MERCATUS CENTER
George Mason University

April 13, 2017

U.S. Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

In response to your request for ideas the Senate Banking Committee can pursue to help benefit individuals and small businesses, I recommend that the Committee consider ways to help support the continued development of innovative credit sources. These sources can help to provide consumers with greater access, better prices, and better terms, and should be provided with a consistent and stable regulatory regime to encourage greater investment and competition.

One important step is codifying the longstanding principle that a loan that is legal and non-usurious at the time it is made does not subsequently become usurious just because it is sold to another party. This principle of "valid when made" reflects well over a century of settled common law and the reasonable expectations of people when they enter into a loan agreement. It is also an important component for securitizations and many of the more innovative means of accessing credit.

Because of outdated regulation that allows banks to export the law of their home state nationwide, while denying the same power to non-bank lenders offering comparable products, many innovative non-bank lenders partner with banks. Such partnerships allow the non-bank lender to offer a consistent product nationwide and take advantage of economies of scale. The bank also benefits by being able to diversify its business, making it more resilient. The bank makes an independent decision as to whether to extend credit to any given borrower, and retains both a financial and reputational interest in the loan.

While this arrangement is a second-best solution,[1] it is still important. It is also under threat. The recent decision by the United States Court of Appeals in the case of *Madden v. Midland Lending LLC.* has called the ability of a non-bank to buy a loan from a bank and continue to service the loan on its original terms into question. This decision has been criticized as incorrect by the Department of Justice and the Office of the Comptroller of the Currency. It has also resulted in a reduction in credit from innovative lenders available to lower-credit score borrowers in the states covered by the Second Circuit. This decision has also given rise to subsequent lawsuits outside of the Second Circuit, including suits filed recently by the state of Colorado against two innovative lenders.[2]

[1] The optimal solution is allowing non-bank lenders to operate nationwide under the same rules enjoyed by banks. While this would be a superior outcome it is likely beyond the scope of what the Committee asked for.
[2] *Julie Ann Meade, Administrator, Uniform Consumer Credit Code v. Avant of Colorado LLC* (D. Colorado) 1:17-cv-00620-WJM-STV Filed 3/9/2017; *Julie Ann Meade, Administrator, Uniform Consumer Credit Code v. Marletter Funding LLC* (D. Colorado) 1:17-cv-00575-PAB Filed 3/3/2017

Codifying the longstanding principle of valid when made will benefit the credit markets utilized by individuals and companies. The greater clarity and legal certainty will encourage investment and competition, which will result in greater access and potentially lower prices. I have attached additional research that more fully explains the issue and what Congress can do to address it. If you have any additional questions please do not hesitate to contact me.

Sincerely,

Brian Knight
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Enclosure