deBanked
March/April 2019

SO GOD MADE A FARMER, BUT WHO'S FINANCING THE FARMS?

Does Your Merchant Cash Advance Company Pass The Scrutiny Test?
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Letter From the Editor

BY
SEAN MURRAY

So God made a farmer, but who's financing the farms? Farmers, an expert says, enjoy abundant long-term credit to buy big-ticket assets, such as land and heavy machinery, but they're struggling to find sources of short-term credit for operating expenses like labor, repairs, fuel, seed, feed, fertilizer, herbicides and pesticides. In this issue we explore who is willing to get their overalls dirty in the underwriting process and what opportunities lurk in the lands outside the urban jungle.

But if underwriting farms would make you feel like a chicken running around with its head cut off, perhaps this issue can at least help you get your ducks in a row. If you're engaged in the merchant cash advance business, we've provided some helpful insight to determine whether or not your company can withstand scrutiny. Today's political climate suggests that if you're operating hog wild and your compliance is a pig sty, that you might just end up reaping what you sow and be put out to pasture.

Meanwhile, developments in online lending are sorting the wheat from the chaff. Companies like Square, PayPal, and Fundation are entirely changing the game. Institutionalization is pushing out smaller players, says one expert. Lenders that can't scale efficiently or quickly may find that it's time to hit the hay while the competition continues to originate until the cows come home.

But finance is a tricky business, always has been, so don't count your chickens before they hatch or put your eggs all in one basket, because we're certain there will be plenty more chances to grow, succeed, and sow your wild oats. Opportunity need not be like looking for a needle in a haystack. Opportunity might just be found in some of the pages of our magazine.

E-I-E-I-O!

–Sean Murray

SO GOD MADE A FARMER, BUT WHO'S FINANCING THE FARMS?

By: ED MCKINLEY

Most mornings, farmers and ranchers wake up worrying about uncooperative weather and volatile commodity prices. Just the same, they pull themselves out of bed to spend the morning tinkering with crotchety machinery or wrangling uncooperative livestock. When they break for lunch, the kitchen radio alerts them to trade wars with distant countries and the unintended results of federal regulation. As they make their way back outdoors for the afternoon's work, they can't help but notice another new house taking shape in the distance as suburban sprawl encroaches on the fields and pastures. By evening, their thoughts have turned to their need for short-term capital

and how the local banker seems increasingly wary of providing funds.

It's that last challenge where the alternative small-business funding industry might be able to help, says Peter Martin, a principal at K-Coe Isom, an accounting and consulting firm focused on the ag industry. "If you as a farmer needing operating funds and you can't get them from a bank, you don't have a lot of options," he says. "Historically, nobody outside of banks has had much interest in lending operating money to a farmer."

The result of that reluctance to provide funding? "I can't tell you the number of calls I get to say, 'Hey, I need

$100,000 and I need it in a couple of days because of X, Y, Z that's come up,'" says Martin. "We don't have a place that we can send those people to. You could make a lot of quick turnaround loans in rural America." What's more, it's a potential clientele that makes a lot of money and prides itself on paying back what they owe.

Martin's not alone in that assessment. While farmers enjoy abundant long-term credit to buy big-ticket assets, such as land and heavy machinery, they're struggling to find sources of short-term credit for operating expenses like labor, repairs, fuel, seed, feed, fertilizer, herbicides and pesticides, notes Mike Gunderson, Purdue University professor of agricultural economics.

But remember that nobody's saying it would be easy for alt funders to break into the agricultural sector. City folks accustomed to the fast-paced rhythms of New York or San Diego would have to learn a whole new seasonal business cycle. Grain farmers, for example, plant corn and soybeans in April, harvest their crops September or October, and may not sell the grain until the following January, says Nick Stokes, managing director of Conterra Asset Management, an alternative-funding company that places and services rural real estate loans.

That seasonality results in revenue droughts punctuated by floods of revenue – a circumstance far-removed from the more-consistent credit card receipt split that launched the alternative small-business funding industry. Alternative funders seeking customers with consistent monthly cash flow won't find them in the agricultural sector, Stokes cautions.

And while the unfamiliarity of farm life might begin with wild swings in cash flow, it doesn't end there. Operating in the agricultural sector would require urbanites to learn the somewhat alien culture of The Heartland – a way of life based on hard physical labor, the fickle whims of the weather, and friendly unhurried conversations, even with strangers.

Even so, the task of mastering the agricultural funding market isn't hopeless, and help's available. Experts in agricultural economics profess a willingness to help outsiders learn what they need to know to get involved. "Selfishly, the first place I'd love to have them reach out to is me," Martin says of alternative funders. "I've been writing and thinking for years about the importance of getting some non-traditional lenders into agriculture." He would have "no qualms" about featuring specific prospective funders in a column he writes for one of the nation's largest farm publications.

It also requires meet-and-greets. During the winter, when farmers aren't in the fields, funders could make connections at trade shows, Martin advises. "Word would get around rural America really quick," he predicts. Networking with advisers such as crop insurance agents, agronomists and ag CPS's – all of whom deal with farmers daily – would also help funders find their way in agriculture, he contends.

Investors who are curious about extending credit in the agricultural sector could rely upon Conterra to help them locate customers and help them service the loans, says Stokes. He can even help acclimate them to the world of agriculture. "If they're interested in investing in agricultural assets – whether that be equipment, real estate or providing operating capital – we would enjoy the opportunity to visit with them," he says.

GETTING STARTED

Alt funders could begin their introduction to the agrarian lifestyle by taking to heart a quotation attributed to President John F. Kennedy: "The farmer is the only man in our economy who buys everything at retail, sells everything at wholesale and pays the freight both ways."

"Agriculture is a very different animal," Martin notes. He sometimes presents a slide show to compare the difference between a typical farm and a typical manufacturer of the same size. At the factory, revenue ratchets up a bit each year and margins remain about the same over time. On the farm, revenue and margins both fluctuate wildly in huge peaks and valleys from one year to the next.

The volatility makes it difficult to manage the risk of lending, Martin admits, while noting that agriculturally oriented banks still have higher returns than non-ag banks, according to FDIC records. "You have to go back to 2006 to find a time when ag banks didn't outperform their peers on return on assets," he says. "What this tells us is that, generally speaking, ag borrowers are better at repaying their loans," he asserts. Charge-offs and delinquencies in ag portfolios are lower than in other industries, he says.

Many of the nation's farms have remained in the same family for more than a century – a stretch of time that's seldom seen in just about any other type of business. Besides making potential creditors comfortable that a particular operation will stay in business, the longevity of farms provides lots of documents to examine – not just tax records but also production history that's tracked by government agencies. A particular farmer's crop yields, for example, can be compared with county averages to calculate how good the borrower is at farming.

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Debt to asset ratio on the nation's farms stands at about 14 percent, which Martin views as "insanely low." But that's not the case on every farm. Highly leveraged farms have ratios of 60 percent or even 80 percent when farmers have grown their businesses quickly or encountered debt to buy land from their parents, he says. Commodity prices are low now, but farms with 14 percent debt to asset ratios still don't have a problem, even in hard times. Farmers deeply in debt, however, have little ability to climb out of the hole. The latter are using operating capital to fund losses.

Farmers with debt to asset ratios of 10 percent have little trouble finding credit and aren't going to pay anything other than bank rates, Martin says. The target audience for non-traditional funding are farmers who are having trouble but will be fine when commodity prices rebound. Another potential client for alternative finance would be farmers who are quickly increasing the size of their operations when opportunities arise to acquire land. Both groups need funders willing to contemplate the future instead of demanding a perfect track record, he maintains.

Farmers generally need loans for operating capital for about 18 months, according to Martin. "Let's say I borrow that money, get my crop in the ground, harvest that and I may not sell my grain right after harvest," he says. The whole cycle can easily take 18 months, he says. Shorter-term bridge lending opportunities also arise in situations like needing a little extra cash quickly at harvest time. Farmers usually have something to put up as collateral – like producing 50 titles to vehicles or offering up some real estate, he says.

An unsecured loan – even one with high double-digit interest – could succeed in agriculture because no one is offering that type of funding, Martin says. Small and medium-sized farms would probably benefit from funding of $100,000 or less, while larger farms might sign up for that amount but often require more, he notes.

LAY OF THE LAND

The Farm Credit System, a nationwide quasi-governmental network of borrower-owned lending institutions, provides more than a third of the credit granted in rural America. That comes to more than $304 billion annually in loans, leases and related services to farmers, ranchers, rural homeowners, aquatic producers, timber harvesters, agribusinesses, and agricultural and rural utility cooperatives, according to published reports.

Congress established the Farm Credit System in 1916, and the Farm Credit Administration was established in 1933 to provide regulatory oversight. "All they're doing is lending money to agriculture," says Martin.

However, the system can go astray in the eyes of some observers. An arm of the Farm Credit System called co-bank lends to co-operatives and other rural entities. At one point Verizon Wireless became a borrower from co-bank, which angered some observers because the system was supposed to be helping rural America, not corporate America, Martin says.

That anger arises partly because the federal government doesn't require Farm Credit to pay income tax, which enables it to lend at lower rates, Martin says. "Part of the allure of borrowing from Farm Credit is you can typically borrow cheaper," he notes. "You'd be very hard pressed to find a farmer who over the years hasn't had some interaction with Farm Credit."

> *AN UNSECURED LOAN—EVEN ONE WITH HIGH DOUBLE-DIGIT INTEREST —COULD SUCCEED IN AGRICULTURE BECAUSE NO ONE IS OFFERING THAT TYPE OF FUNDING...*

Observers sometimes fault the system for what they perceive as a tendency to extend credit only to those who don't really need it, notes Purdue's Gunderson. People working for the system believe they're doing a good job of supporting agriculture, he says, noting that the system is charged with the responsibility of helping new and young farmers.

Another entity, the Federal Agricultural Mortgage Corp., also known as Famer Mac, works with lending institutions to provide credit to the agricultural sector. It's a

publicly traded company that serves as a secondary market in agricultural loans, including mortgages. It purchases loans and sells instruments backed by those loans and was chartered in 1988. Conterra, the alternative-funding company mentioned earlier in this article, ¬works with Farmer Mac and financial institutions to make real estate loans to farmers and ranchers in financial distress. The loans are designed to help borrowers get back on their feet in three to five years so that they would then qualify for regular bank loans.

Then there are the ag lending divisions at the large banks such as Wells Fargo, Chase and the Bank of the West, Martin says. "Lots of these big national banks are doing at least some ag lending," he says. "Some, obviously, have bigger ag portfolios than others."

Some regional banks focus on agriculture, Martin continues. "When you get into the middle of the corn belt, there are going to be some regional banks where traditional ag lending's a huge part of what they do," he says.

Local banks in small towns get involved, too. "Most small community banks are going to have some kind of ag lending portfolio," Martin notes. Hometown bankers can provide operating capital to some farmers, but only to those who haven't experienced recent hiccups in revenue or expenses.

THE NON-BANKS

"Then you get into the non-bank lenders," Martin observes. "A really good example of this is John Deere," the tractor and equipment manufacturer. The company provides a tremendous amount of capital to rural America through equipment lending and also through other credit facilities, he says. In fact some observers estimate that John Deere is the largest lender to agriculture. Even so, the company usually doesn't provide enough non-equipment credit to become the only lender a farmer would use, he says.

The same holds true with other lenders to agriculture, Martin says. Co-operatives, for example, lend money to agriculture even though they're not banks. Typically, they begin by extending credit for products like seed, fertilizer or pesticides and then start making additional credit available to farms and ranches. In recent years, a large co-operative called CHS loaned hundreds of millions of dollars in addition to selling products on credit. Some large CHS loans went bad and caused a ripple effect throughout the cooperative structure, Martin maintains. Other co-ops have looked at CHS and wondered if they're moving too far outside their core competency. So now many co-ops are tying funding to products they're selling.

Some other non-bank lenders have shown up in agriculture, and they fall into two categories, Martin says. One group is making real estate loans in agriculture, so their loan programs are geared to farmers looking to buy land or anything that can be secured by land. Conterra and Ag America are examples. Farmer Mac lends a lot of money against farmland, as well. So farmers who have agricultural land have a lot of access to capital and a lot of lenders who want to provide it, he says.

The second group of non-bank lenders is providing operating capital. "That is a very, very small club," Martin says. "There's really not anybody doing this on a regular basis – with just one or two exceptions." Probably the biggest name among the exceptions is Ag Resource Management, usually known as ARM, he continues. ARM places a value on the potential productivity of a famer's land. Then it looks at the crop insurance the farmer's able to buy to protect the investment in that crop. ARM then lends part of the value of that crop insurance.

Let's say a farmer can grow $10 million worth of crops, according to ARM's projection," Martin says. "You can get crop insurance to cover 80 percent," he continues. "For a total crop failure, you will get $8 million for that crop." Using a formula based on type of crop, location and type of crop insurance, ARM will lend some amount less than $8 million. "Their collateral is pretty rock solid," Martin observes.

ARM uses a system to make sure farmers use the funds only for expenses related to growing the crop they're using as collateral. "Their risk of not getting a crop in the ground that qualifies for the insurance is next to nothing," Martin says. ARM offers differing interest rates, depending upon risk, in at least the high single digits or double digits, and they also charge fees. "So you're going to be paying a lot, but they are the lender of last resort in agriculture right now," he says, adding that ARM operates multiple offices has grown quickly.

Through lenders like ARM, the agricultural sector's becoming familiar with alternative finance. But much remains to be done if alt fin pioneers want to venture into the sector. Those who do will encounter a complicated credit landscape, but one that offers opportunities for anyone willing to learn about unfamiliar business cycles and lifestyles.

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DOES YOUR MERCHANT CASH ADVANCE COMPANY PASS THE SCRUTINY TEST?

By *CHERYL WINOKUR MUNK*

The merchant cash advance business has come under repeated fire of late from regulators, legislators and customers.

"Every aspect of the industry is under scrutiny right now. Syndication agreements, underwriting, and collections are the subject of bills in Congress and across multiple states," says Steven Zakharyayev, managing attorney for Empire Recovery Services in Manhattan, which offers debt recovery services to financial companies.

So how should funders respond amid these obstacles? Here are a few pointers to help funders succeed despite ongoing challenges from a legal, regulatory, business and public relations perspective:


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DIFFERENTIATE BETWEEN CASH ADVANCES AND LOANS AND MODEL BUSINESS DEALINGS ACCORDINGLY

In the eyes of the law, merchant cash advances and loans are very different. With a cash advance, a funder advances the merchant cash in exchange for a percentage of future sales, plus a fee. A loan, on the other hand, is a lump sum of cash in exchange for monthly payments over a set time period at an interest rate that can be fixed or variable. While the two types of funding options have certain similarities, funders have to be extremely careful to make appropriate distinctions in their business practices; otherwise legal trouble can easily ensue, experts say.

Most funders know that they are supposed to draw a bright line between merchant cash advance and lending, but it's critical they put this knowledge into practice. Funders have to ensure the distinction is evident in their business lexicon, says Gregory J. Nowak, a partner in the Philadelphia office of law firm Pepper Hamilton LLP who focuses on securities law.

For example, it's extraordinarily important that funders don't refer to merchant cash advances as loans in their business dealings. Business records, emails and other documents can be requested in litigation for discovery purposes. If the funder's internal documentation refers to cash advances as loans, it's going to be hard for the company to argue that they aren't, in reality, loans.

"Most judges want to see consistency of treatment and that includes your vocabulary," Nowak says. "The word 'loan' should be banned from their email and Word files."

There's a fair amount of litigation surrounding what is and what isn't a cash advance. This can be helpful guidance for funders in setting out the criteria they need to follow to be able to defend their activities as cash advances. Even so, the line is somewhat of a moving target and funders need to be stalwart in these efforts given heightened regulatory scrutiny, experts say.

"If it looks like a loan, the law will treat it as a loan—and all the consequences that follow such a determination," says Christopher K. Odinet, an associate professor of law at the University of Oklahoma College of Law.

BE CAREFUL ABOUT YOUR COLLECTION POLICIES

Obviously companies want to collect their payments. But some funders are too quick to file lawsuits, which could lead to unwanted trouble, says Paul A. Rianda, who heads a law firm in Irvine, Calif.

"The business model of sue first, ask questions later can be a problem," says Rianda, whose clients include merchant cash advance companies.

The concern is that when funders sue, merchants start talking to attorneys and that could open the MCA firm to other types of lawsuits. The more a funder sues, the more it increases media attention and invites examination by state regulators and others. "You invite class action lawsuits and regulatory scrutiny that you really don't want. It's a boomerang thing," he says.

The issue is especially pertinent now as legislators grapple with how to handle the thorny issue of confessions of judgement, more popularly known as COJs. For instance, since the start of the year, New York courts and county clerks have become much more rigid in processing confessions of judgments.

Certainly, not all funders use COJs. Just recently, for instance, Greenbox Capital suspended the use of COJs indefinitely, in response to the heightened industrywide debate over their use. While there's no all-encompassing directive to stop using COJs, experts say it is incumbent upon funders to ensure they are used in a responsible and proper manner, especially amid political and regulatory uncertainty.

For instance, it would be irresponsible and potentially actionable to execute on a COJ simply because the merchant doesn't remit receivables the merchant cash advance company purchased because he didn't generate receivables, says Catherine M. Brennan, a partner at the law firm Hudson Cook LLP in Hanover, Maryland.

To be lawful, the COJ has to be based on a breach of performance under the agreement. Fraud, for instance, is actionable. But simple failure to remit receivables because the business has failed is not, she says.

"Conflating those two things—breaches of repayment versus performance—leads to a world of hurt," she says. "MCA transactions do not have repayment as a concept."

In places like New York, where COJs are more controversial, funders have to be especially careful about using them properly, experts say. Even though COJs are still enforceable under New York law for the time being, funders should understand every county processes them a bit differently, says Zakharyayev of Empire Recovery Services. "If they have a preferred county for filing, they should ensure their COJs are not only compliant with state law, but also complies with local rules," he says.

What's more, funders should ensure their COJs are properly notarized under New York law, ensure party names and the amount confessed is accurate, and avoid blanket statements such as naming each and every county in New York as a possible venue for filing, he says.

While some funders have suggested changing their venue provisions to a COJ-friendly state if New York outlaws COJs, Zakharyayev says he recommend New York funders keep their venue in New York regardless since it would still be one of the most efficient states to enforce a judgment. "I've filed COJs outside of New York and, even without a COJ, New York is much more efficient in judgment enforcement as New York courts are less

restrictive in allowing the judgment creditor to pursue the debtor's assets," he says.

BE CAREFUL WHEN RAISING THIRD-PARTY MONEY

Aside from their dealings with merchants, funders also have to be cautious when it comes to interactions with potential investors.

Some companies have ample balance sheets and don't need money from third-parties to fund their operations. But funders that decide for business purposes to solicit money from investors, have to be careful not to run afoul of SEC rules, says Nowak, the attorney with Pepper Hamilton.

He recommends funders treat these fundraising efforts as if they are issuing securities and follow the rules accordingly. Otherwise they risk being the subject of an enforcement action where the SEC alleges they are raising money using unregulated securities. "You need to be very careful here because these rules are unforgiving. You can't ignore them," Nowak says.

TACKLE ACCOUNTING CHALLENGES

Accounting is another business challenge many funders face. Some have fancy customer relationship management systems, but the systems aren't always set up to provide the detailed information the accounting department's needs to effectively reconcile the firm's books, says Yoel Wagschal, a certified public accountant in Monroe, New York, who represents a number of funders and serves as chief financial officer at Last Chance Funding, a merchant cash advance provider.

Ideally, a funder's CRM and accounting systems should be integrated so both sales and accounting receive the relevant data without the need for either department to input duplicate data. The two systems need a way to get information from each other, without someone manually entering the data in both systems, which is inefficient and prone to error, Wagschal says.

DON'T SKIMP ON LEGAL SERVICES

There's no set standard for funders to follow when it comes to legal advice. Some funders have in-house counsel, some contract with external law firms and some don't have attorneys at all, which, of course, can be a risky proposition.

Some funders use contracts they've poached from a reputable funder online or from a friend in the industry, says Kimberly M. Raphaeli, vice president of legal operations at Accord Business Funding in Houston, Texas. The trouble is what flies in one state may not be legal in another, she says.

Many contracts include things such as jury waivers and class-action waivers or COJs and depending on the state, the rules surrounding the enforcement of these types of clauses may be different. So it's really important to know the nuances of the state you're doing business in and even potentially the states where your merchants are located, she says.

Having dedicated legal staff is arguably better. But at the very least, funders should have an attorney on speed dial who can provide advice on contracts, compliance and other areas of their business. Even when a funder has in-house attorneys, Raphaeli says it's a good idea to tap external counsel to review documents in situations where potential liability exists. Not only does this offer a second set of eyes, it can provide added peace of mind. "A funder should never shy away from paying a little bit of money for long-term business security," Raphaeli says.

FOLLOW BEST PRACTICES

The Small Business Finance Association, an advocacy group for the non-bank alternative financing industry, has developed a list of best practices for industry participants to follow. These encompass principles of transparency, responsibility, fairness and security.

"It's a very competitive market and companies are trying to differentiate themselves. I think it's important to make sure you're following industry standards," says Steve Denis, executive director of the association whose members include funders and lenders.

Funders also need to be mindful that best practices can change based on business and competitive realities, so it's important for funders to review procedures periodically, says Raphaeli, of Accord Business Funding. Because the industry is fast-moving, a good rule of thumb might be for a funder to review the entire set of policies and procedures every 18 months. But more frequent review could be necessary if outside factors such as new case law or regulation demand it, she says.

"Periodically taking a look at your collections techniques, your default procedures, even your funding process down to your funding call – these are all critical components of having a successful MCA funder," she says.

TAKE PAINS TO AVOID INDUCTION INTO THE PUBLIC HALL OF SHAME

While there is no shortage of unseemly news stories involving MCA, funders need to do their best to avoid negative press. This means being extra careful about the way they present themselves to businesses, at public speaking engagements, at conferences, industry trade shows, brokers and others, says Denis of the Small Business Finance Association.

Denis, a long-time Washington, D.C., resident, recommends funders invoke what he calls the "The Washington Post test," though it applies broadly to any news outlet. Before sending an email, leaving a voicemail or saying anything publicly, funding company employees need to ask themselves: Am I comfortable with that information being on the front page of the paper? "I think our industry has a big problem with public relations right now," he says. "The stigma is only as true as our industry allows it to be."

LOANS YOU CAN TAKE TO THE BANK

By *PAUL SWEENEY*

OnDeck, the reigning king of small business lending among U.S. financial technology companies, is sharpening its business strategies. Among its new initiatives: the company is launching an equipment-finance product this year, targeting loans of $5,000 to $100,000 with two-to-five year maturities secured by "essential-use equipment."

In touting the program to Wall Street analysts in February, OnDeck's chief executive, Noah Breslow, declared that the $35 billion, equipment-finance market is "cumbersome" and he pronounced the sector "ripe for disruption."

While those performance expectations may prove true – the first results of OnDeck's product launch won't be seen until 2020 – Breslow's message seemed to conflict with OnDeck's image as a public company. Rather than casting itself as a disruptor these days, OnDeck emphasizes the ways that its business is melding with mainstream commerce and finance.

Consider that the New York-based company, which saw its year-over-year revenues rise 14% to $398.4 million in 2018, is collaborating with Visa and Ingo Money to launch


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an "Instant Funding" line-of-credit that funnels cash "in seconds" to business customers via their debit cards. With the acquisition of Evolocity Financial Group, it is also expanding its commercial lending business in Canada, a move that follows its foray into Australia where, the company reports, loan-origination grew by 80% in 2018.

Perhaps most significant was the 2018 deal that OnDeck inked with PNC Bank, the sixth-largest financial institution in the U.S. with $370.5 billion in assets. Under the agreement, the Pittsburgh-based bank will utilize OnDeck's digital platform for its small business lending programs. Coming on top of a similar arrangement with megabank J.P. Morgan Chase, the country's largest with $2.2 trillion in assets, the PNC deal "suggests a further validation of OnDeck's underlying technology and innovation," asserts Wall Street analyst Eric Wasserstrom, who follows specialty finance for investment bank UBS.

"It also reflects the fact that doing a partnership is a better business model for the big banks than building out their own platforms," he says. "Both banks (PNC and J.P. Morgan) have chosen the middle ground: instead of building out their own technology or buying a fintech company, they'll rent.

"J.P. Morgan has a loan portfolio of $1 trillion," Wasserstrom explains. "It can't earn any money making loans of $15,000 or $20,000. Even if it charged 1,000 percent interest for those loans," he went on, "do you know how much that will influence their balance sheet? How many dollars do think they are going to earn? A giant zero!"

Similarly, Wasserstrom says, spending the tens of millions of dollars required to develop the state-of-the art technology and expertise that would enable a behemoth like J.P. Morgan or a super-regional like PNC to match a fintech's capability "would still not be a big needle-mover. You'd never earn that money back. But by partnering with a fintech like OnDeck," he adds, "banks like J.P Morgan and PNC get incremental dollars they wouldn't otherwise have."

The alliance between OnDeck and old-line financial institutions is one more sign, if one more sign were needed, that commercial fintech lenders are increasingly blending into the established financial ecosystem.

Not so long ago companies like OnDeck, Kabbage, PayPal, Square, Fundation, Lending Club, and Credibly were viewed by traditional commercial banks and Wall Street as upstart arrivistes. Some may still bear the reputation as disruptors as they continue using their technological prowess to carve out niche funding areas that banks often neglect or disdain.

Yet many fintechs are forming alliances with the same financial institutions they once challenged, helping revitalize them with new product offerings. Other financial technology companies have bulked up in size and are becoming indistinguishable from any major corporation.

Big Fintechs are securitizing their loans with global investment banks, accessing capital from mainline financial institutions like J.P. Morgan, Goldman Sachs and Wells Fargo, and finding additional ways—including becoming publicly listed on the stock exchanges – to tap into the equity and debt markets.

One example of the maturation process: through mid-2018, Atlanta-based Kabbage has securitized $1.5 billion in two bond issuances, 30% of its $5 billion in small business loan originations since 2008.

In addition, fintechs have been raising their industry's profile with legislators and regulators in both state and federal government, as well as with customers and the public through such trade associations as the Internet Lending Platform Association and the U.S. Chamber of Commerce. Both individually and through the trade groups, these companies are building good will by supporting truth-in-lending laws in California and elsewhere, promoting best practices and codes of conduct, and engaging in corporate philanthropy.

Rather than challenging the established order, S&P Global Market Intelligence recently noted in a 2018 report, this cohort of Big Fintech is increasingly burrowing into it. This can especially be seen in the alliances between fintech commercial lenders and banks.

"Bank channel lenders arguably have the best of both worlds," Nimayi Dixit, a research analyst at S&P Global Market Intelligence wrote approvingly in a 2018 report. "They can export credit risk to bank partners while avoiding the liquidity risks of most marketplace lending platforms. Instead of disrupting banks, bank channel lenders help (existing banks) compete with other digital lenders by providing a similar customer experience."

It's a trend that will only accelerate. "We expect more digital lenders to incorporate this funding model into their businesses via white-label or branded services to banking institutions," the S&P report adds.

Forming partnerships with banks and diversifying into new product areas is not a luxury but a necessity for Fundation, says Sam Graziano, chief executive at the Reston (Va.)-based platform. "You can't be a one-trick pony," he says, promising more product launches this year.

Fundation has been steadily making a name for itself by collaborating with independent and regional banks that utilize its platform to make small business loans under

$150,000. In January, the company announced formation of a partnership with Bank of California in which the West Coast bank will use Fundation's platform to offer a digital line of credit for small businesses on its website.

Fundation lists as many as 20 banks as partners, including most prominently a pair of tech-savvy financial institutions—Citizens Bank in Providence, R.I. and Provident Bank in Iselin, N.J.—which have been featured in the trade press for their enthusiastic embrace of Fundation.

John Kamin, executive vice president at $9.8 billion Provident reports that the bank's "competency" is making commercial loans in the "millions of dollars" and that it had generally shunned making loans as meager as $150,000, never mind smaller ones. But using Fundation's platform, which automates and streamlines the loan-approval process, the bank can lend cheaply and quickly to entrepreneurs. "We're able to do it in a matter of days, not weeks," he marvels.

Not only can a prospective commercial borrower upload tax returns, bank statements and other paperwork, Kamin says, "but with the advanced technology that's built in, customers can provide a link to their bank account and we can look at cash flows and do other innovative things so you don't have to wait around for the mail."

Provident reserves the right to be selective about which loans it wants to maintain on its books. "We can take the cream of the crop" and leave the remainder with Fundation, the banker explains. "We have the ability to turn that dial."

The partnership offers additional side benefits. "A lot of folks who have signed up (for loans) are non-customers and now we have the ability to market to them," he says. "After we get a small business to take out a loan, we hope that we can get deposits and even personal accounts. It gives us someone else to market to."

As a digital lender, Provident can now contend mano a mano with another well-known competitor: J.P. Morgan Chase. "This is the perfect model for us," says Kamin, "it gives us scale. You can't build a program like this from scratch. Now we can compete with the big guys. We can compete with J.P. Morgan."

For Fundation, which booked a half-billion dollars in small business loans last year, doing business with heavily regulated banks puts its stamp on the company. It means, for example, that Fundation must take pains to conform to the industry's rigid norms governing compliance and information security. But that also builds trust and can result in client referrals for loans that don't fit a bank's profile. "For a bank to outsource operations to us," Graziano says, "we have to operate like a bank."

Bankrolled with a $100 million line of credit from Goldman Sachs, Fundation's interest rate charges are not as steep as many competitors'. "The average cost of our loans is in the mid-to-high teens and that's one reason why banks are willing to work with us," Graziano says. "Our loans," he adds, "are attractively structured with low fees and coupon rates that are not too dramatically different from where banks are. We also don't take as much risk as many in the (alternative funding) industry."

> **“ LOAN APPROVAL—OR DENIALS—ARE LARGELY BASED ON A CUSTOMER'S SALES AND PAYMENTS HISTORY. MONEY CAN APPEAR, SOMETIMES ALMOST MAGICALLY IN MINUTES, IN A BORROWER'S BANK ACCOUNT, DEBIT CARD OR E-WALLET.**

Despite its establishment ties, Graziano says, Fundation will not become a public company anytime soon. "Going public is not in our near-term plans," he told deBanked. Doing business as a public company "provides liquidity to shareholders and the ability to use stock as an acquisition tool and for employees' compensation," he concedes. "But you're subject to the relentlessly short-term focus of the market and you're in the public eye, which can hurt long-term value creation."

Graziano reports, however, that Fundation will be securitizing portions of its loan portfolio by yearend 2020.

PayPal Working Capital, a division of PayPal Holdings based in San Jose, and Square Inc. of San Francisco, are two Big Fintechs that branched into commercial lending from the payments side of fintech. PayPal began making small business loans in 2013 while Square got into the game in 2014. In just the last half-decade, both companies have leveraged their technological expertise, massive data collections, data-mining skills, and catbird-seat positions in the marketplace to burst on the scene as powerhouse small business lenders.

With somewhat similar business models, the pair have also surfaced as head-to-head competitors, their stock prices and rivalry drawing regular commentary from investors,

analysts and journalists. Both have direct access to millions of potential customers. Both have the ability to use "machine learning" to reckon the creditworthiness of business borrowers. Both use algorithms to decide the size and terms of a loan.

Loan approvals—or denials—are largely based on a customer's sales and payments history. Money can appear, sometimes almost magically in minutes, in a borrower's bank account, debit card or e-wallet. PayPal and Square Capital also deduct repayments directly from a borrower's credit or debit card sales in "financing structures similar to merchant cash advances," notes S&P.

At its website, here is how PayPal explains its loan-making process. "The lender reviews your PayPal account history to determine your loan amount. If approved, your maximum loan amount can be up to 35% of the sales your business processed through PayPal in the past 12 months, and no more than $125,000 for your first two loans. After you've completed your first two loans, the maximum loan amount increases to $200,000."

PayPal, which reports having 267 million global accounts, was adroitly positioned when it commenced making small business loans in 2013. But what has really given the Big Fintech a boost, notes Levi King, chief executive and co-founder at Utah-based Nav—an online, credit-data aggregator and financial matchmaker for small businesses – was PayPal's 2017 acquisition of Swift Financial. The deal not only added 20,000 new business borrowers to its 120,000, reported Techcruch, but provided PayPal with more sophisticated tools to evaluate borrowers and refine the size and terms of its loans.

"PayPal had already been incredibly successful using transactional data obtained through PayPal accounts," King told deBanked, "but they were limited by not having a broad view of risk." It was upon the acquisition of Swift, however, that PayPal gained access to a "bigger financial envelope including personal credit, business credit, and checking account information," King says, adding: "The additional data makes it way easier for PayPal to assess risk and offer not just bigger loans, but multiple types of loans with various payback terms."

While PayPal used the Swift acquisition to spur growth and build market share, its rival Square—which is best known for its point-of-sale terminals, its smartphone "Cash App," and its Square Card—has employed a different strategy.

By selling off loans to third-party institutional investors, who snap them up on what Square calls a "forward-flow basis," the Big Fintech barged into small business lending with the subtlety of a freight train. In just four years, Square originated 650,000 loans worth $4.0 billion, a stunning rise from the modest base of $13.6 million in 2014.

Square's third-party funding model, moreover, demonstrates the benefits afforded from being deeply immersed in the financial ecosystem. Off-loading the loans "significantly increases the speed with which we can scale services and allows us to mitigate our balance sheet and liquidity risk," the company reported in its most recent 10K filing.

Square does not publicly disclose the entire roster of its third-party investors. But Kim Sampson, a media relations manager at Square, told deBanked that the Canada Pension Plan Investment Board—"a global investment manager with more than CA$300 billion in assets under management and a focus on sustained, long term returns" – is one important loan-purchaser.

Square also offers loans on its "partnership platform" to businesses for whom it does not process payments. And late last year the company introduced an updated version of an old-fashioned department store loan. Known as "Square Installments," the program allows a merchant to offer customers a monthly payment plan for big-ticket purchases costing between $250 and $10,000.

Which model is superior? PayPal's—which retains small business loans on its balance sheet—or Square's third-party investor program?

"The short answer," says UBS analyst Wasserstrom, "is that PayPal retains small business loans on its balance sheet, and therefore benefits from the interest income, but takes the associated credit and funding risk."

Meanwhile, as PayPal and Square stake out territory in the marketplace, their rivalry poses a formidable challenge to other competitors.

Both are well capitalized and risk-averse. PayPal, which reported $4.23 billion in revenues in 2018, a 13% increase over the previous year, reports sitting on $3.8 billion in retained earnings. Square, whose 2018 revenues were up 51 percent to $3.3 billion, reported that—despite losses—it held cash and liquid investments of $1.638 billion at the end of December.

King, the Nav executive, observes that Able, Dealstruck, and Bond Street – three once-promising and innovative fintechs that focused on small business lending – were derailed when they could not overcome the double-whammy of high acquisition costs and pricey capital.

"None of them were able to scale up fast enough in the marketplace," notes King. "The process of institutionalization is pushing out smaller players."

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INDUSTRY *NEWS*

1/14/19 PayPal announced the appointment of Allison Johnson to EVP and Chief Marketing Officer

Lendistry announced Deanna Bassett had joined the company as Chief Financial Officer

1/16/19 Reuters reported that CommonBond laid off 18% of its staff

1/17/19 Square announced the launch of a debit card for small businesses that gives them immediate access to their Square sales

1/21/19 New York's Erie County Clerk Michael Kearns announced that his county would no longer process Confessions of Judgment, a legal instrument that allows a party to obtain a judgment without the need for litigation

1/22/19 Merchant cash advance provider Bitty Advance selected Swift Prepaid Solutions to faciliate instant funding solutions

BFS Capital's UK operation, Boost Capital, secured a £47M credit line

1/23/19 Funding Circle announced that it had joined the Stripe Partner Program, wihich would allow it to provide financing to Stripe Customers.

1/25/19 It is reported that small business lender Kabbage would be expanding its workforce in India and may be considering entering the Indian market

1/29/19 StreetShares Principal Financial and Accounting Officer, Jesse Cushman, resigned

1/30/19 dv01 Secured $15 Million Series B led by Pivot Investment Partners

Online student lender Climb Credit raises $50M in debt from Goldman Sachs

Members of the New York Assembly introduced a bill to add small businesses to the State's existing usury protection laws

1/31/19 Petal, a US credit card aimed at the unbanked, announced former CAN Capital CEO Parris Sanz as their new general counsel

Enova International reported 2018 net income of $70M on revenue of $1.11B

2/1/19 The founder of Canadian crypto exchange QuadrigaCX died. He was the only one with the encryption key, forever cutting off access to $190 million in crypto holdings.

2/4/19 Members of the New York Assembly introduced a bill to ban Confessions of Judgment from being used in a financial contract

LendingPoint, a consumer lending company, announced that it had secured additional mezzanine financing, a hybrid of debt and equity, bringing the total mezzanine financing to $67.5M

It's revealed that small business lender, Credibilitiy Capital, had relocated from New York City to Newark, NJ, thanks to a $6.5M award from the NJ Economic Development Authority

2/5/19 Bankers Healthcare Group surpassed $4B in financial solutions provided to licensed US healthcare professionals since its founding in 2001

2/7/19 OnDeck announced the closing of an $85M corporate credit facility with a lender group consisting of 4 banks.

2/11/19 Nav raised $44M from investors including Goldman Sachs, Point72 Ventures, and Experian Ventures

2/12/19 OnDeck announced 2018 net income of $27.7M on gross revenue of $398.4M

2/14/19 Commonbond announced that it had signed $750M in lending capacity from Goldman Sachs, Citibank, Barclays, BMO, and ING

2/14/19 The FTC announced that it would be hosting a forum on small business financing on 5/8/19, particularly with regards to online lending

2/15/19 OnDeck announced 3 new hires, Chris McGall as Head of Acquisition Risk Management, Gregory Johnson as Senior Vice President of Business Development and Partnerships, and Matt Cluney as Vice President of Brand and Product Marketing

Bloomberg News reported that online lending hedge fund Direct Lending Investments had lost nearly a quarter of its portfolio value in a telecom financing deal gone bad

It's revealed that Uber recorded a net loss of $1.8B in 2018

2/19/19 LendingClub reported 2018 net loss of $128.2M on revenue of $694.8M

Online student lender College Ave Student Loans secured $65M in financing

2/22/19 Great Elm Capital Corp announced that it had acquired 80% of the outstanding equity interests in Prestige Capital Corporation from PCC's retiring founder, Harvey Kaminski. PCC is a commercial finance company specializing in factoring for early stage and mid-sized companies.

Breakout Capital Finance filed a Reg D announcing a capital raise of $5.3M

2/25/19 CNBC reported that online student lender SoFi would soon begin offering zero-fee ETFs

2/26/19 Provident Bank launched digital lending capability for small business customers powered by Fundation

CNBC reported that online student lender SoFi would soon begin offering cryptocurrency trading through Coinbase

It's reported that PayPal is expanding its small business lending to merchants in Mexico

2/27/19 LoanStreet Inc, a platform that streamlines the process of sharing, managing and originating loans, appointed 3 credit union industry veterans to support the company's aggressive growth.

3/5/19 Kylie Jenner became the world's youngest billionaire at 21

IOU Financial entered into a $50M credit facility with Credit Suisse

3/7/19 International small business lender Funding Circle announced its expansion into Canada.

Nationwide, a national insurance company, and BlueVine, a small business lender, announced a partnership to help business owners get online growth financing

3/11/19 It's reported that the parties in the infamous Madden V. Midland Funding, LLC lawsuit had agreed to a settlement. What remains unfixed is the decision by the Second Circuit Court of Appeals in New York that made it illegal for a debt buyer to enforce the original loan terms agreed upon on a legally acceptable bank loan.

3/14/19 Five business loan brokers in New York were indicted after dangling imaginary loan offers in front of an elderly Ohio business owner and asking him to pay hundreds of thousands in upfront fees while convincing him to turn over the title to 55 vehicles he owned.

3/18/19 Direct Lending Investments (DLI) CEO Brendan Ross resigned from the firm after it was disclosed that the hedge fund had materially overvalued one of its major investments for a number of years. The SEC then sued DLI and announced that the fund was being placed into receivership.

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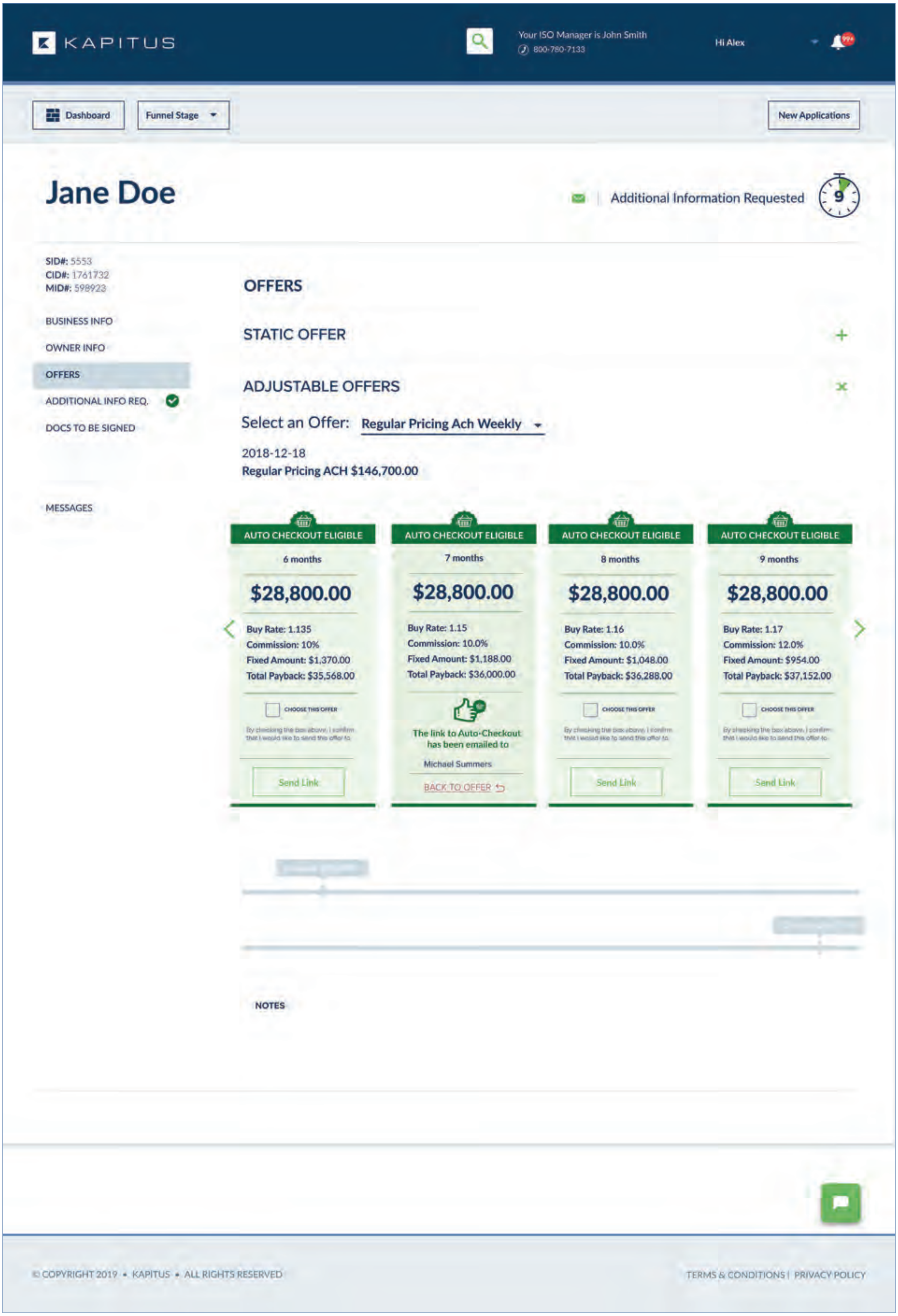
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6 months
$28,800.00
Buy Rate: 1.135
Commission: 10%
Fixed Amount: $1,370.00
Total Payback: $35,568.00
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7 months
$28,800.00
Buy Rate: 1.15
Commission: 10.0%
Fixed Amount: $1,188.00
Total Payback: $36,000.00
The link to Auto-Checkout has been emailed to
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8 months
$28,800.00
Buy Rate: 1.16
Commission: 10.0%
Fixed Amount: $1,048.00
Total Payback: $36,288.00
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$28,800.00
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Commission: 12.0%
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STORYTELLING SALES EXPERT KINDRA HALL TO KEYNOTE BROKER FAIR 2019

Sales expert Kindra Hall will present at Broker Fair 2019 to teach attendees about the irresistible power of strategic storytelling. If you want to learn to sell differently and use the power of storytelling, her keynote is something you won't want to miss!

According to Hall, the shift from a transactional economy to a connected one has people scrambling; when surveyed, companies admit they believe a substantial portion of their revenue is under threat as a result. Businesses, brands, sales forces, marketing teams and leaders at all levels are desperately trying to capture attention and resonate with consumers who expect more. Is there a secret weapon? A silver bullet to humanize and connect? Yes. The answer is strategic storytelling.

The problem? In its rapid rise in popularity, "storytelling" has been reduced to in-actionable jargon. Every day businesses and individuals miss critical opportunities to connect with their elusive audiences in powerful and profitable ways because they lack a storytelling skill. Until now.

ABOUT KINDRA HALL

Kindra Hall is President and Chief Storytelling Officer at Steller Collective, a consulting firm focused on the strategic application of storytelling to today's communication challenges. Kindra is one of the most sought after keynote speakers trusted by global brands to deliver presentations and trainings that inspire teams and individuals to better communicate the value of their company, their products and their individuality through strategic storytelling.

What began as a storytelling assignment in 5th grade, grew into a passion for not only telling stories, but a mastery for teaching others the methods and science of storytelling so they can better tell their own.

She was a National Champion storyteller (yes, they have those), member of the Board of Directors of the National Storytelling Network and has her master's degree in communications where she conducted original research studying the role of storytelling in defining and revealing organizational culture.

Kindra is a former Director of Marketing and VP of Sales. Today, Kindra's work can be seen at Inc.com, Entrepreneur.com and as a contributing editor for SUCCESS Magazine. Kindra's message spans all industries and her clients include Facebook, Hilton Hotels, Tyson Foods, Target, Berkshire Hathaway and the Harvard Medical School. Her much anticipated book will be released by Harper Leadership in the fall of 2019.

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BROKER FAIR 2019 deBanked

Winners will be announced Monday, May 6, 2019

THE HEAD SCRATCHING FATE OF DIRECT LENDING INVESTMENTS

Direct Lending Investments (DLI), viewed by many as the largest online lending-focused hedge fund, reported a 25% loss in value in February 2019 in a failed deal that left many readers scratching their heads. The loss stemmed from a single customer, a defaulted loan to VOIP Guardian Partners I, a company that purportedly advanced funds to small telecom businesses. Telecom receivables seemed a huge leap from DLI's original concept of lending to online small business lenders. Brendan Ross, DLI's founder and CEO who resigned in March, explained early on that his fund was able to generate double digit annual returns because small businesses tended to overpay for credit. That in turn created opportunity for investors and a buffer for them in a recession, he would explain. Over time, DLI's investments expanded into online consumer lending platforms and online real estate lending platforms, all while continuing to supposedly earn double digit returns (These returns would later be challenged as inaccurate by the SEC).

When news of the failed loan to VOIP Guardian Partners I became public, deBanked was able to identify the telecom companies that VOIP was relending the funds out to and they sure weren't the kind of domestic online lending platforms that DLI built its reputation on.

Here's who VOIP reported lending to:

COMPANY	BASED IN	AMOUNT
Telacme, Ltd	Hong Kong	$101 million
Najd Technologies, Ltd	United Arab Emirates	$58 million
Arco Telecom Ltd	Gibraltar	
BTB Systems, UG	Germany	
Hilf Telecom, BV	Netherlands	
Ikarim Business Services, Ltd	United Kingdom	
Interstach, GmbH	Germany	
LTD Tel, SL	United Kingdom	
My Core 4 Wholesale, BV	Netherlands	
Omega Communications, GmbH	Germany	
Plus AMA Plus AG	Germany	
Rudare Communications, SL	Spain	
Sunnymax Trading, GmbH	Germany	

VOIP declared bankruptcy on March 11th with an outstanding balance to DLI of $194 million. The bulk of that arose out of failed loans VOIP made to Telacme Ltd and Najd Technologies, Ltd, two companies with very little information available online. The websites for both had been taken offline prior to this issue going to print.

In March, the SEC sued DLI over practices unrelated to the VOIP fiasco. Prior to this issue going to print, DLI was on track to be put in receivership and wound down.

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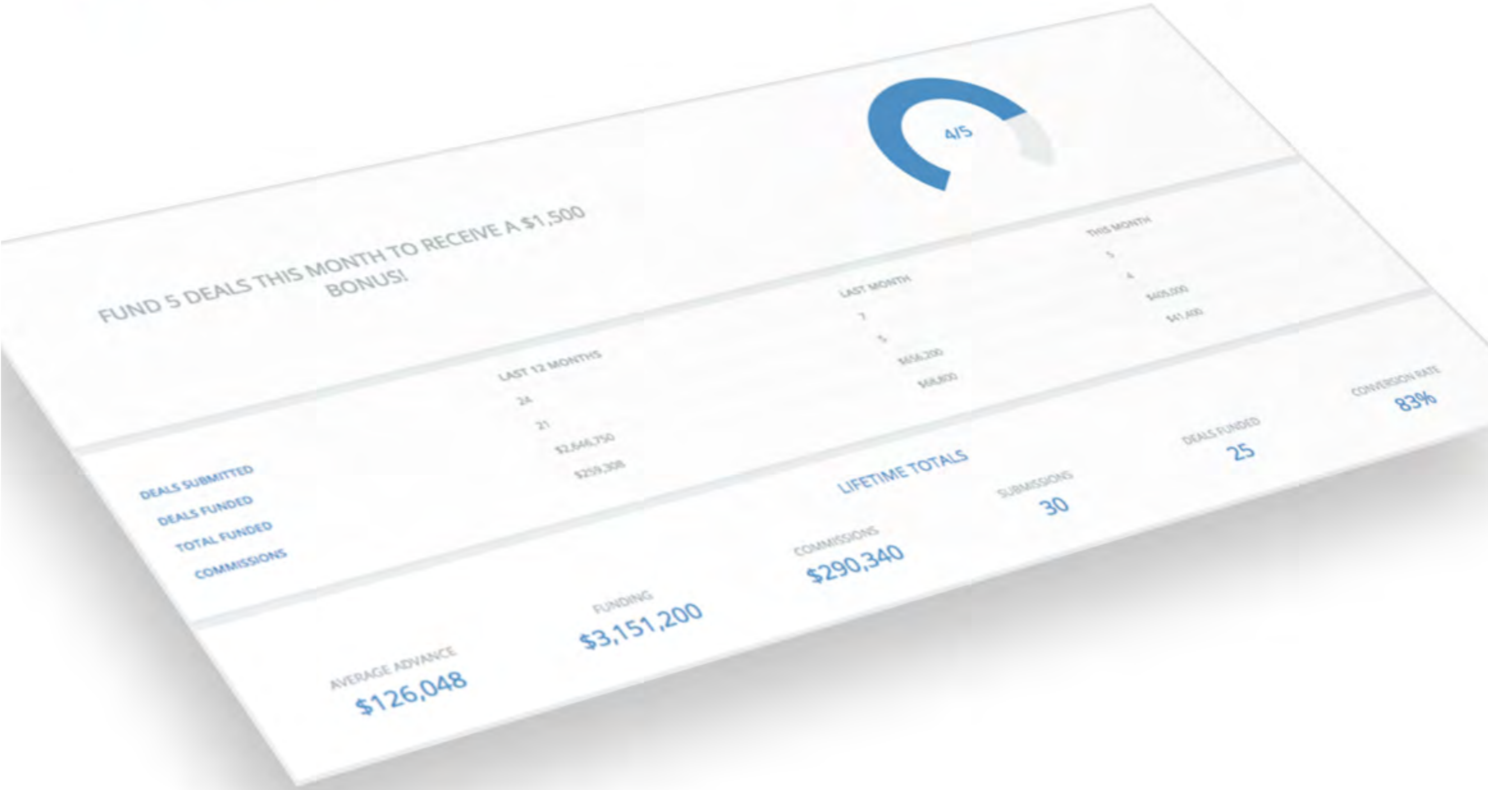

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GUILTY

A former merchant cash advance broker and ringleader of a group that pioneered debt settlement scams in the merchant cash advance industry, pleaded guilty in March to conspiracy to commit bank fraud and conspiracy to commit money laundering. Sergiy Bezrukov, who relied on numerous aliases and company names to carry out his schemes, was the last and final member of the crew to be convicted.

Mailers from Bezrukov advertised that businesses prequalified for a substantial reduction in their merchant cash advance debt and that it could happen in as quick as 6-12 hours with the help of his restructuring service. Why would someone believe it? Well because he claimed he was a debt counselor that had resolved debts over 40,000 times before. In practice, Bezrukov would actually pocket the money that desperate merchants would send to him for help and make no attempt to restructure anything.

deBanked began covering the story (See: http://dbnk.news/1Q) in December 2016 when news of arrests became public. Until recently, Bezrukov had been in prison for two years awaiting his trial, a procedure that was repeatedly postponed because he fired his court-appointed attorneys four times. He is facing a sentence of 57-71 months, where he will likely get credit for the time he has already served.

Below is a breakdown of the participants in the scheme and the convictions:

Sergio Bezrukov	Conspiracy to commit bank fraud and Conspiracy to commit money laundering
Mark Farnham	Conspiracy to commit bank fraud
Vanessa Cardona	Conspiracy to commit mail fraud
Dustin Walker	Conspiracy to commit bank fraud

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COMPETITION STEPS UP IN CANADIAN SMALL BUSINESS LENDING MARKET

By *TODD STONE*

Last week's announcement by Funding Circle that it will establish an operation in Canada later this year is part of a trend of large non-Canadian funders entering or expanding into the Canadian market, according to Adam Benaroch, President of CanaCap, a small business funder based in Montreal.

Funding Circle started in the UK and expanded outwards to the US, Germany, and The Netherlands, but the UK still comprises of more than 60% of their global origination volume. Their foray into Canada is a good thing for small business owners and lenders, according to Paul Pitcher, founder and CEO of SharpShooter, a funder based in Toronto.

"I see it as win-win," Pitcher said.

He said that a win for Canadian small business owners is a win for SharpShooter because it means more potential merchant clients. Pitcher said that he loves OnDeck, a rival, is in Canada, in part because OnDeck's marketing has helped educate Canadian merchants about alternative lending products.

Similarly, Benaroch said he thinks that big companies entering the Canadian market will affect CanaCap positively. For instance, Benaroch said that CanaCap hopes to capture companies that get turned down from OnDeck. And perhaps CanaCap can also capture merchants that are declined by Funding Circle.

Benaroch noted that not all outside funding companies have succeeded in Canada, often because they never established a physical presence there. But Funding Circle will be opening a physical office in Toronto.

"We have been evaluating options for expansion over the last year," said Tom Eilon, who will be Managing Director of Funding Circle Canada. "Canada's stable, growing economy coupled with good access to credit data and a progressive regulatory environment, made it the obvious choice. The most important factor [in coming to Canada] though was the clear need for additional funding options among Canadian SMEs."

Funding Circle's announcement comes on the heels of OnDeck's December 2018 acquisition of Evolocity Financial Group, a small business funder based in Montreal. While OnDeck started operating in Canada as early as 2015, CanaCap's Adam Benaroch said that the acquisition of Evolocity is a significant step for OnDeck because Evolocity has an ISO channel in Canada. That runs counter to Funding Circle's model of mainly going direct to merchant, at least in the US.

Originations (Million)

<table>
<tr><th></th><th>2012</th><th>2013</th><th>2014</th><th>2015</th><th>2016</th><th>2017</th><th>2018</th></tr>
<tr><td>Group[3] (£)</td><td>49</td><td>130</td><td>311</td><td>721</td><td>1,065</td><td>1,738</td><td>2,292</td></tr>
<tr><td>UK[3] (£)</td><td>49</td><td>129</td><td>279</td><td>531</td><td>823</td><td>1,264</td><td>1,531</td></tr>
<tr><td>US ($)</td><td colspan="2">N/A</td><td colspan="2">334</td><td>281</td><td>514</td><td>792</td></tr>
<tr><td>DE (€)</td><td colspan="2">N/A</td><td colspan="2">33</td><td>19</td><td>55</td><td>105</td></tr>
<tr><td>NL (€)</td><td colspan="3">N/A</td><td colspan="2">21</td><td>34</td><td>81</td></tr>
</table>

Funding Circle's loan originations by country by year

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