

# Emerging Trends in P2P Lending and Merchant Cash Advance

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Katten Muchin Rosenman LLP

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# **Merchant Cash Advance and Daily Pay Commercial Financing: Differences and Developments**

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and Merchant Cash Advance

# Katten Muchin Rosenman LLP

- Claudia Callaway – Chair, Consumer Finance Practice
- With M&A Group and Securitization Practice, Represent Merchant Cash Advance Providers and their Capital Sources
- *Captain Bounce v. BFS*

# What Is a Merchant Cash Advance?

- Emerged in mid-'90s
- Financing option for small and mid-sized businesses in need of working capital
- “Not a loan\*”
  - No personal guarantee\*
  - No liens or collateral\*
  - No fixed payment schedule\*
  - No absolute obligation to repay (buyer assumes the risk of business failure)\*

# How Does a Merchant Cash Advance Work?

- *Business Factoring*
- Merchant cash advance provider purchases specific amount of card receivables from the business at a discount and receives a small percentage of the owner's daily future credit and/or debit card receivables
- Each time a sales transaction is made, a percentage of the card receivables is forwarded to the cash advance provider or purchaser until all of the purchased receivables are forwarded to advance provider
- Repayment follows the owner's revenue trend, and is directly related to the success of the owner's business

# How Is Daily Pay Commercial Financing Different from an MCA?

- *Extremely* different
- Daily Pay Commercial Financing is a loan, repaid on each business day by an agreed upon ACH amount
- Litigation risk differs between models
- Sophisticated capitalization structures for select providers (VCs, Hedge Funds, etc.)

# Litigation:

## MCA v. Daily Pay Commercial Financing

- “Factor” v. Loan
  - *Contract Language*
  - *“Recourse”*
  - *Practices*
- State Law: License Required?
- Commercial v. Consumer
  - *Who is the Seller/ Borrower?*

# What Is the Current State of MCA v. Daily Pay Commercial Financing?


- Market interest in both products
  - Seeing many traditional MCA companies add loan product to portfolio of offerings
- Fine-tuning of contracts as a result of litigation
- Significant interest from capital sources



# Q & A

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# **“Peer to Peer” Lending: How It Works in the United States**

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- Conor French, Associate General Counsel
- Funding Circle is the world's leading online small business loan marketplace
- \$600M lent to date to over 5,000 small businesses
- This year, we plan to lend over \$550M globally, with \$80M of that lending in the US
- Founded in 2010, we have raised \$123M in equity funding
- Growth from 12 employees in our US office this time last year to 70 now

# Benefits of P2P:

## *Building a Better Financial World*

- P2P platforms allow individuals or small business borrowers to obtain aggregated capital from investors from the platform
- For Borrowers:
  - Improve access to fast, fairly-priced capital for borrowers with few other financing options
  - Enable borrowers to refinance / avoid higher-rate debt
- For Investors:
  - Provide fixed income investors with access to a new asset class
  - Offer attractive, risk-adjusted returns

# “Peer to Peer” in the US ... *Isn't*

- In prior decade, entrepreneurs sought to create “peer to peer” marketplaces in the United States
- Regulators said “not so fast”
  - Who is the lender?
  - Is the lender licensed?
  - Does the interest rate comply with applicable law?
  - Is it a security?

# Current *Commercial* Model

- Lender makes loan directly to a small business
- Lender must comply with all applicable state licensing and lending law\*
- Institutional investors may purchase the whole loan
- Accredited investors may (i) purchase a loan payment dependent security or (ii) invest in a pooled vehicle of whole loans and/or securities
- Lender services the loan
- Investor receives P&I (net of servicing fees)

# Current *Consumer* Model: Securitized Bank Loans

- Federally-insured bank can export its home state interest rate on all\* consumer loans
- Consumer borrower gets loan from bank
- Bank hires third-party marketer to advertise loans and to find “investors”
- Fund purchases loans
- “Investors” open investment accounts or IRAs with the fund

# How P2P Works

- Lender/marketer screens and scores creditworthy borrowers who list their loan request
- Investors review loan listings and invest in those that meet their criteria
- Borrowers make fixed monthly payments and investors receive their share directly to their investment account




# What Is the Future of P2P?

- Litigation
- Regulatory scrutiny
  - Prudential regulators
  - CFPB (for *consumer* P2P loans)

# Q & A

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# Daily Pay Commercial Financing and P2P Lending: Regulatory Considerations

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# DPCF and P2P: Regulatory Considerations

- MCA v. P2P Lending: Critical Traits and Differences
- Merchant Cash Advance:
  - Regulatory Checklist
- P2P Lending:
  - Regulatory Checklist
- Q & A

# DPCF v. P2P: Critical Traits and Differences

- DPCF
  - Commercial, not consumer
  - MCA: Purchase of receivables (“factor”), not loan/credit; non-recourse
  - Loans: Licensing?
- P2P
  - Consumer loan
  - Usury/interest rate considerations
  - Security law considerations
  - Broker?
  - BSA/AML

# Daily Pay Commercial Financing: Regulatory Checklist

- Contract Language
- Commercial or Consumer?
- UCC Filing?
- Non-Recourse (MCA) or Recourse (Loan)?
- Guaranty / “Bad Actor” Provision?
- Default/Breach of Contract?
- Governing Law?
- Arbitration Provision/Class Action Waiver?
- *Licensing/Model Difference?*

# P2P Lending: Regulatory Checklist

## ■ P2P LENDERS

- Federally-insured financial institution (bank): interest rate exportation/uniform contract
- Non-bank: consumer loan licensing/state-by-state contract
- Arbitration Agreement/Class Waiver

## ■ INVESTORS/CAPITAL SOURCES

- Securities registration
  - Accredited
  - Disclosures
  - Contract
- Arbitration Agreement/Class Waiver