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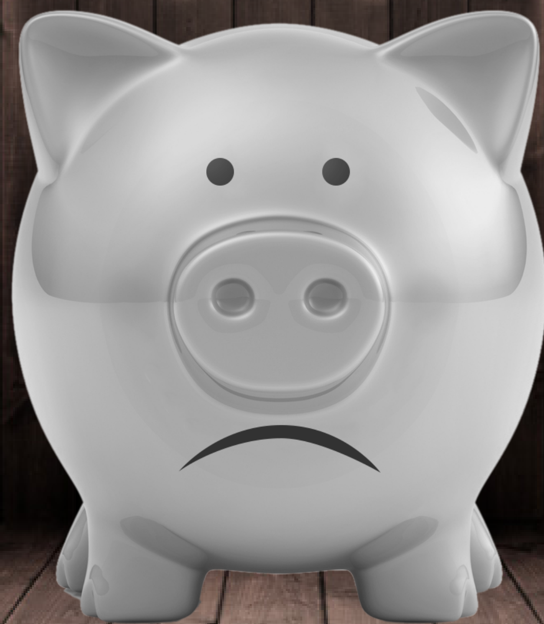
November/December 2018

LESS THAN PERFECT—
NEW STATE REGULATIONS

Open Banking—A U.S. Pipedream or Near-term Reality?
By Cheryl Winokur Munk

The ABCs of SBDCs
By Ed McKinley



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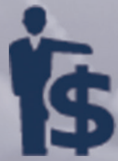

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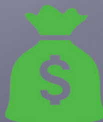

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Table of Contents

November/December 2018

Featured

2

LESS THAN PERFECT—
NEW STATE REGULATIONS

By: PAUL SWEENEY

Inside

02
LESS THAN PERFECT—NEW STATE REGULATIONS

12
OPEN BANKING—A U.S. PIPEDREAM OR NEAR-TERM REALITY?

20
WHO ARE THE NEW YORK CITY MARSHALS?

22
2018'S MAJOR MOVES

24
WHAT BLOOMBERG BUSINESSWEEK GOT WRONG

26
INDUSTRY NEWS

28
LETTERS TO THE EDITOR (L2E)

30
THE ABCs OF SBDCs

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Letter From the Editor

BY
SEAN MURRAY

2018 ends on a roller coaster. State legislation, a media blitz, and questions about practices that are so rarely relied upon, we had to look them up. We slightly delayed the printing presses on this issue just so that we could catch up on as many breaking new developments as possible.

But who's surprised? We're heading into the last year of the twenty-teens, and if it didn't end with a bang, well then all of the change that unfolded over this decade would've felt somewhat inconsequential. So as 2019 plays out, remember that change was inevitable. If you wanted comfort and monotony, you have lamentably chosen the wrong career path.

So prepare yourself as we delve into the commercial lending disclosure framework that is gaining steam in the largest states, explore open banking, and tackle the role of Small Business Development Centers for entrepreneurs. We also touch upon some of the questions being asked by folks who work in the world of MCA. It's a bit of a doozy and I expect that there will be more to come.

I hope this issue gives you just enough information to leave you satisfied, but hungry enough to continue on the journey with us in 2019. No matter what may come, we'll always be deBanked.

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–Sean Murray

LESS THAN PERFECT—NEW STATE REGULATIONS

By: PAUL SWEENEY

You could call California's new disclosure law the "Son-in-Law Act." It's not what you'd hoped for—but it'll have to do.

That's pretty much the reaction of many in the alternative lending community to the recently enacted legislation, known as SB-1235, which Governor Jerry Brown signed into law in October. Aimed squarely at nonbank, commercial-finance companies, the law—which passed the California Legislature, 28-6 in the Senate and 72-3 in the Assembly, with bipartisan support—made the Golden State the first in the nation to adopt a consumer-style, truth-in-lending act for commercial loans.

The law, which takes effect on Jan. 1, 2019, requires the providers of financial products to disclose fully the terms of small-business loans as well as other types of funding products, including equipment leasing, factoring, and merchant cash advances, or MCAs.

The financial disclosure law exempts depository institutions—such as banks and credit unions—as well as loans above $500,000. It also names the Department of Business Oversight (DBO) as the rulemaking and enforcement authority. Before a commercial financing can be concluded, the new law requires the following disclosures:

(1) An amount financed.
(2) The total dollar cost.
(3) The term or estimated term.
(4) The method, frequency, and amount of payments.
(5) A description of prepayment policies.
(6) The total cost of the financing expressed as an annualized rate.

The law is being hailed as a breakthrough by a broad range of interested parties in California—including non-profits, consumer groups, and small-business organizations such as the National Federation of Independent Business. "SB-1235 takes our membership in the direction towards fairness, transparency, and predictability when making financial decisions," says John Kabateck, state director for NFIB, which represents some 20,000 privately held California businesses.

"What our members want," Kabateck adds, "is to create jobs, support their communities, and pursue entrepreneurial dreams without getting mired in a loan or financial structure they know nothing about."

Backers of the law, reports Bloomberg Law, also included such financial technology companies as consumer lenders Funding Circle, LendingClub, Prosper, and SoFi.

But a significant segment of the nonbank commercial-lending community has reservations about the California law, particularly the requirement that financings be expressed by an annualized interest rate (which is different from an annual percentage rate, or APR). "Taking consumer disclosure and annualized metrics and plopping them on top of commercial lending products is bad public policy," argues P.J. Hoffman, director of regulatory affairs at the Electronic Transactions Association.

The ETA is a Washington, D.C.-based trade group representing nearly 500 payments technology companies worldwide, including such recognizable names as American Express, Visa and MasterCard, PayPal and Capital One. "If you took out the annualized rate," says ETA's Hoffman, "we think the bill could have been a real victory for transparency."

California's legislation is taking place against a backdrop of a balkanized and fragmented regulatory system governing alternative commercial lenders and the fintech industry. This was recognized recently by the U.S. Treasury Department in a recently issued report entitled, "A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation." In a key recommendation, the Treasury report called on the states to harmonize their regulatory systems.

As laudable as California's effort to insure greater

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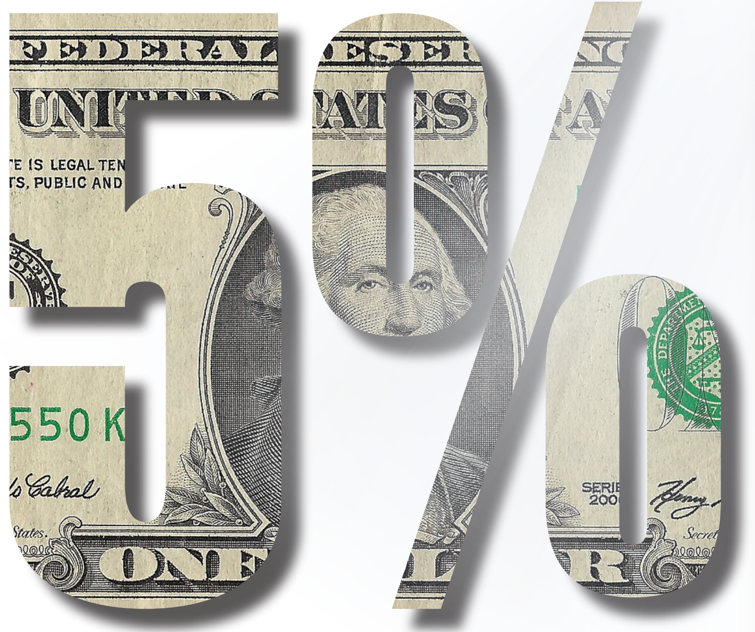

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transparency in commercial lending might be, it's adding to the patchwork quilt of regulation at the state level, says Cornelius Hurley, a Boston University law professor and executive director of the Online Lending Policy Institute. "Now it's every regulator for himself or herself," he says.

Hurley is collaborating with Jason Oxman, executive director of ETA, Oklahoma University law professor Christopher Odinet, and others from the online-lending industry, the legal profession, and academia to form a task force to monitor the progress of regulatory harmonization.

For now, though, all eyes are on California to see what finally emerges as that state's new disclosure law undergoes a rulemaking process at the DBO. Hoffman and others from industry contend that short-term, commercial financings are a completely different animal from consumer loans and are hoping the DBO won't squeeze both into the same box.

Steve Denis, executive director of the Small Business Finance Association, which represents such alternative financial firms as Rapid Advance, Strategic Funding and Fora Financial, is not a big fan of SB-1235 but gives kudos to California solons—especially state Sen. Steve Glazer, a Democrat representing the Bay Area who sponsored the disclosure bill—for listening to all sides in the controversy. "Now, the DBO will have a comment period and our industry will be able to weigh in," he notes.

While an annualized rate is a good measuring tool for longer-term, fixed-rate borrowings such as mortgages, credit cards and auto loans, many in the small-business financing community say, it's not a great fit for commercial products. Rather than being used for purchasing consumer goods, travel and entertainment, the major function of business loans are to generate revenue.

A September, 2017, study of 750 small-business owners by Edelman Intelligence, which was commissioned by several trade groups including ETA and SBFA, found that the top three reasons businesses sought out loans were "location expansion" (50%), "managing cash flow" (45%) and "equipment purchases" (43%).

The proper metric to be employed for such expenditures, Hoffman says, should be the "total cost of capital." In a broadsheet, Hoffman's trade group makes this comparison between the total cost of capital of two loans, both for $10,000.

Loan A for $10,000 is modeled on a typical consumer borrowing. It's a five-year note carrying an annual percentage rate of 19%—about the same interest rate as many credit cards—with a fixed monthly payment of $259.41. At the end of five years, the debtor will have repaid the $10,000 loan plus $5,564 in borrowing costs. The latter figure is the total cost of capital.

Compare that with Loan B. Also for $10,000, it's a six-month loan paid down in monthly payments of $1,915.67. The APR is 59%, slightly more than three times the APR of Loan A. Yet the total cost of capital is $1,500, a total cost of capital which is $4,064.33 less than that of Loan A.

Meanwhile, Hoffman notes, the business opting for Loan B is putting the money to work. He proposes the example of an Irish pub in San Francisco where the owner is expecting outsized demand over the upcoming St. Patrick's Day. In the run-up to the bibulous, March 17 holiday, the pub's owner contracts for a $10,000 merchant cash advance, agreeing to a $1,000 fee.

Once secured, the money is spent stocking up on Guinness, Harp and Jameson's Irish whiskey, among other potent potables. To handle the anticipated crush, the proprietor might also hire temporary bartenders.

When St. Patrick's Day finally rolls around—thanks to the bulked-up inventory and extra help—the barkeep rakes in $100,000 and, soon afterwards, forwards the funding provider a grand total of $11,000 in receivables. The example of the pub-owner's ability to parlay a short-term financing into a big payday illustrates that "commercial products—where the borrower is looking for a return on investment—are significantly different from consumer loans," Hoffman says.

SBFA's Denis observes that financial products like merchant cash advances are structured so that the provider of capital receives a percentage of the business's daily or weekly receivables. Not only does that not lend itself easily to an annualized rate but, if the food truck, beautician, or apothecary has a bad day at the office, so does the funding provider. "It's almost like the funding provider is taking a ride" with the customer, says Denis.

Consider a cash advance made to a restaurant, for instance, that needs to remodel in order to retain customers. "An MCA is the purchase of future receivables," Denis remarks, "and if the restaurant goes out of business—and there are no receivables—you're out of luck."

Still, the alternative commercial-lending industry is not speaking with one voice. The Innovative Lending Platform Association—which counts commercial lenders OnDeck, Kabbage and Lendio, among other leading fintech lenders, as members—initially opposed the bill, but then turned "neutral," reports Scott Stewart, chief executive of ILPA. "We felt there were some problems with the language but are in favor of disclosure," Stewart says.

The organization would like to see DBO's final rules resemble the company's model disclosure initiative, a

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"capital comparison tool" known as "SMART Box." SMART is an acronym for Straightforward Metrics Around Rate and Total Cost—which is explained in detail on the organization's website, onlinelending.org.

But Kabbage, a member of ILPA, appears to have gone its own way. Sam Taussig, head of global policy at Atlanta-based financial technology company Kabbage told deBanked that the company "is happy with the result (of the California law) and is working with DBO on defining the specific terms."

Others like National Funding, a San Diego-based alternative lender and the sixth-largest alternative-funding provider to small businesses in the U.S., sat out the legislative battle in Sacramento. David Gilbert, founder and president of the company, which boasted $94.5 million in revenues in 2017, says he had no real objection to the legislation. Like everyone else, he is waiting to see what DBO's rules look like.

WHEN THE FEDS ISSUE A MANDATE TO THE STATES...THEY USUALLY ACCOMPANY IT WITH SOME KIND OF SWEETENER OR SANCTION. FOR EXAMPLE, IN THE FIRST ENERGY CRISIS BACK IN 1973, CONGRESS TIED HIGHWAY FUNDS TO THE REQUIREMENT (FOR STATES) TO LOWER THE SPEED LIMIT TO 55 MILES PER HOUR.

"It's always good to give more rather than less information," he told deBanked in a telephone interview. "We still don't know all the details or the format that (DBO officials) want. All we can do is wait. But it doesn't change this business. After the car business was required to disclose the full cost of motor vehicles," Gilbert adds, "people still bought cars. There's nothing here that will hinder us."

With its panoply of disclosure requirements on business lenders and other providers of financial services, California has broken new legal ground, notes Odinet, the OU law professor, who's an expert on alternative lending and financial technology. "Not many states or the federal government have gotten involved in the area of small-business credit," he says. "In the past, truth-in-lending laws addressing predatory activities were aimed primarily at consumers."

The financial-disclosure legislation grew out of a confluence of events: Allegations in the press and from consumer activists of predatory lending, increasing contraction both in the ranks of independent and community banks as well as their growing reluctance to make small-business loans of less than $250,000, and the rise of alternative lenders doing business on the Internet.

In addition, there emerged a consensus that many small businesses have more in common with consumers than with Corporate America. Rather than being managed by savvy and sophisticated entrepreneurs in Silicon Valley with a Stanford pedigree, many small businesses consist of "a man or a woman working out of their van, at a Starbucks, or behind a little desk in their kitchen," law professor Odinet says. "They may know their business really well, but they're not really in a position to understand complicated financial terms."

The average small-business owner belonging to NFIB in California, reports Kabateck, has $350,000 in annual sales and manages from five to nine employees. For this cohort—many of whom are subject to myriad marketing efforts by Internet-based lenders offering products with wildly different terms—the added transparency should prove beneficial. "Unlike big businesses, many of them don't have the resources to fully understand their financial standing," Kabateck says. "The last thing they want is to get steeped in more red ink or—even worse—have the wool pulled over their eyes."

California's disclosure law is also shaping up as a harbinger—and perhaps even a template—for more states to adopt truth-in-lending laws for small-business borrowers. "California is the 800-lb. gorilla and it could be a model for the rest of the country," says law professor Hurley. "Just as it has taken the lead on the control of auto emissions and combating climate change, California is taking the lead for the better on financial regulation. Other states may or may not follow."

Reflecting the Golden State's influence, a truth-in-lending bill with similarities to California's, known as SB-2262, recently cleared the state senate in the New

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Jersey Legislature and is on its way to the lower chamber. SBFA's Denis says that the states of New York and Illinois are also considering versions of a commercial truth-in-lending act.

But the fact that these disclosure laws are emanating out of Democratic states like California, New Jersey, Illinois and New York has more to do with their size and the structure of the states' Legislatures than whether they are politically liberal or conservative. "The bigger states have fulltime legislators," Denis notes, "and they also have bigger staffs. That's what makes them the breeding ground for these things."

Buried in Appendix B of Treasury's report on nonbank financials, fintechs and innovation is the recommendation that, to build a 21st century economy, the 50 states should harmonize and modernize their regulatory systems within three years. If the states fail to act, Treasury's report calls on Congress to take action.

The triumvirate of Hurley, Oxman and Odinet report, meanwhile, that they are forming a task force and, with the tentative blessing of Treasury officials, are volunteering to monitor the states' progress. "I think we have an opportunity as independent representatives to help state regulators and legislators understand what they can do to promote innovation in financial services," ETA's Oxman asserts.

The ETA is a lobbying organization, Oxman acknowledges, but he sees his role—and the task force's role—as one of reporting and education. He expects to be meeting soon with representatives of the Conference of State Bank Supervisors (CSBS), the Washington, D.C.-based organization representing regulators of state-chartered banks. It is also the No. 1 regulator of nonbanks and fintechs. "They are the voice of state financial regulators," Oxman says, "and they would be an important partner in anything we do."

Margaret Liu, general counsel at CSBS, had high praise for Treasury's hard work and seriousness of purpose in compiling its 200-plus page report and lauded the quality of its research and analysis. But Liu noted that the conference was already deeply engaged in a program of its own, which predates Treasury's report.

Known as "Vision 2020," the program's goals, as articulated by Texas Banking Commissioner Charles Cooper, are for state banking regulators to "transform the licensing process, harmonize supervision, engage fintech companies, assist state banking departments, make it easier for banks to provide services to non-banks, and make supervision more efficient for third parties."

While CSBS has signaled its willingness to cooperate with Treasury, the conference nonetheless remains hostile to the agency's recommendation, also found in the fintech report, that the Office of the Comptroller of the Currency issue a "special purpose national bank charter" for fintechs. So vehemently opposed are state bank regulators to the idea that in late October the conference joined the New York State Banking Department in re-filing a suit in federal court to enjoin the OCC, which is a division of Treasury, from issuing such a charter.

Among other things, CSBS's lawsuit charges that "Congress has not granted the OCC authority to award bank charters to nonbanks."

Previously, a similar lawsuit was tossed out of court because, a judge ruled, the case was not yet "ripe." Since no special purpose charters had actually been issued, the judge ruled, the legal action was deemed premature. That the conference would again file suit when no fintech has yet applied for a special purpose national bank charter—much less had one approved—is baffling to many in the legal community.

"I suspect the lawsuit won't go anywhere" because ripeness remains a sticking point, reckons law professor Odinet. "And there's no charter pending," he adds, in large part because of the lawsuit. "A lot of people are signing up to go second," he adds, "but nobody wants to go first."

Treasury's recommendation that states harmonize their regulatory systems overseeing fintechs in three years or face Congressional action also seems less than jolting, says Ross K. Baker, a distinguished professor of political science at Rutgers University and an expert on Congress. He told deBanked that the language in Treasury's document sounded aspirational but lacked any real force.

"Usually," he says, such as a statement "would be accompanied by incentives to do something. This is a kind of a hopeful urging. But I don't see any club behind the back," he went on. "It seems to be a gentle nudging, which of course they (the states) are perfectly able to ignore. It's desirable and probably good public policy that states should have a nationwide system, but it doesn't say Congress should provide funds for states to harmonize their laws.

"When the Feds issue a mandate to the states," Baker added, "they usually accompany it with some kind of sweetener or sanction. For example, in the first energy crisis back in 1973, Congress tied highway funds to the requirement (for states) to lower the speed limit to 55 miles per hour. But in this case, they don't do either."

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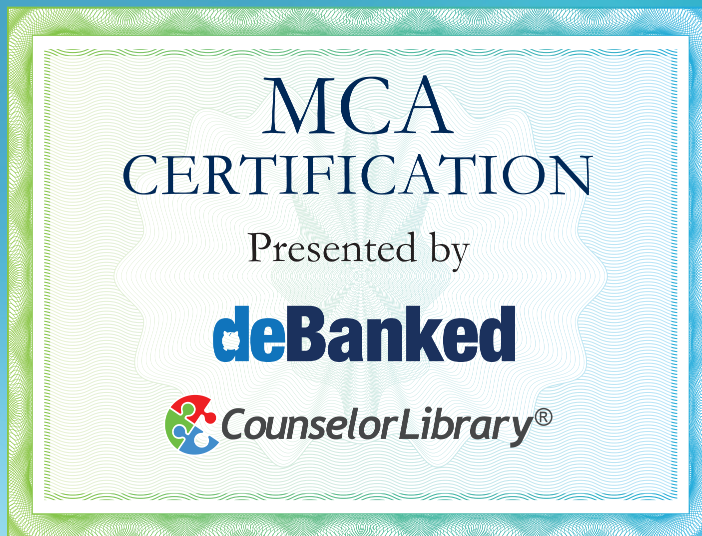

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OPEN BANKING—A U.S. PIPEDREAM OR NEAR-TERM REALITY?

By *CHERYL WINOKUR MUNK*

Some alternative funders are anxious for "open banking" to become the gold standard in the U.S., but achieving widespread implementation is a weighty proposition.

Open banking refers to the use of open APIs (application program interfaces) that enable third-party developers to build applications and services around a financial institution. It's a movement that's been gaining ground globally in recent years. Regulations in the U.K., a forerunner in open banking, went into effect in January, while several other countries including Australia and Canada are at varying stages of implementation or exploration.

For the U.S., however, the time frame for comprehensive adoption of open banking is murkier. Industry participants say the prospects are good, but the sheer number of banks and the fragmented regulatory regime makes wholesale implementation immensely more complicated. Nonetheless, industry watchers see promise in the budding grass-roots initiative among banks and technology companies to develop data-sharing solutions. Regulators, too, have started to weigh in on the topic, showing a willingness to further explore how open banking could be applied in U.S. markets.

Open banking "is a global phenomenon that has great traction," says Richard Prior, who leads open banking policy at Kabbage, an alternative lender that has been active in encouraging the industry to develop open banking standards in the U.S. "It's incumbent upon the U.S. to be a driver of this trend," he says.

The stakes are particularly high for alternative lenders since they rely so heavily on data to make informed underwriting decisions. Open banking has the potential to open up scores of customer data and significantly improve the underwriting process, according to industry participants.

"Open banking massively enables alternative lending," says Mark Atherton, group vice president for Oracle's financial services global business unit. What's missing at the moment is the regulatory stick to ensure uniformity. Certainly, data sharing is gradually becoming more commonplace in the U.S. as banks and fintech companies increasingly explore ways to collaborate. But even so, banks in the U.S. are currently all over the map when it comes to their approach to open banking, posing a challenge for many alternative lenders. Many alternative lenders would like to see regulators step in with prescriptive requirements so that open banking becomes an obligation for all banks, as opposed to these decisions being made on a bank-by-bank basis. Especially since many consumers want to be able to more readily share their financial information, they say.

"It will create huge value to everyone if that data is more accessible," says Eden Amirav, co-founder and chief executive of Lending Express, an AI-powered marketplace for business loans.

THE GREAT DIVIDE

Some global-minded banks like Citibank have been on the forefront of open banking initiatives. Spanish banking giant BBVA is also taking a proactive approach. In October, the bank went live in the U.S. with its Banking-as-a-Service platform, after a multi-month beta period. Also in October, JPMorgan Chase announced a data-sharing agreement with financial technology company Plaid that will allow customers to more easily push banking data to outside financial apps like Robinhood, Venmo and Acorns.

There are several other examples of open banking in action. Kabbage customers, for instance, authorize read-only access to their banking information to expedite the lending process through the company's aggregator

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A GLOBAL VIEW

In the U.S. more banks are using APIs internally and have been exploring how they can work with third-party technology companies

Only the U.K.'s nine largest banks and building societies must make customer data available

The Monetary Authority of Singapore has endorsed guidelines for Open Banking

The Hong Kong Monetary Authority published its open API framework

In Europe, the second Payment Services Directive (PSD2) requires banks to open up their data to third-parties

All major banks will be required to make available data on credit and debit card, deposit and transaction accounts

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partners, says Sam Taussig, head of global policy at Kabbage.

Also, companies such as Xero and Mint routinely interface with banks to put customers in control of their financial planning. And companies like Plaid and Yodlee connect lenders and banks to help with processes such as asset and income verification.

Some banks, however, are more reticent than others when it comes to data sharing. And with no regulatory requirements in place, it's up to individual banks how to proceed. This can be nettlesome for alternative lenders trying to get access to data, since there's no guarantee they will be able to access the breadth of customer data that's available. "As an underwriter, you want the whole financial picture, and if data points are missing, it's hard to make appropriate lending decisions," Taussig says.

The problem can be particularly acute among smaller banks, industry participants say. While the quality of data you can get from one of the money-center banks is quite good, "as you go down the line, it becomes a little less consistent," says James Mendelsohn, chief operating officer of Breakout Capital Finance.
For these smaller banks, the issue is sometimes one of control. There's a feeling among some community banks, that "if I make it easier for my small business customers to get loans elsewhere, I'm done," says Atherton of Oracle.

Absent regulatory requirements, alternative lenders are hoping that this initial hesitation among some banks changes over time as they continue to gain a better understanding of the market opportunity and as more of their counterparts become open to data sharing through APIs.

Open banking could be a boon for banks in that it would enable them to service customers they probably couldn't before, says Jeffrey Bumbales, marketing director at Credibly, which helps small and mid-size businesses obtain financing. Open banking makes for a "better customer experience," he says.

CHALLENGES TO ADOPTION

One challenge for the U.S. market is the hodge-podge of federal and state regulators that makes reaching a consensus a more arduous task. It's not as simple here as it may be in other markets that are less fragmented, observers say.

Major rule-making would be involved, and there are many issues that would need attention. One pressing area of regulatory uncertainty today is who bears the liability in the event of a breach—the bank or the fintech, says Steve Boms, executive director of the Northern American chapter of the Financial Data and Technology Association. Existing regulations simply don't speak to data connectivity issues, he says.

To be sure, policymakers have started to give these matters more serious attention, with various regulators weighing in, though no regulator has issued definitive requirements. Still, some industry participants are encouraged to see regulators and policymakers taking more of an interest in open banking.

A recent Treasury Report, for example, notes that as open banking matures in the United Kingdom, "U.S. financial regulators should observe developments and learn from the British experience." And, The Senate Banking Committee recently touched on the issue at a Sept. 18 hearing. Industry watchers say these developments are a step in the right direction, though there's significant work needed, they say, in order to make open banking a pervasive reality.

"We're seeing the pace and interest around these things picking up pretty significantly," Boms says. Even so, it can take several years to implement a formal process. "The hope is obviously as soon as possible, but the financial services sector is a very fragmented market in terms of regulation. There's going to have to be a lot of coordination," Boms says.

Another challenge to overcome is customers' willingness to use open banking. Many small business owners are more comfortable sending a PDF bank statement versus granting complete access to their online banking credentials, says Mendelsohn of Breakout Capital Finance. "There's a lot more comfort on the consumer side than there is on the small business side. Some of that is just time," he adds.

Certainly sharing financial data is a concern—even in the U.K. where open banking efforts are well underway. More than three quarters of U.K. respondents expressed concern about sharing financial data with organizations other than their bank, according to a recent poll by market research body, YouGov. This suggests that more needs to be done to ease consumers into an open banking ecosystem.

The topic of data security came up repeatedly at this year's Money20/20 USA conference in Las Vegas. How

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to make people feel comfortable that their data is safe is a pressing concern, says Tim Donovan, a spokesman for Fundbox, which provides revolving lines of credit for small businesses. Clearly, it's something the industry will have to address before open banking can really become a reality in the U.S., he says.

A GLOBAL VIEW

Despite these challenges, many market watchers feel open banking in the U.S. is inevitable, given the momentum that's driving adoption worldwide. Several countries have taken on open banking initiatives and are at varying states of implementation—some driven by industry, others by regulation. Here is a sampling of what's happening in other regions of the world:

In the U.K., for example, the implementation process is ongoing and is expected to continually enhance and add functionality through September 2019, according to The Open Banking Implementation Entity, the designated entity for creating standards and overseeing the U.K's open banking initiative.

At the moment, only the U.K.'s nine largest banks and building societies must make customer data available through open banking though other institutions have and continue to opt in to take part in open banking. As of September, there were 77 regulated providers, consisting of third-parties and account providers and six of those providers were live with customers, according to the U.K. open banking entity.

In Europe, the second Payment Services Directive (PSD2) requires banks to open up their data to third-parties. But implementation is taking longer than expected—given the large number of banks involved. By some opinions, open banking won't really be in force in Europe until September 2019, when the Regulatory Technical Standards for open and secure electronic payments under the PSD2 are supposed to be in place.

In Australia, meanwhile, the country has adopted a phase-in process to take place over a period of several years through 2021. Starting in July 2019, all major banks will be required to make available data on credit and debit card, deposit and transaction accounts. Data requirements for mortgage accounts at major banks will follow by February 1, 2020. Then, by July 1 of 2020, all major banks will need to make available data on all applicable products; the remaining banks will have another 12 months to make all the applicable data available.

For its part, Hong Kong is also pushing ahead with plans for open banking. In July, the Hong Kong Monetary Authority published its open API framework for the local banking sector. There's a multi-prong implementation strategy with the final phase expected to be complete by mid-2019.

Singapore, by contrast, is taking a different approach than some other countries by not enforcing rules for banks to open access to data. The Monetary Authority of Singapore has endorsed guidelines for } Open Banking, but has expressed its preference to pursue an industry-driven approach as opposed to regulatory mandates.

Other countries, meanwhile, are more in the exploratory phases. In Canada, the government announced in September a new advisory committee for Open Banking, a first step in a review of its potential merits. And in Mexico, the county's new Fintech Law requires providers to provide fair access to data, and regulators there are reportedly gung-ho to get appropriate regulations into place. Still other countries are also exploring how to bring open banking to their markets.

THE U.S. TRAJECTORY

The U.S. meanwhile, is on a slower course—at least for now. More banks are using APIs internally and have been exploring how they can work with third-party technology companies. Meanwhile, companies like IBM have been coming to market with solutions to help banks open up their legacy systems and tap into APIs. Other industry players are also actively pursuing ways to bring open banking to the market.

As for when and if open banking will become pervasive in the U.S., it's anyone's guess, but industry participants have high hopes that it's an achievable target in the not-too-distant future.

Thus far, there has been little pressure for banks to adopt open banking policies, says Taussig of Kabbage. But this is changing, and things will continue to evolve as other countries adopt open banking and as pressure builds from small businesses and consumers in an effort to ensure the U.S. market stays competitive, he says.

Open banking "is going to happen in the near future," Taussig predicts.

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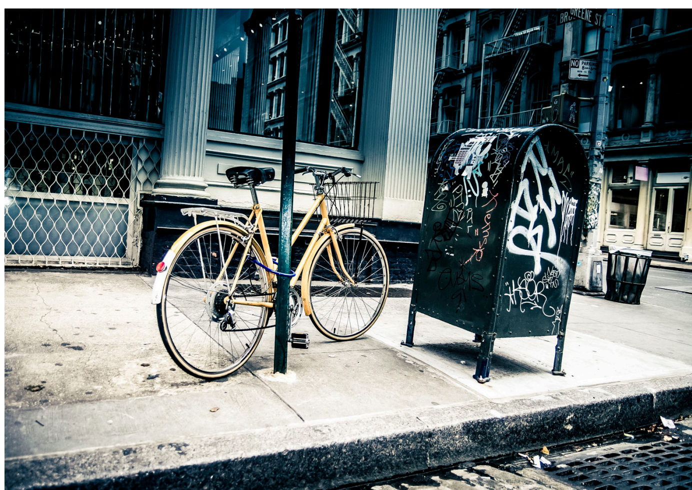
WHO ARE THE NEW YORK CITY MARSHALS?

By *DEBANKED STAFF*

In 2017, New York City Marshal Ruth Burko earned less in poundage than she owed the city in annual fees. At 91-years old, Burko's tenure as a city licensed judgment enforcer has finally come to an end. She technically announced her retirement at the end of 2016 but her long career began when Mayor John Vliet Lindsay appointed her in 1967. She held on to that role ever since, grossing more than $500,000/year well into her late 70s, nearly double the annual salary of current Mayor Bill de Blasio

With the exception of Burko in her last few years, just about every New York City marshal grosses more than the Mayor. A profile by Bloomberg Businessweek says that Vadim Barbarovich outperforms all 38 of his peers when it comes to earnings, but city records reveal that the title on a gross income basis belongs to Manhattan-based Ronald Moses, who earned $3.27 million last year. Moses's haul is down from the $5 million he earned in 2010.



70-year old Marshal Martin Bienstock, meanwhile, was the first to gross more than $2 million/year, a feat he pulled off in 1998. Records show that in 2017 he was still a top performer, ranked 2nd only to Moses.

Gross figures are before expenses like staff, rent, and other normal administrative costs of running a business. A marshal's income stems from poundage, a 5% fee tacked on to whatever amount they collect. The city takes a small cut of that in addition to an annual fee for the privilege of being a marshal. Still, many have become millionaires on the job depending on how much work they've put in or how much risk they've undertaken.

Though the marshals can effectively enforce any judgment in New York City for private litigants, a popular one is tenant evictions. Two marshals have been murdered in the course of duty, most recently in 2001 when a marshal named Erskine Bryce "was pushed over the bannister in a Bedford-Stuyvesant apartment building during an attempted eviction," according to The New Yorker. "The culprit, a fifty-three-year-old woman who had no intention of giving up her place, then clubbed him with a pipe, doused him with paint thinner, and set him aflame."

In 2015, one marshal knocked on a door to handle a routine tenant eviction only to be greeted by a man covered in blood. The landlord's motionless body lie inside after being stabbed to death by the tenant unwilling to leave. The marshal immediately called 911.

A recent online story says they have also enforced judgments obtained in connection with commercial finance transactions, even where the judgment-debtor is alleged to be located outside the city limits. No law prohibits marshals from seeking to seize assets outside the state, those with knowledge of the rules say.

A spokesperson for the city's Department of Investigation told deBanked that the marshals are regulated by the Department but that they're not city employees.

It's long been rumored that it helps to know someone to get the gig. Marshal Stephen Biegel, a retired police Lieutenant, for example, is Mayor Bloomberg's former bodyguard. Biegel grossed $2.2 million last year and has consistently grossed more than $1 million each year since 2010.

91-year old Ruth Burko got the job shortly after running Mayor Lindsay's 1965 campaign. Burko had previously been appointed a position on a Bronx Community Board and she would continue to do both simultaneously for the rest of her life. In 2014 she told the Wall Street Journal about her experience in dual roles. "The positions give me the opportunity to serve the community, my friends, and my neighbors, whom I have coexisted with for so many years," she said.

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2018's MAJOR MOVES

Things move so quickly in the industry that it can be easy to forget just how much things changed in 12 months. Here's a recap of some of the major events of 2018:

March 15, 2018

The Merchant Cash Advance concept scored its biggest ever legal victory when the Appellate Division of the First Department in New York ruled that a merchant cash advance made by Pearl Beta Funding, LLC was not a usurious transaction, settling the issue that had been debated at the trial court level dozens of times over several years. Read the full story and decision on Champion Auto Sales, LLC et al. v Pearl Beta Funding, LLC at: **http://dbnk.news/1I** (That's a one followed by a capitalized i)

May 8, 2018

Florida-based World Global Financing declared bankruptcy

May 14, 2018

The first-ever industry conference, Broker Fair 2018, is held at The William Vale in Brooklyn, NY. 400 people attended the sold-out event. Broker Fair 2019 will be held at The Roosevelt Hotel in New York City on May 6, 2019. See all the photos at of Broker Fair 2018 at **http://dbnk.events/9** Register for Broker Fair 2019 at **https://brokerfair.org**

June 5, 2018

Fora Financial acquired a significant stake in US Business Funding, making the combined company one of the largest small business loan originators in the country. Initial estimates put them on track to originate $400 million a year. Both companies will retain their independent brand names. Read more about this at: **http://dbnk.news/1J**

June 19, 2018

deBanked learned that the much-publicized "stacking lawsuit" between Pearl Capital and RapidAdvance had ended in a settlement approximately one week before the case was scheduled to go to trial in the Circuit Court of Maryland. The case had dragged on for nearly 3 years only to have an unceremonious end.

July 30, 2018

1 Global Capital LLC and 1 West Capital, LLC (DBA as 1st Global Capital from Hallandale Beach, FL) filed a joint motion for bankruptcy. The bankruptcy filings revealed shocking details, specifically that the company was being investigated by both the SEC and US Attorney's office.

August 23, 2018

The SEC filed a sealed complaint against 1st Global Capital and the company's owner, alleging that the company relied on unregistered securities to raise money from individuals and their retirement accounts. Also alleged is that the funds were mismanaged. The complaint was unsealed on August 28.

August 31, 2018

The California state legislature passed a commercial financing disclosures bill that will require a set of mandatory disclosures on contracts in accordance with a Department of Business Oversight rule.

October 2, 2018

National Funding acquired QuickBridge, a company it already had a minority interest in. Both companies will continue to operate independently and retain their individual brands. Read more: **http://dbnk.news/1K**

November 9, 2018

A co-conspirator in a business loan debt settlement scheme pled guilty on conspiracy to commit bank fraud. He was the third person to plead guilty in connection with a fake debt settlement company allegedly operated by an individual named Sergiy Bezrukov. Bezrukov's trial is scheduled to begin at the end of December.

November 17, 2018

The largest MCA deal in history, with more than $40 million in outstanding RTR, suffered a major setback when the bulk of the locations were closed and shuttered by creditors.

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	LAST 12 MONTHS	LAST MONTH	THIS MONTH
DEALS SUBMITTED	24	7	5
DEALS FUNDED	21	5	4
TOTAL FUNDED	$2,646,750	$656,200	$405,000
COMMISSIONS	$259,308	$68,800	$41,400

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WHAT **BLOOMBERG BUSINESSWEEK** GOT WRONG

As someone who occasionally enjoys reading stories in Businessweek, the four-part series published this November were gut-wrenching. If you haven't seen it, it's titled, "The Predatory Lending Machine Crushing Small Businesses Across America."

Look close enough at the merchant cash advance industry and you will find a few bad apples and a handful of unsettling stories. Nobody likes that and we can all strive to do better.

But Businessweek framed the outcome of what occurs in less than ½ of 1% of future receivable transactions as typical of all transactions and trotted out an assortment of questionable victims, one of whom is a millionaire TV station owner, to support their argument.

The narrative included the use of New York City marshals to enforce legally obtained judgments, a tactic that has to be relied upon so infrequently, that I had to look up what a marshal even was (and I've been covering this space for a long time.) For your own reference, we've published a summary of who they are in this issue.

MCAs were repeatedly described as 400% interest as if to imply that the structure of the transactions themselves were inherently expensive. MCA is a colloquial term for a future receivable transaction. They could be any price, low or high. Aside from the obvious fact that the fees attached to MCAs are not interest, I have never encountered one in which the cost amounted to 4x what someone received.

Some folks believe that no response to this series was warranted and that it will go away on its own. Aside from the fact that one of the authors is a Pulitzer prize winner whose words hold water, regulators and legislators across the nation took great interest in it and trial lawyers have already begun attaching the articles as exhibits in court cases.

Without any rebuttal of the facts, Businessweek's story series could become the defining authority of how an industry works, no matter how far removed any of the details are from the mainstream.

When accurate examples of wrongdoing can be truthfully established, the industry would greatly benefit so as to make adjustments and do things better next time. But when a fanciful tale is conjured up to produce a sexy Wall Street thriller, everyone loses, including any actual businesses that have truly suffered at the hands of wrongdoers.

The industry can do better, but so can Businessweek.

–The Editor

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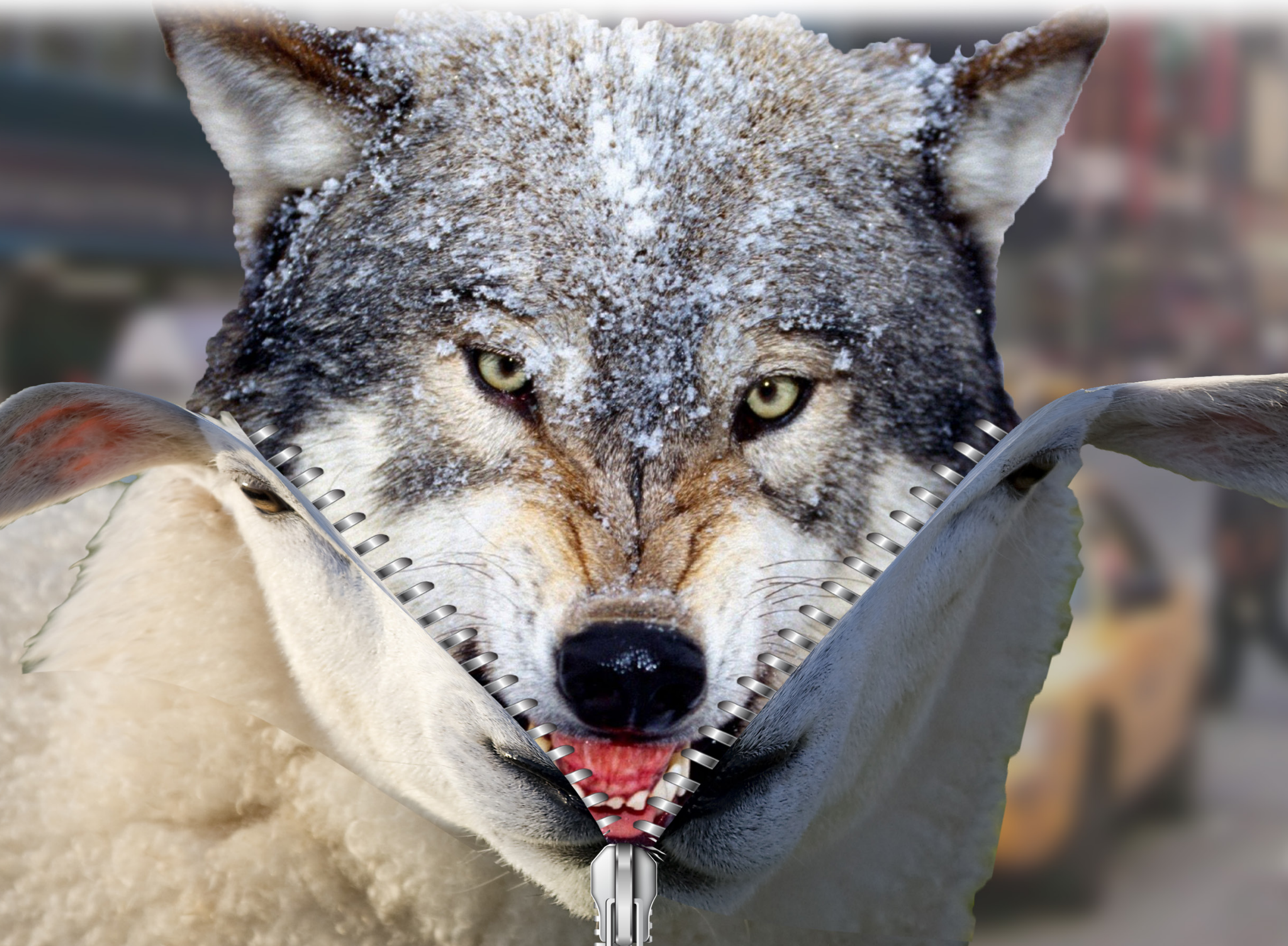

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INDUSTRY *NEWS*

9/14 The New York Department of Financial Services sued the OCC to prevent them from moving forward on its plans with a special-purpose national bank charter. It was the 2nd such lawsuit, the first was dismissed by the judge for being premature because nothing had actually happened yet

Upgrade CEO Renaud Laplanche told CNBC that he pledged not to make the same mistakes that he made as CEO of Lending Club

9/16 It was announced that Salesforce CEO Marc Benioff and his wife would be buying Time Magazine

9/17 6th Avenue Capital, BlueVine and FundBox joined the Innovative Lending Platform Association (a trade group)

9/18 CAN Capital announced that it would be moving its finance and executive functions from New York to Kennesaw, GA

9/26 Stripe received a valuation of $20 billion in a capital raising round of $245 million

Yellowstone Capital introduced a “Smarter Box” to increase transparency on their contracts

9/27 The FTC announced that victims of payday lending kingpin Scott Tucker would get refunds totalling $505 million

9/28 Funding Circle has IPO in the UK worth $1.96B

The SEC charged Renaud Laplanche with fraud. He and two other former Lending Club executives agreed to settle charges lodged against them and to pay more than $4.2 million in combined penalties. The SEC also barred Laplanche from the securities industry

10/1 Breakout Capital announced that Tim Buzby had joined the company as CFO. Buzby is the former CEO of Farmer Mac

California’s commercial finance disclosure bill, SB 1235, was signed into law by Governor Jerry Brown

10/2 Capify celebrated 10 years of serving the UK SME market

Nelnet announced that it had withdrawn its ILC bank charter application

Its reported that Marlin Financial, an online auto lender based in Florida, had stopped making new loans

National Funding acquired Quickbridge

10/3 At San Diego-based Reliant Funding, Matt price was promoted to Chief Sales Officer

At San Diego-based National Funding, Justin Thompson was promoted to Chief Revenue Officer

10/4 Square announced Square Installments, a program to extend credit to customers of merchants

deBanked CONNECT - San Diego, a networking event, was held at the Andaz Hotel in San Diego

10/11 IOU Financial surpassed $600M in loans

The Commercial Observer reported that Strategic Funding Source expanded its presence in a Midtown office building by 10,207 square feet

10/15 In New Jersey, S2262, a commercial financing disclosures bill, started making its way through the state legislature

10/16 OnDeck announced the creation of a new subsidiary, ODX, which will help banks become more efficient online lenders. Brian Geary will serve as the company’s president

Lendio Surpassed $1B in originations

The New York Institute of Credit, Alterrnative Finance Bar Association, IFA Northeast, and deBanked, hosted a half-day conference in New York City

10/19 National Business Capital surpassed $1B in originations

10/22 OnDeck’s ODX adds PNC Bank as a client

10/22 Affirm announced plans to open a Pittsburgh office with plans to hire 500 people in 5 years

HSBC partnered with Avant to offer personal loans

10/23 Coinbase and Circle announced the launch of a digital dollar, a stablecoin backed by USD

10/24 Kabbage announced that they were at the point where they were extending more than $10 million in credit to small businesses per day

10/25 Shopify Capital, Shopify’s funding arm, announced that they had issued $76.4M in merchant cash advances in Q3

10/29 Elevate announced a Q3 loss of $4.2M

10/30 StreetShares, a veteran-run small business lender, revealed a fiscal year-end loss of $6.5M

11/1 Funding Circle changed their minimum amount that investors can lend to individual businesses on their platform from £20 to £10

11/5 National Funding announced that Joseph Gaudio had joined the company as President

11/6 OnDeck revealed a net income of $9.8M for Q3 and loan originations of $648M

Lending Club revealed a net loss of $22.7M for Q3 and loan originations of $2.9B

11/8 Square Capital originated more than 62,000 business loans in Q3 for a total of $405M

11/9 Fortune Magazine was sold to a Thai businessman for $150M

11/12 According to the Wall Street Journal, SoFi experienced a $12M EBITDA loss in Q3

11/13 Clearbanc surpassed $100M in MCA originations

11/14 Fora Financial launched online checkout to provide faster financing for small businesses

Prosper announced a Q3 net loss of $19.8M and loan originations of $640M

IOU Financial revealed positive earnings in Q3 and $36.1M in loan originations

11/15 Former CAN Capital CEO Dan DeMeo joined Chicago-based Lendr as Chief Revenue Officer

11/20 Bloomberg Businessweek published an attack piece on “shady small business loans”

11/21 Elevate Funding announced new partnership with PerformLine to strengthen compliance monitoring abilities

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JAN '18

BUSINESS OPERATIONS SERVICES

Funded Amount	Factor Rate	Term Length
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FEB '18

SAFETY SUPPLY DIST.

$259,389
funded amount

$22.9k commission	9 month term

FEB '18

SOLAR ENERGY & ROOFING

Funded Amount	Commission	Commission %
$306.7k	$36.4	11.88%

FEB '18

BUSINESS CONSULTING

$241,530
funded amount

$29.2k commission	12.08% commission %

FEB '18

DOOR MANUFACTURING

Funded Amount	Commission Amount	Term Length
$360k	$26.7k	7.5 mo.

JAN '18

CONSTRUCTION & RESTORATION CO.

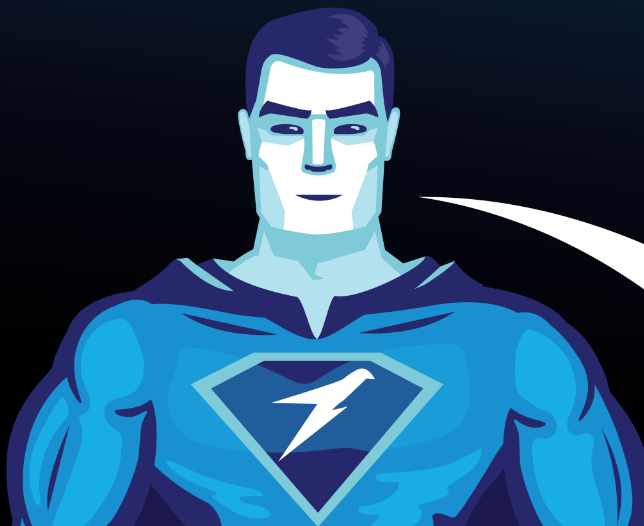
$344,651
funded amount

1.29 factor rate	9 month term

FEB '18

RESTAURANT

Funded Amount	Term Length	Commission %
$59.2k	9.5 mo.	22.74%



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L2E {LETTERS to the EDITOR}

Q:

I heard that brokers were under fire in connection with the 1st Global Capital SEC case. Why would they be in trouble for brokering deals to them? Does that mean we'll have to pay back commissions?

a:

First, 1st Global has been sued by the SEC but at the time of writing this, the Court has not found them guilty of anything yet. Second, you probably heard the term broker in a different context. 1st Global is alleged to have relied on salespeople (brokers) to sell investments to the general public so that 1st Global could fund its operations and small businesses. These investments, or notes as they've been described, are alleged by the SEC to be unregistered securities. While it is impossible to say what will happen with everything when the case is resolved one way or another, the kind of brokers that referred MCA deals for a commission are not the ones under the spotlight.

!

There's a typo on your site. The top headlines says ICO with a C, not ISO.

a:

Thanks. We've actually gotten a note about this a few times. The C is intentional. ICO stands for Initial Coin Offering, a blockchain-based methodology of raising capital similar to an IPO. That's totally different from an Independent Sales Organization a/k/a a loan/MCA Broker or payment processing sales office.

ICOs were really popular in 2017 and early 2018, but lately have become heavily scrutinized by securities regulators in the US. If you see ICO in the headline, it's a story about Initial Coin Offerings, not brokers.

Q:

I sent my deal to xxxxxx and they didn't pay me the commission after they funded it. For the first week they told me it would be hitting my account any day now, but it never did, and now they're avoiding me. It's been a month. How can I get them xxxxxx to pay me?

a:

We've unfortunately never heard of that company. The challenge with dealing with a funder that is virtually unheard of in an industry that has so many well-known players, is that legal action is your only remedy.

Well-known companies know that their reputations are on the line and will typically work to resolve a dispute (even if it leads to an unfavorable result for you) rather than just duck and hide. If that little known or unknown person is using a free e-mail address to contact you, don't even bother working with them. I'm sorry to hear about your experience with that company but considering we've never heard of them, you may either have to cut your losses or hire a lawyer to pursue them if the amount is large enough.

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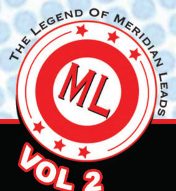

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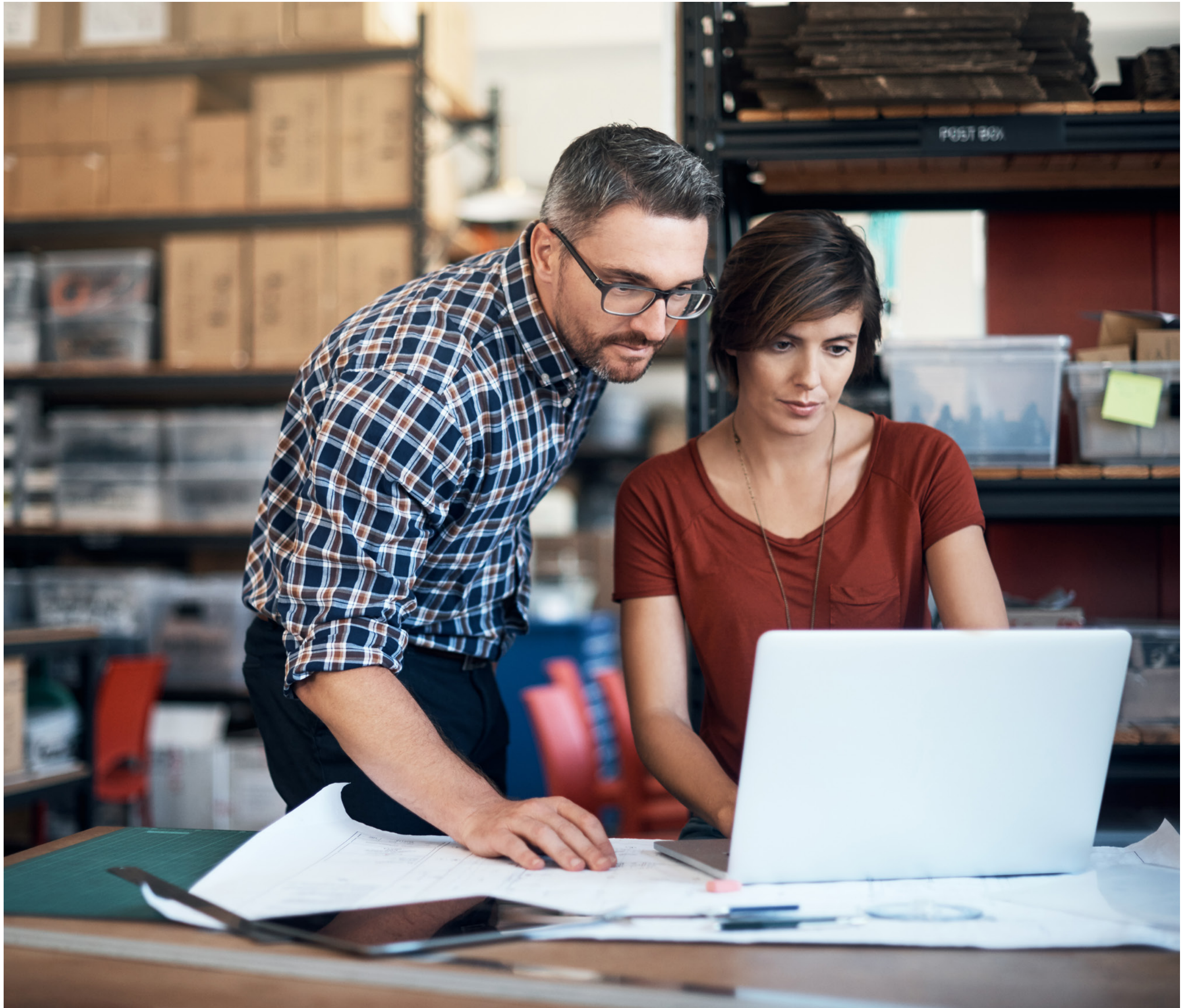
THE ABCs OF SBDCs

By *ED MCKINLEY*



An often-overlooked national network of nearly a thousand Small Business Development Centers has the potential to help alternative funders cement relationships with existing clients and locate new ones. The centers, known as SBDCs, offer free or low-cost training and consultation to established and aspiring merchants and manufacturers.

The earliest SBDCs have been around for four decades. The centers operate in conjunction with the Small Business Administration as public-private partnerships and serve about 1.5 million clients annually. Centers help small-business owners evaluate ideas, organize companies, find legal assistance and obtain operating capital.

But not everyone knows all that. "The network is underutilized," says Donna Ettenson, vice president of operations for Washington-based America's SBDCs, which functions much like a trade association for the

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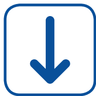

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centers scattered across the nation. "We're one of the best-kept secrets in the United States federal government."

That means alternative funders can assist customers by simply informing them that the centers exist and can offer potentially beneficial services. Providing basic information on the SBDCs could become part of a consultative approach to selling that brings repeat business, especially with merchants who lack business skills or experience, observers suggest.

What's more, alt funders who want to increase their chances of benefitting from SBDCs can go beyond merely providing clients with a rundown on the centers. The funders can become actively involved with the work of carried out at the centers.

One way of taking part is to contact nearby centers and offer to make presentations at seminars or workshops, Ettenson says. Funders could provide information to fledgling business owners on the instruments available through the alternative-funding industry, such as cash advances, loans and factoring, she suggests.

To get started, alternative funders can visit the America's SBDC website, where they'll find a search tool that provides contact information for their nearest centers, Ettenson says. From there, they could discuss possible connections with officials at the local centers, she advises.

That involvement would not only provide exposure to merchants in need of capital but also to center officials who point merchants toward capital sources. If enough members of the alt funding industry took part, their work could eventually give rise to something akin to the lists of attorneys that some centers maintain, Ettenson says.

Centers often tap attorneys—perhaps quarterly—to lecture on a rotating basis on what type of business to form. That could mean organizing as a corporation, limited-liability partnership or some other form. In much the same way, funders could share their knowledge of instruments for obtaining capital.

Funders could emulate the lawyers who use the centers as a forum for soft marketing, Ettenson says. The speaker becomes a familiar face and can leave business cards that students could use to contact them as questions arise. However, speakers must provide general information and are prohibited from using speaking opportunities as blatantly self-promotional unpaid advertisements, she cautions.

What's more, the centers have to exercise caution to avoid recommending specific attorneys, accountants or sources of capital because they could incur liability if events go sour and a service provider absconds to Bogata, Columbia, Ettenson points out. That keeps the centers "ecumenical," in that they provide a list of professionals for clients to interview and rather than pointing to a single source.

Alternative funders can explore other ways to become involved with SBDCs, too. The national organization presents an annual trade show and professional development conference for service-center directors and service-center staff members who teach or consult with clients. Alternative funders who have taken booth space on the exhibition floor or made presentations in the accompanying conference include RapidAdvance, Breakout Capital, Kabbage and Newtek Business Services.

When America's SBDCs issues a call for presentations at the annual conference, it receives approximately 300 applications for about 140 speaking slots. Some of the speakers come from the rosters of presenters at past shows, while companies newer to the trade show can purchase an entry-level sponsorship that includes booth space and the right to conduct a workshop.

The attendees at those annual conferences can tell their clients about the funders they encounter there. Attendees can also find out more about the alternative-funding industry and then pass that information along to merchants.

Some regional centers in states with large populations—such as California—can also hold conventions for their officials, says Patrick Nye, executive director for small business and entrepreneurship at the Los Angeles Regional SBDC Network, which is based at Long Beach City College. His state was planning its second statewide gathering this year and intends to do it again every other year. Alternative funders could participate, he says.

With so much going on at the centers, someone has to front the cash to keep the lights on. Local organizations are funded partly through federal appropriations administered by the SBA. "In order for the federal money to be pulled down, a matching non-federal dollar must be provided as well," Ettenson says. The federal funds are apportioned based on the amount of matching funds the centers provide.

The matching funds usually flow from colleges, universities and state legislatures. "It's a mix," Ettenson says of the sources. Institutions of higher learning often meet part of their matching-fund goals by providing "in kind" resources—such as classrooms, services and

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In the six states that administer the centers through their economic development departments, the state legislatures generally appropriate matching funds. In Texas, the representatives of the state's four regional programs combine forces to lobby the legislature for matching funds, and that teamwork reduces the cost of their efforts in Austin.

The federal funds and matching funds support local and regional centers that belong to a network based on 62 host institutions. Of the 62, six operate through the economic development departments of state governments. They're in Indiana, Illinois, Ohio, West Virginia, Minnesota and Colorado. The rest of the host institutions are mostly universities or community colleges. Some are based in economic development agencies.

One can think of the regional centers as something akin to corporate headquarters and the local centers as retailers, says Nye, who administers the Southern California regional center. The local centers under his regional's jurisdiction are located in only three counties but pull in the sixth-largest share of funding because of Southern California's huge population, he notes.

The local service centers provide training and consulting for entrepreneurs starting or expanding their enterprises. About 60 percent of the clients are already in business. Of the 40 percent who don't own a business, about half launch one after receiving assistance from an SBDC, Ettenson says.

The centers don't charge for consulting services, and the fees for training are just large enough to cover expenses. The training fees usually remain in the centers that provide the instruction where they're used to cover expenses like buying computers.

In Southern California centers, the business advisors are usually under contract and have knowledge to share from their experience in business, marketing, banking, social media, consulting or other realms, says Nye. Not many college instructors work in the centers, he notes, adding that the centers are monitored to avoid conflicts of interest among advisors.

To track how well advisors are performing, the national organization produces economic impact statements by interviewing thousands of clients. Interviews generally take place two years after consulting sessions. That should provide enough time to get results, Ettenson says.

Thus, America's SBDCs this year surveyed clients who received services in 2016. Those long-term clients received $4.6 billion in financing, while last year the clients surveyed who got underway in 2015 had received $5.6 billion in financing. She could not break down that financing by categories like banks and non-banks.

Discussing those surveys, Ettenson offers some details. "If you talk to us for two minutes, we don't consider you a client," she emphasizes. The SBDC definition of what constitutes a client calls for at least one hour of one-to-one consulting or at least one two-hour training session, she says. The organization defines "touches" as people with less exposure, such as those who call on the phone with a question.

When an SBDC client needs funding, officials at the centers have no qualms about including alternative funders in their recommendations to clients who are seeking funds, says Ettenson. "We don't exclude anybody in any way, shape or form unless there's some reason to think they're fraudulent," she notes.

But malfeasance isn't the worry it once was, Ettenson asserts, noting that alternative funders have gained credibility in the last five or so years as they began policing their own industry. "They've learned to keep track of who's in their space and how they're operating," she says.

Alternative financing has established a niche that benefits small-business people who know how to use it, Ettenson maintains. "They understand that they're borrowing money for a short period of time and it's going to cost you a fair amount," she says. "It's a short-term bridge to get to whatever your goal is." Merchants seeking funders should learn the differences among alternative funders—whom she says all operate a little differently from each other—to choose their best option.

And opportunity for alternative funders may abound at the centers in the near future. Nye cites the two biggest goals for his centers as new business starts and capital infusion. Center advisors help develop business plans that aid clients in obtaining financing, he says. Last year, his region received a little over $4 million from the SBA and used it to help start 365 new businesses and raise $148 million in capital infusions. Those efforts created 1,700 jobs, he says.

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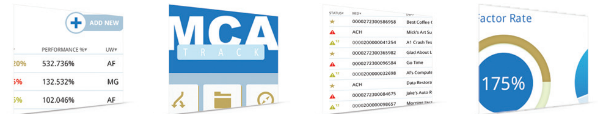

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