative uses for the plant. “There are so many applications and new products that keep appearing, like ice cream with marijuana, vaporizers, inhalers, and syrup,” he says. “Now, there are mints—something I hadn’t seen before—and different ways to ingest the product and get high and not look like a druggie.”

Jordan Fein, chief executive at Greenbox Capital in Miami, says his firm prefers to fund downstream companies selling cannabis products. “We do agricultural lending but it’s less attractive and harder to qualify the business. It’s not as tangible as a retail business which will have a website and product reviews. The same goes for edibles.”

Recent Greenbox Capital deals in 2019, Fein says, included one with merchant cash advances of \$80,000 and \$60,000 in growth capital to a Colorado dispensary. The operation put the money to work adding two retail outlets during the year, he says, bringing to four its total number of storefronts. In addition to cannabis flower, the dispensary sells “edibles, tinctures, lotions, and wax concentrates,” Fein reports. Both short-term cash advances require regular ACH payments.

Greenbox Capital also made a \$135,000, 10½-month cash advance to a cannabis-testing laboratory in Southern California in August, 2019 for the purchase of sophisticated equipment. The company, he says, is doing \$140,000-a-month in revenue and cashflow is strong and on the rise.

“Greenbox is always interested in higher risk deals,” Fein says, noting that banking services remain off-limits to legal cannabis firms. “But we fund them for the same reason we fund lawyers and auto sales—things that most others will not do. There’s nothing wrong with risk,” he adds, “as long as you clearly assign a proper value to the deal and price to it.”



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Steve Sheinbaum, a New York broker and chief executive at Circadian Funding, has unabashedly climbed aboard the cannabis bandwagon. “The market is exploding and it’s attractive to lenders because it’s a product people can put their hands on,” he says. “If I’m dealing with a grower, I can leverage real estate and usually there’s equipment. If they’re producing, there’s inventory and I can look at the income statement to see what kind of cash flow the business is generating.”

He recently brokered a \$10 million loan for a licensed grower and distributor of medicinal marijuana in New England with monthly revenues of \$3-\$4 million. The credit bore a 17% annual percentage rate and a six-year maturity, he says. The deal was brought to Circadian by a private equity investor who was looking to grow the enterprise tenfold. The deal, which was interest-only, was secured by a second position on real estate and a lien on the borrower’s license. “The lender was comfortable with the interest-only loan,” Sheinbaum explains. “They can refinance in six years.”

In another recent deal, Circadian arranged an unsecured merchant cash advance for \$300,000 to a Pacific Northwest technology company developing specialty, point-of-sale software for the cannabis industry. The firm showed monthly revenues of \$300,000.

“It’s not federally permitted for cannabis firms to take payments from Visa, Mastercard or American Express,” Sheinbaum explains. “But this technology company is using debit or credit cards to pay for cryptocurrency which is stored on a prepaid card which customers can then use to purchase cannabis.”

The tech company had been struggling to find money and Sheinbaum took satisfaction in a deal announcement that went out in an e-mail to the industry. “Funding complicated deals is what gets our blood flowing,” Sheinbaum wrote. “Anyone can get a restaurant or dentist funded. No one needs help with that.”

Manny Columbie, a Miami-based senior funding manager at H&J Capital Group, an Orlando firm, reports funding agricultural and dispensary businesses in California, Colorado and Washington State. In the Evergreen State, he says, he recently provided funding to a woman who owned a marijuana-themed café connected to a cannabis dispensary. The deal went through after examining her recent bank statements and two years of federal tax returns.

“The best thing about lending to people in this industry is their ability to repay,” Columbie says. “They’re never lacking in funds.”

He provided more detail on a deal currently in the works involving a physician in Irvine, California, with

an 800-plus credit score from the rating agency Experian and personal tax returns showing \$2 million in annual income. The doctor, Columbie says, has been making transdermal patches infused with THC in addition to his medical practice and needs specialized equipment to lower his manufacturing costs to 55 cents per patch. The patches sell for \$40-\$60 apiece, Columbie says, depending on the THC content.

If the deal goes through and is approved by H&J’s credit committee, the physician would likely be extended a \$350,000 loan with a 10-year maturity secured by the Chinese-manufactured equipment. Factoring in the doctor’s excellent credit and other positives, the interest rate on the credit could be as low as 5%-7%.

While the environment for legal cannabis seems to grow more favorable by the day, market participants urge funders to remain circumspect. One remaining fly in the legal cannabis ointment has been the persistence of an illegal black market. Estimates are that as much as 60% to 80% of the marijuana market in California is illicit, says Craig Behnke, an equity analyst at MJBiz.

Law-abiding businesses must also contend with overbearing regulators and high taxation. The California Department of Fee and Tax Administration recently jacked up its excise tax on cannabis to 80%, effective on Jan. 1, 2020.

And the state’s constabulary isn’t helping matters either, notes Sanger of Oak Funds. “There are going to be a lot of operators that end up being losers because of the regulatory environment,” she says. “Law enforcement is using all of its resources to make sure legitimate businesses are following the rules instead of clamping down on black market activity. That makes it harder for legitimate retailers to make money because people are still shopping in the black market.”

The recent collapse of the shares of publicly traded Canadian cannabis companies, which some blame in part on the illicit competition from the black market, also stands as a cautionary sign. Last August, the Motley Fool listed ten “Pot Stocks”—including Canopy Growth and Aurora Cannabis, both of which are listed on the New York Stock Exchange—that together lost a stunning \$20 billion in market capitalization.

The drubbing that heedless investors have taken in the Canadian stocks reminds analyst Behnke of the debacle in dotcom stocks back in 2001-2002, but with a big difference. “The dotcoms were a brand-new invention and people had no idea how big the Internet companies would be,” he told **deBanked**. “But cannabis has been around for a thousand years. I feel like it was a shame on investors and the companies. This shouldn’t have happened.”

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INDUSTRY NEWS

11/20/19 – Business insurance tech company Vouch, raised \$45M in a Series B. Vouch's founder, Sam Hodges, was one of the original co-founders of Funding Circle.

The Canadian Lenders Association hosted its annual summit in Toronto.

Fundation, a small business loan technology provider, announced it had collaborated with Fifth Third Bank on loan origination capabilities.

11/24/19 – Former NYC Mayor and billionaire Michael Bloomberg announced that he was running for president.

11/25/19 – Fora Financial, a small business lender, closed on two new credit facilities, increasing its borrowing capacity to \$120 million.

11/26/19 – LendingPoint, a data and technology platform, closed two securitizations. One was \$175.6M via direct-to-consumer loans, the other \$61.7M via point-of-sale loans.

11/27/19 – Stock trading startup Robinhood announced that it had voluntarily withdrawn its bank charter application with the OCC.

11/28/19 – KOHO, a Canadian company that offers a smart spending account with no fees, raised \$25M in a Series B led by US venture capital firm Drive Capital.

The Chinese Government announced that all existing peer-to-peer lending platforms in China must become small loan providers within two years.

11/29/19 – The FBI arrested Virgil Griffith, a research scientist for the Ethereum Foundation, for allegedly teaching North Korea how to launder money and evade sanctions through cryptocurrency and blockchain technology.

12/2/19 – Merchant Growth, a Canadian alternative small business finance provider, partnered with goeasy Ltd. to offer financing options to Canadian small businesses.

12/3/19 – The New York Department of Financial Services granted virtual currency and money transmitter licenses to SoFi Digital Assets. The company is a subsidiary of Social Finance Inc and will be used to offer its New York customers the ability to buy and sell virtual currency.

UK peer-to-peer lender Zopa raised £140M from IAG Capital to support its bid to secure a banking license.

12/4/19 – Bakkt CEO Kelly Loeffler was appointed to the US Senate to replace Georgia Senator Johnny Isakson. Bakkt is the Intercontinental Exchange's bitcoin-focused subsidiary.

12/5/19 – Figure, an online lender run by CEO Michael Cagney, closed a \$103M Series C round led by Morgan Creek Digital and joined by MUFG Innovation Partners Co., Ltd.

Landbay, one of the first peer-to-peer lenders in the UK, closed off access on its Buy-To-Let loans to retail investors, following regulatory scrutiny on the industry.

12/9/19 – ThinCats, a UK-based peer-to-peer lender, announced it was closing down due to the business model no longer being cost effective.

12/10/19 – Velocity Group USA, a small business finance provider based in Melville, NY, announced they had originated over \$75M to small businesses in their first year.

12/11/19 – Ocululus, a fintech company that transforms documents into actionable data, announced a new premium extension to its core technology.

Lendio, a small business loan platform, was honored with a Glassdoor Employees' Choice Award as a Best Place to Work.

12/11/19 – The New Jersey state legislature continued to push S3581, a bill that would prohibit the use of Confessions of Judgment in business financing contracts.

12/15/19 – GRID Finance, an Irish peer-to-peer merchant cash advance company, revealed to Ireland-based Business Post that it had plans to raise €100M.

12/16/19 – LendingHome, a fix and flip lender, announced the origination of \$5 billion in loans in just five years of mortgage lending.

12/17/19 – Kapitrus, a provider of financing to small and medium-sized businesses, announced it had closed its 2nd asset-backed securitization for \$160M.



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INDUSTRY NEWS CONT'D

12/18/19 – The Securities and Exchange Commission voted to propose amendments to the definition of accredited investor.

12/19/19 – Realio, an end-to-end digital asset issuance platform, announced it was partnering with YAD Capital, an investment manager in merchant cash advances.

12/27/19 – The Nasdaq finished above 9,000 points for its first time ever.

12/30/19 – The South China Morning Post reported that about 6,000 peer-to-peer lending companies had defaulted on payments, absconded with cash or gone out of business as of September 2019.

1/6/20 – Primary Capital, a merchant cash advance provider and small business servicing company, announced it had acquired a division of Infinity Capital Funding.

Criminal and civil charges were filed against Steven A. Schwartz, the former Director and Chief Operating Officer of defunct merchant cash advance firm 1 Global Capital, for his alleged role in the company's securities fraud.

1/7/20 – The United States Senate confirmed Jovita Carranza to head the Small Business Administration. Carranza was a Treasury Department official who previously served as deputy SBA administrator during George W. Bush's presidency.

SoFi announced the opening of its first Florida office in Jacksonville's St. Johns Town Center.

1/8/20 – Emerald Capital Funding, a private mortgage lender, announced it had changed its name to Pacific Equity & Loan.

Old Hill Partners provided a \$5M revolving-to-term credit facility to an unnamed merchant cash advance company.

1/9/20 – Law firm Pepper Hamilton merged with Troutman Sanders to form a new law firm named Troutman Pepper.

Steven A. Schwartz pled guilty for his role in the wire and securities fraud conspiracy related to 1 Global Capital.

1/10/20 – The DOW Jones crossed \$29,000 for the first time ever.

1/13/20 – The UK Peer to Peer Finance Association (P2PFA) disbanded due to the industry's declining relevance.

Visa revealed that it would be acquiring Plaid in a deal worth \$5.3B.

Small business finance provider Sprout Funding announced it had acquired Jet Capital.

1/14/20 – TBF Financial, a leading purchaser of non-performing equipment leases, loans, and merchant cash advances, closed transactions in December totaling \$100M.

Jean Noonan, a Partner at Hudson Cook, LLP was appointed to the Consumer Financial Protection Bureau Taskforce on Federal Consumer Financial Law.

Nav, a financing matchmaking company, announced that Greg Ott had been promoted to CEO. Levi King stepped down from the role and was named Executive Chairman of the company's Board of Directors.

Breakout Capital, a small business lender, announced that McLean Wilson had been promoted from Chief Credit Officer to Chief Executive Officer and President.

1/16/20 – Quarterspot, a small business lender, reportedly announced that it was shifting its business focus and would no longer be originating loans.

deBanked CONNECT MIAMI kicked off at the Loews Hotel in Miami Beach.

1/17/20 – Shopify, an e-commerce giant, announced that in addition to its existing merchant cash advance program, it would begin providing startup loans to qualifying applicants looking to test out entrepreneurship.

Alan Heide, the former CFO of 1 Global Capital, was sentenced to 5 years in prison for his role in the company's securities fraud.

Expansion Capital Group, a small business finance provider, appointed Brittney Newell to the CFO position. Newell joined the company in 2015.

UK-based Liberis, a merchant cash advance provider, raised £32M to help fund growth of the company across Europe and the United States.

Hudson Cook Partner Catherine Brennan was recognized with a national ranking in the Chambers FinTech 2020 USA Guide for Corporate, Securities & Financing.

Broker Fair 2020 announced two special keynote speakers, professional presidential pollster Scott Rasmussen and celebrity venture capitalist John Henry.

1/22/20 – OnDeck, a small business lender, appointed Scott Totman as the company's Chief Product and Technology Officer.



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ONE OF THE MOST DEVASTATING COURT DECISIONS AGAINST MERCHANT CASH ADVANCES HAS BEEN OVERTURNED

By SEAN MURRAY

Merchant Cash Advances have sat on comfortable legal footing in New York ever since an appellate court ruled in favor of Pearl Beta Funding, LLC against Champion Auto Sales, LLC in 2018, but even so, it hasn't stopped lawyers from trying to invalidate merchant cash advance (MCA) contracts on behalf of aggrieved customers.

That's because an MCA provided by New York-based Merchant Funding Services LLC to a business known as Volunteer Pharmacy in 2016 was ruled by New York Supreme Court Judge David F Everett to be so "criminally usurious on its face" that the normal process required to vacate a Confession of Judgment could simply be bypassed without even having to evaluate the merits of each side's arguments and the matter automatically won in favor of Volunteer Pharmacy. The judge's written decision, which voided the MCA contract ab initio, was replete with a scathing opinion of MFS's business model.

The decision quietly stunned the merchant cash advance industry. MFS understandably appealed.

Dozens of lawsuits against MCA companies in the ensuing years went on to cite Judge Everett's decision in *Volunteer Pharmacy* with limited success. And while the industry sat around to find out what would happen in that case, Pearl Beta Funding, a rival to Merchant Funding Services, won an appeal of its own, the landmark usury case in March 2018 that seemingly solidified once and for all the commonly held understanding that such MCA agreements were not usurious.

Despite this, the uncertainty of *Volunteer Pharmacy* still lingered in the background, that is until now.

On January 29th, 2020 the Appellate Division, 2nd Department, of the Supreme Court of New York, overturned Judge Everett's decision and ruled in favor of Merchant Funding Services. The panel of judges said they need not even weigh a lot of Everett's contentions because he was wrong on the underlying procedural issue, that a judgment by confession could be vacated in such an instance without having to go through the normal legal process.

The ruling ultimately provides clarity on the process that determines how a judgment by confession can be vacated. One major impact is that lawyers seeking to invalidate merchant cash advance agreements will no longer have *Volunteer Pharmacy* as a crutch to rely on.

CLEAN SWEEP

Merchant Cash Advance companies swept the New York Courts in January, winning 3 of 3 cases that had been decided on appeal. Those cases were:

Merchant Funding Services, LLC v Volunteer Pharmacy, Inc.

Merchant Funding Services, LLC v Micromanos Corporation

QFC, LLC v Iron Centurian, LLC

All of these cases were heard by the Appellate Division, 2nd Department of The Supreme Court of New York.

All of the cases addressed the procedure to vacate a confession of judgment.



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