



GEORGETOWN UNIVERSITY LAW CENTER

Adam J. Levitin

Agnes N. Williams Research Professor of Law

Written Testimony of

**Adam J. Levitin
Professor of Law
Georgetown University Law Center**

Before the United States House of Representatives
Committee on the Financial Services
Subcommittee on Financial Institutions and Consumer Credit

“Examining Opportunities and Challenges in the Financial Technology (“Fintech”) Marketplace”

January 30, 2018
10:00 am
2128 Rayburn House Office Building

Witness Background Statement

Adam J. Levitin is the Agnes N. Williams Research Professor of Law at the Georgetown University Law Center, in Washington, D.C., where he teaches courses in financial regulation, structured finance, contracts, bankruptcy, and commercial law. Among his publications are *Pandora's Digital Box: The Promise and Perils of Digital Wallets*, 166 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 305 (2018).

Professor Levitin has previously served on the Consumer Financial Protection Bureau's Consumer Advisory Board, as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School, as the Robert Zinman Scholar in Residence at the American Bankruptcy Institute, as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP), and, as relevant to this hearing, as an expert witness for the FDIC in rent-a-bank litigation.

Before joining the Georgetown faculty, Professor Levitin practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York, and served as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin holds a J.D. from Harvard Law School, M.Phil and A.M. degrees from Columbia University, and an A.B. from Harvard College. His scholarship has won numerous prizes, including the American Law Institute's Young Scholar's Medal.

Professor Levitin has not received any federal grants or any compensation in connection with his testimony, and he is not testifying on behalf of any organization. The views expressed in his testimony are solely his own.¹

¹ I would like to thank Julia Dimitriadis for her research assistance with this testimony.

Chairman Leutkemeyer, Ranking Member Clay, Members of the Subcommittee:

Thank you for inviting me to testify at this hearing. My name is Adam Levitin. I am the Agnes N. Williams Research Professor of Law at Georgetown University, where I teach courses in financial regulation among other topics. I am here today solely in my academic capacity and am not testifying on behalf of any entity. I'm also pleased that many of the students from my Consumer Finance class are here today to witness the legislative policy process in action.

The main point I wish to make today is that the term “fintech” covers a broad array of nonbank financial services companies. Some of these companies offer payment services and some credit services. Some compete with banks, and some partner with banks. Many are good actors, but unfortunately some are not. All of this means that different segments of the fintech industry raise different regulatory concerns.

Payment fintechs are currently regulated primarily through a duplicative state-level money transmitter licensing regime. The main concern they raise from a regulatory perspective is the potential loss of customer funds. Payment fintechs would benefit from uniform regulation through the creation of a federal money transmitter license and concomitant insurance regime.

Credit fintechs raise more concerns, most notably in the areas of fair lending and lending without regard to borrowers' ability to repay—that is abusive lending. Fair lending concerns are best addressed through a no-action letter process tied to self-testing, while abusive lending is best addressed in the first instance through state usury and consumer protection laws, although ultimately Congress or the Consumer Financial Protection Bureau, through its existing rulemaking authority, should consider adopting a general ability to repay requirement for all forms of credit.

I. WHAT IS A FINTECH?

Today's hearing focuses on the appropriate regulatory framework for so-called “fintechs” or financial technology companies. As a starting point, it is important that the terminology used here be clear. The term “fintech” is vague and lacks a precise definition. It is hard to speak in any meaningful way about “fintechs” as a group. The term “fintech” is a rubric used to describe a large range of nonbank financial services companies. Some of these companies offer consumer credit, some payments, some insurance, some investment services, and some financial advice. Some of these companies compete directly with banks, while others partner with banks. Additionally, some fintechs deal directly with consumers, while some provide support services for other financial institutions. Given this Subcommittee's jurisdiction, my testimony today focuses largely on consumer-facing fintechs that deal with credit and payments (including crypto-currencies), although one of my suggestions, relating to the portability of consumer account data, also implicates financial advisory fintechs.

The sheer variety of firms that are called fintechs has an important implication for regulation: because different types of fintechs do very different things, they raise different

types of regulatory concerns and should be addressed differently. Put another way, it might not be very useful to speak about “fintechs” generally when discussing regulatory frameworks. Instead, as a starting point, I think it is helpful to break fintechs into “payment fintechs” and “credit fintechs”. One can make further differentiations within these groups, but payments companies like Venmo, Square, or Zelle raise fundamentally different issues for regulators than credit companies like Quicken Loans, LendUp or Think Financial.

To the extent we can speak of fintechs as a general category, however, they have two distinguishing features. First, fintechs are nonbank financial services companies. In other words, they are marked by what they are not, namely banks. And second, they use some sort of digital technology to provide financial services to consumers. These technologies include web- or mobile-based consumer interfaces, automated underwriting, neural network and other machine-learning-based underwriting, and the use of non-traditional underwriting data sources.²

Critically, neither of these features alone makes a firm a fintech. Nonbank financial services companies have been around since time immemorial. Likewise, banks and other well-established players in the financial services industry regularly make use of a range of digital technologies. Fannie Mae and Freddie Mac have been using “automated underwriting” technology (rather than relying on individual loan officer determinations) for over a quarter of a century. Bank credit card issuers have used neural networks for both fraud detection and underwriting decisions for well over a decade.

What’s new here, then, is not so much the use of technology, but that there are a set of new nonbank entrants in the financial services marketplace that are operating across state lines and frequently using the Internet, rather than brick-and-mortar stores or agents, brokers, and correspondents with physical locations, as their mode of consumer interface. Traditionally banks relied on their monopoly of access to the payment system through deposit accounts as a way of obtaining customers for other products—the customer relationship with the depositor enabled the cross-selling for other products. Nonbank finance companies had to maintain brick-and-mortar presences to compete or rely on agents, brokers, and correspondents with physical locations, all of which added to the expense of their products.

The Internet has made it possible for nonbank financial services companies that do not partner with banks to readily acquire customers without the deposit-relationship-based cross-sell. It has also made them more competitive on a cost-basis and facilitated rapid expansion to national operations. Thus, what is new about fintechs is that they are nonbank financial companies with ready ability to acquire consumers because of the Internet.

This means that despite the regular use of buzzwords like “transformative” and “disruptive” in discussions about fintechs, there really isn’t anything particularly transformative or disruptive about them. All fintechs still provide the same basic financial

² The range of technologies used by fintechs is so broad as to make it an almost meaningless characteristic.

services that traditional financial institutions provide: payments, credit, savings and investments, insurance and advice. A mortgage lender or a payday lender that interfaces with consumers over the Internet is still just a mortgage lender or a payday lender. The improvements that fintechs offer are ones on the margins, such as facilitating access to credit for borrowers with thin credit files or enabling faster payments. These are good things, but it is an overstatement to call them “transformative.” While fintechs offer some competition for banks, they often operate in market segments that are not well-served by banks; they are not eating the banks’ lunch yet.

The forgoing definitional discussion is not merely academic. The use of technology by banks has not challenged the adequacy of the current bank regulatory regime. Instead, it is the growth of importance in the financial system of nonbank players that poses the challenge, and this points to the primary issue with fintech regulation being about the adequacy of the current framework for regulation of nonbanks, not the adequacy of regulation of technologies used in financial services.

II. FINTECHS: THE GOOD, THE BAD, AND THE UGLY

Fintechs hold out both promise and perils. Fintechs potentially help increase financial inclusion by making credit accessible to populations not well served by banks such as borrowers with poor credit, small businesses, and millennials. They may make credit available more quickly than traditional lenders, which is generally good for consumers. They expand other consumers’ choices for loans and payments. Fintechs hold out a great deal of promise for helping to serve underserved populations and for creating efficiencies in the consumer financial services space.

Yet it’s also important to understand the risks fintechs pose. Credit-fintechs often lend at high interest rates to consumers whose ability to repay has not been verified. Given that some of these credit fintechs securitize their loans, they have a reduced incentive to ensure that borrowers are in fact able to handle the credit they are given.

Credit-fintechs also sometimes use alternative underwriting data and techniques. The use of non-standard underwriting data and methods can raise the possibility of discriminatory lending, even if it is unintentional, and, to the extent a lender uses neural networks for its underwriting, the lender may not even understand how the underwriting is working. Even payment fintechs pose a risk to consumers—some payment fintechs—those that operate so-called “staged wallets”, such as PayPal and Venmo, allow consumers to maintain a balance on their accounts. These balances are not insured by the FDIC. If the fintech were to fail, consumers could lose their funds and there could be serious economic disruption. It’s also easy to imagine a fintech failing—if one payment fintech were hacked, it could result in a run on other payment fintechs.

A. Cautionary Fintech Tale #1: CompuCredit

The other witnesses today aren’t going to highlight the problems that have arisen with fintechs, so I’m going to point out a pair of cautionary tales. First is the example of CompuCredit. CompuCredit is a nonbank consumer finance company based in Georgia

that specializes in lending to consumers with poor credit—a subprime lender. CompuCredit had an arrangement with three FDIC-insured state banks in which they would issue CompuCredit-branded credit cards to consumers according to CompuCredit’s underwriting guidelines and with CompuCredit’s marketing materials.³ CompuCredit would within 24 hours purchase all but \$1 million of the receivables on the cards from the banks. In other words, CompuCredit was a fintech operating a classic “rent-a-bank” operation (a transaction type discussed in more detail below in Part III).

CompuCredit also used nontraditional data sources in its underwriting. In addition to standard underwriting elements, such as a FICO score, CompuCredit’s underwriting accounted for particular transactions consumers had undertaken. If a consumer had his tires retreaded, or visited a marriage counselor or a massage parlor, the consumer would find his interest rates increased. CompuCredit did not have algorithms that showed a mathematical relationship between particular transactions and risk.⁴ Instead, its underwriting was based on a neural network that identified correlations without being able to express an algorithmic relationship.

The FTC sued CompuCredit for unfair and deceptive acts and practices for failing to disclose this unusual behavior-based underwriting, and the FDIC sued the three banks that rented out their charters for engaging in unsafe and unsound banking practices. The FTC settled with CompuCredit for over \$114 million in consumer relief, and the FDIC settled its suits against the banks that rented out their charters.⁵

CompuCredit was adjusting its pricing based on particular transactions a consumer had undertaken. None of those transactions obviously related to a protected class under the Equal Credit Opportunity Act, but it’s not hard to see how that could easily happen. Imagine if a firm found risk correlations were based on the regular purchase of Goya or Manischewitz products or no-lye relaxer or with one’s college major (computer science, Afro-Am studies, etc.). The underwriting wouldn’t just be creepy; it would likely be illegal. That’s the sort of risk that lies in the use of nontraditional underwriting data.

The point here is not about discriminatory intent, but about discriminatory effects, which may occur unwittingly with algorithmic or neural underwriting. Indeed, if a firm used neural networks for its underwriting, it might not even understand the nature of the

³ *In the Matter of CompuCredit Corporation, Atlanta, Georgia*, FDIC Nos. 08-139b and 08-140k (June 10, 2008); *In the Matter of Columbus Bank and Trust Company, Columbus, Georgia*, FDIC Nos. 08-033b and 08-034k (June 9, 2008); *In the Matter of First Bank and Trust, Brookings, South Dakota*, FDIC Nos. 07-228b and 07-260k (June 10, 2008); *In the Matter of First Bank of Delaware, Wilmington, Delaware*, FDIC Nos. 07-256b and 07-257k (June 10, 2008).

⁴ Complaint at 34-35, *Federal Trade Commission v. CompuCredit Corporation and Jefferson Capital Systems, LLC*, 2008 WL 8762850 (N.D. Ga.) (FTC No. 062-3212).

⁵ Press Release, FDIC, *FDIC Announces \$114 Million Settlement With Subprime Credit Card Company Charged With Deceptive Credit Card Marketing* (December 19, 2008); Press Release, FTC, *Subprime Credit Card Marketer to Provide At Least \$114 Million in Consumer Redress to Settle FTC Charges of Deceptive Conduct* (December 19, 2008); Press Release, FDIC, *FDIC Seeks in Excess of \$200 Million Against Credit Card Company and Two Banks for Deceptive Credit Card Marketing* (June 10, 2008).

correlations being found through the machine learning process, but fair lending requirements look at effect, not intent.

B. Cautionary Fintech Tale #2: Mt. Gox

The second cautionary tale is that of Mt. Gox, a failed bitcoin exchange and clearinghouse. Mt. Gox was at one point the largest bitcoin intermediary in the world. In this regard, it was a payments fintech, much in the way PayPal stands between the ultimate buyer and seller of goods. In February 2014, Mt. Gox filed for bankruptcy, saying that because of a hacking it had “lost” something in the range of 7% of all bitcoins. Mt. Gox customers are still trying to get their bitcoins back. Something as pedestrian as a hacking can bring down a payment fintech very rapidly, and without adequate insurance requirements for such fintechs, consumers stand to lose their funds.

My point here is not to argue that fintechs are good or bad. Instead, it’s to emphasize that they have both promise and perils, and any regulatory framework needs to account for both, facilitating the good work that fintechs can do, while also protecting against the harms they can wreak.

III. BANK PARTNERSHIPS WITH FINTECHS

While some fintechs compete against banks, others partner with banks. Partnerships between banks and fintechs tend to be either payment-fintech partnerships with large banks or credit-fintech partnerships with small banks. Yet it is important to recognize that few banks overall engage in partnerships with credit-fintechs, and only a handful of community banks partner in any way with fintechs.

Bank-fintech partnerships raise a unique set of concerns, both in terms of safety-and-soundness for the banks and in terms of consumer protection. Some bank partnerships with fintechs involve payments, and these relationships expose banks to reputational risk if the fintech has operational problems and potentially to credit losses if customer funds are lost (which the bank would likely have to cover under the Electronic Funds Transfers Act, 15 U.S.C. § 1693h).

More commonly, bank-fintech partnerships are with credit fintechs and involve “**rent-a-bank**” relationships. In a rent-a-bank transaction, the loans will be originated by a bank according to guidelines set by the marketplace lender or payday lender. The loans are then sold almost immediately to the marketplace lender or payday lender under a standing agreement to purchase all or almost all such loans. The loan disbursement will generally be by the bank in this sort of arrangement, and loan payments might in fact be made to the bank, but the bank is not the real economic party in interest nor is it exercising meaningful control over the design of the loan product. The point of this sort of rent-a-bank transaction is for the nonbank fintech to avoid the application of state usury laws by sheltering in federal law’s preemption for banks of usury laws and certain other consumer protection laws.

It’s hard to call this anything other than “**loan laundering.**” Federal regulators have long frowned on this sort of arrangement, but it is important to emphasize that there

are no actual prohibitions against it.⁶ Instead, there is only non-binding regulatory guidance. Moreover, the level of supervision of bank-fintech partnerships is discretionary and quite likely to vary by Administration. Thus, while Mr. Smith characterizes regulatory supervision of bank partnerships with fintechs as “rigorous,” there is reason to doubt that it will continue to be so under the current Administration, as indicated by the CFPB (now under the control of a Trump Administration appointee) recently dropping its suit against several affiliated Internet payday lenders—fintechs that were engaged in a rent-a-tribe scheme (involving an attempt to shelter in tribal sovereignty against state usury laws, rather than National Bank Act or Federal Deposit Insurance Act preemption).

Rent-a-bank transactions pose both safety-and-soundness and consumer protection concerns. From a safety-and-soundness perspective, there is the danger that the fintech fails to honor its obligation to purchase the loans made by the bank. If so, the bank is stuck with a bunch of loans that it would never have made on its own—the loans present a risk profile with which the bank is not comfortable; were it otherwise, the bank wouldn’t bother partnering with the fintech, but would just make the loans itself. For a small bank, the exposures can be material. Moreover, the bank is exposed to the reputational risk that comes with partnering with the fintech, particularly if the fintech services the loan and handles collections. Aggressive collections tactics by the fintech might harm the bank’s reputation.

The consumer protection concerns from rent-a-bank operations are more serious. The *sole* purpose of a rent-a-bank transaction structure is the evasion of state usury and consumer protection laws. Congress has exempted national banks and federally insured state-chartered banks from the application of state usury laws. But this exemption does not exist in a void. It is part and parcel of an extensive federal regulatory regime for banks. Rent-a-bank transactions, in contrast, create an abominable regulatory vacuum: the nonbank partner purports to receive the benefits of federal preemption without being subject to the concomitant federal regulatory scheme.

I want to emphasize that most depositories are careful not to abuse third party relationships and would not even contemplate engaging in a rent-a-bank transaction. The handful of banks that do so are very much exceptions in the industry. Protecting rent-a-bank transactions is only in the interest of a handful of bad actors in the banking space.

It is in this context that two bills have been introduced that would, unfortunately, facilitate rent-a-bank schemes. These bills are H.R. 4439, the “Modernizing Credit Opportunities Act” (also known as the “Deemed Lender” bill) and H.R. 3299, the “Protecting Consumers Access to Credit Act of 2017” (also known as the “Madden Fix” bill). Both bills are misguided and would ultimately be harmful to consumers and the safety-and-soundness of the banking system.

⁶ See, e.g., FDIC, Guidance for Managing Third-Party Risk, FIL-44-2008 (June 6, 2008); OCC Risk Management Guidance: Third Party Relationships, OCC Bulletin 2013-29 (Oct. 30, 2013).

A. The Modernizing Credit Opportunities Act, H.R. 4439

When confronted with rent-a-bank situations, courts have often focused on the economic realities of the transaction and looked to see which party is the “true lender” on the loan. If the true lender is not a bank or a native tribe, then that party is not able to shelter in federal preemption for the bank or tribal sovereignty.

H.R. 4439 would instruct courts to disregard economic realities and instead adhere to a legal fiction that the bank is the true lender simply because it is the originator of the loan. This is a terrible idea. “True lender” doctrine is an important doctrinal tool to police against abuses of the banking system. It’s disgraceful that Congress would attempt to protect sham transactions, yet that is precisely what H.R. 4439 does. It deems the bank to be the true lender in a transaction no matter what the underlying facts and circumstances are.⁷

Thus, under H.R. 4439, even if a nonbank were to dictate the underwriting and marketing terms of a loan and assume 100% of the risk on the loan and handle the servicing of the loan, the bank would still be deemed the lender for purposes of preemption of state usury laws. The facts that the bank might formally fund the loan and that payments are made to the bank are irrelevant—the funding is indirectly coming from the fintech and all payments received are being remitted to the fintech.

It is true, as Mr. Smith notes in his written testimony, that because true lender doctrine is a standard that looks at the totality of facts and circumstances that it can complicate transaction planning. But good lawyers will have no trouble advising their clients about how to avoid running afoul of the doctrine. Lawyers advise clients in the shadow of standards based regimes all the time; every state has an unfair and deceptive acts and practices (UDAP) statute, and there are also federal UDAP and UDAAP (unfair, deceptive, and abusive acts and practices) statutes.⁸ The mere fact that there is a standards-based doctrine is not grounds for legislative intervention, much less the particular intervention contemplated by H.R. 4439. The fact that true lender doctrine is a standard, not a rule, is only a problem for those financial institutions that want to “push the envelope,” and that’s exactly how it should be. H.R. 4439 encourages predatory lenders to “push the envelope,” and that’s an outrage.

B. The Protecting Consumers Access to Credit Act of 2017, H.R. 3299

H.R. 3299 has been voted out of committee. Nevertheless, I think it is important to put into the record for the consideration of the full House the serious flaws of the bill. H.R. 3299 is a response to a court ruling called *Madden v. Midland Funding, LLC*.⁹ *Madden* held that National Bank Act preemption of state usury laws did not apply to a loan that had been made by a national bank once the loan had been sold (post-default) to a debt buyer.

⁷ It’s also unclear what H.R. 4439 has to do with financial “innovation.” Usurious lending is as old as recorded human history, and sham transactions such as “dry exchange” that attempt to circumvent usury prohibitions are well-documented by the Middle Ages.

⁸ 12 U.S.C. §§ 5531, 5536; 15 U.S.C. § 45(a).

⁹ 786 F.3d 246 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 2505 (2016).

The *Madden* decision caused consternation in four distinct parts of the consumer finance industry: debt buyers, securitizers, marketplace lenders, and payday lenders. *Madden's* application to debt buyers is clear enough. Securitization of consumer debts involves the transfer (and typically the repeated transfer) of the debts from the originating entity (such as a national bank) to a nonbank securitization entity that holds the debts and issues securities against them. Marketplace lenders and payday lenders will sometimes originate loans themselves, but they will also sometimes engage in rent-a-bank transactions.

H.R. 3299 would effectively overturn the *Madden* decision and provide that a loan that was “valid” with respect to usury laws when the loan was made would continue to be valid even after a subsequent assignment.¹⁰ In so doing, H.R. 3299 purports to restore the “valid when made” legal doctrine that it claims is a:

cornerstone of United States banking law for over 200 years, as provided in the case *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103, 106 (1833), where the Supreme Court famously declared: “Yet the rule of law is everywhere acknowledged, that a contract free from usury in its inception, shall not be invalidated by any subsequent usurious transactions upon it.”¹¹

H.R. 3299 also claims to stand on a scholarly study that concluded that “the *Madden v. Midland* decision has already disproportionately affected low- and moderate-income individuals in the United States with lower FICO scores”.¹²

Both of these statements are incorrect. Moreover, there is no evidence whatsoever to support the bill’s claim that “if the valid-when-made doctrine is not reaffirmed soon by Congress, the lack of access to safe and affordable financial services will force households in the United States with the fewest resources to seek financial products that are nontransparent, fail to inform consumers about the terms of credit available, and do not comply with State and Federal laws (including regulations).”¹³

1. The “Valid-When-Made” Doctrine Is a Modern Invention, Not a “Cornerstone” of US Banking Law.

Whatever the merits of the so-called “valid when made” doctrine, it is *not* a cornerstone of US banking law now, nor has it ever been. It has not existed for 200 years, but is instead a very recent fabrication with scant support in law. H.R. 3299 is not restoring the law to its long-existing state, but is, in fact, radically changing it.

As an initial matter, the valid-when-made doctrine could not be 200 years old because it involves an issue that could not have arisen prior to the 1864 National Bank Act. Prior to the National Bank Act, state usury laws applied to all entities equally. There were no classes of entities such as national banks that were exempt from state usury laws. Thus, prior to 1864, it was not possible for a loan to be non-usurious in the hands of an original lender and subsequently become usurious in the hands of an assignee simply on the basis of

¹⁰ H.R. 3299, § 3.

¹¹ H.R. 3299, § 2(2).

¹² H.R. 3299, § 2(5).

¹³ H.R. 3299, § 2(6).

the assignment. This alone should cast doubt on the claims of a historical “valid-when-made” doctrine.

Even with extensive research, I have been unable to identify any case prior to the late 20th century that deals with the question of whether the usurious character of a loan changes merely by fact of the loan’s assignment. The “valid when made” issue was simply never a question, so it could not have been a doctrine.

The 1833 Supreme Court case cited in H.R. 3299, *Nichols v. Fearson*, pre-dates the National Bank Act, which should already make us suspect of its relevance to the issue of “valid when made.” More critically, though, *Nichols* did not in any way announce a doctrine that means that a loan if not usurious when made can never subsequently be usurious.¹⁴ Instead, *Nichols* says that a valid contract cannot become usurious by a “*subsequent* usurious transaction” (emphasis added).¹⁵ The distinction is critical for understanding the doctrinal point in *Nichols*, which is that usury in transaction #2 does not affect transaction #1.

Nichols involved a valid note for \$101 payable to the defendant. The defendant subsequently indorsed and sold the note to the plaintiff for \$97.¹⁶ The discount from the face value of the note was treated as implied interest—just as original issue discount on a security is treated today as interest for tax or bankruptcy claim calculation purposes. When the maker of the note refused to pay, the plaintiff sued the defendant on its indorsement of the note (indorsement made the indorser liable for the note). The defendant claimed that the note was void on account of the usurious discounting, but the Supreme Court disagreed, noting that the usurious discounting did not void the original note and were the rule otherwise, the indorser would escape liability on its indorsement.

Nichols, then, does not stand for any sort of “valid when made” doctrine. Instead, it stands for a narrower principle that a non-usurious transaction is not invalidated by a subsequent and separate usurious transaction. In other words, usurious transaction #2 does not infect valid transaction #1. That’s a totally different legal principle than H.R. 3299 claims *Nichols* represents.

This interpretation of *Nichols* as standing for the principle that usury in a separate, later transaction does not affect the validity of a prior transaction is borne out in every 19th century treatise on usury published in America or the United Kingdom. Thus, Webb’s 1899 usury treatise observes that:

A contract, free from usury at its execution, cannot be rendered invalid by any subsequent usurious agreement between the same or other persons. A subsequent agreement may be usurious in itself and thereby become either

¹⁴ I will refrain from commenting on H.R. 3299’s claim that the Supreme Court made any sort of “famous” declaration in this entirely forgotten case. Cf. Pete Wells, *As Not Seen on TV: Restaurant Review of Guy American Kitchen & Bar in Times Square*, N.Y. TIMES, Nov. 13, 2012 (“What exactly about a small salad with four or five miniature croutons makes Guy’s Famous Big Bite Caesar (a) big (b) famous or (c) Guy’s, in any meaningful sense?”).

¹⁵ 32 U.S. at 109.

¹⁶ 32 U.S. at 103.

wholly or partly nugatory; but its fate cannot be visited upon the original valid contract.¹⁷

To the extent there was ever a historical “valid when made” doctrine it has no relation to the one claimed by H.R. 3299, but instead meant that if transaction #2 was usurious, there was no infection of transaction #1. There is no historical pedigree for the “valid when made” doctrine claimed by H.R. 3299. It’s a modern invention.

2. The Invented “Valid-When-Made” Doctrine Is Nonsensical Because Preemption Is Not Assignable

Putting aside the valid-when-made doctrine’s suspect pedigree, it makes no sense as a doctrinal matter. The idea that federal preemption would follow a loan is itself nonsensical. National Bank Act or Federal Deposit Insurance Act preemption is not a *property right*, but a *status* that goes with being a national bank or a federally insured state bank. The common law of assignments covers only property interests. It does not cover inalienable status, such as personal privileges or statutory status. Thus, a building that has been grandfathered in to current zoning can be sold with the grandfathering rights because those rights relate to the specific property itself. But an assignor that receives favorable tax treatment on an asset cannot transfer that tax treatment with the asset. The tax treatment is personal to the assignor; it is not a characteristic of the asset.

To give additional illustrations of this point, a diplomat has broad immunity for torts, including those committed with a car. When a diplomat sells his car, the buyer does not acquire diplomatic immunity for torts committed with the car. Likewise, if a diplomat were to commit a crime on behalf of a non-diplomat third party, that third party could not shelter in diplomatic immunity because diplomatic immunity is a non-transferable status. Similarly, the sale of a medical practice does not transfer the right to practice medicine in a state. That is a personal privilege of a medical licensee—it is not a property characteristic of assets of the medical practice. And it is obvious that the sale of loans by a bank does not transfer with it the bank’s FDIC insurance coverage or banking charter.

Preemption of state usury laws is a right that goes with FDIC insurance coverage under the Federal Deposit Insurance Act or with a national bank’s charter under the National Bank Act. Preemption is part of a bundle of regulatory burdens and privileges under these statutes, and it cannot be unbundled and freely alienated as a type of property; preemption is an *in personam* defense or immunity, it is not an *in rem* feature of the loan. The idea that preemption would be assignable makes little sense as a policy matter. National banks and insured state banks are not subject to certain state laws because they are subject to an alternative federal regulatory regime. An assignee of a national bank or insured state bank is not subject to those regulatory regimes, however. Therefore, it should not get that regime’s benefit of preemption of state law lest there be a regulatory vacuum.

The valid-when-made doctrine also makes sense given that the National Bank Act and Federal Deposit Insurance Act do not void state usury laws. Instead, these federal

¹⁷ JAMES AVERY WEBB, *A TREATISE ON THE LAW OF USURY, AND INCIDENTALLY, OF INTEREST* 344 (1899).

statutes merely forestall the application of those usury laws to particular entities; there is no debate that the state usury laws would apply to nonbanks that directly originate loans. The implication is a national bank or state-insured bank can in fact make a usurious loan, but the state usury law will not have any affect on the bank because of the bank's privilege under federal law. The loan's rate still exceeds that allowed under the state usury law, so when the loan parts from the bank, it is no different from any other usurious loan. Rather than the point being "valid when made," it is "Once usury, always usury".¹⁸

3. *There Is No Evidence that the Madden Ruling Harms Consumers*

Third, contrary to the claims of H.R. 3299, there is no evidence that the *Madden* ruling has harmed consumers or that it will result in their substituting less-regulated credit for more-regulated credit. The sole evidence we have on the effect of the ruling is an unpublished study that relies on private data from a single, unidentified marketplace lender. The study seems to indicate that there was a reduction in lending by this single lender to consumers with very low FICO scores, even as lending to consumers with higher FICO scores increased. Critically, the study does not indicate the total dollar amount of the credit contraction to low FICO score borrowers. We cannot tell if it was a material amount or not. More importantly, we cannot tell if this apparent reduction in lending was offset by increased lending from other sources, much less the terms of the lending. We simply do not know the net effect of *Madden* on credit markets.

In the summer of 2017, I was eager to understand more about the study and inquired with the authors of the study both via email and in person about the extent of the credit reduction indicated in the study. The authors explained to me that they could not provide an answer because they are restricted from sharing the underlying data under a nondisclosure agreement with the lender. This is not standard operating procedure for empirical scholarship because it prevents other scholars from checking the work and raising questions about assumptions and attempting to cut the data in different ways that might answer questions differently. Empirical studies should be replicable, and this one is not because of the limitations on data sharing.

I do not say this to in any way impugn the authors of the study, whom I greatly respect. Rather, I say this to emphasize that the study cited by H.R. 3299 is not a basis for what is in fact a radical policy move. Indeed, none of the authors of the study cited by H.R. 3299 have endorsed the bill, in part because they understand that their study does not answer the key question about net consumer welfare. It might well be that the *Madden* decision resulted in reduced lending by *one* lender, but that other lenders filled the void. Ultimately we do not know what happened with the *total* volume of consumer lending and the terms of that lending. Until we do, it would be reckless to legislate a change to the decision. The American financial system has operated just fine without the

¹⁸ *Id.* 346-47.

valid-when-made doctrine and continues to do so. There's simply no need for H.R. 3299.¹⁹

More generally, H.R. 3299 and H.R. 4439 make the mistake of confusing “easy” credit with “beneficial” credit. Credit is a two-edged sword. Access to credit can be tremendously valuable for consumers, but only if that credit is affordable and sustainable. State legislatures have, in their wisdom, determined that there are certain limitations on credit terms that are proxies for whether credit is likely to be beneficial rather than harmful. Those are not determinations that Congress should blithely override through bills like H.R. 3299 and H.R. 4439. If Congress believes that state usury laws and other consumer protection laws are bad idea, it should override them plainly and directly, rather than through an obfuscation such as pretending to restore a made-up legal doctrine.

4. H.R. 3299 Is Overbroad and Facilitates Not Just Marketplace Lending, but Unrestricted Payday Lending

The proponents of H.R. 3299 emphasize its importance for so-called “marketplace” lenders. It is critical to recognize, however, that H.R. 3299 does not distinguish between marketplace lenders and payday lenders and debt buyers, and would protect them all. H.R. 3299 would facilitate not just marketplace lending, but also payday lending, and not just payday lending generally, but payday lending without *any* restrictions on interest rates, something that no state currently permits. Payday lending is only permitted or feasible currently in only around half of the states, but all of those states impose limits on the rates and terms payday lenders can charge. Under H.R. 3299, a lender with a rent-a-bank or rent-a-tribe relationship would not have to comply with any state restrictions on payday lending. H.R. 3299, then, represents a radical deregulation of consumer credit markets beyond anything that any state has been willing to allow in terms of payday lending. As consumer credit policy goes, H.R. 3299 is “pushing the envelope.”

IV. THE FINTECH REGULATORY FRAMEWORK

A. The Current Regulatory Regime for Nonbank Consumer Finance Companies

Currently, nonbank consumer finance companies are regulated on both the state and federal levels. Nonbank consumer finance companies are required to be chartered and licensed by states. State licensing regimes are not reciprocal, so a company needs a license for every state in which it operates. The requirements for obtaining a license vary by state and by the particular type of license involved. Different state licenses allow for different types of activities. For example, a lender in Illinois is required to choose between a Consumer Installment Loan Act license and a Payday Loan Reform Act license, each of which permit different types of loans. Beyond licensing, states have different supervision regimes, different substantive laws, and different enforcement policies. All of this means

¹⁹ The argument that *Madden* will result to a shift to less regulated credit is also hollow. The type of credit that is most at risk from *Madden* is rent-a-bank lending, whether by marketplace lenders or payday lenders. The whole point of rent-a-bank lending is that it avoids regulation.

that there are increased regulatory burdens for nonbank financial services companies that operate in multiple states.

In addition to state regulation, virtually all nonbank consumer finance companies are regulated by the Consumer Financial Protection Bureau. The CFPB has rulemaking and enforcement authority over all of these companies and exercises supervisory authority over some of them (primarily mortgage lenders and payday lenders). CFPB regulation provides a modicum of consistency in regulation for nonbank consumer finance companies. Moreover, the CFPB is charged with ensuring that it enforces federal consumer financial law “consistently, without regard to the status of a person as a depository institution, in order to promote fair competition.”²⁰

Additionally, prudential bank regulators exercise supervisory authority over bank partnerships with fintechs. Yet it is critical to recognize that regulation in this space is almost all informal and non-binding, except to the extent that the CFPB has UDAAP rulemaking and enforcement jurisdiction over fintech partners of banks that qualify as “service providers” under the Consumer Financial Protection Act. Finally, the Department of Justice and Department of Housing and Urban Development have authority over the Fair Housing Act, which covers both mortgage lending and rentals.

B. Issues with the Current Fintech Regulatory Framework

There is no acute crisis with the current fintech regulatory framework. It might be less than ideal, but so too is the general structure of US financial regulation. Fintechs have been able to blossom and prosper under the current regulatory regime. What this means is that Congress should proceed deliberately and carefully in making changes to the fintech regulatory framework, with the first principle being “do no harm.”

None of this is to say that the current fintech regulatory framework does not have issues. But the issues posed by the existing regulatory framework vary depending on what a fintech does. For fintechs that are payments processors, the key issue with the current regulatory regime is that they need 50+ state money transmitter licenses to operate on a national scale. Many of them operate this way currently, but dealing with 50+ regulatory regimes certainly poses a hassle. Critically, for payments fintechs, the issue is about the number of regulatory regimes, rather than their substantive terms.

In contrast, fintechs that engage in consumer lending are concerned less about a multiplicity of licensing regimes than about the substantive terms of state law, particularly state usury laws and other consumer protection laws. These laws restrict the terms on which they can lend. Additionally, to the extent credit-fintechs use nontraditional data sources, there are concerns about liability under the Equal Credit Opportunity Act and (if mortgage lenders) under the Fair Housing Act.

C. Suggestions for Fintech Regulation Going Forward

Based on the forgoing analysis, I would make six concrete suggestions to the Subcommittee regarding fintech regulation going forward.

²⁰ 12 U.S.C. § 5511(b)(4).

(1) Create a federal money transmitter license. State money transmitter laws date back to the days when Wells Fargo actually operated a stagecoach and the federal government played a minimal role in financial regulation. There's no good case for maintaining state-specific money transmitter regulation particularly given the number of large, national money transmitters. There's no obvious benefit from the 50-state regime, as the substantive requirements are materially similar. Money transmitters that operate nationally merely end up complying with the strictest of regimes. A federal money transmitter license, coupled with some sort of federal insurance for funds held by money transmitters (such as balances in a PayPal or Venmo account) would be a simple move that would help reduce unnecessary regulatory burdens.

Such a federal money transmitter license should be created by statute, as it is questionable whether any existing regulators have authority to issue such a charter. I would urge that the chartering authority—and the concomitant insurance and regulatory regime—be placed with the FDIC. I would also suggest that any such charter not include cryptocurrency institutions, at least initially.

(2) Facilitate portability of consumer account data. One of the major problems in consumer finance is the stickiness of consumer financial relations. Consumers do not switch financial service providers nearly as often as they should. Financial institutions know this, and they know it means that they can extract supracompetitive profits from customers.

There are several reasons for the stickiness of consumer financial relations.²¹ The first are the search costs of finding a new and better financial relationship. Consumer financial products are fundamentally commodity products, but financial institutions make great efforts to facially differentiate products and make comparison-shopping difficult. All of this increases search costs, and there is no guaranty that a search will be successful. Second, there are unavoidable transaction costs to establishing a new financial relationship such as account-opening paperwork for both internal administrative needs of the financial institution and for compliance with anti-money laundering regulations. Third, there are the costs to switching relationships. For example, direct deposit and automatic bill pay services, although very helpful for consumers, increase switching costs because of the potential disruption to the consumer's payments. Fourth, to the extent that consumers care about physical locations of financial services, there may in fact be few convenient choices available because of entry restrictions in the depository market. And fifth, consumer psychology contributes to a degree of stasis (some of which is rational for the other reasons, but some of which may not be).

One way the consumer financial marketplace could be made more efficient is through facilitating the portability of consumer account data. Financial institutions will generally claim that they “own” the data on a consumer account, such that the consumer cannot freely transfer that data—transaction histories, etc.—to other financial institutions. Quite frequently, it is fintechs that want access to consumer data. These fintechs are

²¹ See, e.g., K. Jeremy Ko & Yoon-Ho Alex Lee, *Consumer Mistakes in the Mortgage Market: Choosing Unwisely Versus Not Switching Wisely*, 14 U. PA. BUS. L.J. 417 (2012).

sometimes financial advisors, rather than direct competitors with the banks, but their advisory services might include advice for a consumer to change a banking relationship. Not surprisingly, banks are not always eager to share consumer data.

The CFPB under former Director Cordray put forth a set of principles on the sharing and portability of consumer data.²² Those principles are non-binding, but are a starting point for achieving a policy that facilitates consumer data portability without creating undue fraud risks for banks. Congress should encourage regulators to press for greater data portability, and, if the issue cannot be resolved informally, Congress should consider legislation that enables greater data portability rights for consumers.²³

(3) Do not create a federal fintech charter for credit-granting institutions unless such institutions (a) are subject to federal consumer protection laws that are at least as protective as the most protective state law regimes and (b) are required to operate on a level playing field with depositories. While there is a strong case for federal licensing of money transmitters, there is not such a case for federal licensing of non-bank lenders. Nonbank lenders' interest in federal chartering is virtually entirely about avoiding state consumer protection laws. If a federal charter did not come with preemption benefits, there would be no interest in such a charter.

Federal chartering should not be a move to eviscerate state consumer protection laws. Federally chartered institutions should be held to a *higher* standard than state chartered institutions. A federal charter is an unusual privilege for any business, and it should be paired with expectations that the charter holder will act to benefit the commonwealth, which means treating consumers (that is taxpayers) fairly and honestly in all dealings. At the very least, a federal charter should be paired with a general ability to repay requirement for all lending (with administrable safe harbors for fully amortizing loans under a specific interest rate), a positive amortization requirement, and restrictions on rollovers on short-term loans.

Any sort of federal charter for nonbank financial institutions must also maintain competitive parity with depositories. That means that nonbanks should be subject to some form of capital and liquidity regulation, as well as Community Reinvestment Act obligations.

(4) Consider adopting a general federal “ability to repay” requirement for all forms of consumer credit excluding student loans. Currently, federal law has statutory ability to repay requirements for mortgage loans and credit card loans. Additionally, the CFPB's Payday Rule creates an ability to repay requirement for certain payday and vehicle title loans. I would urge the Subcommittee (and the CFPB) to

²² CFPB, *Consumer Protection Principles: Consumer-Authorized Financial Data Sharing and Aggregation*, Oct. 18, 2017, http://files.consumerfinance.gov/f/documents/cfpb_consumer-protection-principles_data-aggregation.pdf.

²³ A related issue is the need to encourage the use of open APIs to ensure interoperability of different institutions' technology platforms.

consider a general ability to repay requirement for all consumer credit other than student loans.

In the traditional lender-borrower relationships, lenders and borrowers were essentially partners—the lender would only make money if the borrower repaid, so the lender was incentivized to ensure that the borrower did not receive more credit than he or she could handle. This traditional partnership model of lending has been replaced in many parts of the consumer finance market.

First, many lenders securitize their loans, so the repayment risk is not held by the party that makes the lending decision. Because securitizers receive payment for the loans upfront, they may be incentivized to increase lending volume at the expense of sustainability of loans.

Second, some lenders have adopted a “sweatbox” model of lending, in which the interest and fees on loans are so high that they will offset any loss of principal if the loan performs long enough; even if the borrower defaults prior to maturity, the lender can still make money. In such a situation, a lender may be incentivized to increase its volume of loans at the expense of a higher default rate.

Third, to the extent that a lender can upsell a consumer (e.g., an auto dealer selling the consumer the “TruCoat”²⁴ finishing or rustproofing at a huge markup), a loan may be a loss-leader, such that the lender may be willing to incur more defaults because those defaults may be offset by other purchases or transactions with the consumer.

Fourth, loan officer incentives may encourage extensions of credit beyond what is in the interest of the lender institutionally. The clearest case of this is the Wells Fargo fake account scandal. Wells Fargo created incentives that encouraged its employees to open up fake credit card accounts for consumers that resulted in fraudulent card use, and Wells Fargo incurred some of the losses from this fraud.

All of this suggests that lenders cannot be relied upon to consistently ensure that they do not extend credit beyond borrowers’ ability to repay. Overlending to a borrower may actually be in a lender’s economic interest. But it is hardly in the borrower’s interest, and this is where a general regulatory standard such as an ability-to-repay requirement would be helpful. Such a requirement could be made more administrable through regulatory safe harbors along the lines of what the CFPB has done in its Payday Rule. Ultimately, this approach would enable uniform federal regulation of the consumer credit industry, rather than state specific usury and term regulation.

(5) Encourage federal regulatory agencies to use time-limited no-action letters for the use of underwriting with non-traditional data. Nontraditional underwriting data potentially expands access to credit to underserved populations, particularly the millions of Americans with thin or non-existent credit files with the three major consumer reporting agencies. The use of such nontraditional underwriting data is potentially beneficial, but also poses the risk of discriminatory impacts in lending. Currently, the Equal Credit Opportunity Act and Fair Housing Act allow

²⁴ See FARGO (1996).

lenders to “self-test” without being subject to discovery in litigation for their self-testing results.²⁵ The idea behind self-testing is that it allows lenders to discover unintentional discrimination and change their practices, but self-testing is not a waiver of liability, even though corrective behavior by a lender is likely to be considered as a mitigating factor in public enforcement.

The use of nontraditional underwriting data could be further facilitated through time-limited no-action letters conditioned upon self-testing by the recipient lender (and reporting of the results to regulators). The individualized no-action letter process would ensure that responsible lenders could experiment with using nontraditional underwriting data without incurring liability for unintentional discriminatory effects. I prefer this no-action letter approach to a broader “sandbox” approach because it is more individually crafted, enabling an upfront consideration by regulators of the firm and data involved, rather than being an open playground. There is currently regulatory authority to issue such no-action letters, but their use has been quite limited to date and should be encouraged. Further, regulators should be encouraged to coordinate their no action processes through the Federal Financial Institutions Examination Council.

(6) Require the CFPB to fulfill its mandate under section 1071 of the Dodd-Frank Act to collect data on small business lending. An important segment of credit fintechs are so-called “marketplace lenders.” It appears that a large percentage of marketplace lending is in fact small business lending, even if it is formally lending to individuals, not businesses. A great deal of marketplace lending is in fact small business lending.²⁶ Unfortunately, regulators lack a good view of what is happening in this market. The CFPB is charged under the Dodd-Frank Act with collecting data on small business lending.²⁷ To date, however, the CFPB has not implemented this data collection. Absent data, it is difficult to craft good regulatory policy on small business lending, much less ensuring that the market is not plagued by discriminatory lending.

CONCLUSION

Fintechs hold out both the promise of improved financial services for consumers and risks for consumers and the safety-and-soundness of the financial system. The particularly regulatory issues raised vary by the type of fintech involved, but these risks can be managed through appropriate regulation by both federal and state governments.

Attachments:

Adam J. Levitin, “*Madden Fix*” *Bills Are a Recipe for Predatory Lending*, AM. BANKER, Aug. 28, 2017.

²⁵ 15 U.S.C. § 1691c-1 (Equal Credit Opportunity Act); 42 U.S.C. § 3614-1 (Fair Housing Act).

²⁶ Jared Bennett, *Is Congress expanding credit for the poor or enabling high-interest lenders?*, The Center for Public Integrity (last updated January 12, 2017, 11:20 AM), <https://www.publicintegrity.org/2017/12/22/21441/congress-expanding-credit-poor-or-enabling-high-interest-lenders>.

²⁷ 15 U.S.C. § 1691c-2.



BankThink 'Madden fix' bills are a recipe for predatory lending

By Adam J. Levitin

Published August 28 2017, 10:24am EDT

More in [Midland Funding v Madden](#), [Policymaking](#), [Payday lending](#), [Online banking](#)



Print



Email



Reprints



Share

Editor's note: This is an altered version of a post that originally appeared on the [Credit Slips blog](#).

Currently pending in both houses of Congress are [versions](#) of the [Protecting Consumers Access to Credit Act of 2017](#) — bills that would “fix” the 2015 appellate court decision in [Madden v. Midland Funding LLC](#). Unfortunately, these so-called legislative solutions are based on a faulty reading of case law.

The Madden case held that National Bank Act preemption of state usury laws applies only to a national bank, and not to a debt collector assignee of the national bank. The decision has potentially broad implications for all secondary markets in consumer credit in which loan assignments by national banks occur: securitizations, sales of defaulted debt and [rent-a-BIN](#) lending.

Unfortunately, the “Madden fix” bills are overly broad and unnecessary and will facilitate predatory lending. Specifically, the Madden fix bills claim to be restoring the so-called “valid-

when-made" doctrine, which, according to proponents of the legislation, means that the usurious or nonusurious nature of a loan is fixed at the time when the loan is made. The problem is that this particular doctrine is wholly concocted. There is a "valid-when-made" doctrine in commercial law, but it means something entirely different than the Madden fix proponents claim.



Bills to address concerns about the effects of the Madden court decision would facilitate predatory lending through schemes that have no purpose other than evading state usury laws.

Adobe Stock

The actual "valid-when-made" doctrine provides that the maker of a note cannot invoke a usury defense based on an unconnected usurious transaction. The basic situation in all of the 19th-century cases establishing the doctrine involves *X* making a nonusurious note to *Y*, who then sells the note to *Z* for a discount. The discounted sale of the note can be seen as a separate and potentially usurious loan from *Y* to *Z*, rather than a sale. The valid-when-made doctrine provides that *X* cannot shelter in *Y*'s usury defense based on the discounting of the note. Even if the discounting is usurious, it does not affect the validity of *X*'s obligation on the note. In other words, the validity of the note is a free-standing obligation, not colored by

extraneous transactions.

“Valid-when-made” was a sensible and indeed critical rule for 19th-century commercial law. In the 19th century, negotiable instruments such as notes passed as currency, and their liquidity depended on them being “travelers without baggage,” such that parties could accept them without undertaking diligence beyond the four corners of the note itself. The rule is not only practical, but also just — why should *X* get a windfall because of *Y*’s separate dealings with *Z*?

But notice that the actual valid-when-made doctrine has absolutely nothing to do with the Madden situation. The consumer in the court case did not attempt to invoke the rights of the national bank against the debt collector. Instead, the consumer’s argument was that the interest rate on the debt was usurious — and clear — under state law from the get-go. The state usury law’s application is preempted by the National Bank Act as applied to national banks, but only as to national banks; the National Bank Act does not void the state usury law, only stay its application. Once the note leaves the hands of a national bank, the state usury law applies as it always would. This too is a sensible outcome. National banks are not subject to certain state laws because they are subject to an alternative federal regulatory regime. An assignee of a national bank is not subject to that regulatory regime, however, so it should not get that regime’s benefits lest there be a regulatory vacuum. And because consumer debts are not used as currency, there is no policy reason to enhance their liquidity by excusing debt purchasers from basic diligence.

The point is that Madden did not reverse long-standing case law; the National Bank Act was not held to preempt state usury laws in any circumstances until 1978. Instead, Madden reversed some relatively recent assumptions of the financial services industry about the scope of National Bank Act preemption in secondary markets, the foundations of which I questioned in [a 2009 article](#). The Madden fix bills are not restoring long-standing doctrine, but creating it out of whole cloth to meet the financial services industry’s desires about what the law should be, not what it is.

The flawed legal foundations of the Madden fix bills also present another problem: They fail to incorporate an important corollary doctrine. The courts have consistently distinguished between a situation in which there is a legitimate loan and an unconnected usurious

transaction, and situations in which the assignee is the true lender and the assignment is a sham. Thus, the sale of defaulted loans to a debt collector who has had no input in the loan's underwriting is entirely different under this doctrine than a rent-a-BIN operation, in which the assignee is substantially involved in marketing and underwriting the loans.

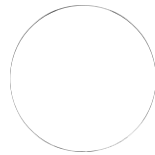
The Madden fix bills fail to distinguish between these situations. Instead of merely protecting relatively benign financial transactions, like credit card securitization or even facilitating a secondary market in defaulted loans, the Madden fix bills are actually facilitating predatory lending through rent-a-BIN and [rent-a-tribe](#) schemes that have no purpose other than the evasion of state usury laws and other consumer protections.

In any event, it's not clear that the Madden court decision poses any problem that needs fixing. The bills cite a [single, unpublished academic study](#) that shows that some marketplace lenders responded to Madden by limiting credit to borrowers with low FICO scores. The study does not indicate the total dollar amount of that credit contraction, much less if it was offset by increased lending from other sources, or its effect on consumer welfare. We simply don't know the net effect of Madden on credit markets.

Even if there were a net reduction in credit as a result of Madden, that access to credit must be balanced against sensible borrower protections. If access to credit were everything, we should be eliminating limitations on debt collection and allowing consumers to pledge their children and organs as collateral.

Usury laws are the oldest form of borrower protection known. They are blunt tools, but that is also their virtue, insofar as they are easy to administer. Congress should be hesitant to do a quickie, backdoor repeal of laws that have been on the books since colonial times, especially as state legislatures are free to repeal their usury laws directly.

It's reasonable to rethink the role of state usury laws in national credit markets, but any erosion of consumer protections on the state level must be matched by a strengthening of those protections on the federal level, such as with a federal usury floor or an ability-to-repay requirement. Sadly, the Madden fix bills don't do this, and instead gut state usury laws in the name of restoring an imaginary legal doctrine that never existed.



Adam J. Levitin

Adam J. Levitin is a professor of law at Georgetown University.