

BORN TO BORROW

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Growth in the Making

By Cheryl Winokur Munk

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2

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By: ED MCKINLEY

Inside

02

**BORN TO BORROW
FINANCIAL EDUCATION
MIGHT NOT MATTER**

08

**SNAPSHOT ON AUSTRALIA:
GROWTH IN THE MAKING**

16

**GOLD RUSH: MERCHANT
CASH ADVANCES ARE
STILL HOT**

26

INDUSTRY NEWS

28

TORONTO RECAP

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Letter From the Editor



BY
SEAN MURRAY

Why does history repeat itself? Why do some people continue to make adverse decisions even after being supplied with the necessary tools and knowledge to avoid them? There's a theory out there based on research that financial education has virtually no impact on how consumers approach their finances. It's a wild idea to consider, that education isn't an effective way to change financial behavior. Because if that doesn't work, then what does? Does anything? In *Born to Borrow*, we delve into the amount of debt consumers have racked up in the post financial crisis era and explore how this may have happened.

But that's the USA. What about Australia? It's been four years since deBanked examined the Australian market, so we've checked in and found (*gasp!*) that there are similarities with the Canadian market, a market we've become intimately familiar with. So as you read about Australia, make sure to follow that up by checking out the coverage of our event in Toronto. deBanked CONNECT Canada was a major success and we'll be back there again next year.

I hope you enjoy our last issue of Summer 2019. I look forward to seeing you at our event in San Diego on October 24th. You can visit at www.debankedsandiego.com

—Sean Murray



Featured Story

BORN TO BORROW

FINANCIAL EDUCATION MIGHT NOT MATTER

By: ED MCKINLEY



C

onsumer debt has surpassed \$4 trillion for the first time, and it's continuing its ascent into the stratosphere. It's getting big enough to trigger the next recession, and financial education isn't changing the underlying consumer behavior.

Personal loan balances shot up \$21 billion last year to close 2018 at a record high of \$138 billion, according to a TransUnion Industry Insights Report. The average unsecured personal loan debt per borrower was \$8,402 as of the end of last year, TransUnion says.

Much of the increase in consumer debt has emerged with the rise of fintechs—such as Personal Capital, Lending Club, Kabbage and Wealthfront—notes Rutger van Faassen, vice president of consumer lending at a U.S. office of London-based Informa Financial Intelligence, a company that advises financial institutions and operates offices in 43 countries.

In fact, Fintech loans now comprise 38% of all unsecured personal loan balances, a larger market share than any of the more traditional institutions, the TransUnion report notes. Banks' market share has decreased from 40% in 2013 to 28% today, while credit unions' share has declined from 31% to 21% during the same time period, TransUnion says.

Fintechs are also gaining at the expense of the home-equity market, van Faassen maintains. "They're eating away at some of the balance that maybe historically was in home-equity loans," he says. While total debt is increasing, the amount that's in home equity loans is actually shrinking, he notes.

What's more, fintechs are changing the way Americans think about credit, van Faassen continues. Until recently, consumers experienced a two-step process. First, they identified a need or desire, like a washer and dryer or home renovation. Realizing they didn't have the cash to fund those dreams, they took the second step by approaching a financial institution for a loan.

If consumers chose a home equity line of credit to procure the cash, they had to wait for something like 40 days from the beginning of the application process to the time they got the money, van Faassen says. "You really had to be sure you wanted something," or the process wasn't worth the effort, he says.

Fintechs have removed a lot of the "pain" from that process, van Faassen says. With algorithms helping to assess the risk that an applicant can't or won't repay a debt and digitization easing access to financial records, fintechs can quickly evaluate and make a decision on an application. Tech also helps assess applicants with thin or nonexistent credit files, which broadens the clientele while also contributing to total consumer debt.

Meanwhile, mimicking an age old process in the car business, merchants are beginning to make credit available at the point of sale. Walmart, for example, recently signed a deal with Affirm, a Silicon Valley lender, to provide point-of-sale loans of three, six or 12 months to finance purchases ranging from \$150 to \$2,000. Shoppers apply for the loans by providing basic information on their mobile phones and don't have to talk to anyone in person about their finances. Affirm's CEO Max Levchin has called the underwriting process "basically instant."

If that convenience comes at too high a cost, it doesn't matter much because borrowers can later find another

finance vehicle with better terms, van Faassen says. "So if I get the money at the point of sale, which might have been zero for six months and then it steps up to 20-plus percent, there is no problem with refinancing that debt," he says.

But there's a downside to the ease of borrowing, van Faassen cautions. It could trigger the next recession, even though unemployment remains low. Despite modest recent gains, wages have remained nearly stagnant for years. That means an increase in interest rates could lessen consumers' ability to pay off their debts, he says.

Meanwhile, at least some large mortgage lenders have begun running into problems, a situation that bears an eerie resemblance to the beginning of the Great Recession that struck near the end of 2007, notes a report in luckbox magazine, a publication for investors. Stearns Holding, the parent of Sterns Lending, the nation's 20th largest mortgage lender, filed for bankruptcy protection just after the July 4 holiday, the luckbox article says.

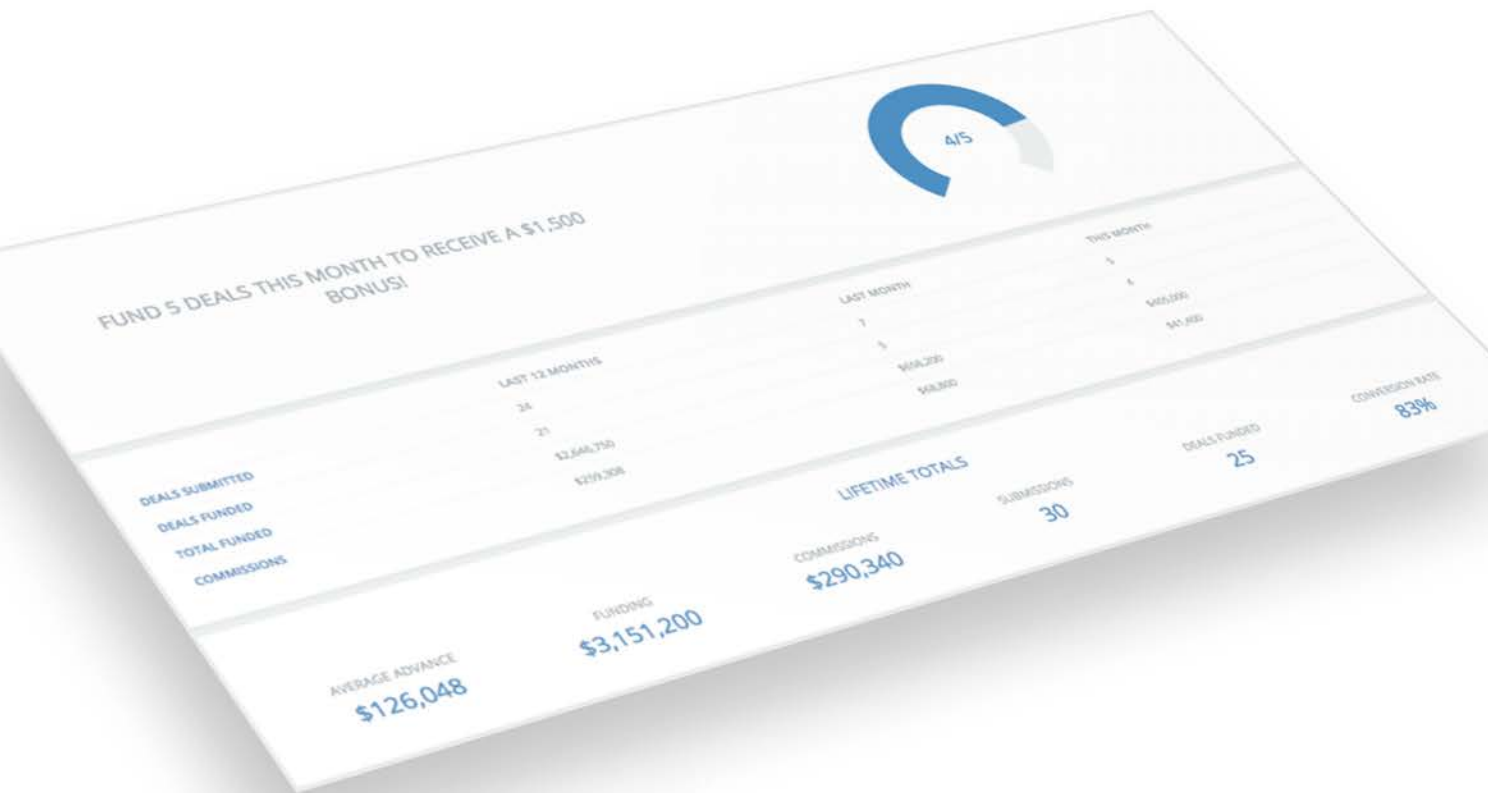
Another worrisome sign with regard to the possibility of recession is emerging as institutional investors buy into the peer to peer lending market. Institutional investors bought batches of sliced and diced home mortgage securities that helped bring about the Great Depression.

Then there's the nagging notion that the country and the world are becoming ripe for recession simply because no downturns have occurred for a while. Talk to that effect was circulating at the recent LendIt Conference, van Faassen observes. Fintech executives often come from the banking world and thus still find themselves haunted by the specter of the Great Recession. That's why they're already beginning to tighten underwriting for consumer credit van Faassen says.

One difference this time around lies in the fact that nothing about the increase in consumer debt appears to be hidden from public view, van Faassen says. Before, investors fell victim to the mistaken impression that risky mortgage-backed securities were rated AAA when they weren't.

Plus, the increase in peer-to-peer lending could keep the economy going even if big financial institutions freeze the way they did during the Great Recession, van Faassen notes. "Hopefully, with the new structures that are out there, we can keep liquidity going," he says.

That raises key questions for the alternative small-business funding community. The industry came into being partly as a response to banks' tightened lending



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policies during the Great Recession, so perhaps a downturn isn't such a bad thing for the sector. But a downturn for the economy in general could cripple merchants' ability to pay off debt.

But all bets are off during hard times. In the last recession the conventional wisdom that consumers make their mortgage payment before paying other bills was turned on its head. Instead of making the house payment—because foreclosure would take several months—people were choosing to make their car payments so they could get to work. Nobody really knows ahead of time what will happen in a recession, van Faassen notes.

After all, economics relies to at least some degree upon the often-irrational financial decisions of the general public. And science demonstrates that it's no easy task to convince consumers to handle their cash, credit and debt responsibly, says Mariel Beasley, principal at the Center for Advanced Hindsight at Duke University and Co-Director of the Common Cents Lab (CCL), which works to improve the financial behavior of low- to moderate-income households.

"For the last 30 years in the U.S. there has been a huge emphasis on increasing financial education, financial literacy," says Beasley. But it hasn't really worked. "Content-based financial education classes only accounted for .1 percent variation in financial behavior," she continues. "We like to joke that it's not zero but it's very, very close." And that's the average. Online and classroom financial education influenced lower-income people even less.

Lots of other factors influence financial behavior, Beasley notes. How much a person saves, for example, depends upon how much they make, what their bank tells them and what practices they encountered at home as children, she says. The CCL has been finding out some other things, too.

In one example of its findings, it discovered that putting an amount for a minimum payment on a credit card decreases how much consumers pay. That happens because listing a minimum payment amount creates an anchor, and borrowers adjust their payment upward from there, Beasley says. If the card carrier doesn't specify a minimum, consumers tend to adjust downward from the full amount they owe. "It turns out to be incredibly powerful," she contends.

It's the kind of problem that shows financial institutions haven't devised many systems to reduce

consumer debt by speeding up repayment, Beasley maintains. In this example, suggesting higher payments would prompt some consumers to pay off their debt more quickly.

In an exception to standard practice, a credit card company called Petal does exactly that by placing a slider on its website to help borrowers determine the amount of their payment, she notes.

Meanwhile, people tend to base financial decisions on the examples they see other people set, Beasley says. Problems arise with that tendency because they may see one neighbor spending money freely to dine in restaurants but don't see any of the many neighbors eating at home to save money. They see a neighbor driving a new car but don't know how much that neighbor is setting aside for retirement.

That's why most people overestimate how much others spend to dine out in restaurants, Beasley says. When shown the error, most reduce their own spending in restaurants, she notes, but within two weeks their behavior returns to its original level, their newfound knowledge "drowned out by the noise in the world," she says.

That's not good for consumers or small businesses, but help is on the way, according to John Thompson, chief program officer of the Financial Health Network, a national nonprofit research and consulting firm that works with financial institutions and other companies to improve consumer financial health.

As part of that mission, the Network has formulated procedures to assess the financial health of individuals and small businesses, Thompson says. It's too early to say whether the tool will help with loan underwriting, he notes, but financial wellness determines the ability to pay back debt, he notes.

The Network also publishes the U.S. Financial Health Pulse, which recently pronounced just 28% of Americans financially healthy, meaning that they have sufficient income, savings and planning to handle an unexpected expense and act on the decisions they make. About 55% are relegated to various stages of coping, and 17% find themselves in a vulnerable state.

So Americans aren't feeling financially secure, and they've borrowed \$4 trillion to reach that unenviable state. They're borrowing more and learning virtually nothing useful about their financial errors. Thompson has a way of summing up the situation. "It's crazy," he says.

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SNAPSHOT ON AUSTRALIA: GROWTH IN THE MAKING

By: Cheryl Winokur Munk



The Australian alternative lending market continues to gain momentum, bolstered in part by increased awareness, heightened competition and growing dissatisfaction with the status quo.

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Indeed, there's been significant growth in the few years since *deBanked* first wrote about the nascent alternative lending business down under. Notably, Australia's alternative funding volume surpassed \$1.14 billion in 2017, up 88 percent from \$609.59 million in 2016, according to the latest data available from KPMG research. It's the largest country in terms of total alternative finance market volume in the Asia Pacific region, excluding China, according to KPMG.

To be sure, the Australian market is still relatively small—at least compared with the U.S. Digging deeper, the largest share of market volume in 2017—the latest data available—came from balance sheet business lending, accounting for more than \$574 million, according to KPMG. P2P marketplace consumer lending had the second largest market volume at \$256 million. Invoice trading was the next largest segment of the Australian alternative finance market, accounting for \$142.65 million, according to the KPMG report.

Its small size notwithstanding, what makes the Australian market particularly interesting is the potential promise it holds for the companies already established there and the opportunities it may offer to new entrants that find ways to successfully compete in the market.

Certainly alternative lending opportunities in Australia are growing, as awareness increases and the desire by consumers and businesses for favorable rates and faster service intensifies. The Australian alternative lending market is similar to Canada in that a small number of large banks dominate the market both in terms of consumer lending and small business lending. But, like in Canada, alternative lenders are gaining ground amid a changing customer mindset that values speed, favorable rates and a digital experience.

Equifax estimates that alternative finance volume in Australia is now growing at about 10 percent to 15 percent per year; that compares to a decline of approximately 20 percent for some major traditional lenders in terms of credit growth, says Moses Samaha, executive general manager for Equifax in Sydney. This presents an opportunity for alternative lenders to serve parts of the market the banks don't want and those that are more attuned to a digital experience.

Even so, challenges persist. For instance, digital disruptors are still working on gaining brand awareness, and the market is only so big to be able to accommodate a certain number of alternative players. Time will tell whether there will be consolidation among alternative lenders and more bank partnerships, which haven't been so successful to date. "It doesn't feel like they are as active

as they were announced to be," Samaha says.

At present, the Australian market consists of a few dozen alternative lenders pitted against four major banks. RateSetter, SocietyOne and Wisr are among the largest alternative players in the consumer lending space. On the small business side, Capify, GetCapital, Moula, OnDeck, Prosra and Spotcap are some of the leading companies. PayPal Working Capital also has a growing presence in the Australian small business lending market.

New lenders continue to eye the Australian market for entry, but it's not an easy market to crack, according to industry participants. The market consists of mostly home-grown players and that's not expected to change drastically. (Capify, OnDeck and Berlin-based Spotcap are notable exceptions. Another U.S. major player, Kabbage, previously provided its technology to Australia's Kikka Capital, but that agreement is no longer in force.)

There can be a steep learning curve when it comes to outsiders doing business in Australia. What's more, there's no longer the first-to-market advantage that existed a decade or so ago. It's also a relatively limited market in terms of size, which can be off-putting. Australia has a population of around 25 million, making it less populated than the state of California, with an estimated 39.9 million residents.

Still, for alternative players that are able to successfully navigate the challenges the Australian market presents, there's ample opportunity to grab market share away from traditional players—similar to the pattern that's emerged elsewhere around the globe.

Take consumer lending, for example. The unsecured consumer lending market in Australia sits at about \$70 billion, with the large banks occupying maybe a 90 percent share of that, says Mathew Lu, chief operating officer of Wisr (previously known as DirectMoney Limited). Compared with other markets such as U.K. and the U.S., who went through a similar journey around a decade ago, "Australia is probably three or four years into that same journey of growth. It's shifting and changing," he says.

Alternative lenders have made strides in undercutting the large banks by offering generally lower rates and typically faster loan times. Unfavorable press related to bank lending practices has also benefited alternative lenders. Lu refers to these conditions as "a perfect storm" for growth.

Wisr, for instance, saw loan origination volume spike 409 percent in fiscal year 2018. The company secured \$75 million in loan funding agreements last year and boasts more than 80,000 customers, according to a

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Marketplace lender, SocietyOne, which in March reached \$600 million in loan originations, is another example of an alternative lender that has benefited from the momentum. The company—celebrating its 7th anniversary this summer—is hoping to reach \$1 billion in loans by 2020, according to its website.

RateSetter—another major player in this space—has also experienced significant growth since launching in Australia in 2014, and is now funding over \$20 million in loans each month, according to its website. In April, the company soared past \$500 million in loans funded and in May it saw a record number of new investors register. The company has more than 15,000 registered investors by its own account.

One question for the future is whether the consumer alternative lending space in Australia will ultimately be too crowded amid a spate of new entrants. Wisr's Lu says "there's a big question mark" regarding how many alternative lenders the market can sustain. "Will there be a level of consolidation or amalgamation? These are questions ahead of us," he says.

For its part, alternative lending to small businesses is also a growing force within Australia.

As a testament to the development of this market, in June 2018, a group of Australia's leading online small business lenders released a Code of Lending Practice, a voluntary code designed to promote fair terms and customer protections. Currently, the Code only covers unsecured loans to small businesses. Signatories include Capify, GetCapital, Moula, OnDeck, Prosopa and Spotcap.

Capify—an early entrant to Australia—has been pursuing businesses there since 2008. The company, which integrated its U.S. business in 2017 to Strategic Funding Source (now called Kapitup) is now operating only in Australia and the U.K. In Australia, it has executed more than 7,500 business financing transactions for Australian businesses and has more than 50 staff members in its Australian offices.

The company recently closed a deal with Goldman Sachs for a \$95 million line of credit for growth in Australia and the U.K., which includes building out its broker program to increase distribution and technology investment.

David Goldin, the company's chief executive, says Capify is hoping to grow its Australian business between 25 percent and 30 percent in 2019. The company is looking at M&A activity as well as organic growth.

Since Capify has been in the market, he has seen a number of new entrants—some more successful than others. One concern Goldin has is the lack of experience by some of these competitors. Many aren't pricing the risk properly and not underwriting prudently to be able to weather a downturn, he says. They are so new, he questions whether they have the expertise to be able to survive a downturn given what he characterizes as pricing and underwriting missteps.

"You can't go out 24 months on a 1.25 factor rate—that's crazy," he says, referring to some contracts he's seen. "I've seen this movie in the U.S. before and it doesn't end well."

Meanwhile, competition has driven down prices and made moving quickly on potential leads more of a necessity. When leads come in today, if you're not on the phone in 30 minutes, you could lose it to a

competitor, he says.

While the small

business market is an enticing one for alternative lenders, raising awareness of their offerings continues to be a challenge.

"The small business market is fragmented and raising awareness is expensive," says Beau Bertoli, co-founder and co-chief executive of Prosopa, another prominent small business lender in Australia. "There hasn't been much innovation in small business banking, but many Australians still don't think of switching from banks and traditional lenders," he says.

That said, more small businesses are turning to alternative lenders and these companies say they expect growth to increase over time. Recent research commissioned by OnDeck found that 22 percent of small

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and medium-sized businesses would consider an online lender, up from 11 percent in the past. This could be buoyed further by the introduction of Open Banking in Australia, which was set to be introduced in Australia in 2019, but this was pushed back to early 2020.

“We look forward to the introduction of Open Banking in Australia as it should allow lenders to use incremental data points to improve risk modeling, and increase competition in the SME lending space, ultimately providing SMEs with improved access to cashflow solutions to grow and run their businesses,” says Cameron Poolman, chief executive of OnDeck in Australia.

Bertoli of Prospa, which recently listed on the Australian Stock Exchange, says the Australian alternative lending market will also benefit from strong support from industry and government to increase competition and improve consumer and small business outcomes. The

government recently established a \$2 billion Australian Business Securitisation Fund, which is a huge win for small business, he says, that will ultimately make the finance available to small business owners more affordable by lowering the wholesale cost of funds for alternative lenders. “We expect this will boost credibility and consideration of alternative lenders among small business owners,” he says.

Declining property values is another factor helping alternative lending. “In November 2018 we saw the largest annual fall in property prices in Australia since the global financial crisis in 2009,” says Simon Keast, managing director of Spotcap Australia and New Zealand.

“As property prices decline, business owners find it more difficult to use their home as loan security and as such, turn to alternative lenders such as Spotcap that can provide them with unsecured loans for their business,” he says. What’s more, the SME Growth Index in March showed for the first time that business owners are almost as likely to turn to an alternative lender as they are to their main bank to fund growth, says.

Overall, the market opportunity for alternative lending to small businesses is compelling, says Bertoli of Prospa. “We estimate the potential market for small business lending in Australia is more than \$20 billion per annum and we’ve penetrated only about 2 percent of the market so far. There are 2.3 million small businesses in Australia, and they’re crying out for capital,” he says.

Keast of Spotcap says he expects to see more banks and non-financial enterprises looking to leverage the technology fintech lenders have built to provide swift and digital lending products to small businesses. He offers the example of a partnership Spotcap, a German-based company, has with an Austrian Bank to provide same-day finance to SMEs in Austria as an example of the types of partnerships the company could also seek in Australia. “We have already partnered with an Austrian Bank that is leveraging our lending platform to provide same-day finance to SMEs in Austria, and there is plenty of interest for similar partnerships on the ground here,” he says.

OnDeck, meanwhile, expects to see a shake-out within the alternative finance sector, which will result in a smaller number of bigger players, with the ability to scale and serve multiple customers with a variety of products, according to Poolman, the company’s chief executive.

For his part, Goldin of Capify is bullish on the Australian small business market, but he cautions others that it’s not a gold rush type of place where everyone who comes in can make money.

“The state of California has more opportunity than the entire continent of Australia,” he says.



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GOLD RUSH:

MERCHANT CASH ADVANCES ARE STILL HOT

By: Paul Sweeney

Last year, when Kevin Frederick struck out on his own to form his own catering company in Annapolis, the veteran caterer knew that he'd need a food trailer for his business to succeed.

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He reckoned that he had a good case for a \$50,000 small-business loan. The Annapolis-based entrepreneur boasted stellar personal credit, \$30,000 in the bank, and a track record that included 35 years of experience in his chosen profession. More impressively, his newly minted company—Chesapeake Celebration Catering—was on a trajectory to haul in \$350,000 in revenues over just eight months of operations in 2018. And, after paying himself a salary, he cleared \$60,000 in pre-tax profit.

But Frederick's business-credit profile was so thin that no bank or business funder would talk to him. So woeful was his lack of business credit, Frederick reports, that his only financing option was paying a broker a \$2,000 finder's fee for a high-interest loan.

Luckily, he says, everything changed when he discovered Nav, an online, credit-data aggregator and financial matchmaker.

Based in Utah, Nav had him spiff up his business credit with Dun & Bradstreet, a top rating agency and a Nav business partner. This was accomplished with a bankcard issued to Frederick's business by megabank J.P. Morgan Chase. Soon afterward, he says, Nav steered him to Kapitus (formerly Strategic Funding Source), a New York-based lender and merchant cash advance firm that provided some \$23,000 in funding.

"They led me in the right direction," Frederick says of Nav. "A lady there (at Nav) helped me with my credit, warning me that the credit card I'd been using had an effect on my personal credit. Then she led me to Kapitus, all probably within a week."

Now, Frederick has his food trailer. He reports that its total cost—\$14,000 for the trailer, which came "with a concession window, mill-finished walls, and flooring" plus \$43,000 in renovations—amounted to \$57,000. Equipped with a full kitchen—including refrigeration, sinks, ovens, and a stove—the food trailer can be towed to weddings, reunions, and the myriad parties he caters in the Delmarva Peninsula. In addition, Frederick can also park the trailer at fairgrounds and serve seafood, barbeque, and other viands to the lucrative festival market.

Meanwhile, the caterer's funders are happy to have him as their new customer. The people at Kapitus, to whom he is making daily payments (not counting weekends and holidays), are especially grateful. "Nav provides a valuable service," says Seth Broman, vice-president of business development at Kapitus. "They know how to turn coal into diamonds,"

Nav does not charge small businesses for its services. As it gathers data from credit reporting services with which

it has partnerships—Experian, TransUnion, Dun and Bradstreet, Equifax—and employs additional metrics, such as cashflow gleaned from an entrepreneur's bank accounts, Nav earns fees from credit card issuers, lenders and MCA firms.

The company has close ties to financial technology companies that include Kabbage and OnDeck, and also collaborates with MCA funders such as National Funding, Rapid Finance, FundBox, and Kapitus. "We give lenders and funders better-qualified merchants at a lower cost of client acquisition," says Caton Hanson, Nav's general counsel and co-founder, adding: "They don't have to spend as much money on leads."

As banks have increasingly shunned small-business lending in the decade since the financial crisis, and as the economy has snapped back with a prolonged recovery, alternative funders—particularly unlicensed companies offering lightly regulated, high-cost merchant cash advances (MCAs)—have been piling into the business.

And service companies like Nav—which is funded by nearly \$100 million in venture capital and which reports aiding more than 500,000 small businesses since it was founded in 2012—are thriving alongside the booming alternative-funding industry.

Over the past five years, the MCA industry's financings have been growing by 20% annually, according to 2016 projections by Bryant Park Capital, a Manhattan-based, boutique investment bank. BPC's specialty finance division handles mergers and acquisitions as well as debt-and-equity capital raising across multiple industries and is one of the few Wall Street firms with an MCA-industry practice. By BPC's estimates, the MCA industry will have more than doubled its small business funding to \$19.2 billion by year-end 2019, up from \$8.6 billion in 2014.

Bankrolled by a broad assortment of hedge funds, private equity firms, family offices, and assorted multimillionaire and billionaire investors on the *qui vive* for outsized returns on their liquid assets, the MCA industry promises a 20%-80% profit rate, reports David Roitblat, president of Better Accounting Solutions, a New York accountancy specializing in the MCA industry. Based on doing the books for some 30 MCA firms, Roitblat reports that the range in profit margins depends on the terms of contracts and a funder's underwriting skills.

The numerical size and growth of the MCA industry is hard to ascertain, reports Sean Murray, editor of deBanked (this publication), which tracks trends in the industry and sponsors several major conferences. "So much is anecdotal," Murray says.

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Even so, the evidence that MCA companies are proliferating—and prospering—is undeniable. Over the past two years, deBanked's events, which experience substantial attendance from the MCA industry, have consistently sold out, requiring the events to be moved to larger venues. In Miami, attendance in January this year topped 400-plus attendees, Murray reports, roughly double the crowd that packed the Gale Hotel in 2018.

Similarly, the May, 2019, Broker Fair in New York at the Roosevelt Hotel drew more than 700 participants compared with the sellout crowd of roughly 400 last year in Brooklyn. (Despite ample notice that this year's Broker Fair at the Roosevelt was sold out and advance tickets were required, as many as 40-50 latecomers sought entry and, unfortunately, had to be turned away.)

industry over the past few decades.

As scientists searched for biologics to battle diseases like cancer and AIDS, the Boston-area company began producing experimental animals known as “transgenic mice.” Informally known as “smart mice,” Charles River's test animals are specially designed to carry human genes, aiding investigators in their understanding of gene function and genetic responses to diseases and therapeutic interventions. (The smart mouse's antibodies can also be harvested. “Seven out of the eleven monoclonal antibody drugs approved by the Food and Drug Administration between 2006 and 2011,” according to biotechnology.com, “were derived from transgenic mice.”)

In the MCA version of the gold rush, a bevy of law and accounting firms, debt-collection agencies and



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The upsurge of capital and the swelling number of entrants into the MCA business has all the earmarks of a gold rush. “Everybody and his brother is trying to get a piece of the action,” asserts Roitblat, the New York accountant.

And there are two ways to hit paydirt in a gold rush. One way is to prospect for gold. But another way is to sell picks and shovels, tents, food, and supplies to the prospectors. “If you can find a way to service the gold rush, you can make a lot of money,” says Kathryn Rudie Harrigan, a management professor and business-strategy expert at the Columbia University Graduate School of Business. “It's like profiteering in wartime.”

As Professor Harrigan suggests, cashing in on the gold rush by servicing it has parallels across multiple industries. Consider the case of Charles River Laboratories, which has capitalized on the rapid development of the biotechnology

credit-approval firms, among other service providers, have either sprung to life to undergird the new breed of alternative funder or added expertise to suit the industry's wants and needs. (This cohort has been joined, moreover, by a superstructure of Washington, D.C.-based trade associations and lobbyists that have been growing like expansion teams in a professional sports league. But their story will have to wait for another day.)

Rather than being exploitative, supporting companies serve as a vital mainstay in an industry's ecosystem, notes Alfred Watkins, a former World Bank economist and Washington, D.C.-based consultant: “A gold miner can't mine,” he says, “unless he has a tent and a pickaxe.”

And in the high-risk, high-reward MCA industry, which can have significant default rates depending on the risk model, many funders can't fund if they don't have reliable debt collection. Many of the bigger companies, says Paul



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Boxer, who works on the funding side of the industry, have the capability of collecting on their own. But for many others—particularly the smaller players in the industry—it's necessary to hire an outside firm.

One of the more widely known collectors for the MCA industry is Kearns, Brinen & Monaghan where Mark LeFevre is president and chief executive. The Dover (Del.)-based firm, LeFevre says, first added MCA funders to its client roster in 2012; but it has only been since 2014 that “business really took off.”

LeFevre won't say just how many MCA firms have contracted with him, but he estimates that his firm has scaled up its staff 35%-40% over the past five years to meet the additional MCA workload. The industry, LeFevre adds, “is one of the top-growth industries I've seen in the 36 years that I've been in business.”

He also says, “People in the MCA industry know a lot about where to put money, but collections are not one of their strong points. They need to get a professional. It gives them the free time to make more money while we go in behind them and collect.”

If repeated dunning fails to elicit a satisfactory response, KBM has several collection strategies that strengthen its hand. The big three, LeFevre says, are “negotiation, identifying assets, and litigation.” He adds: “We have a huge database of attorneys who do nothing but file suit on commercial debt internationally. Then we can enforce a judgment. You don't want someone who just makes a few phone calls.”

Because business has become so competitive, LeFevre

says, he won't discuss his fee schedule. As to KBM's success rate, he says no tidy figure is available either, but asserts: “Our checks sent to our clients are more than most agencies because of our proprietary collection process.”

Jordan Fein, chief executive at Greenbox Capital in Miami and a KBM client told deBanked: “We work with them. They're organized and communicate well and they know to collect. They're on the expensive side, though. I've got other agencies that I use that are cheaper.”

Debt-collection firm Merel Corp, a spinoff from the Tamir Law Group in New York, might be a lower-cost alternative. Formed in just the past 18 months to service the growing MCA industry, Merel typically takes 15%-25% of whatever “obligation” it can collect, says Levi Ainsworth, co-chief operating officer.

A successful collection, Ainsworth asserts, really begins with the underwriting process and attention to detail by the funders. “Instead of coming in at the end,” he says, “we try to prevent problems at the start of the process.”

For an MCA firm dealing with an excessive number of defaults, Merel sometimes places one of its employees with the funder to handle “pre-defaults,” for which it charges a lower fee. The collections firm has also built a reputation for not relying on a “confession of judgment.” Now that COJs have been outlawed for out-of-state collections in New York State, Merel's skills could be more in demand.

Better Accounting Solutions, which has its offices on Wall Street, is another service-provider promising to lighten the workload of MCA firms by providing back-office support. The company is headed by Roitblat, a 36-year-old





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former rabbinical student turned tax-and-accounting entrepreneur. Since he founded the company with two part-time employees in 2011, it's ballooned to some 70 employees.

Roitblat does not have all of his firm's eggs in one MCA basket. His firm handles tax, accounting and bookkeeping work for law firms, the fashion industry, restaurants and architectural firms. Even so, he says, thirty MCA clients—or more than half his clientele—rely on the firm's expertise, three of whom were just added in June. His best month was January, 2018, when six funders contracted for his services. "Growth in the MCA industry has been explosive," he says.

MCA accounting work has its own vagaries and oddities. For example, because of the industry's high default rate, Roitblat notes, a 10%-slice of every merchant's payment is funneled into a "default reserve account." And when an actual default occurs, credits are moved from the receivables account to the default reserve account.

Roitblat takes pride that his firm's MCA work has passed audits from respected accounting firms like Friedman, Cohen, Taubman and Marcum LLP. Moreover, he has helped clients uncover internal fraud and, in one instance, spotted costly flaws in a business model. An early MCA client, Roitblat says, had no idea that "he was losing close to \$100,000 a month by spending on Google ads."

Better Accounting also keeps its rates low. The firm typically assigns a junior accountant to handle clients' accounts while a senior manager oversees his or her work. "He (Roitblat) does a fantastic job," says David Lax, managing partner of Orange Advance, a Lakewood (N.J.)-based MCA firm. "They understand the MCA business. And even if your business is small, they can set up the infrastructure and do the work more economically and efficiently than you can. You'd have to create the position of comptroller or senior-level accountant," Lax adds, "to equal their work."

Top-notch competence and low rates, Lax says, are not the only reasons he often refers Roitblat's firm to fellow MCA companies. "The only thing better than their work," he says, "is the people themselves."

Whether it's oil and gas, banking and real estate, construction, health care or high-technology—you name it—lawyers have an important role across nearly every industry. So too with the MCA industry where, as has been shown, there is an especially high demand for attorneys skilled at winning debt-collection cases.

To hear Greenbox's Fein tell it, a skilled lawyer handling debt collection can write his or her own ticket. A talented

attorney, he says, not only retrieves lost money and prevents losses, but enables the funder to "offer the product cheaper than the competition."

"We use a ton of attorneys in 35 states in the U.S. and in Canada," Fein adds, "and you have no idea how many attorneys we go through until we find a good one."

Until recently, much of the MCA industry's success has resulted from a hands-off, *laissez faire* legal and regulatory environment—particularly the legal interpretation that a merchant cash advance is not a loan. The industry has also benefited from the fact that most credit regulation focused on consumer credit and not on business and commercial financings.

But now, as the MCA industry is maturing and showing up on the radar screens of state legislatures, Congress, regulatory agencies, and the courts, there is heightening demand for legal counsel. In just the past 12 months, California passed a truth-in-lending statute requiring MCA firms not only to clearly state their terms, but to translate the short-term funding costs of MCAs into an annual percentage rate. The state of New York, as has been noted, passed legislation restricting the use of COJs.

Moreover, notes Mark Dabertin, special counsel at Pepper Hamilton, a top national law firm based in Philadelphia, the state of New Jersey is contemplating licensing MCA practitioners. The Minnesota Court of Appeals recently determined in *Anderson v. Koch* that, because of a "call provision" in a funding contract, a merchant cash advance was actually a loan.

And, Dabertin warns, the Federal Trade Commission, which has the authority to treat a merchant cash advance as a consumer transaction—replete with the full panoply of consumer disclosures and protections—is training its gunsights on the industry. "On May 23," Dabertin reports in a memo to clients, "the FTC launched an investigation into potentially unfair or deceptive practices in the small business financing industry, including by merchant cash advance providers."

These pressures from government and the courts will only make doing business more costly and drive up the industry's barriers to entry. Failing to stay legal, moreover, could not only result in punitive court judgments, but render an MCA firm vulnerable to legal action by their investors.

"It's inevitable that the industry will evolve," Dabertin says, and firms in the industry will have to self-police. "They will need to hire counsel and a compliance staff," he adds. "You can't just do it by the seat of your pants."

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INDUSTRY NEWS

5/21/19

Marqeta, a card issuing platform provider, raised \$260M in a Series E, valued at nearly \$2B

5/22/19

TransferWise, a money transfer business, became Britain's most valuable fintech company, valued at \$3.5B

5/23/19

BFS Capital and Mulligan Funding joined Innovative Lending Platform Association, a trade association of small business financing and service companies

Bloomberg News revealed that the Federal Trade Commission had opened an investigation into potentially unfair or deceptive practices in the merchant cash advance industry

5/28/19

Liquid FSI partnered with Stackfolio

UK-based Lendy, a property peer-to-peer lender, reportedly collapsed and was revealed to be under investigation by the Financial Conduct Authority

5/29/19

Global Payments and TSYS, two massive payments giants, agreed to a \$21.5B merger

SoFi announced it has closed a \$500M+ equity investment led by the Qatar Investment Authority

Funding Circle announced that it had moved to cap the pay of its CEO in light of disappointing company performance

ForwardLine Financial, a small business lender, secured \$100M senior credit facility with Credit Suisse AG, Cayman Islands Branch, and Neuberger Berman private equity funds

5/30/19

IOU Financial revealed that they had originated \$32.8M in loans in Q1

Home Capital Group Inc announced it was investing \$3M into Lendified to support the growth of small business in Canada

5/31/19

Coinbase President and Chief Operating Officer Asiff Hirji announced his resignation. Was replaced by Emilie Choi

6/3/19

Ebay partnered with Santander-backed app, Asto, to offer UK Ebay sellers loans

6/4/19

The UK's Financial Conduct Authority announced tougher rules for crowdfunding platforms

The SEC filed a lawsuit against Kik, an instant messaging app company with nearly half a billion users, for raising money via an Initial Coin Offering

6/6/19

JP Morgan scrapped its mobile banking app, Finn

6/10/19

Alexandra Shapiro joined Lending Club as Chief Marketing Officer

CNBC revealed that Uber was expanding its financial services efforts by hiring dozens of engineers and product managers in New York

Amazon announced the launch of Amazon Credit Builder, a new secured credit card in partnership with Synchro Bank

Student loan startup Splash Financial raised \$4.3M

6/11/19

JP Morgan announced an investment of \$1.6M to the non-profit Accion

6/12/19

Reliant Funding CEO Adam Stettner won EY's Entrepreneur of the Year Award in the business services category for San Diego

KKR bought the publisher of Business Insider for \$7.7B

6/16/19

American Banker revealed that both Google and PayPal considered applying for the new OCC fintech charter but decided not to move forward

6/17/19

Idea Financial, a small business lender, announced a \$70M warehouse credit facility with Cross River Bank

6/18/19

Facebook unveiled its own cryptocurrency plans called Libra
Plaid co-founder William Hockey stepped down

Direct Lending Investments, a defunct online lending hedge fund, consented to judgment by the SEC

6/20/19

Lawmakers reacted negatively to Facebook's cryptocurrency plans and called for a US Senate hearing

Maine passed a law to license and regulate student loan servicers

6/21/19

Lending Club made its 3 millionth loan

6/24/19

Cross River Bank acquired business banking company Seed

6/25/19

Ocrolus raised \$24M

6/26/19

Square announced that users of Cash App could begin depositing Bitcoin to their accounts

6/28/19

Expansion Capital Group announced Herk Christie as new COO

Lendio moved its headquarters from South Jordan to Lehi, UT

7/2/19

Funding Circle halved its revenue growth guidance as demand fell
Kabbage secured \$200M in the form of a revolving credit facility

7/8/19

Ascentium Capital, a leasing company and small business lender, reported \$394.6M funded in Q2

7/9/19

Reliant Funding announced Gianna Ravenscroft as General Counsel

BlueVine surpassed \$2B in total funded volume since inception

7/10/19

Forbes revealed that Mike Cagney's blockchain startup, Figure, is issuing \$85M in loans per month

7/11/19

The Dow Jones and S&P 500 hit new record highs, at 27,088 and 3,000 respectively

7/12/19

Whitepages Pro spun off from its Whitepages.com operations and rebranded to Ekata

7/15/19

Lendbuzz, an AI auto startup, raised \$150M. \$130M was debt financing and the remaining portion was an equity investment led by 83North

7/16/19

SumUp Inc, a UK payments startup, secured a \$371M loan from Bain Capital Credit, Goldman Sachs Private Capital and others

First Associates closed an investment round with Stone Point Capital and merged operations with Portfolio Financial Servicing Company

Billie, a Berlin-based fintech company that does B2B invoicing and payments, raised \$33.5M in Series B funding led by Creandum

Cross River Bank announced Melissa Ballenger as CFO

7/17/19

SecurCapital acquired Breakout Capital Finance's lending business

7/18/19

Expansion Capital Group announced Jason Gross as Director of Marketing

SPOTLIGHT ON DEBANKED CONNECT TORONTO

By: Brendan Garrett

deBanked CONNECT Toronto



As the heat of the Toronto sun split the stones outside, the crowd inside the Omni King Edward's seventeenth-floor Crystal Ballroom mingled and munched as part of deBanked's most recent CONNECT event.

The first of its kind to be held in Toronto, the CONNECT series are half-day events that take place in both San Diego and Miami as well. Despite not being

as established as the latter two, Toronto proved just as eventful, with a variety of speakers and topics broached, as well as a host of attendees from differing backgrounds making an appearance. It was par for the course for an inaugural deBanked show with the attendance figures being reminiscent of deBanked's first ever event in the USA, a market that's 10x the size.

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The day was kicked off by entrepreneur, a dragon on the *Canadian Dragons' Den* series, and co-founder of Clearbanc, Michele Romanow, whose anecdotes detailed the adventures that accompany the beginning of a startup. Regaling the audience with the story of Evandale Caviar, Romanow began with telling the room of a post-college venture that saw her working tooth and nail to secure a fishing license, studying YouTube fish gutting tutorials that were exclusively in Russian, and getting her hands dirty with the other co-founders when the time came to put their time spent online to use.

But it wasn't all blood and glory for Romanow, as the tale shifted from one of youthful expansion to one of reflection and acceptance of the unknown. Speaking





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on the effect of tech giants in various fields, Romanow explained that “we have no idea of how these industries will shape out.” The likes of Uber and AirBnb never planned change the world, just to change a product and thus solve a problem, and their meteoric rises are unpredictable as a result. Iteration, rather than innovation, is what drives a company forward according to Romanow.

And this sentiment was brought further along with the following panel, which featured Vlad Sherbatov of Smarter Loans, Paul Pitcher of SharpShooter Funding, and SEO expert Paul Teitelman, speaking on the trials and novelties of the sales and marketing scene. Offering wisdom on various aspects of the field, the three men covered the need to go beyond the traditional forms of advertising,





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instead looking outward towards unorthodox methods of marketing; the hardships that come with the grind of a sales job; and the role that SEO can play when raising public awareness of your company; respectively.

“It’s a matter of spreading the word,” one conference goer noted when asked about the sales panel afterwards. “Businesses have to know who we are, and we’re working on that.”

Similarly, Martin Fingerhut and Adam Atlas discussed the existing legal topics of note to Canadian alternative financing companies, as well as those incoming rulings that may be worth knowing about. Covering both the English-speaking provinces and Quebec, the duo gave a comprehensive crash course

on the legal landscape of the industry, highlighting laws unique to the regions. Aaron Iannello of Top Funding considered the talk to be particularly engaging, commending it for relaying information that might otherwise be unknown to American companies.

Following this, Kevin Clark, President of Lendified, took to the stage to talk about the importance of the Canadian Lenders Association (CLA). Saying that in the absence of a regulatory body, the CLA seeks to offer guidance to those companies who are looking for it. Clark asserted that “it’s a good thing for our industry to have oversight from a regularly body,” and that he looks forward to the day when one is established.





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And before wrapping up the speakers for the day, Clark was joined by IOU Financial's President, Robert Gloer, to discuss contemporary risk management. Covering everything from the next recession to the emergence of AI, the pair, which accumulatively have been in the industry for decades, offered knowledge learnt from years of experience in both the pre- and post-crash eras.

And the prophesizing of what will be the next big episode to shake the industry continued beyond the day's scheduled agenda as many attendees continued on well into the evening at smaller networking functions offsite.

As the sun started to touchdown on the tips of Toronto's skyscrapers, the salvo of excited conversation briefly harmonized to produce a singular axiom, that there was an abundance of opportunity in Canada.





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