Valid When Made

Background - The contractual doctrine of Valid-When-Made which, as applied to lending agreements, provides that a loan which is valid at inception cannot become usurious upon subsequent transfer to another person. **This important principle derives from the common law and its application has been a cornerstone of U.S. banking law for over 100 years**. This long-standing doctrine has and does enhance liquidity in the credit markets and, consequently, reduces the cost of credit to borrowers and applies when valid loans are sold, transferred or assigned to third parties. The *Madden v. Midland Funding, LLC* case, decided by the U.S. Court of Appeals for the Second Circuit, contradicted this well-established principle of law (without even adequately addressing the doctrine). The *Madden* case is unusual in the breadth of legal experts (regulatory and industry) challenging the decision. Amicus briefs were filed against the Madden decision by ICBA, ABA, CBA, The Clearing House, and Financial Services Roundtable. **The Obama Administration's Solicitor General, in consultation with federal banking regulators, called the decision, "incorrect" with an "analysis reflect[ing] a misunderstanding" of section 85 of the National Bank Act and Supreme Court precedent.** The FDIC and OCC have issued guidance recognizing 3rd party lending arrangements (FIL-50).

Current and Potential Impact - If left without clarification from Congress, the Second Circuit's decision may well have expansive impact to products and markets built around long-standing interpretation of the Valid-When-Made doctrine and the National Bank Act. The decision could significantly disrupt secondary markets for consumer and commercial credit, impacting all stripes of financial services products and other businesses that rely on the availability and post-sale validity of loans originated by national or state-chartered depository institutions. The decision has had an immediate impact on credit markets, impacting borrowers in the 2nd circuit. **A Columbia-Stanford study (below) shows that 2nd Circuit borrowers with credit scores under 625 have seen a 52% reduction in credit post *Madden*.** The decision has has already created some market uncertainty and has the potential to affect all types of securitized debt or whole loan sales of all types, impacting access to credit and risk mitigation. As it stands, there is a lack of uniform interpretation of banking law across the country. And while this decision only has an impact on three states, the lack of legal certainty has brought forward similar cases in at least one other jurisdiction.

Legislative Status - Rep. Patrick McHenry and Rep. Gregory Meeks are preparing to introduce the Valid When Made reaffirmation bill in the House in the next few weeks. We currently expect Senate introduction to be led by a Democrat office making it bipartisan across Capitol Hill. As a policy issue with strong bipartisan support, this is the type of important but narrow technical clarification that would be a constructive legislative agenda item.

1. https://www.justice.gov/sites/default/files/osg/briefs/2016/06/01/midland.invite.18.pdf

3. http://www.ballardspahr.com/alertspublications/legalalerts/2016-05-26-solicitor-general-was-incorrectly-decided-recommend-denial-supreme-court-review.aspx

4. https://law.stanford.edu/publications/what-happens-when-loans-become-legally-void-evidence-from-a-natural-experiment/

5. https://www.fdic.gov/news/news/financial/2016/fil16050.html