



THE 'LOAN' STAR STATE

TEXAS IS AN ALTERNATIVE
FINANCE NEXUS

By Paul Sweeney

Alternative Lenders
Spread Their Wings
Internationally

By Cheryl Winokur Munk

Humans vs. Bank
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By Ed McKinley



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By PAUL SWEENEY

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PUBLISHER

Sean Murray

EDITOR-IN-CHIEF

Sean Murray

ART DIRECTOR

Deborah Barlay

SALES

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Letter From the Editor



BY
SEAN MURRAY

Howdy partners,

It's shaping up to be an eventful year. Immediately prior to this issue going to print, several people asked me if I thought recent events with some major small business financing companies meant that there was no longer any opportunity in that space. On the contrary, I believe it has created a void for others to fill. It means that there is a chance to learn from what didn't work despite the appearance of it working for so long. It means that other players will have a chance to show what they're doing right. And it means that the future of how small businesses access capital hasn't exactly been set in stone just yet.

It means we are really just beginning.

In this issue we look out at how some of these players are achieving success, on a local level in the Great State of Texas and far, far beyond in other countries. We chose Texas after I noticed just how big alternative finance had taken hold there on my recent trip to Austin and Fort Worth that included the 23rd Annual Factoring Conference. While I don't know that I could say that, "everything is bigger in Texas," it most certainly is big and in this issue we give the State their due.

There's more of, of course, there always is. So prepare yourselves friends and colleagues to become de-Banked all over again.

—Sean Murray

EDITOR'S CORRECTION:

In the last issue, we incorrectly printed that SoFi had partnered up with Promontory Financial Group. The company SoFi actually partnered up with was Promontory Interfinancial Network.

▶ Featured Story / **THE ‘LOAN’ STAR STATE**
Texas is An Alternative Finance Nexus
by PAUL SWEENEY



We're at Able Lending in Austin, Texas, a financial technology company occupying three floors deep in the heart of the Seaholm power plant overlooking Lady Bird Lake.

The fortress-like building anchors an inner-city complex of offices and residences, chic restaurants, boutique shops, and a Trader Joe's. Once the main source of electricity for Texas's

capital city, the natural gas-fired boilers have given way to a warren of glassed-in offices and meeting rooms connected by angular metallic stairways and a carpeted mezzanine.

It is here, in a tiny conference room, that Will Davis, a slim man of 35 and an alumnus of Harvard Business School, is drawing a bell curve on a whiteboard. Dressed for the balmy Texas weather

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in tan Bermuda shorts, a black tee-shirt and Nike running shoes, the company's chief executive and co-founder is explaining how Able's friends-and-family lending formula "widens" the risk curve.

"We all compete here in this box on price," Davis says, drawing a square at the topmost point of the bell curve, indicating where the near-prime borrowers abide and where lenders are crowded in pursuit. But when loans from friends and family form 10%-15% of the total loan, he says, drawing squiggly lines just to the left of the box, a cohort with less-than-stellar credits now becomes credit-worthy.

Because of the "peer pressure" and "behavioral change" exerted by the involvement of family and friends, the formula produces a "positive-selection effect on the loan portfolio" Davis says, declaring: "We can serve more of the market."

It all sounds very business-schoolish. But here's the bottom line: Able's lending model sharply reduces both risk and borrowing costs, allowing it to go head-to-head with national rivals like Funding Circle, Bond Street, OnDeck and StreetShares. Thanks in large part to its reduced risk, asserts Able's director of development, 30-year-old Matt Irving, the Austin fintech can lend twice as much money as its competitors at half the interest rate.

Since opening its doors and firing up its computers in the fourth quarter of 2014, Able's average loan size has climbed to \$231,200 from \$100,000. Of that, an average of 3.2 "backers" have accounted for \$40,691, or 17.6% of the average total loan amount. The average "blended" annual percentage rate is 16.41%.

Meanwhile, Able, which has made some \$48 million in loans to entrepreneurs through the end of April, 2017, reports CEO Davis, is itself on sound financial footing. According to the data-services firm Crunchbase, Able has raised \$12.5 million in three rounds of venture capital financing from 21 investors. Principal equity financiers are Peter Thiel's Founders Fund, Peterson Ventures, RPM Ventures, and Blumberg Capital. On Sept. 27, 2016, moreover, Able added another \$100 million to its arsenal in debt financing from Community Investment Management, a San Francisco investment firm. Borrowers include owners of food trucks and apparel shops; professionals including doctors, dentists, veterinarians, and accountants; "creatives" like public relations and

advertising firms; and construction companies. Since its inception, Davis says, just one borrower has defaulted, resulting in an \$85,000 charge-off.

So far in 2017, the company has lent out nearly \$15 million in the first quarter, but it's on track to make \$80 million this year. "We're ramping up," Davis declares.

Welcome to fintech in the Lone Star State. While everything may be bigger in Texas, as the saying goes, that's not quite true of financial technology. The geographic contours of fintech operations are roughly 60% in California (especially Silicon Valley/San Francisco), 30% New York, and 10% scattered about the rest of the country, says 40-year-old Mihir Korke, the San Francisco-based chief marketing officer at Able.

Nonetheless, Texas offers fertile ground for the burgeoning fintech industry. The vaunted Texas business climate promises a relaxed regulatory regime, the absence of either a personal or corporate income tax, and a lower cost of living. All of which were cited by Able Lending, as well as an additional pair of fintech companies that specialize in factoring and merchant cash advances: Jet Capital, located in North Richland Hills in the Dallas-Fort Worth "metroplex"; and Ironwood Finance in Corpus Christi, a port city on the Gulf of Mexico.

"What's interesting about fintech companies is that they can choose to locate where they want to do business," says Erin Fonte, an attorney at Dykema Cox Smith in Austin whose legal practice includes mobile payments, mobile wallets and financial technology. "They don't necessarily get a regulatory advantage because much of what they do is based on their customers' location," says Fonte, who is currently serving as a member of the Federal Reserve's Faster Payments Taskforce. "That said," she adds, "some companies have chosen to locate in Texas because of the labor and talent pool, because it's a good source of venture capital, and it's more affordable."

Jet Capital's 42-year-old chief executive, Kenneth Wardle, confirms many of Fonte's observations. "So far, Texas has been friendly to MCA companies," he says, using the initials for "merchant cash advance." Especially favorable to his industry is the fact that "Texas regulators do not define an MCA as a loan," he adds.



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Prior to co-founding Jet Capital with chief operating officer Allan Thompson, 49, Wardle served as a portfolio manager at Exeter Finance Corp, a \$3 billion company in nearby Irving which specializes in subprime auto financing. Wardle has also held leadership positions at AmeriCredit Corp., now GM Financial, and Drive Financial, now Santander Consumer USA.

His 20-year background has included the gritty work of repossessing cars when owners fell into arrears on their auto loans. "Most of my career in auto finance was in risk management and I've driven a repo truck," he says. "You take off with the car right away and then chain it down after you've gone a couple of blocks so you don't lose it out on the highway."

Backed by more than \$5 million in equity financing from a family office in Puerto Rico, Jet Capital makes cash advances of \$25,000-\$30,000, on average, for working capital.

The sweet spot for Jet's financings are retail establishments, trucking companies, hair-and-nail

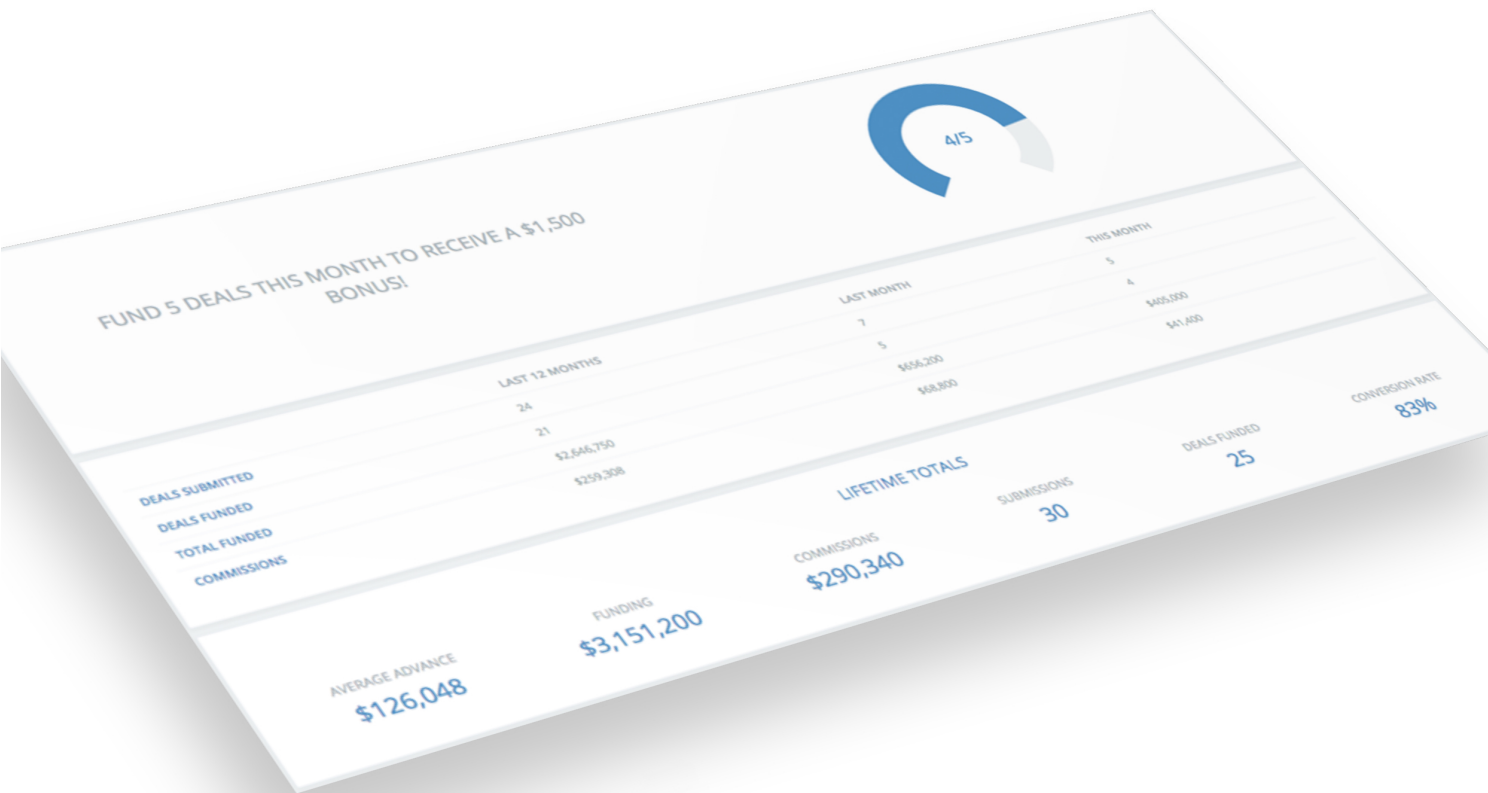
spas, and medical doctors. Doctors in particular are prime candidates for a Jet cash advance. "They have a pretty good gap between when they perform services and when they get paid by insurance companies" during which they have to cover payroll expenses and overhead, Wardle notes. Prospecting for customers is done largely through independent sales offices, direct mail, and pay-per-click services offered by Google, among additional online channels.

"Our defaults are relatively in line with expectations" and were largely confined to the first year of business, Wardle says. "We made some underwriting and verification changes last September and October," he adds, "and we changed our minimum credit scores. Since then we've seen defaults migrate in the right direction."

Since Wardle and Thompson took occupancy of an empty office outside Fort Worth in October, 2015, Jet has grown to 12 employees who today have "a variety of roles" says Thompson, citing sales, underwriting, customer service, collections, analytics, and information technology. "They wear a lot of hats



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and there's a lot of cross pollination," he says.

Looking ahead, Wardle foresees Jet expanding its product line beyond merchant cash advances to offer lines of credits and installment loans. "Our goal is to be a one-stop, nonbank financing solution," Wardle says.

Kevin Donahue, 37, owner of Ironwood, bootstrapped the South Texas company, which opened in 2013, using personal savings of \$1.5 million remaining from the sale of mobile home parks in South Dakota and Texas. He also plowed earnings into Ironwood from a subsequent job as a commercial loan broker.


Donahue, who grew up in a family of fishermen on the Oregon and California coasts and is a 2006 graduate of California Polytechnic State University at San Luis Obispo, says that he turned up in Corpus Christi somewhat by accident. While operating the mobile home park in nearby Kingsville, he got married, started a family, and put down roots.

With 20 employees, Ironwood focuses on providing merchant cash advances in the \$5,000-\$50,000 range, Donahue says, "but we can go up to \$1 million." The average cash advance – usually \$10,000-\$15,000 – is put to use as working capital by what he dubs "Main Street" businesses: restaurants, boutiques, trucking and transportation companies, professionals, and contractors. Ironwood charges clients factoring fees that are collected via ACH.

"Many times (these businesses) don't qualify for bank loans," Donahue says. And even when they do qualify, he notes, "banks take forever – up to three months – while we're using our own money and can do it in three days. We're very low on requiring a lot of documents."

For his part, Donahue wants to see a customer's bank statements, a photo I.D., voided checks, and a financial report. But, he says: "Cash flow is much more important than financials."

Clients typically find their way to Ironwood through the website, although they often arrive through referrals from brokers and real estate agents, attorneys, accountants and "anyone doing commercial lending," Donahue says he closed down a call center. "The way to get leads is more through relationships than marketing," he says.



WHAT'S INTERESTING ABOUT FINTECH COMPANIES IS THAT THEY CAN CHOOSE TO LOCATE WHERE THEY WANT TO DO BUSINESS...THEY DON'T NECESSARILY GET A REGULATORY ADVANTAGE BECAUSE MUCH OF WHAT THEY DO IS BASED ON THEIR CUSTOMERS' LOCATION.

Trucking companies are important customers. "They work on thinner margins, the barriers to entry are lower, sometimes their customers don't pay their bills," Donahue says of the industry's economics. "They have huge expenses for fuel, payroll, insurance – and they might not get paid (by their customers) for 30 days or more."

Ironwood's advance for a million dollars, cited earlier, was made to a trucking company in Midland, Texas, which hauled both general freight and oilfield equipment. The money was put to use both to smooth out cash flow and as growth capital. The trucking concern "used part of that for expansion, making down-payments with Volvo or Peterbilt," Donahue recalls.

Backstopped by the titles for 18 trucks valued at roughly \$1.5 million, the deal was structured as a three-year, sale-leaseback agreement with "no interest" but rather a fee, Donahue says. Payments were \$32,000 monthly, he says, amounting to \$152,000 above the advance.

Donahue has no trouble justifying the steep fee



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schedules. Not only does he release money quickly but in many instances Ironwood has stepped in to bail out businesses that could have gone belly-up. He cites a trucker in the Midwest who had a “very lucrative” business hauling Boeing jet engines worth \$30 million to Seattle where they could be worked on and returned to the planes for installment. In order to fulfill the contracts – which earned the hauler \$25,000 monthly – the trucking company’s owner needed to purchase pricey insurance.

The owner, however, “had horrible credit,” Donahue says, largely the result of cash flow problems after investing in a special trailer for the jet engines, compounded by a messy divorce. To secure the \$10,000 for the special insurance, the trucker sold Ironwood \$14,000 of their future receivables. “For his investment of \$4,000 he’s making \$25,000-a-month forever,” Donahue explains.

Back in Austin, Able is gearing up for another round of capital-raising to bulk up staff and, according to Korke, win licensing to do business in California. At the same time, its friends-and-family credit structure is winning kudos for reaching what researcher David O’Connell calls “the unloaned.”

A senior analyst at Aite Group, a Boston-based consulting firm, O’Connell recently completed a study disclosing that 35% of small and medium-sized businesses in the U.S were unable to obtain credit over a recent two-year period. Able’s lending model is “a good example of using covenants to structure a deal that brings down borrowing risk,” the Bostonian says. “It’s terrific.”

Able’s staff doesn’t have to travel far to witness the fruits of their efforts. On Congress Avenue, in the heart of downtown Austin, is Jae Kim’s food truck offering Korean barbecue thanks to a \$100,000-plus loan from the fintech lender. Kim, the founder and chief executive at food vendor Chi’lantro, enlisted his mother to pitch in \$10,000. All told, family and friends ponied up 30% of the total loan.

In the three years since he hooked up with Able, Kim has gone on to bigger things, including a television appearance last November on Shark Tank that netted him \$600,000 from celebrity investor Barbara Corcoran.

Chi’lantro is now operating five restaurants and

four food trucks and as Kim disclosed on Shark Tank, annual sales topped \$4.7 million last year.

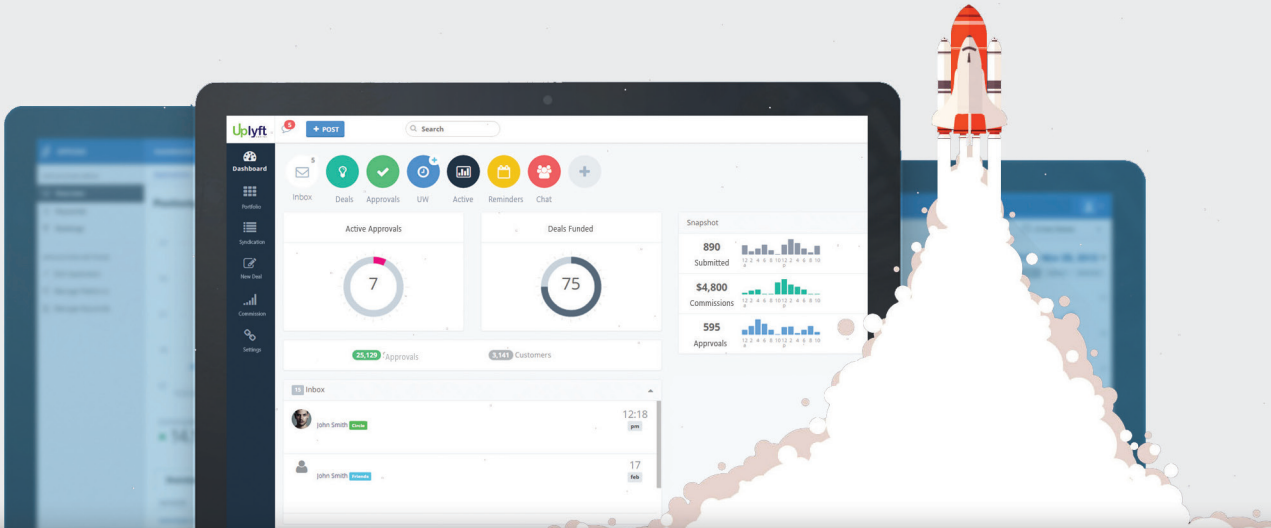
In an interview, he told deBanked that he counts himself fortunate to have gotten the Able “micro-loan.” It played a key role in generating the cash flow that qualified his company for a \$200,000 bank loan backed by the Small Business Administration. “It was one of many opportunities, and now we have good relationships with banks,” he says.

And then, a little farther south, there’s Stephanie Beard’s “esby apparel,” a women’s clothing boutique named for her initials. Beard, 35, came to Austin in 2013 after a decade in New York designing men’s clothing at Tommy Hilfiger and Converse. Originally from North Carolina and a graduate of Appalachian State University, she had zero connections in Texas and only a little money.

But she had a big vision: She would open a store and design and sell top-quality, flattering clothes for women that had “a menswear mentality.” Men, she had discovered, buy fewer clothes than women. But men tend to buy clothes that are durable, clothes that they can wear again-and-again over many years. After she sold \$65,000 worth of her casual clothing line on the website Kickstarter, Beard developed a fan base and was put in touch with Able. “Actually, they contacted me,” she says.

To qualify as an Able borrower, Beard assembled \$20,000 from friends and family, she reports, including \$2,500 from her future mother-in-law, another \$2,500 from the proprietor of a dress shop that “wholesaled” her collection, and the rest from aficionados of her wares. Once that money was gathered, Able lent her \$100,000 at a 10% APR in October, 2014, which enabled her to open her shop. The combined interest rate was 9.8%. Monthly payments have automatically been withdrawn from her business’s checking account.

She’s scheduled to repay both Able and her backers in full by this October. Total sales for the shop have cleared \$1 million and Beard expects annual revenues for 2017 to hit \$900,000. “A lawyer friend who helped me out with the paperwork pro bono told me that Able was practically giving money away,” she says. “I definitely was lucky.”



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RECENT COURT DECISIONS IMPACTING MERCHANT CASH ADVANCES STILL NOT A LOAN

In the United States District Court, Southern District of New York, a judge expounded on his decision as to why the Purchase and Sale of Future Receivables contract between TVT Capital and Epazz, Inc. was not a loan.

In this case, the “receipts purchased amounts” are not payable absolutely. Payment depends upon a crucial contingency: the continued collection of receipts by Epazz from its customers. TVT [TVT Capital] is only entitled to recover 15% of Epazz’s daily receipts, and if Epazz’s sales decline or cease the receipts purchased amounts might never be paid in full. See counterclaims, Exhs. A-C at 1. The agreements specifically provide that “Payments made to FUNDER in respect to the full amount of the Receipts shall be conditioned upon Merchant’s sale of products and services and the payment therefore by Merchant’s customers in the manner provided in Section 1.1.” Id. at 3 § 1.9.

Defendants’ argument that the actual daily payments ensure that TVT will be paid the full receipts purchased amounts within approximately 61 to 180 business days, id. ¶¶ 33-47, is contradicted by the reconciliation provisions which provide if the daily payments are greater than 15% of Epazz’s daily receipts, TVT must credit the difference to Epazz, thus limiting Epazz’s obligation to 15% of daily receipts. No allegation is made that TVT ever denied Epazz’s request to reconcile the daily payments. TVT’s right to collect the receipts purchased amounts from Epazz is in fact contingent on Epazz’s continued collection of receipts. See *Kardovich v. Pfizer, Inc.*, 97 F. Supp. 3d 131, 140 (E.D.N.Y. 2015), quoting *Amidax Trading Grp. v. S.W.I.F.T. SCRL*, 671 F.3d 140, 147 (2d Cir. 2011) (“Where a conclusory allegation in the complaint is contradicted by a document attached to the

complaint, the document controls and the allegation is not accepted as true”).

None of the defendants’ arguments, Counterclaims ¶¶ 51-109, change the fact that whether the receipts purchased amounts will be paid in full, or when they will be paid, cannot be known because payment is contingent on Epazz generating sufficient receipts from its customers; and Epazz, rather than TVT, controls whether daily payments will be reconciled.

The judge relied heavily on the reconciliation clause common to merchant cash advance agreements, whereby merchants can adjust their daily ACH amount to correlate with their actual sales activity. The case # is: 1:16-cv-05948-LLS. The full decision can be downloaded through a link contained at: <http://dbnk.news/7>

MISREPRESENTATIONS? WHAT MISREPRESENTATIONS?

In the New York Supreme Court, a judge addressed a business owner’s allegations that they had been misled into entering into purchase agreements when they actually wanted loans. In the decision excerpt below, Passley is Shaun Passley, one of the plaintiffs in the case.

[The plaintiffs] state that they would not have knowingly entered into merchant agreements, because what they really wanted were loans. Indeed, plaintiffs allege that “the word ‘purchase’ or ‘sale’ would have caused Passley to decline a transaction with [defendants] because a loan – the product Passley wanted to obtain – is not a purchase or sale.”

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not only do they all clearly state that they involve purchases or sales, but they all expressly state they are not loans. Even if someone were confused by the contracts, or did not understand the obligation or the process, by reading the documents, one would grasp immediately that they certainly were not straightforward loans. The very first heading on the page was "Merchant Agreement," and the second heading says "Purchase and Sale of Future Receivables."

[...] For plaintiffs to state that they would not have entered into a purchase or sale if they had known that that is what they were doing is utterly undermined by the documents themselves. As the Second Department has held, in *Karsanow v. Kuehlewein*, 232 A.D.2d 458, 459, 648 N.Y.S.2d 465, 466 (2d Dept. 1996), "the subject provision was clearly set out in the ... agreements, and where a party has the means available to him of knowing by the exercise of ordinary intelligence the truth or real quality of the subject of the representation, he must make use of those means or he will not be heard to complain that he was induced to enter into the transaction by

misrepresentations." So too here, plaintiffs had the means to understand that the agreements set forth that they were not loans. As it has long been settled that a party is bound by that which it signs, the Court finds that the ninth cause of action, for rescission based on misrepresentation or mistake, and the tenth cause of action, for fraudulent inducement based on misrepresentation, must be dismissed as a matter of law. *Pimpinello v. Swift & Co.*, 253 N.Y. 159, 162-63 (1930) ("the signer of a deed or other instrument, expressive of a jural act, is conclusively bound thereby. That his mind never gave assent to the terms expressed is not material. If the signer could read the instrument, not to have read it was gross negligence; if he could not have read it, not to procure it to be read was equally negligent; in either case the writing binds him.").

The case # is 54755/2016 in the County of Westchester in the New York Supreme Court. The full decision can be downloaded through a link contained at: <http://dbnk.news/8>

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ALTERNATIVE LENDERS SPREAD THEIR WINGS INTERNATIONALLY

By CHERYL WINOKUR MUNK

As alternative lending gains global traction, a growing number of U.S.-based alternative lenders are exploring international growth, with large companies like OnDeck, Kabbage and SoFi leading the way.

Some alternative lenders have begun their expedition closer to home by extending their reach into Canada. Others are traveling farther beyond to parts of Europe and Australia, for example, while others are eyeing eventual growth in Asia.

Propelling the opportunity is the fact that a number of international banks are still unprepared to offer online lending on their own and thus are more amenable to partnerships with U.S.-based alternative lenders, according to Rashmi Singh, senior manager in the wealth management practice at EY.

It also helps that the options for local partners are somewhat limited. "There are not a lot of digital lenders [outside the U.S.] at the same level as some of the folks here," Singh says.

To be sure, international expansion requires extensive time, money and regulatory know-how, and some U.S. alternative lenders may never reach the critical scale to be able to compete effectively. Nonetheless, as globalization proliferates, industry observers expect that additional forward-thinking

companies will push beyond the limits of their current geographical borders.

"The question is not if, but when (and where) U.S. fintech companies will expand internationally," contends Ryan Metcalf, chief of staff and director of international markets at Affirm, a San Francisco-based fintech that has partnered with Cross River Bank of Fort Lee, New Jersey, to allow shoppers pay for purchases over time with simple-interest loans.


Affirm—which works with more than 900 retailers and recently announced that it had processed its 1 millionth consumer installment loan—has focused on domestic growth so far, but the company is now considering a number of options for international expansion, Metcalf says.

SIZING UP THE MARKET

Certainly, there are numerous opportunities for homegrown lenders to expand internationally given the healthy growth alternative lending is experiencing in other parts of the world. Each market, of course,

has its nuances and individual growth patterns.

Europe, for instance, has seen substantial growth over the past few years, with the U.K. leading the way in alternative finance. It has four times higher volumes in aggregate than the rest of



**THE QUESTION IS NOT IF, BUT
WHEN (AND WHERE) U.S.
FINTECH COMPANIES WILL
EXPAND INTERNATIONALLY...**

Continental Europe, according to a 2016 report from KPMG and TWINO, one of the largest marketplace lending platforms in Europe. (P2P consumer lending is the largest component of alternative online lending in Europe, capturing 72 percent of the total in the first through third quarters of 2016, according to the report.)

After the U.K., France, Germany and the Netherlands are the top three countries for online alternative finance by market volume in Europe, according to a September 2016 report by the Cambridge Centre for Alternative Finance.



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Asian markets, meanwhile, show significant promise for alternative finance players to make their mark due to the sizeable population of digitally-savvy consumers who are still largely underbanked. China is by far the largest market for alternative lending in Asia. It's also the world's largest online alternative finance market by transaction volume, registering \$101.7 billion in 2015, according to the March 2016 Cambridge Centre for Alternative Finance report. This constitutes almost 99 percent of the total volume in the Asia-Pacific region, the research shows. To date, most of the growth in China specifically has been from local firms, but that could change as the market there continues to develop.

Although there are many possible international markets to explore, U.S. lenders have to tread carefully before planting roots elsewhere, observers say. Some smaller U.S. lenders may find domestic expansion easier and more cost-effective because of the time, regulatory and financial commitment that goes along with exploring international markets. It's a lot easier, for instance, to expand from New York to California, than it is to build out internationally.

"Why take on all the added costs and regulatory pressures, when you haven't fully explored your home market, unless the business that you're in deems it necessary," says Mark Abrams, partner with Trade Finance Global, a London-based international corporate finance house, specializing in cross-border trade.

"It doesn't make sense to start as a U.S. lender, do a few loans and then jump over to the U.K.," he contends.

What's more, foreign banks looking for alternative lending partners typically prefer to work with larger, more established players. Even though new players' technology may be ahead of the curve, the banks still want a longer track record. "It's reputational for these banks," says Singh of EY.



EFFICIENT AF

MANY CHALLENGES TO INTERNATIONAL EXPANSION

Several alternative lenders say they see significant growth opportunities by expanding internationally. At the same time, however, they are mindful of the substantial headwinds they face.

Regulation is among the biggest, if not the biggest, challenge. A lot of firms in the U.S. have invested a lot of time and money to get up to speed on U.S. regulations. When they look to Europe or to Canada or Mexico or elsewhere, there are different regulations. “If you’re speaking to folks in three continents, now you are looking at regulations times three,” says Singh of EY.

Certainly there’s a time commitment involved; it can take six to eight months for a U.S. lender to get their U.S.-based platforms compliant with regulations in another country, she says.

What’s more, regulatory barriers can vary greatly country to country, notes Metcalf of Affirm. Take Canada for example where very low barriers to entry exist with some provincial exceptions. In the U.K., on the other hand, it can take eight months or more to receive a lending license, he says.

That’s why it’s so important for online lenders to make strategic decisions about where they want to invest their time and resources—even if they have sound technology that’s easily adaptable outside the U.S. “The minute you throw in cross-border regulations, it gets very complicated,” Singh says.

Understanding the local culture of the market you’re trying to tap is also crucial, according to Rob Young, senior vice president of international at OnDeck, where he oversees all aspects of the company’s non-U.S. expansion efforts.

Within the past several years, OnDeck has begun offering small business loans to customers in Canada and Australia. Frequently Canada is a first step for U.S. companies that want to expand internationally because of the shared language and similarities between the economies, Young explains.

After the Canadian operation was successfully underway, the opportunity arose for the online lender to expand to Australia—which shares several similarities with the Canadian market. OnDeck doesn’t break out how much of its overall loan portfolio comes from these two markets, but it has announced publicly that it’s delivered more than CAD\$50 million in financing to Canadian small

businesses since 2014.

“So far we’re very satisfied with the performance,” Young says, referring to its expansion into both Canada and Australia.

Young notes that while a U.S.-based alternative lender can leverage certain things like technology from a central location within its home country, having dedicated teams on the ground in local markets is also critical. Marketing and pricing all have to be competitive with the needs of the local market, he says.

In Canada and Australia, for example, On Deck has found that the “personal element” is really important. Young says customers there expect to interact with sales representatives who have ties to the community, understand the local market and can relate to the issues small businesses there are facing.

“I don’t think you can establish that rapport if you are trying to serve them with a sales team overseas,” he says.

U.S.-based alternative lenders also need to be careful to create products that fit the culture and needs of a particular market. For instance, alternative players that focus on luxury asset-based lending would want to look at countries with high concentrations of wealth. “It doesn’t make sense to grow to a country where there’s very little wealth because you’re not going to have much success,” says Abrams, of Trade Finance Global.

Even knowing the market well doesn’t guarantee results, which Lending Technologies, a white label technology provider for the MCA space, has discovered first hand.

Markus Schneider, the company’s chief executive, is originally from Switzerland and he knows the market there well, so he set out to fill a void he saw for an MCA-like product. However, Lending Technologies, which has offices in New York and Zurich, has hit some roadblocks along the way.

“It’s a very different mind-set there. People are more risk-adverse,” Schneider says.

The company already has a Swiss distribution partner in place, but has had trouble finding a lender willing to underwrite the funds. Schneider would also be willing to work with a U.S. lender that wants to partner with Lending Technologies to provide MCA services to merchants in his home country.

“We’re going to do this. It’s just a matter of time,” he says. “There’s a tremendously underserved segment of the market there.”

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FINDING THE RIGHT FIT

To be successful internationally, U.S. companies also have to be willing to shift gears as needed when things aren't working out as expected.

Take Kabbage, for example. The small business lender expanded into the U.K. in 2013, two years after its U.S. debut. But the company found that having its own small business lending business in the U.K. was too challenging for regulatory and capital reasons. It no longer offers new loans from this platform.

Instead, the funding company decided that a better global strategy was to license its technology to financial institutions in international markets—a less capital-intensive, yet economically sound way of doing business.

Kabbage—which recently announced the establishment of its European headquarters in Ireland—has licensing arrangements with Santander in the U.K., Kikka Capital in Australia, Scotiabank in Canada and Mexico and ING in Spain. The company plans to launch operations in several additional countries this year where banks use Kabbage's technology to offer online loans to their clients, says Pete Steger, head of business development at Kabbage.

"We are partnering with local experts. That's our strategy," Steger says.

Funding Circle has also made changes to its international strategy. Earlier this year, the company—which got its start in the U.K.—announced that it would stop issuing new loans in Spain. The Spanish version of the company's website says that it continues to monitor ongoing loans so investors receive monthly payments for the projects they have invested in.

A spokeswoman for Funding Circle said the company continues "to look at new geographies, but we have no immediate plans for expansion and are focused on building a successful business here in the U.S., U.K., Germany and the Netherlands." She declined to comment further.

Without divulging too many details, a handful of U.S.-based alternative financiers say they continue to look at additional markets outside their home turf.

For its part, SoFi has announced plans to expand to Australia and Canada this year. The company's chief executive has also talked about European and Asian expansion in the future.

On the international front, Affirm is currently evaluating markets that make the most sense for its business model, Metcalf says. Affirm is also looking at possible acquisitions in developed markets such as the U.K. and

Sweden as well as considering "serious investment" in new distribution models in southeast Asia, Mexico and Brazil, he says.

LendingClub, meanwhile, last November announced a significant partnership with National Bank of Canada and its U.S. subsidiary Credigy.

The agreement provides for Credigy to invest up to \$1.3 billion over the subsequent twelve months.

A spokeswoman for LendingClub said the company has nothing to share about plans for international expansion.

As for OnDeck, Young says the company is exploring a number of options; it's a matter of finding markets where gaps exist in small business lending and where potential customers have a willingness to borrow online.

"We want to be the preferred choice for small businesses. It's not necessarily defined geographically," Young says. "We review markets all the time. There are a number of markets that are interesting to us."



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HUMANS VS. BANK STATEMENTS

AN UNDERWRITING JOURNEY

By ED MCKINLEY

Automation hasn't replaced humans yet when it comes to reading bank statements in the alternative small-business finance industry. ISOs, brokers, funders and underwriters still fend off drowsiness and ignore the risk of eye strain as they pore over months of paper or electronic documents.

Many consider the drudgery a necessary part of the business. A merchant's bank statements

expense often prevents that direct and relatively simple approach, multiple sources contend.

"Merchants simply don't want to give up their username and password to enable someone to log into their bank account," says Sam Bobley, CEO of Ocrolos, a company that specializes in automating the reading of paper statements and statements that have been converted to PDFs. Fear of somehow falling victim to an electronic robbery may be at the root of that reluctance, many in the industry agree.

Whatever the source of the hesitancy to share login information, the wariness usually seems more pronounced at the beginning of the underwriting process than toward the end, notes Arun Narayan, senior vice president of risk and analytics at Strategic Funding Source Inc., a New York City-based direct funder. "I don't think that's a problem after the commitment to fund," he says, "but it is a problem before the commitment to fund." Funders can try to



can reveal negative balances and commitments to previous loans or previous cash advances – any of which can indicate a bad risk, observers say. Moreover, detecting altered statements can expose fraudulent attempts to obtain credit, they add.

So why not dispense with the tedium and possible tampering of reading paper statements and pdfs? Instead, interested parties could simply obtain the login credentials for a credit or advance applicant's bank accounts and explore their banking records firsthand. But a mixture of fear, fraud and

leverage their market power to urge brokers to obtain a username and password from a merchant, Narayan suggests. But he admits that approach works only some of the time.

Merchants who have had a bad experience applying for loans or advances or are submitting their first application exhibit the most fear of surrendering login credentials, according to John Tucker, managing member at 1st Capital Loans, a broker with headquarters in Troy, Mich. "If they've been through the process before, they pretty much



Smart

Business Funding

know what's expected of them," he says.

All too often, applicants balk at presenting their login information because they have something to hide, notes Cheryl Tibbs, owner of One Stop Commercial Capital, an Atlanta-based brokerage that handles deals for multiple ISOs. She says her detective work with bank statements uncovers an average of two fraudulent applications per week.

Attempts at fraud average more than five a day at Elevate Funding, a Gainesville, Fla.-based director funder, says CEO Heather Francis. Her company's underwriters learn what to look for in bank statements that can indicate a merchant is trying to defraud a funder, she says.

First, an underwriter who's manually checking bank statements knows that documents bearing the names of certain banks have a higher likelihood of being bogus, Francis says. Apparently, fraudsters find the statements from those banks easier to alter, or perhaps they have the templates for those banks and can plug in false information, sources speculate.

Besides, anyone hoping to bilk a funder can buy a customized "vanity statement" for \$25 or \$30 on craigslist, complete with whatever deposits, opening balances and closing balances they choose, Francis notes. That can tempt troubled merchants as well as outright criminals, observers agree.

And some of the more bizarre errors that appear in falsified statements can seem almost comical. Tibbs cites the example of a statement she saw that was supposedly for January but was populated with transactions dated in February. On altered statements the ending balance for one month might not match the beginning balance for the next month, several sources note.

Sometimes the fake numbers that wayward applicants choose to include in their fraudulent statements can send up red flags, Tibbs maintains. If a merchant is seeking \$40,000 and presents account documents indicating \$80,000 or \$90,000 balances at the end of each month, something's amiss "10 times out of 10," she says.

Tibbs tells the story of a referral partner from a one- or two-person ISO calling her in a state of near-euphoria in the middle of the night, breathlessly describing a potential customer with monthly sales of \$800,000 and a need for \$500,000 in capital. Experience told her immediately that something

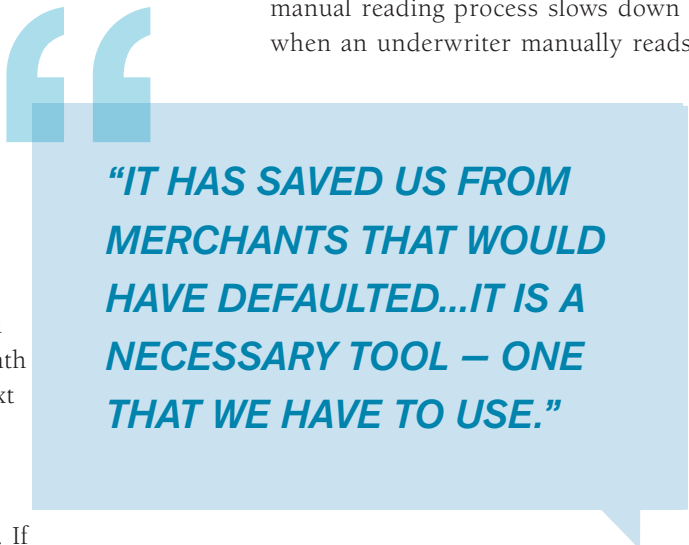
wasn't right. In the morning, she saw the statement's ending balances of \$300,000 to \$400,000, which confirmed her suspicions.

Yet grafting such unlikely numbers to a forged bank statement isn't as unsophisticated as some of the telltale signs that the industry sees when viewing bank statements manually, notes Francis. Some aspiring crooks doctor genuine statements with white-out correction fluid and then type in new numbers in a mismatched font, she says.

Anyone reading bank statements should also beware of applicants who "shotgun" applications to multiple ISOs, often on the same day, Tibbs warns. She often comes across that scam because numerous partners refer deals to her, she says.

Whether paper or pdf bank statements prove to be on-the-level or not, reading them manually takes time. An experienced underwriter who knows where to look for what he or she needs to find to verify a statement requires 15 to 20 minutes to approve one from a familiar financial institution, Francis says.

It seems that nearly every bank or credit union has its own way of designing statements, so the manual reading process slows down when an underwriter manually reads



"IT HAS SAVED US FROM MERCHANTS THAT WOULD HAVE DEFAULTED...IT IS A NECESSARY TOOL – ONE THAT WE HAVE TO USE."

a document with an unfamiliar layout, Francis notes. Unfamiliar types of statements sometimes come from small, obscure credit unions or remote community banks, observers say.

Familiar or unfamiliar, statements represent a key part of the underwriting process, and some funders accept the time and expense of reading them manually as simply a cost of doing business, according to Francis. But that expense can become a

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significant portion of the cost of a credit evaluation, according to Narayan.

That's why Narayan and his colleagues at Strategic Funding Source have been working with Oculus, a startup company that automates the reading of paper statements and pdf's of statements. Oculus uses optical character recognition, or OCR, to automate the reading of those statements.

Simply stated, OCR enables a machine to make sense of the characters it perceives in an image, says Bobley, the Oculus executive quoted earlier. When the platform can't make out certain data points, they're snipped and verified by humans in crowdsourced mini CAPTCHA tests, which stands for Completely Automated Public Turing.

They're those tests that ask computer users to type what they see to prove they're not robots, Bobley notes. When two of three crowd workers agree on what an image says in the CAPTCHA test, the Oculus platform accepts their verdict as correct, he says.

Oculus envisions a large market for its new platform among the many funders still reading bank statements manually in the early stages of underwriting, Bobley says. However, in the later stages of underwriting many of those funders already use bank sync companies to verify statements.

Bank sync companies include DecisionLogic, MicroBilt, Yodlee, Plaid and Finicity. They connect directly with some financial institutions to verify statements. Funders often mention the expense when they talk about bank sync companies, and they also note that bank sync companies have not yet established connections with some lesser-known financial institutions.

But late in the funding process, Elevate Funding requires merchants to cooperate with the bank sync company it uses unless extenuating circumstance dictate otherwise, says Francis. The bank sync company can gain direct access to statements using encrypted login information that does not reveal the true username or password to Elevate Funding or the bank sync company, she maintains.

Some of Elevate Funding's brokers maintain portals that merchants can use to provide their login credentials to get the bank sync process underway, Francis notes. The portal takes merchants to a page with Elevate Funding branding through a white-label program the bank sync company provides.



In about 85 percent of Elevate deals, the bank sync company is connected with the merchant's financial institution and therefore theoretically capable of gaining access to the accounts in question, Francis notes.

Over the past 30 days the Elevate Funding bank sync results included 3 percent bank error and 17 percent merchant error, while 73 percent of the statements were verified, Francis says. Bank error occurs when the bank sync company is connected to the bank but still can't obtain the account information. Merchant error sometimes happens when the potential client provides an incorrect user name or password, probably after forgetting the right one. Merchant error can also mean that the applicant was plotting fraud and abandoned the bank sync process upon realizing he or she was about to get caught.

The upshot? Some 73 percent of the bank statements submitted are verified, meaning that the information the merchants submitted matches the numbers at the bank, Francis reports. That also means that for whatever reason 7 percent don't even start the process they've requested, she says.

Meanwhile, the bank sync connection also provides real time data that would indicate to the funder whether the merchant has had a decline

in sales, an increase in negative activity or the recent addition of a credit provider, Francis says.

The service can pay off. In an average month, the bank sync service detects about 10 or 15 bad deals that Elevate Funding underwriters had accepted, Francis says. "It has saved us from merchants that would have defaulted," she says. "It is a necessary tool – one that we have to use."

But what about those cases where the bank sync company can't connect with the financial institution and the merchant still won't give up the login for the account? At 1st Capital Loans, Tucker can sometimes handle the situation by getting a bank activity sheet that lists transactions. If that type of sheet's not available, he arranges a phone call to with a representative of the bank to verify that nothing's amiss with the applicant's bank account.

It's another example of how – even with today's rampant automation – the human touch sometimes remains indispensable in assuring that merchants deserve the loans or advances they seek.



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INDUSTRY NEWS

4/11

- Regions Bank recruited Kabbage's chief technology officer, Amala Duggirala, to become its chief information officer

4/12

- Federal Reserve Published their 2016 Small Business Credit Survey

4/13

- Marathon Partners, a minority shareholder of OnDeck, publicly called on the company to make changes
- Fifth Third Bank partnered with Accion to support lending to underserved small businesses

4/17

- Affirm surpassed the mark of making more than 1 million loans since inception

4/20

- YieldStreet surpassed \$100M in loans funded since inception

4/21

- Glenn Goldman stepped down as Credibly's CEO

4/25

- SmartBiz Loans announced partnership with Sacramento-based Five Star Bank
- CommonBond begins offering loans to undergrads directly

4/26

- State regulators sued OCC over fintech charter proposal

4/28

- IOU Financial announced that they loaned \$107.6M to small businesses in Q1
- China Rapid Finance announced their IPO

5/2

- Funding Circle closed their online forum
- Elevate's Debt facility with Victory Park Capital increased from \$150M to \$250M

5/3

- Prosper Marketplace disclosed that it miscalculated returns shown to retail investors
- Square announced that they loaned \$251M to small businesses in Q1
- Nav raised \$13M from investors that include Goldman Sachs and Steve Cohen's Point72 Ventures

5/4

- Vermont governor signed into law new licensing requirements for anyone soliciting loans to Vermont borrowers.

- Lending Club announced that they loaned \$1.96B in Q1

5/5

- Thomas Curry steps down as OCC head, replaced by Acting Head Keith Noreika

5/8

- OnDeck announced it was substantially reducing its workforce as part of its plan to achieve profitability. The stock price proceeded to hit record lows.
- Dv01 announced reporting partnership with SoFi
- With no IPO on the horizon, SoFi revealed that they began letting their employees sell some of their stock

5/9

- In the United States District Court, The Southern District of New York ruled that a purchase of future receivables was not a loan largely because it was not absolutely payable. *Colonial Funding Network, Inc. as servicing provider for TVT Capital, LLC v. Epazz, Inc. Cynergy Corporation, and Shaun Passley a/k/a Shaun A. Passley*
- The value of 1 Bitcoin surpassed \$1,700.

5/10

- CFPB announces that it will begin work on small business loan data collection pursuant to Section 1071 of Dodd-Frank.
- CFPB publishes a white paper on small business lending
- SoFi revealed that they will apply for an industrial bank charter

5/12

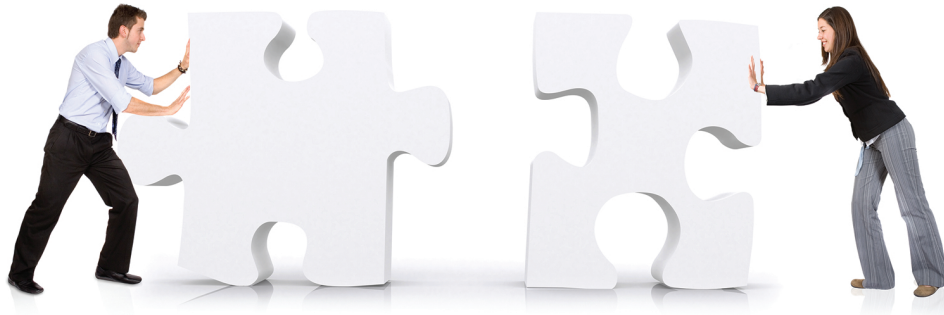
- NY's banking regulator sued the OCC over its proposed fintech charters

5/15

- Prosper announced that they lent \$585M in Q1 and had a net loss of \$23.9M

5/16

- Media outlets reported that SoFi is expanding into wealth management
- Lending Club named PayPal's former head of Global Credit Steve Allocca as President
- OnDeck's share price hit a new all-time low



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WHAT YOU NEED TO KNOW ABOUT THE CFPB AND SMALL BUSINESS LENDING

By SEAN MURRAY

On May 10th, the Consumer Financial Protection Bureau (CFPB) held a hearing on small business lending. Here's why it mattered and what you need to know:

WHY: The 2010 Wall Street Reform and Consumer Protection Act, aka Dodd-Frank, empowered the CFPB to collect data on small business lending. The CFPB is just now getting around to rolling this out. The purpose is to facilitate enforcement of fair lending laws and enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses. In short, to determine if women and minority-owned businesses are operating on a level-playing field when it comes to accessing credit.

WHO: *"I'm an MCA funder, factor, equipment lessor or other, and this only applies to lenders right?"*

Maybe, maybe not. Although Section 1071 makes several references to loans and credit, it doesn't refer to the companies subject to data collection as small business lenders. Instead it says financial institutions which it defines as "any partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity that engages in any financial activity." That sounds incredibly broad.

WHAT: What are they trying to collect?

- the number of the application and the date on which the application was received;
- the type and purpose of the loan or other credit being applied for;
- the amount of the credit or credit limit applied for, and the amount of the credit transaction or the credit limit approved for such applicant;

- the type of action taken with respect to such application, and the date of such action;
- the census tract in which is located the principal place of business of the women-owned, minority-owned, or small business loan applicant;
- the gross annual revenue of the business in the last fiscal year of the women-owned, minority-owned, or small business loan applicant preceding the date of the application;
- the race, sex, and ethnicity of the principal owners of the business; and
- any additional data that the Bureau determines would aid in fulfilling the purposes of this section.

HOW: Great question. The law says that where feasible the underwriter or analyst isn't allowed to know if the business is woman-owned or minority-owned and that this information must be captured separately and kept secret from the underwriter. The section is actually called the "NO ACCESS BY UNDERWRITERS" section. Oddly, as this applies to all small business lending, not just faceless transactions, one wonders how an underwriter is supposed to avoid discovering the gender or ethnicity of the applicant. It is possible that in 2009 when this section was drafted, the architects could not imagine a business lending universe that looked beyond FICO scores and balance sheets.

WHEN: It's still early days. Right now the CFPB just wants to know everything about what these "financial institutions" do and how they do it before they start requiring the data be collected. To that end, they've published a Request For Information, seeking voluntary responses so that they can start formulating the data collection framework in a way they believe best.

WHERE: Where can you read and watch more about this? We've got some information on this page including a video of the hearing: <http://dbnk.news/9>

WHAT SHOULD I DO? SHOULD I DO ANYTHING?

Join an industry trade association. When it came to the proposed regulation in New York, they did most of the heavy lifting. There are many to choose from depending on your business model. In New York though, the regulations were purely proposed. Under Dodd-Frank, the CFPB already has the power to collect data. They're just finally getting around to using it.

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