deBanked
November/December 2015

Even the strongest praise can't exaggerate the accomplishments of CAN Capital

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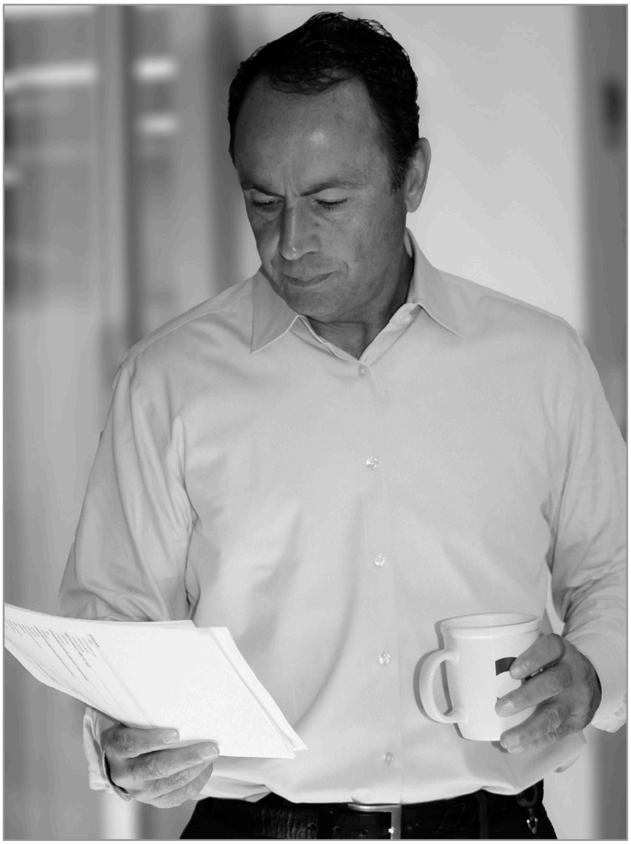

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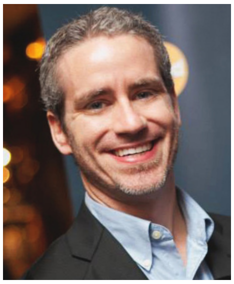

BY
SEAN MURRAY

Somehow 2015 is already over. It started off as the *year of the broker* but it ended up as a culmination of many things. It was the year of capital raising and rebrands, the year of regulatory interest and RFIs, the year of unicorns and leaderboards. 2015 solidified alternative lending's place across multiple continents. Bankers started talking like technologists and technologists like bankers.

In 2015, we introduced William Ramos who went from working at a Lowes Home Improvement store to driving a Maserati after he landed a temporary job as a financial cold caller. We also showed you Jared Weitz, who went from working as a plumber to running a financial company that's now on pace to originate $100 million in small business funding a year.

As we close out 2015 here, we'll introduce you to the man whose company is producing billions (that's billions with a 'b') of small business funding. Daniel DeMeo is the CEO of CAN Capital, a company who has weathered both the dot-com bust and the financial crisis and still manages to be one of the industry's top players. DeMeo shared what he's all about and the story of CAN you haven't read anywhere else.

That's the good stuff, but there's some bad stuff too. While critics have broadcast some of the not so flattering stories in alternative lending's rise, there's a darker side that no one has dared write about, bad borrowers. Perhaps a byproduct of rapid technological change, merchant fraud has become an all too common occurrence. These predatory merchants are causing chaos, damaging margins, exploiting underwriting weaknesses and potentially driving up the cost for the good guys. In this issue, we explore the reality of bad guys and their tactics.

And that's not all we have of course. In 2015, we compiled the first report on merchant cash advance and small business lending in collaboration with Bryant Park Capital. We measured the industry's growth, learned of its diversity, and got a numerical sense of the confidence for the future. A sample of that report is included within.

That was 2015 summed up, the year that Marty McFly met us all in the future. 2016 will undoubtedly mean robots, laser beams and interplanetary colonization. Sprinkled in between all that will be online loans, merchant cash advances, bitcoins, and financial disruption. In 2016, the world may become deBanked once and for all.

–Sean Murray

CAN CAPITAL: BEYOND HYPERBOLE

By *ED MCKINLEY*

Even the strongest praise can't exaggerate the accomplishments of CAN Capital

It's usually risky to say "first," "largest" or "best," but CAN Capital invites those superlatives and more.

Asked whether the company's the biggest in the alternative funding business, CEO Dan DeMeo hedges only a little with qualifiers like "might" or "probably" before proudly announcing that the company has provided access to more than $5.5 billion in working capital through 163,000 fundings to merchants operating in over 540 different kinds of businesses.

Glenn Goldman, the company's CEO from 2001 to 2013 and now Credibly's chief executive, doesn't mince words about his former employer when he calls CAN Capital the biggest and most profitable small business alternative finance company in the U.S.

Cofounder and Chairman Gary Johnson proclaims without hesitation that CAN Capital was the first alternative small business finance company. His wife and cofounder, Barbara Johnson, came up with the idea of the Merchant Cash Advance in 1998 when she had trouble raising funds to promote her business, he said.

CAN Capital developed the first platform to split card receipts between the merchant and funder, and it gave birth to the idea of daily remittances, Johnson continued. Within a few years of its founding the company was turning a profit, another first in alternative finance, he claimed.

The innovation continued from there, according to Andrea L. Petro, executive vice president and division manager of Lender Finance, a division of Wells Fargo Capital Finance. She cited a couple of possible firsts she's witnessed in her dealings with CAN Capital.

When CAN Capital received a loan from Wells Fargo in 2003, it may have been the first sizeable placement in the alternative finance industry by a major traditional financial institution, Petro said. In 2010, CAN Capital was among the first alternative funders to offer direct loans, she noted.

Petro stopped short of characterizing CAN Capital as the best in the alternative finance business, but she praised the company's management and lauded its systems for underwriting and monitoring funding. "They continually upgrade their systems, upgrade their software, upgrade their people," she said.

Calling CAN Capital one of the best comes naturally to Kevin Efrusy, a partner at Accel Partners and a CAN Capital board member. Accel saw opportunity in alternative finance because banks were reluctant to lend at the same time that an explosion of data on small businesses was informing the underwriting process. When Accel sought a position in the industry, it contacted CAN Capital, he said.

"Frankly, CAN Capital didn't need or want our money," Efrusy said. "We approached them." Five years ago, Accel convinced CAN Capital that additional resources could help the company grow, and it bought a stake in the company.

With so many extolling the virtues of CAN Capital, deBanked asked DeMeo for a look at the thinking that underlies the success.

PLOTTING STRATEGY

CAN Capital pursues a strategy that DeMeo visualizes as a honeycomb. In the center cell, he places the objective of "helping small businesses succeed." The compartmental element above that provides a place for the goal of serving as "the preferred provider of financial solutions to small business," he said. The company's cultural values, summarized as "Care, Dare and Deliver," reside in the compartment below the center cell as table stake underpinnings, he added.

DeMeo also describes the company as driven by four strategic planks: "1) Expand the market, 2) broaden the product set, 3) deepen relationships with customers, and 4) achieve operating excellence," he said.

What does success look like to the company? To DeMeo, it's dramatic growth in the number of customers, resulting in increased revenue, a more valuable company and better career opportunities. "Digital automation and customer experience are at the center of those efforts," he said.

CAN Capital operates with a "huge appetite for 'test and learn,'" according to DeMeo. "That's how we keep innovation alive," he said.

And the result of all that? The company has increased fundings by 29 percent (CAGR) and revenue by 24 percent (CAGR), with corresponding growth in earnings, DeMeo said. It has also grown its digital business by 600 percent since 2014, he noted.

AT THE WHEEL

DeMeo, the man at the top of CAN Capital, joined the company in 2010 as chief financial officer and became CEO early in 2013. He was previously CFO at 1st Financial Bank, and also served as CFO for JP Morgan Chase's consumer and small business unit. DeMeo also was chief marketing officer and ran business development head for GE Capital's consumer card unit. His career began at Citibank, where he held senior roles in marketing and customer analytics.

"I was very fortunate to work for some pedigree companies earlier in my career," DeMeo said. "Those companies emphasized market based training and development, and I worked with very smart and hardworking people. I also had great experience in unsecured lending." His formative years left him with great appreciation for "behavioral analytics and the quantitative, information-based approach to business finance."

Experience convinced him, as a CEO, the importance of attention to the balance sheet and income statement. It's vital to combine that with innovation and growth orientation, DeMeo said. He seeks to lead, inspire and motivate employees, he emphasized.

DeMeo grew up in Atlantic City, NJ, with parents who valued hard work, education and maximizing opportunity. His wife and three children have supported him in his career despite the long hours and dedication necessary for success.

At CAN Capital DeMeo has faced the challenge of managing the business through internal and external cycles. Running the company often comes down to balancing what customers want with what makes economic sense, he said. "Pigs eat, and hogs get slaughtered," he maintained. "You can't get too greedy."

DeMeo runs the company without the help of a President or Chief Operating Officer. While DeMeo serves as the public face of the company, he also devotes himself to every aspect of operations, he said.

WHAT'S IN A NAME?

Although CAN Capital's drive for technological innovation and its measured approach to fundings have remained constant, the company has renamed itself several times to fit changing times.

In November 2013, it rebranded itself publicly as CAN Capital, and the company now provides access to business loans through CAN Capital Asset Servicing Inc, and Merchant Cash Advances through CAN Capital Merchant Services.

With the CAN Capital rebranding, it dropped the umbrella name of Capital Access Network. At the same time, it retired the AdvanceMe, New Logic Business Loans and CapTap names.

Most of the company's old names applied to products or distribution channels, DeMeo said. The company had added them when it presented a new product, such as loans, or introduced a way of going to market, like end-to-end digital technology.

Consolidating the names reflected the company's decision to put its direct marketing efforts on equal footing with business generated by partner companies, DeMeo said. Having just one name would result in a more efficient approach to building a stronger brand, he noted.

"The opportunity is to create one brand, multiple products and omni-channel distribution under one company," he said. "For a company our size, it would be hard to create brand awareness if you had to put significant promotional support behind every one of those sub-brands."

CAN Connect is a sub-brand that has survived. "That's not a product name or distribution channel name," DeMeo said. "It's the technology suite we use to connect with partners so that we can exchange information in real time."

CAN Connect is a way to speed up the process and eliminate friction for customers and partners. For example, a partner is able to link their CRM directly into CAN Capital's decision engine,

eliminating manual steps in submitting and generating offers. For partners with a customer-facing portal, CAN Connect enables an offer to be made available in real time to a small business owner, taking advantage of data sharing APIs to tailor the marketing message to fit the prospective customer's needs.

Attention to detail pays off in repeat business for CAN Capital, in DeMeo's view. "Almost 70% of our merchants return for another contract," he said

THE GENESIS

By all accounts, CAN Capital is a company born of necessity. Barbara Johnson, who had the brainstorm that became CAN Capital, was running four Gymboree playgroup franchises in Connecticut and needed funds to finance summertime direct marketing efforts for fall enrollment.

But her company didn't have much in the way of assets to pledge, so banks weren't interested in providing funds. Why, she reasoned, couldn't she just borrow or receive an advance against the credit card receipts she knew would flow in when the kids came back in the autumn? Thus, she gave birth to an industry.

Barbara Johnson and her husband, direct marketing executive Gary Johnson, cofounded the company as Countrywide Business Alliance and put up their own money to build a computerized platform to split card revenue, Gary Johnson said.

Then they persuaded a card processor to partner with them. Once they were operating and had signed their first customer, venture capital began flowing their way to grow the business. These days, the Johnsons remain major shareholders.

"What made it an interesting concept was how huge the market potential was," Gary Johnson said. "That's what the attraction still is today." Although Merchant Cash Advances may now seem commonplace, they were startling at first, he said.

"When we first went out in the marketplace, everybody thought it was a crazy idea," he noted.

The company earned patents on processing related to Merchant Cash Advances and daily remittances, Gary Johnson said. At first, the patents deterred potential competitors from entering the business, but the company was unable to defend the patents successfully in court. Rivals then entered the fray.

Just the same, the company became profitable early on through "deliberate decision-making, having the right people in place and being bigger than everybody else," he said.

Much of the company's early business came through firms that provide merchants with transaction services, and that remains the case today, DeMeo said. Many were placing point of sale terminals in stores and restaurants to accept credit cards, and working capital became an upsell or cross-sell, he noted.

The large base of business CAN Capital built with merchant services companies means it will always be an important channel for the company. Recently, new merchant sign-ups have come from more diverse channels, including cobranded and referral partners, and the fast-growing direct marketing channels.

From the beginning, the merchants receiving capital used it to grow their businesses, DeMeo said. "That feeds the whole economic system and creates jobs," he said.

TODAY'S NUTS AND BOLTS

Daily remittances give CAN Capital nearly constant insight into how well customers are performing, which enables the company to discover potential issues quickly and take action. Such close monitoring also provides the company with enough information to enable funding opportunities that competitors might pass up, DeMeo said.

"The basis for our decisions is how the business performs and business-specific indicators, such as capacity and consistency, versus looking at the personal credit history of the business owner," DeMeo noted.

Having that data also helps the company create models it can use to serve other businesses in the same classification, DeMeo said. "It's poured into machine learning for future decisioning," he maintained. "It's a cool concept, right?"

The company's 450 or so employees work in several locations. Three hundred of the total are attached to the office in Kennesaw, GA, the region where the company first set up operations. To this day, that's where the company conducts most of its business, DeMeo said.

About 25 employees work in technology and operating support in offices in Salt Lake City because the area offers a strong talent pool and provides the company with additional time zone coverage, DeMeo said.

Some of the company's former executives came from Western Union, which had a presence in Costa Rica. About a hundred employees are now stationed there, working on technology, maintenance and development. That location also houses back-office redundancy for the company, too.

On Manhattan's 14th Street, the company has 30 or so employees, who include digital engineers, marketing and business development teams, the human resources lead, the chief financial officer, the chief legal officer, and the chief executive officer. The company moved its executive office there from Scarsdale, NY to take advantage of the digital boom,

> **THE OPPORTUNITY IS TO CREATE ONE BRAND, MULTIPLE PRODUCTS AND OMNI-CHANNEL DISTRIBUTION UNDER ONE COMPANY," HE SAID. "FOR A COMPANY OUR SIZE, IT WOULD BE HARD TO CREATE BRAND AWARENESS IF YOU HAD TO PUT SIGNIFICANT PROMOTIONAL SUPPORT BEHIND EVERY ONE OF THOSE SUB-BRANDS...**

he said, adding that, "Google's right around the corner."

Compared with most companies in alternative finance, CAN Capital has little venture capital as part of its ownership structure, DeMeo said. "It's a self-sustaining business. We're not forced to approach the capital market to cover our burn rate. We're cash-flow positive." Competitors have to borrow to fund their growth, he noted.

The company has taken on infusions of debt financing, not equity financing. In the latter, a company is selling part of itself, DeMeo said. "We raised $650 million from a syndicate with five new banks and 10 banks in total." The company completed a securitization of $200 million the year before, he said.

CAN Capital recently introduced the new TrakLoan product that has no fixed maturity date, with daily payments that are based on a fixed percentage of card receipts. This way, payments ebb and flow with the merchant's card sales. CAN Capital is also testing "bank-like" installment loans of as much as $500,000 with a payback period of up to four years.

And there's nowhere to go but up, in the view of CAN Capital executives. With a market of 28 million small American merchants and penetration of between 5 percent and 10 percent, they see plenty of potential to keep earning superlatives.

GOT A FERRARI OR FINE ART? IF SO, YOU MAY HAVE MORE LEVERAGE THAN YOU THINK

By *CHERYL WINOKUR MUNK*

If you own a Ferrari, fine art or expensive wine, getting access to capital may be easier than you think.

Although it's still a niche market, luxury asset-backed lending has been gaining traction lately, particularly with small and mid-size business owners. These executives are enticed by the ability to use certain high-priced valuables as a means of getting large amounts of cash quickly and often at a lower cost than other funding sources.

"People are increasingly learning that this is another option. It's not for everybody, but it's another option," says Tom McDermott, chief commercial officer at Borro, a New York-based asset-backed lender that deals exclusively with luxury asset-based loans.

It's notable that luxury asset-based lending by alternative funders is gaining ground at a time when unsecured money is so easy to come by. There are several reasons business owners are attracted to the idea of leveraging their valuables to attain cash. First off, they don't need stellar credit or a proven track record in business to qualify. Secondly, they can typically get larger sums of money and at better rates than they might through other financing channels. A third reason is that many of them have already tapped out other funding options and leveraging their assets allows them to obtain additional funds quickly.

"A lot of small business owners have assets, so it's something else for them to utilize in getting access to attractive small business financing," says Steven Mandis, chairman of Kalamata Capital LLC, an alternative finance company in Bethesda, Maryland.

Here's how the process typically works at most luxury asset-based lenders. Say a business owner wants to borrow against a high-priced item such as a top-of-the-line car, fine art or wine, jewelry or a luxury watch. First the luxury-based lender hires a third-party to appraise the item. Generally, depending on the asset and its marketability, lenders will lend 50 percent to 70 percent of the asset's value. If the owner moves forward, the item or items are held and insured in a lender's secure storage area until the loan is paid back. Default rates on these types of loans are relatively low, lenders say.

"People don't want to put their house at risk when they need capital," says McDermott of Borro. "They'd rather lose the Maserati or a lovely piece of art than the house," he says. And even then, it doesn't happen very often, he says. Borro clients only default on their loans about 8 percent of the time, McDermott says.

BARRIERS TO ENTRY

To be certain, luxury-based lending is not a business that every funder wants to be in. For starters, there are a lot of regulatory hoops a funder has to jump through in order to do it. You need a pawnbroker's license and a second-hand dealer license. You also need a secure facility or facilities to house the collateral, have secure ways of transporting the valuables, and you need to carry large amounts of insurance for the transfer of the items as well as during the holding period.

Indeed, keeping the items secure is critical. PledgeCap, a Lynbrook, New York-based funder, says on its website that it uses "cutting edge technology, top of the line bank vaults and armed guards" to keep a customer's items safe. What's more, all items are insured during transit and storage. All items are shipped through secured and insured FedEx shipping vendors for pickups and drop-offs.


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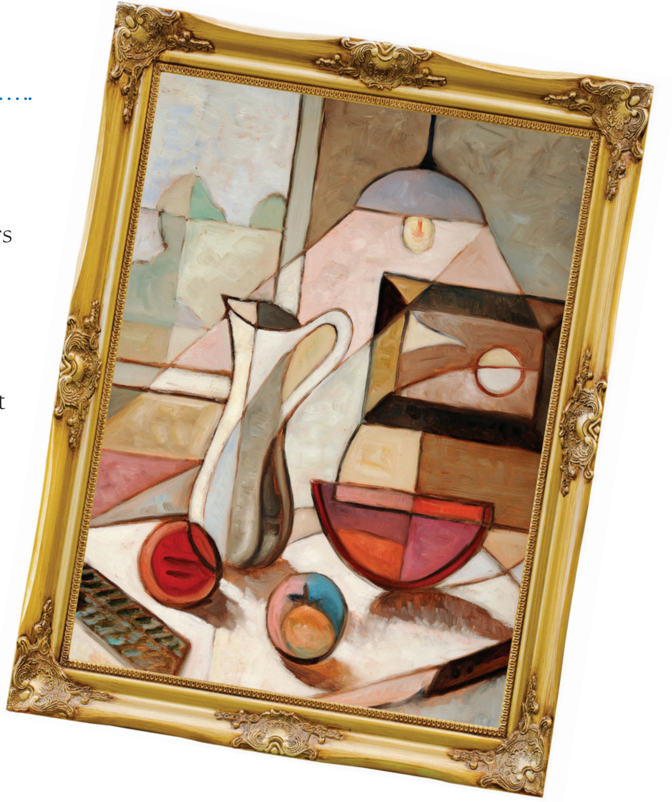
"There aren't a lot of players in the market because there are a lot of operational and legal requirements to adhere to. There are a lot of barriers to entry," says Gene Ayzenberg, the company's chief operating officer.

PUTTING THINGS IN PERSPECTIVE

Luxury asset-based lending is only a small subset of the overall asset-based lending market, which as a whole has been gaining ground in the past few years. After getting badly burned in the most recent recession, many lenders have come to appreciate the security blanket that collateral offers. According to the Commercial Finance Association's quarterly Asset-Based Lending Index, U.S. ABL loan commitments rose 7.2 percent in the second quarter, compared with the year-earlier period. In addition, new ABL credit commitments were 6.3% higher than the same period a year ago.

"Asset-based lending at one time used to be the lending of last resort. Now it's the type of lending that it is accepted globally," says Donald Clarke, president of Asset Based Lending Consultants Inc., a Hollywood, Florida-based company that provides due diligence services for lenders. "Today, everybody wants an asset."



There's not a lot of public data to gauge the size of the luxury market within the broader asset-based lending market. But a 2014 report that focuses on art lending gives more perspective to at least one facet of luxury asset-based lending.

Thirty six percent of the private banks polled said they offer art lending and art financing services using art and collectibles as collateral. That's up from 27 percent in 2012 and 22 percent in 2011, according to the report by consulting firm Deloitte and ArtBanc, a company that provides art sales alternatives, valuations and collections management services.

Meanwhile, 40 percent of private banks said this would be a strategic focus in the coming 12 months, up considerably from the 13 percent who named this as a priority in 2012.

These market changes are likely driven by client demand. The Deloitte/ArtBanc survey found that 48 percent of established art collectors polled said they would be interested in using their art collection as collateral for a loan, up from 41 percent in 2012.

Many big banks won't touch asset-based lending deals unless they are worth north of $5 million. Some community banks will do smaller deals, but many don't have the necessary infrastructure or skill sets, explains Clarke, of Asset Based Lending Consultants. This, of course, leaves an opening for alternative funders to capture market share.

LUXURY ASSET-BASED LENDING EXPECTED TO EXPERIENCE GROWTH

Some lenders say they expect demand for luxury asset-based loans to continue to increase over time as more people accumulate big-ticket items and they become more aware that they can satisfy their capital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needs by leveraging those assets. “A lot of times they don’t even know they have this option available to them,” says Ayzenberg of PledgeCap.

He says most of his company’s customers are small and mid-size business owners. Often they have temporary cash flow issues, but bank loans aren’t necessarily an option for them for any number of reasons. For instance, some may have bad credit. Others may have excellent credit but not enough of a business track record to qualify for a bank loan. Others may not have the cash flow to secure the amount of money they need, or they may need the money very quickly. Asset-based lenders can generally make the money available within a day, whereas bank loans require a lot of paperwork and can take months to obtain.

Mandis, of Kalamata Capital, says his company has seen an increased willingness by business owners to put up their luxury assets as collateral in order to get larger amounts of money at more favorable terms. Many times business owners have a high-priced asset that they don’t want to sell and pay a tax or can’t easily unload within a short-time frame. By borrowing against the luxury asset, they will get the capital to take advantage of a short-term opportunity and make an attractive return quickly without having to worry about finding a buyer or paying taxes on the sale of the asset, he explains.

Certainly luxury asset-based lending is not for every customer. Not only do you have to have a valuable asset to be used as collateral, but you also have to be willing to part with the item while the loan is outstanding. The risk of default and not getting the item back may also be a barrier for some people.

“I would be very hesitant to put up my wife’s diamond ring for my business. I don’t think it’s typically someone’s first choice,” says Ami Kassar, chief executive and founder of Multifunding LLC, a company in Ambler, Pennsylvania that helps small businesses find the best loan for their business. He remembers considering this option for a client only once in the past several years and the client ultimately chose another funding source.

But companies that focus on luxury asset-based lending say there is a viable market for their services that will continue to grow as more people hear about it and use it successfully to fulfill their funding needs. People have been taking their small items to pawn shops for many years. Working with a licensed lender to leverage their larger and often more expensive items gives them an option they may not have had previously. “You can’t just drive a tractor into a local pawnshop and say, ‘Here just put this in your safe,’” says Ayzenberg of PledgeCap.

Also, unlike pawn shops, luxury asset-based lenders say they aren’t looking to sell the items to make a quick buck and will only sell the item as a last resort if a customer defaults and they can’t reach agreeable terms. “We want them to keep their items,” says Ayzenberg whose company has been in business since 2013. For every 100 loans, there are only a small percentage of customers that default and lose the items, he says.

> **“CERTAINLY LUXURY ASSET-BASED LENDING IS NOT FOR EVERY CUSTOMER. NOT ONLY DO YOU HAVE TO HAVE A VALUABLE ASSET TO BE USED AS COLLATERAL, BUT YOU ALSO HAVE TO BE WILLING TO PART WITH THE ITEM WHILE THE LOAN IS OUTSTANDING...**

Every lender runs their business slightly different. At Borro, for example, loans typically range between $20,000 and $10 million and span in time frame from three months to three years. Rates start in the mid-teens and are based on the size of the loan, the time frame and how easy the asset would be to sell. In order to work with Borro, the asset typically has to be worth more than around $40,000, McDermott says.

Borro, which has been in business since 2009, deals with customers directly. But it also gets a good number of referrals from other lenders. Let's say a customer needs $500,000 and a particular lender can only offer a maximum of $350,000. That lender might refer the client to Borro, which kicks in $150,000 based on the value of a leveraged asset. The referring company gets a commission based on the loan value and doesn't lose the whole deal. "It's a way to keep your customers tied in with you," McDermott says, adding that Borro has no intention of getting into other types of lending. "We complement each other. We don't compete."

PledgeCap also focuses exclusively on asset-based lending. The company typically funds loans between $1,000 and $5 million. The length of each loan is four months. Customers don't have to pay every month, though most do. For every month the loan is outstanding customers pay a rate of 3 percent on average. Other fees, payable at the end of the loan, are assessed based on costs PledgeCap incurs and depend on factors such as the cost of insurance, the appraisal fee and the cost of transporting the item to the secure facility.

By contrast, Kalamata Capital, which has been in business since 2013, offers asset-backed loans in connection with several other small business financing options—such as working capital loans, SBA loans, lines of credit, merchant cash advance and invoice factoring—to give customers more flexibility in terms of rates.

In Kalamata's case, it will evaluate the cash flow and other assets of a small business for financing options. Kalamata then combines both the amount it would lend against an asset and the amount it would lend to the small business, possibly giving the business a lower rate—and more options—in the process.

While it's not a type of funding that works for everyone, Mandis, the chairman of Kalamata, expects to see continued growth in this area. "I don't think the loan market for luxury assets is as large as many of the traditional small business finance areas, but it is something that can be helpful to small business owners," he says.

GETTING A CALIFORNIA LENDER'S LICENSE

By *PAUL A. RIANDA, ESQ.*

Given the fact there have been a number of successful lawsuits against cash advance companies in California, many cash advance companies have decided to take a different route and get a lending license to provide loans to merchants in the state. If done correctly, this can allow companies to provide loans to merchants in California at roughly the same profit margins one could expect from a cash advance. Below I will discuss the process for obtaining a California lender's license and some tips for making that process less painful.

To start, go to the California Department of Business Oversight and get the form titled "Application for a License Under the California Finance Lenders Law." The application is long and detailed but don't let that scare you. Most of the information you provide is really more related to letting the State know about your company and the main people that will be responsible for managing the lending operations. As you complete the form, one thing you do need to do is make sure you are very careful and meticulous as any small mistake will cause the application to be rejected making the process much longer.

The first part of the application requests basic information about your company and its officers. In filling out this and other parts of the application, it is essential to respond to all the questions. If you fail to miss just one response the application will be rejected. To that end, even if a question does not apply to you I find it better to respond "N/A" or "not applicable" rather than just leaving a blank. By doing that you force yourself to fill in every blank and therefore reduce the chances for missing a response resulting in a rejection of your application.

Also, you need to be very precise in your responses. I have experienced a situation where the examiner rejected an application because the name of the company was incorrectly spelled on the application. The name of the company was submitted on the application with "Inc" instead of the complete "Inc." at the end of the company's name. The examiners are very good at what they do and very thorough. You need to make sure the packet you submit is perfect and also that there are no inconsistencies in the document.

Another important point to remember is that the application requires you to name the person that will be responsible for running the location where the lending is occurring. The main requirement is that the person running the location must be physically present at the location. As a result, you could not manage a California office remotely from New York for instance. In another twist, if your principal location is out of state, you will need to get the license and fill out the main application for that out of state address. For the California location, you will need to fill out the short form application in addition to the main application and submit the short form application as part of the packet to allow the license to apply to the location in the state of California.

There are a number of exhibits you also have to provide as part of the process. Some of them are simple like a balance sheet for the company. It is acceptable that the company is new and has little in the way of assets. You just have to make sure you attach a balance sheet and that it is prepared in compliance with generally accepted accounting principles. I have seen times when the balance sheet was rejected because there was no line item for liabilities for instance, even though the company was new and therefore had none. It is probably wise to engage your accountant to make sure you submit a balance sheet that complies with those guidelines.

You also have to get a surety bond in the amount of $25,000. There are readily available bonding companies that specialize in providing these bonds. In addition, you need some other exhibits like a statement of good standing for your company, authorization for financial disclosure, social security number (on a separate exhibit), organizational chart and a few other documents. As with the rest of the application the key is to make sure you include everything they are asking for exactly as requested.

The most involved exhibit is the "Statement of Identity and Questionnaire." That exhibit has to be filled out for each owner, officer and manager listed on the application. It requests detailed information going back 10 years for each person for items like residence address and work history.

In addition, there are a series of questions on topics such as whether the person has been involved in lawsuits, had any licenses revoked or declared bankruptcy. Fingerprints are also taken as part of the process. This part of the

"I HAVE SEEN TIMES WHEN THE BALANCE SHEET WAS REJECTED BECAUSE THERE WAS NO LINE ITEM FOR LIABILITIES FOR INSTANCE, EVEN THOUGH THE COMPANY WAS NEW AND THEREFORE HAD NONE...

application is trying to vet the various people working for the company to make sure they are suitable to be in the lending business.

Once you have all the documents prepared, you need to put them together in a packet to send off to the Department of Business Oversight to be reviewed. Again, I cannot overemphasize how important it is to completely and accurately answer the questions and put the packet together. You need to make sure things are in the proper order and complete. Triple check the application for errors and to make sure that packet is presented in the best manner possible. You also need to determine the amount of fees to submit with the application. Then, send the package by overnight delivery to make sure you have proof of delivery.

So what happens next? Well there is usually a bit of a wait. Typically it takes 3 months or more to get a reply. If you have done your homework, you might get lucky and successfully get your license on the first try. If there are any deficiencies, you will get a response

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letter from the State detailing the items that need to be corrected in the application and a time frame in which you have to respond or the application is abandoned.

On the first go round, you are usually given at least 2 months so you should have plenty of time. Digest the things they want and provide the required information. The deficiency letters are very detailed so it should be easy to make the requested changes. Resubmit the requested items and wait for the next response. It could be in the form of another deficiency letter but it could be an approval of the license. Just keep on trying until you are finally successful.

That's it, you are finally a licensed lender in California! But that is where the fun begins. You are subject to many laws in California and audits by the State. To get the right to operate as a licensed lender, you need to make sure you prepare your application correctly. Once you have done that, you need to get all your loan documents drafted in compliance with California law. Make sure you have adequate experience and professional help to take on those tasks.

** Paul A. Rianda, Esq. is an attorney who has specialized in providing legal advice to the cash advance and bankcard industries for over 20 years. For more information about this article or any other matters, please contact Mr. Rianda at (949) 261-7700 or via email at paul@riandalaw.com*

*** The information contained herein is for informational purposes only and should not be relied upon in reaching a conclusion in a particular area. The legal principles discussed herein were accurate at the time this article was authored but are subject to change. Please consult an attorney before making a decision using only the information provided in this article.*

BAD MERCHANTS: LIES, FRAUD, AND HARD TIMES

By *ED MCKINLEY*

Critics seldom tire of bashing alternative finance companies, but bad behavior by merchants on the other side of the funding equation goes largely unreported. Behind a veil of silence, devious funding applicants lie about their circumstances or falsify bank records to "qualify" for advances or loans they can't or won't repay. Meanwhile, imposters who don't even own stores or restaurants apply for working capital and then disappear with the money.

"People advertise on craigslist to help you commit fraud," declared Scott Williams, managing member at Florida-based Financial Advantage Group LLC, who helped start DataMerch LLC to track wayward funding applicants. "Fraud's a booming business, and every year the numbers seem to increase."

Deception's naturally on the rise as the industry continues to grow, according to funders, industry attorneys and collections experts. But it's also increasing because technology has made it easy for unscrupulous funding applicants to make themselves appear worthy of funding by doctoring or forging bank statements, observers agreed.

Some fraud-minded merchants buy "novelty" bank statements online for as little as $5 and fill them out electronically, said David Goldin, president and CEO of Capify, a New York-based funder formerly called AmeriMerchant, and president of the SBFA, which in the past was called the North American Merchant Advance Association.

To make matters worse, dishonest brokers sometimes coach merchants on how to create the forgeries or modify legitimate records, Goldin maintained. Funders have gone so far as to hire private investigators to scrutinize brokers, he said.

But savvy funders can avoid bogus bank statements, according to Nicholas Giuliano, a partner at Giuliano, McDonnell & Perrone, a New York law firm that handles collections. Funders can protect themselves by remaining skeptical of bank records supplied by applicants. "If the merchant cash advance company is not getting them directly from the source, they can be fooled," Giuliano said of obtaining the documents from banks.

Another attorney at the firm, Christopher Murray, noted that many funders insist upon getting the merchant's user name and password to log on to bank accounts to check for risk. That way, they can see for themselves what's happening with the merchant.

Besides banking records, funders should beware of other types of false information the can prove difficult to ferret out and even more difficult to prove, Murray said. For example, a merchant who's nine or ten months behind in the rent could convince a landlord to lie about the situation, he noted. The landlord might be willing to go along with the scam in the hope of recouping some of the back rent from a merchant newly flush with cash.

Merchants can also reduce their payments on cash advances by providing customers with incentives to pay with cash instead of cards or by routing

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transactions through point of sale terminals that aren't integrated onto the platform that splits the revenue, said Jamie Polon, a partner at the Great Neck, N.Y.-based law firm of Mavrides, Moyal, Packman & Sadkin, LLP and manager of its Creditors' Rights Group. A site inspection can sometimes detect the extra terminals used to reduce the funder's share of revenue, he suggested.

In a ruse they call "the evil twin" around the law offices of Giuliano, McDonnell & Perrone, merchants simply deny applying for the funding or receiving it, Giuliano said. "Suddenly, the transaction goes bad, and they deny they had anything to do with it," he said. "It was someone who stole the merchant's identity somehow and then falsified records."

In other cases, merchants direct their banks not to continue paying an obligation to a funder, or they change to a different bank that's not aware of the loan or advance, according to Murray. They can also switch to a transaction processor that's not aware of the revenue split with the funder. Such behavior earns the sobriquet "predatory merchant," and they're a real problem for the industry, he said.

Occasionally, merchants decide to stop paying off their loans or advances on the advice of a credit consulting company that markets itself as capable of consolidating debt and lowering payments, Giuliano said. "That's a growing issue," agreed Murray. "A lot of these guys are coming from the consumer side of the industry."

The debt consolidator may even bully creditors to settle for substantially less than the merchant has agreed to pay, Murray continued. Remember that in most cases the merchants hiring those companies to negotiate tend to be in less financial trouble than merchants that file for bankruptcy protection, he advised.

"More often than not, they simply don't want to pay," he said of some of the merchants coached by "the credit consultants." They pay themselves a hundred thousand a year, and everyone else be damned. You continue to see them drive Humvees."

Merchants sometimes take out a cash advance and immediately use the money to hire a bankruptcy attorney, who tries to lower the amount paid back, Murray continued. However, such cases are becoming rare because bankruptcy judges have almost no tolerance for the practice and because underwriting continues to improve, he noted.

Still, it's not unheard of for a merchant to sell a business and then apply for working capital, Murray said. In such cases, funders who perform an online search find the applicant's name still associated with the enterprise he or she formerly owned. Moreover, no one may have filed papers indicating the sale of the business. "That's a bit more common than one would like," he said.

In other cases the applicant didn't even own a business in the first place. "They're not just fudging numbers – they're fudging contact information," said Polon. "It's a pure bait and switch. There wasn't even a company. It's a scheme and it's stealing money."

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Whatever transgressions the merchants or pseudo-merchants commit, they seldom come up on criminal charges. "It is extremely, extremely rare that you will find a law enforcement agency that cares that a merchant cash advance company or alternative lender has been defrauded," Murray said. It happens only if a merchant cheats a number of funders and clients, he asserted. "Recently, a guy made it his business to collect fraudulent auto loans," he continued. "That's a guy who is doing some time."

However, funders can take miscreants to court in civil actions. "We're generally successful in obtaining judgments," said Giuliano. "Then my question is 'how do you enforce it?' You have to find the assets." About 80 percent of merchants fail to appear in court, Murray added. Funders may have to deal with two sets of attorneys – one to litigate the case and another to enforce the judgment. Even merchants who aren't appearing in court to meet the charges usually find the wherewithal to hire counsel, he said.

Funders sometimes recover the full amount through litigation but sometimes accept a partial settlement. "Compromise is not uncommon," noted Giuliano. Settling for less makes more sense when the merchant is struggling financially but hasn't been malicious, said Murray.

To avoid court, attorneys try to persuade merchants to pay up, said Polon. "My job is to get people on the phone and try to facilitate a resolution," he said of his work in "pre-litigation efforts," which also included demand letters advising debtors an attorney was handling the case.

But it's even better not to become involved with fraudsters in the first place. That's why more than 400 funding companies are using commercially available software that detects and reduces incidence of falsified bank records, said a representative of Microbilt, a 37-year-old Kennesaw, Ga.-based consumer reporting agency that has supplied a fraud-detection product for nearly four years.

"Our system logs into their bank account and draws down the various data points, and we run them through 175 algorithms," he said. "It's really a tool to automate the process of transferring information from the bank to the lender," he explained.

The tools note gross income, customer expenditures, loans outstanding, checks returned for non-sufficient funds and other factors. Funders use the portions of the data that apply to their risk models, noted Sean M. Albert, MicroBilt's senior vice president and chief marketing officer.

Funders pay 25 cents to $1.25 each time they use MicroBilt's service, with the rate based on how often they use it, Albert said. "They only pay for hits," he said, noting that they don't charge if information's not available. Funders can integrate with the

OUR SYSTEM LOGS INTO THEIR BANK ACCOUNT AND DRAWS DOWN THE VARIOUS DATA POINTS, AND WE RUN THEM THROUGH 175 ALGORITHMS...

MicroBilt server or use the service online. The company checks to make sure that potential customers actually work in the alternative funding business.

MicroBilt is testing a product that gathers information from a merchant's credit card processing statement to analyze ability to repay an advance, a company representative said.

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Excessive chargebacks reflected in the statements could spell trouble, and seasonality in receipts should show up, he noted.

Additional help in avoiding problem merchants comes from the Small Business Finance Association, which maintains a list of more than 10,000 badly behaving funding applicants, said the SBFA's David Goldin. The nearly 20 companies that belong to the trade group supply the names.

SBFA members, who pay $3,000 monthly to belong, have access to the list. According to Goldin, the dues make sense because preventing a single case of fraud can offset them for some time, he maintained. Besides, associations in other industries charge as much as $10,000 a month, he added.

Another database of possibly dubious merchants, maintained by DataMerch LLC, became available to funders in July, according to Scott Williams, who started the enterprise with Cody Burgess. It became integrated with the deBanked newsfeed by early October, causing the number of participating funders to double to a total of about 40, he said. The service is free now, but will carry a fee in the future.

It's not a blacklist of merchants that should never receive funding again, Williams emphasized. Businesses can return to solvency when circumstances can change, he noted. That's why it's wise to regard the database as an underwriting tool. In addition, merchants can in some cases add their side of the story to the listings.

Funding companies directly affected by wayward merchants can contribute names to the list, Williams said. About 2,500 merchants made the list within a few months of its inception, he noted. "We're super happy with our numbers," he said of the database's growth.

Many merchants find themselves in the database because of hard times. Of those who land on the list because of fraud, perhaps 75 percent actually own businesses and about 25 percent are con artists applying for funding for shell companies, Williams said.

So far, only direct funders – not brokers or ISOs – can get access to the database, he continued, noting that DataMerch could rethink the restriction in the future. "We don't want hearsay from a broker who might not know the full scope of the story," he said.

DataMerch might grant brokers and ISOs the right to read the list to avoid wasting time pitching deals to substandard merchants, but the company does not intend to enable members of those groups to add merchants to the database, Williams said.

Williams sees a need for the new database because smaller companies can't afford belonging to the SBFA. The association also tracks deals about to become final, which could prevent double-funding but makes some users uncomfortable because they don't want to disclose their good merchants, Williams said.

Although dishonesty's sometimes a factor, merchants often go into default just because of lean times, Jamie Polon, the attorney, cautioned. A restaurant could close, for example, because of construction or an equipment breakdown. "Were they not serving dinner anymore, or was there something much deeper going on?" he said. Fraud may play a role in 10 percent to 20 percent of the collections cases his law firm sees, he noted. More than 95 percent blame their troubles on a downturn in business, and the rest claim they didn't understand the contract, he said.

To understand the downturn, it's important to amass as much information about the merchant as possible, said Mark LeFevre, president and CEO of Kearns, Brinen & Monaghan, a Dover, Del.-based collections agency that works with funders. That information sheds light on a merchant's ability to repay and could help determine what terms the merchant can meet, he said.

Timeliness matters because the sooner a creditor takes action to collect, the greater the chance of recouping all or most of the obligation, LeFevre maintained. When distress signals arise – such as closing an ACH account or a spate of unreturned phone calls – it's time to place the merchant with a collections expert, he advised.

LeFevre's company also traces a troubled merchant's dwindling assets to help the funder receive a fair share. Funders can sometimes recover all or most of what they pay a collection agency by imposing fees on the merchant, he noted.

Pinning the collection fees to merchants in default makes sense because that's where the guilt often resides, observers said. It's part of balancing the bad-behavior equation, they agreed.

INDUSTRY MESSAGE BOARDS CRACK DOWN ON ANONYMOUS DEAL GRABBERS

By *SEAN MURRAY*

Industry message boards, including deBanked's, have begun taking a stronger stance against anonymity to facilitate transparency and protect users. While anyone can still register with their personal addresses, a corporate email address must be provided in the course of soliciting business. Industry participants have reached a general consensus that soliciting deals while hiding behind a free email address raises a red flag.

With hundreds of legitimate vendors to choose from, there should be little need to transact with users that lack basic things such as a company name, office address and phone number.

"I'm bombarded with probably 10 emails every day of the week from a supposedly new lender that wants my business, and they're really just a broker shop like we are," said Cheryl Tibbs, in the September/October issue of deBanked Magazine. She warned that fake funders can steal deals and pocket the entire commission. They solicit deals in online forums, by email message or over the phone, and then they offer the deals to companies that really do function as direct funders, she said.

While no online forum was specified in the story, at least two forums have responded by cracking down on anonymity by suspending or banning violators. The age of the *gmail* funder is coming to a close. Don't buy leads from HotLeads4u69@hotmail.com and definitely don't syndicate with a company that has no known address.

THE SMALL BUSINESS FINANCING REPORT

We are pleased to present our preliminary results to date of our inaugural Industry CEO survey. Our initial findings are drawn from a survey of twenty-seven C-level participants, whose companies primarily offer merchant cash advances and small business loans. Combined, the participants represent more than $1.9 billion in annual origination volume. The survey was sent to over one-hundred eligible respondents, with participation open to all of them equally and included both direct funders and brokers.

CEO RESPONDENTS ARE MEANINGFUL INDUSTRY PARTICIPANTS

Thirteen respondents reported being on pace to originate $50 million or more in 2015.

Seven respondents reported being on pace to originate $100 million or more in 2015.

THE INDUSTRY HAS A COMPOUND ANNUAL GROWTH RATE OF **56%**

THE INDUSTRY HAS A DIVERSIFIED PRODUCT MIX

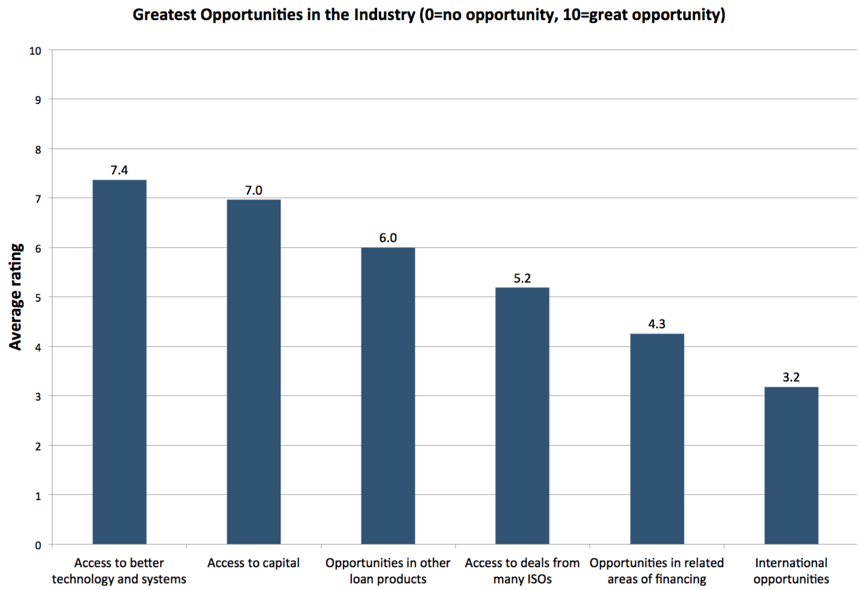
Respondents revealed a diversified product mix beyond merchant cash advance. Five participants actually reported originating no merchant cash advances at all and instead offered term loans or other products.

THE INDUSTRY CEOS HAVE A CONFIDENCE INDEX OF 83.7

Based on responses from CEO/participants asked to give their confidence level in the continued success of the small business lending/MCA industry over the next 12 months on a scale of 0–100, with 100 being the highest.

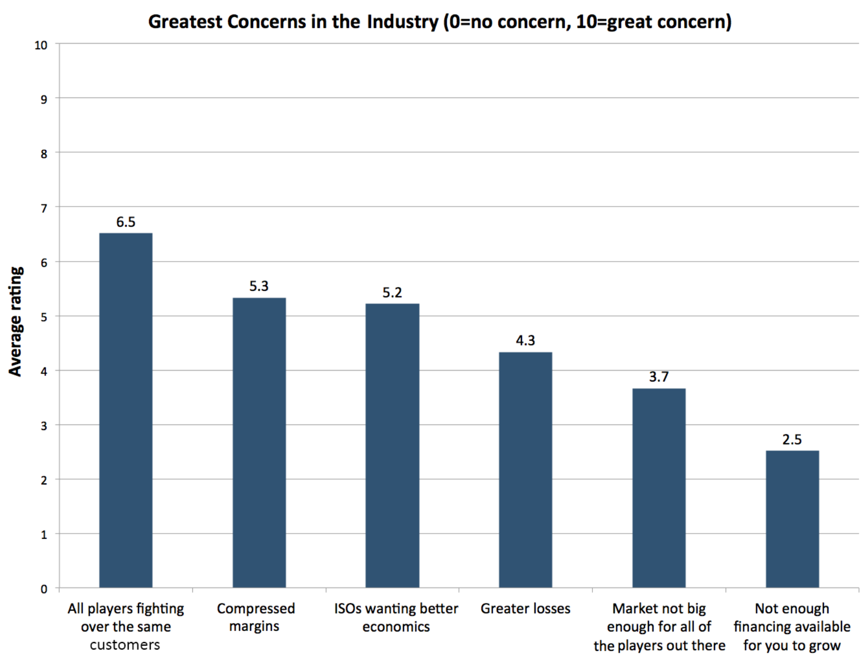
ACCESS TO BETTER TECHNOLOGY AND SYSTEMS IS THE GREATEST OPPORTUNITY IN THE INDUSTRY

Based on responses from participants asked to score the importance of opportunities on a scale of 0–10, with 10 being the highest.



ALL PLAYERS FIGHTING OVER THE SAME CUSTOMERS IS THE GREATEST CONCERN IN THE INDUSTRY

Based on responses from participants asked to score their concerns on a scale of 0–10, with 10 being the highest.



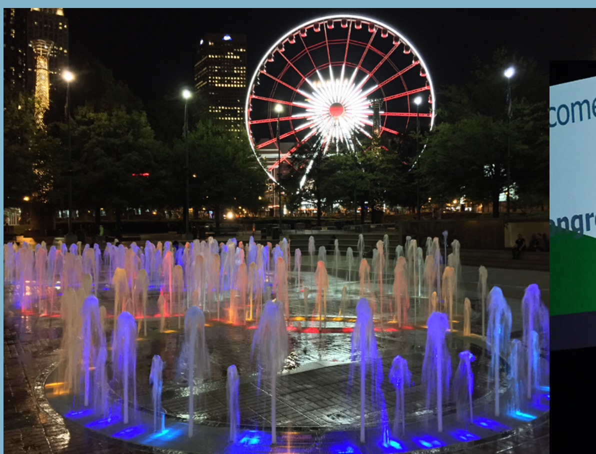
NOTES:

The identities of participants and their individual responses are confidential. Participants were asked a total of 27 questions and had the ability to waive a response to any question, including the disclosure of their identity to the surveyors themselves.

Survey participants are eligible to receive the full anonymized report. Industry players who complete the full survey will automatically receive a full copy of this report. If you are not part of an operating company in the industry and you would like to obtain a copy of the report or participate in the survey, please contact Bryant Park Capital or deBanked.

THE END OF YEAR CONFERENCE WRAP UP

LEND360 / ATLANTA, GA (OCTOBER 13–15, 2015)



"God bless the online lenders," said Democratic Congressman David Scott to kick off the conference. The theme of his speech was directed at the regulatory challenges that alternative lenders are facing, particularly those in small dollar consumer lending. Campaigns such as Operation Choke Point are the result of government feeling like they need to come to the rescue, Scott argued. The Four Oaks bank fraud case was cited as one example.

He advised that the best way to combat an overzealous government on regulations is to "raise the issue," which could roughly be translated to "hire lobbyists."

Coincidentally, Tom Sullivan, who heads the Coalition for Responsible Business Finance (CRBF), an advocacy and education platform for those that provide alternative capital for small businesses, immediately followed Scott on stage to promote a proactive approach to dealing with regulations.

"Federal regulators and Congress are interested in what you're doing," said Sullivan. "That could be a good thing or a bad thing."

More information about the CRBF can be found at: **http://www.responsiblefinance.com**

MONEY2020 / LAS VEGAS, NV (OCTOBER 25–28, 2015)

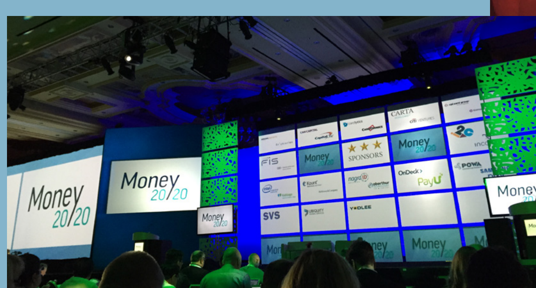
"You have to have enough bad loans to build a good credit model," said OnDeck CEO Noah Breslow during a panel discussion. Just a few days later, OnDeck announced their second straight profitable quarter. Their stock price however still hung at about half their IPO price as of the time this story went to print. At Money2020, several panelists drew a distinction between public valuations and private market valuations.

"A unicorn valuation in private markets could be from just two people," said Robert Greifeld, the CEO of Nasdaq, at the conference. "Whereas public markets could be 200,000 people." At best, he described a private market valuation as being just a rough indicator.

His comments were well-timed. Just a week before, Kabbage inked a $135 million equity raise that gave it a private market valuation of $1 billion. And SoFi had just raised $1 billion to give it a valuation of nearly $4 billion. And that's where it gets cloudy because Square's valuation of $6 billion in the private market dropped down to less than $3 billion in their IPO on November 19th, just weeks after Money2020.

Todd Baker, the managing principal of Broadmoor Consulting, would later tell deBanked that, "when public valuations are sharply lower than private valuations, there is something wrong, and it can usually be found in the private valuation side."

Unicorn fever over alternative lending and those starting to feel a hangover from it at Money2020 would eventually come to a head in the form of a debate at the Marketplace Lending and Investing Conference the following week in New York City.



THE END OF YEAR CONFERENCE **WRAP UP**

MARKETPLACE LENDING AND INVESTING
/ NEW YORK, NY (NOVEMBER 4–5, 2015)

"You're big buyers of some of this paper until you're not," said Todd Baker, to a crowd of institutional investors and bankers at the conference. Seated to his right was his debate adversary, SoFi CEO Mike Cagney. The two had previously battled through Op-eds published in American Banker.

"The beauty of marketplace lending is we're balance sheet light," said Cagney, in defense to accusations that SoFi and **marketplaces** like them would be in trouble in the next recession.

Ultimately, the two disagreed on the consequences for a marketplace in the eventuality that there is no loan buying demand. Baker predicted that it would kill a marketplace and Cagney argued that such a scenario couldn't ever happen and even if it did, it would not kill their company.

Kalamata Capital