Podcast 67: Brian Korn

Welcome to the Lend Academy Podcast, Episode No. 67. This is your host, Peter Renton, Founder of Lend Academy.

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Peter Renton: Today on the show, we are talking about legal issues. I've got the person who is probably the leading attorney in this space, Brian Korn. He is a Partner at Manatt, Phelps & Phillips in New York. He is involved in all kinds of deals in this space. I see his name all over the place, he knows this space probably better than any other attorney in this country. I wanted to get him on the show because there is so much to talk about the legal side right now, I wanted to go and delve into the regulations that are actually in place today, so we actually go into some depth on that. We talk about Madden vs. Midland, we talk about the Reg A+ offerings. Brian gazes into his crystal ball and shows us what he believes is going to happen when it comes to regulation down the track. I hope you enjoy the show!

Welcome to the podcast, Brian.

Brian Korn: Thanks for having me, Peter.

Peter: Okay, so let's just get started by giving the listeners a little bit of background about yourself.

Brian: Okay, I'm a corporate and securities attorney, Partner at Manatt, Phelps & Phillips which is a law firm of approximately 500 lawyers, offices in Los Angeles, New York, Washington, San Francisco principally. I have been the leader of their digital finance and marketplace lending practice for the last two years. Prior to that, originated the same group at Pepper Hamilton and before that was in in-house legal roles on the investment banking side for both Barclays Capital and Citigroup Global Markets. Started my career at Weil, Gotshal & Manges here in New York doing capital markets, securities offerings, high yield debt, leverage buyout transactions and IPOs.

Peter: Okay, so then when did marketplace lending or peer to peer lending first get on your radar? I presume that was when you were at Pepper Hamilton, right?

Brian: That's right, so we were initially engaged to help P2P Capital originate their UK listed fund and it was really an eye opening experience because it was the convergence of peer to peer lending with the Jumpstart Our Business Startups Act of 2012 here in the US, the act that really jumpstarted and revolutionized what we see today as modern investment crowdfunding. We had always had rewards crowdfunding at Kickstarter and Indiegogo had been around for quite a while and obviously Lending Club and Prosper had existed since back to 2006/2007.

What the JOBS Act did is as part of Title II allowed for advertised private placements for the first time so in the old world you had a public offering or you had a private placement and the private placement had to be very private and if you went out and engaged in broad marketing efforts, you always ran the risk that you were going to be engaged in a solicitation which would not be allowed. The JOBS Act said and the SEC have been working on projects similar to this, but it finally came together in 2012 with the ability to now advertise a private placement so long as you only sell to accredited investors.

That's the current framework that we have and the rules were finalized in 2013. You saw quite a few p2p marketplace lending sites pop up that offered online investments to accredited investors and that's still the primary mode that people invest is accredited investors logging into a website and making an investment decision. Most sites are what they call advertised; you can be advertised or not advertised. In an advertise site you have income or net worth verification, but that really changed quite a bit of how we interact and how alternative investing and finance really came about.

Peter: Right, right, okay. Yeah, I do want to get into that a little bit, but first I want to just talk about the current state of regulation today. Now we have...there's still really only two platforms that have gone through the S-1 registration and are available to retail investors, Lending Club and Prosper, but I'd like to step back a little bit. I think one of misnomers for people, one of the misconceptions for people who really just first learned about this industry...they assume it's online lending, it's unregulated and I want to kind of sort of tease that out a little bit and have you describe for both the borrower side and the investor side how this industry is regulated today.

Brian: Sure, so there are really two touch points of regulation here. One is we have a loan transaction that's being originated. The second is once the transaction has been finalized there are various ways to invest in the transaction to buy the loan, to buy securitization interest in the loan and really the format of how that distribution works.

On the origination side, many people are surprised to learn that you do not have to be a bank in the United States in order to extend a loan. In many states you have state lender licensing requirements, some states don't have any state lender licensing requirements and of course, if you choose to be a bank or if you partner with a bank then you'll have certain advantages. One of those advantages is the ability of the bank that's chartered in one state to operate in all 50 states as long as that bank is FDIC insured.

The advantage of having the ability to do that is that you are able to export the rate of the home bank state to all of the other states. So even if I'm in a state like New York which has a civil usury cap of 16%, if I'm using a bank from a different state that has a higher rate, I'm able to export the rate of the higher rate and effectively offer credit to borrowers in that state at the higher rate, according to my home state. It's similar to if two states have different ages for driving a car and you're able to get a driver's license in California where the driving age is 16 and that person comes to New York where the driving age is 17, even though that person could not drive and get a New York license at 17, they're still able to drive in the California license for a 16-year old is honored in New York.

So in that similar fashion, you have the bank...what platforms have done is they have for efficiency purposes sought to partner with banks that offer attractive interest rates or a range of rates that can be offered to borrowers and effectively use those banks in partnership programs similar to the Lending Club, Prosper, Avant, Web Bank relationships and Cross River Bank partnering with Marlette and many other platforms.

The second way that you can issue a loan is by actually being licensed by that state and many platforms have gone through the process of obtaining state licenses. There are several platforms that have licenses in 10, 15, 20 states and rather than going through the bank partnership model where you're counting on the rate exportation and the ability to extend credit in a different state, in that case the platform or subsidiary of the platform is itself licensed to lend in that state.

On the lender side that's how we see things. That's all related to primarily consumer lending. Consumer lending is the most regulated form that we have. There are several federal statutes that govern how we extend credit to consumer borrowers, what disclosures have to be made, what procedures are in place to ensure fair debt collection, fair credit reporting.

On the small business side and by analogy the real estate side, which are essentially small business loans, if you are lending to a business entity for a commercial purpose, not for a household or family purpose, then there are five states that require absolute lending licenses and many require physical locations in that state, but the vast majority of states do not require a lender license. That does not mean that you are going to be exempt from the usury laws of that state although many states such as Delaware have provisions where a corporate borrower cannot claim usury as a defense with respect to invalidating a loan transaction.

So we really have a dichotomy on the borrower side between consumer lending and small business lending. In the small business context it is more lightly regulated and that does not mean that small business platforms don't also use banks. There are certain states that it is more advantageous to use a bank in order to lend above the state usury cap primarily and there are a handful of other states that do not recognize bank partnerships or have had cases in those states that have called into question, what we call the true lender issue on whether a bank is actually doing the lending. Most notable of those is Iowa and West Virginia. So that's the borrower side.

On the investor side, it really depends on what we are doing. If we're selling loans outright to an investor the prevailing view of securities lawyers is that a loan in that context would not be characterized as a security under something called the *Howey and the Ernst & Young vs. Reves* case. Now that does not mean that that analysis is going to be applicable in all situations and is completely bullet proof, but the general practice is that whole loan sales sold to large investors, investors that are in the business of investing, are generally not going to be characterized as securities transactions.

As you move down the investor sophistication scale there is more and more increasing possibility that the transaction would be characterized as a securities offering and so as we start to offer loans and whole loan sales to one-off entities and smaller institutions we get concerned about whether this transaction needs to qualify either as a public offering which would be a registered transaction with the SEC or a private placement which would be exempt from SEC registration but would still need to be reported after the fact on something called a Form D as well as published out to various states.

Now the platforms that have retail marketplaces...so in that situation you have a loan that's originated by a bank, it is sold back to the platform and then retail investors can invest in a payment dependent note which payment would be dependent on whether payments are received by the borrower. So the notes would not be recoursed to the platform, but are really dependent on whether the borrower pays. The borrower pays early, you get paid early; the borrower pays late, you get paid late; the borrower defaults, you may not get any recovery at all. There's a big issue now about what amount of effort and expense has to go into the recovery efforts on defaulted loans and what control, if any, do investors have in that process.

But in the sale of a payment dependent note, everyone agrees that that would be a security and in most cases, other than Lending Club and Prosper as you mentioned, those are qualified under Reg D as private placements. A Form D is filed with the SEC and state notice forms are filed. New York has an issuer specific form not a transaction specific form called Form 99 which also needs to be filed. By and large most platforms that have retail marketplaces opt for that private placement model and we can talk a little bit more. There have been some innovations in bringing more platforms into the retail market through something called Regulation A which was modernized by the JOBS Act.

Peter: Right, we'll get to that in a bit, but I just want to go back and ask...you mentioned that some platforms partner with an issuing bank, some platforms go and directly get state lending licenses. I just want to be 100% clear here, if you're issuing loans through a state license, I just want to get your take on…are all federal laws, federal protection for borrowers, those are still in play, right?

Brian: Yes, so federal law in this context will always apply with respect to these transactions to the extent that there is a federal law that affects the business of lending. Those will continue to apply so if you have a state license that does not mean that you can violate the Truth in Lending Act. Now state laws will also exist that effectively mirror the federal laws so it wouldn't be the case where any state would have a more lax regime than what the federal government requires, but many states do rely on the federal statutes and so you would have to comply with those laws.

Also, I should mention in the small business context a third option is something called the Choice of Law Theory which is that the business would locate in a jurisdiction that has little or no usury cap and claim that the transaction is being originated from this state, collections are being done in this state and that you, the borrower, are virtually coming to this state to borrow money from us in that state. Similar to if you're a consumer, you're subject to the sales tax of whatever state your purchase is being made so if I fly to Chicago then I would be subject to Illinois sales tax.

Same analogy for lending, if you lend to a platform that has chosen for example, Virginia choice of law then that law would govern. Now most courts have found that in a consumer context the borrower's state of residence will be the law controlling regardless of what the parties have elected through their forms to choose as choice of law which is why you don't see a tremendous amount of movement to those states from the consumer side.

However, in the small business context there are several platforms that have concluded that possibly in addition to state licensing or in addition to bank partnership we will locate in a state such as Virginia which has more permissive lending laws and no usury cap for corporations. Many cases have found that the more substantial the contacts are and the more legitimate the transaction is related to that state where law is chosen, the more likely that that will be law that governs in the event that there is a question or controversy.

Peter: Right, right, okay. I want to move on now to really the case that has sort of been talked about I think most over the last 12/18 months in this industry and that's Madden vs. Midland. I just would like you to just very briefly describe the case. Most people know about it so I don't want to spend a lot of time on it, but what I do want to delve into is where we're at today. We're recording this on June 10th and I know it's a somewhat fluid case, but if you could just give us a little bit of background about that.

Brian: Absolutely, so Saliha Madden is a consumer from New York, she took out a credit card with Bank of America, the card was ultimately sold to an entity called FIS Card Services. B of A and FIS are national banks. Ms. Madden defaulted on her balance which was approximately $5,300 and her account was sold to Midland Funding which is a collections firm. Midland informed Ms.Madden that interest was still due on the account at the same rate that she accrued when she had the original credit card and so they continued to charge her at the rate that Bank of America had charged her.

Her lawyers filed a lawsuit challenging the ability of Midland as a non-bank to charge a rate that a national bank could charge even though the loan was now in the hands of Midland and not a bank. This is New York, a national bank has no maximum interest rate although they're now subject to CFPB norms and requirements and those directives of the OCC and the FDIC. She was paying a rate that was north of the New York usury cap which for civil usury is 16%, for criminal usury it's 25%. If you have a New York license you can charge up to the criminal rate, but not more. Bank of America as a national bank charged her in excess of 25% which it is entitled to do and then when the case was transferred to Midland they charged her in excess of that rate. So the question before the court was…was she overcharged a rate that Midland could not effectively charge?

The District Court which is the initial trial court held for the collection firm for Midland said that under the preemption statute federal law trumps state usury law and the bank can charge what it wants and the collection firm as a purchaser of that note can continue to charge the same amount under something called the Valid When Made Doctrine…so if it was valid when it was made that asset can then be sold to and be in the hands of non-banks and they can continue to charge. It was appealed to the Second Circuit Court of Appeals in New York where the court reversed and said no, state law cannot be preempted by federal law in this case.

Many people felt that that was a mistake. There was an appeal made for the Second Circuit to reconsider its decision. The motion to reconsider, what we call a Rehearing En Banc, was denied and Midland filed for review by the US Supreme Court. At the US Supreme Court, the case was heard in a conference. The conference is comprised of justices and their clerks and at least four justices out of nine, although now there are eight currently serving on the court, at least four must agree to hear the case for the case to be docketed for oral argument and hearing. Instead of, what happens in many cases where the court simply denies hearing the case, they did two things.

Number one, they required Madden to file a response brief so that they could hear both sides. That's usually an indication that they're somewhat interested in the case. Second thing they did is they required the Solicitor General of the United States, which is the official litigator before the court, to file a brief and give his view on the case. In that brief the SG also includes the view of the Office of the Comptroller of the Currency and so we have the view of the national banking authorities on that case. In that very important brief that was filed a few weeks ago, the Solicitor General flat out claims that this case was wrongly decided.

Under the National Bank Act, you are able to charge a rate and a fundamental power of a bank is the power to originate a loan and therefore the power to sell that loan and dispose of that asset and no state law can actually interfere with that power including state usury law. The SG nonetheless recommended that the court not hear the case because it claimed that the litigants had failed to make the proper arguments about preemption and that it was likely that Midland would prevail ultimately under two alternate arguments.

The first is that both parties agreed to Delaware law when she signed her credit card agreement. In the fine print there she agreed to abide by Delaware law which would allow for her to be charged the rate she was charged. The second is failing that even if New York law applies that Valid When Made Doctrine would also apply. So we are back now with the justices who have had the brief of the Solicitor General and they now must decide whether to grant cert. and hear the case which would obviously be next term because the court's term is up at the end of June. They don't meet again until famously the first Monday in October and there will be some work behind the scenes in terms of whether the case will be heard, but we should have a decision I think by the end of this month on whether the case will be heard, but that could go into the summer into the next term so that's really where we stand.

The result of the case, which again, this is a National Bank Act, this is not the FDIA or any statute that marketplace lenders operate under because the ones that use partner banks are not using national banks, they're using state banks. Maybe that's a nuance, but I think it's an important nuance is that it has called into question whether loans that are originated out of the Second Circuit states, which are New York, Vermont and Connecticut can exceed the usury rates of the states of the borrower. For New York, for example, there's an open question because of Madden and because of the current state of the case as to whether a loan that exceeds 16% would ultimately be enforceable and because of that these loans have been priced out of the distribution market.

Additionally, there have been studies that have shown that marketplace lenders are stopping loans to the Second Circuit that would exceed the usury limit; in many cases stopping all loans to the Second Circuit. So there is a study by Columbia and Fordham that have shown that...I saw a number that about 48% decline in available credit to borrowers in New York versus an increase in the rest of the country so the case is very important. It is currently the law that under the National Bank Act cannot trump state usury laws in those states.

Most people including the government feel that is the wrong answer, but it is the answer for now. What many platforms are hoping for is that the court grants cert and reverses the case. What ultimately could happen as well is that when the case goes down to the District Court, the choice of law of Delaware will be granted, although many people doubt that because in the consumer context the borrowers state is usually the laws we explained before and even under New York law that New York will acknowledge Valid When Made and wouldn't impose usury requirements although that argument is arguably more sketchy than the other two. So it puts us in a world of a little bit of uncertainty.

Most people believe that a loan that's originated in the current context where the court is still hearing the case is almost not possible for that to be declared invalid and therefore uncollectible although if you're in the risk management business and if you have available options of buying loans from Pennsylvania instead of New York, it seems like investors are becoming somewhat cautious in the wake of the Second Circuit outcome.

Peter: Yeah, okay I want to move on now to some investor issues. You've touched on it briefly Reg A, Reg A+. I know you've done some work in that area, so just firstly briefly explain what Reg A+ and what it means for individual investors and give your opinion on whether or not this is really going to be used widely in marketplace lending.

Brian: Sure, so Regulation A+ refers to the changes to Regulation A as a result of the JOBS Act from 2012. Regulation A before 2012 was a very little used statute that exempted you from filing for a public offering for transactions of up to $5 million. One of the requirements of using Regulation A is that you had to file with the SEC a disclosure document and you also had to get permission from every state that you wanted to sell, what we call State by State Blue Sky Merit Review. This is different than the Reg D filings which are notice filings where there is no process for a state to say yes or no after a private placement. In 2012, as part of Title IV for the JOBS Act, Reg A was substantially revamped. We now have two parts of Reg A, Tier 1 and Tier 2.

Tier 1 has the same rules as the old Reg A except you can offer up to $20 million over a 12-month period. You still have to go to each state. Tier 2 allows you to offer up to $50 million and a granted Blue Sky preemption which means that you do not have to ask the states for permission before making offers. So this has really revolutionized the world of alternative finance in the debt and in the equity context. A company that is looking to raise capital and doesn't have access to traditional venture financing which would typically be done under Reg D private placements or fund investing can now access the public markets, both accredited and non-accredited investors, in a transaction where they can advertise and engage in a publicity campaign.

At the end of the day for equity, you can have a security that's listed on either the OTC or the NASDAQ. If you go on the NASDAQ then you have to file as a public filer and you have to become basically a public reporting company, but the OTC market has made great strides in welcoming Regulation A issuers and several Reg A offerings.

The first one was a company called Elio Motors which is an innovative car manufacturer listed on the OTC markets using a Regulation A transaction. The cost savings versus a public offering are less than half or a third of an IPO. The reporting requirements for a company following a Regulation A transaction include an annual report similar to an SEC 10-K although much less extensive in scope, semi-annual reports instead of quarterly reports and then a current report which is similar to an 8-K but with much fewer requirements called a 1-U. Also, if you have been a reporting company for a certain period of time and you have less than a certain number of shareholders you can file to exit the Reg A filing regime by filing a 1-Z exit form.

So how does this apply to online lending? Well, firstly online lenders who are looking to raise venture rounds now have a second option where they can raise part of their funds through Regulation A. It's a non-exclusive safe harbor so you use Reg A and do a private placement all at the same time, you don't have to worry about publicity. This concept we have called integration which is we do a private placement at the same time as an IPO, it's possible that the private placement is tainted by the IPO and you lose your private placement exemption. You don't have that in the Regulation A context. Importantly, there's sort of two other developments here under Reg A for marketplace lenders.

Number one is you can issue debt on a continuous basis under Reg A to members of the general public, not just accredited investors. Now this debt would be recourse debt to the company, but it could be under whatever terms you decide, pre-payable at any time, no covenants, no bank approvals. It effectively works as a bankless working capital line and renews itself. You can issue up to $50 million in any rolling 12 month period. So if you have a market for people buying debt securities of the platform, you can use this as your ability to raise capital or raise working capital in a way that is less expensive than entering into a bank transaction of revolving capital line of credit.

The second thing which is still in the works is the introduction of the Payment Dependent Note under Regulation A. So instead of Lending Club and Prosper which have gone through the SEC S-1 process, we are going to see payment dependent notes offered under Regulation A, a much lighter, less costly regulatory regime than being a fully registered public company and at the same time the ability to offer payment dependent notes to non-accredited investors. Right now only Lending Club and Prosper can offer payment dependent notes to non-accredited investors. So that will be an exciting development in bringing the retail investor closer to the online lending platforms which are really only enjoyed now by accredited investors.

Peter: So when will that be in place for the borrower, the payment dependent notes?

Brian; Well, it's a work in progress. I've had several discussions with the SEC and I'm, in fact working on a few transactions right now. I would expect we'll see a Reg A offering with payment dependent notes by the end of this year.

Peter: Okay, that's encouraging. So I know we're running out of time, but I just want to ask about offshore investing because there is certainly...I wrote about the Chinese platform CreditEase coming in to Avant and Prosper. Companies today obviously are looking for investors probably more than they have been in many years. What are the main issues in getting international money whether it's from China, the UK or what have you, what is the main roadblocks for getting international money onto US platforms?

Brian: Well, fortunately, it's actually not a legal issue in most cases. The first thing that you have to look for is where is the money coming from and is the investor doing something that is legal under the home country statutes? So if you're talking about Chinese investors there are specific rules around how you can use funds overseas and how onshore Chinese money can make its way offshore.

There's something that's informally referred to as the $50,000 rule where if you're going to export more than that, you need specific approvals. So all of those obviously have to be dealt with. Many Chinese funds have offshore money quote in Hong Kong and invest through Cayman Islands funds or Singapore funds and subsidiaries which are tax efficient. The offshore platform and the offshore investors are primarily yield-driven and they're looking for a product that they can invest in that will satisfy their investor needs at home. It is possible that these notes that are purchased are not going to just sit on the balance sheet of the investor, but they'll be funds and other participation interests that are generated on the domestic side to allow investors domestically to take part in the performance of these investments. So if you have a company that buys $50 million worth of loans in bulk from a US platform there may be a fund locally that's investing somehow in those funds indirectly.

Now the concerns that the offshore platforms have besides the tax issues and obviously one of the biggest issues is structuring a transaction that avoids what we call Effectively Connected Income. If you realize income that's effectively connected to a US trade or business then you might be subject to US tax liability and US tax reporting which is something offshore investors generally do not want and so these transactions are generally not pass through US LLCs or other entities that require the issuance of a K-1 form.

The next is specifically how does the platform originate, what exposure do they have, what sort of transparency do they have to their process? Specifically, this notion of adverse selection, how do I make sure that I'm getting my orders filled in the way that I described while still being fair to the platform so I'm not going to be super picky over the terms of these loans. For example, I wouldn't say I only want the Prosper B and C loans. That would require a little bit of manual handholding by Prosper to do that, but their biggest points are how do we ensure that the performance of the loans allocated to these investors perform at about the same ability as similar loans that are allocated to the retail channels and to the US channels?

That takes due diligence, a lot of phone calls, memos and discussions around the process and it's not simply somebody describing the allocation process, but we also look into how do we know that the computer that is doing these allocations is allocating in the way that the platform thinks it is because somebody can describe me a great platform and a great allocation program but nobody really knows if it's actually happening in the way that everyone describes including them. The only way to test that is to do backtesting and periodic other testing to make sure that you're getting a fair slug of loans. Most of these transactions involve weekly buys, many are kind of a take it or leave it basis so you'd have a block of loans. The investor would either say yes or no, there is no cherry picking allowed in terms of these loans.

The third issue you have to think about is protection of personally identifiable information. So borrower information is not going to go out to the investor. The investor is going to appoint a third party to act as custodian as well as a back-up servicer. Those entities will have the borrower information and they'll be licensed to all that information, but obviously from a US borrower protection basis, I'm sure wouldn't...you know, it's not something that anyone would expect that their loan application to be sent overseas for investors to review.

Peter: Right.

Brian: So those are kind of the key concerns in those transactions.

Peter: Okay, okay, so final question. We've had a lot of interest over the last 6 to 12 months from the federal government, we've had the Treasury white paper that came out a month ago, we were both at the FTC yesterday where they were talking about marketplace lending and the OCC, the FDIC, there has been a plethora of government agencies it feels like looking at this industry. I want you to just gaze into your crystal ball and tell me how do you think...if we come back together in two years time, what sort of regulatory framework will we be operating under, what will have changed?

Brian: Well, first I'm going to ask you who's going to win the elections?

Peter: laughs...right, I have no idea on that one, that's part of the equation.

Brian: It shouldn't matter although the people who are looking at marketplace lending at the FDIC, at the FTC, at the Treasury Department, many of them are administration appointees and it stands to reason although it's not necessarily going to follow that a Trump presidency would be more business friendly than say a Hilary Clinton/Elizabeth Warren type ticket which we're hearing about, but to be fair to this and obviously these agencies worked through all sorts of administrations, I think there's been a lot of interest in agencies in getting up to speed on how these platforms work. I think there is an earnest effort by them to understand what's happening and take a thoughtful look at the industry. I do believe that the distinction has been made properly between marketplace lending and payday lending, that they are not the same and they need to be treated differently.

For the marketplace lenders, it's really going to come down to cooperation and collaboration. There's no way around the fact that as interest grows in the space, regulatory attention is going to increase. We're going to see more inquiries, we're going to see more follow up letters, we are seeing an increase in the amount of attention that's being paid to ensure that the thesis you posited at the beginning which is these platforms aren't banks, you know, this industry has really grown up in an exception world. We're not banks, we're not brokers/dealers, we're not investment advisers, we're not investment companies. Who's actually watching us?

Federal regulators and state regulators are very good at reviewing and regulating entities that acknowledge they fall within their purview. What is more challenging is looking at conduct that's on the margin and deciding are they really doing something that's already regulated and in many cases, for example in the bank model. One of the advantages of working on some of these overseas investments is that we've done very deep dives into the Web Bank and Cross River models and there is a lot more involvement by the banks than many people assume. The banks are actually funding these loans, not the platforms. So in defense of...you know, I was a skeptic of the bank partnership model but when you really review the data and the process and what happens, it is very much arms length and it's very substantive in terms of what the banks role is in that process.

Now whether the banks will be able to...and this process will continue under it's current path, nobody knows. If I had to guess...you know, unfortunately we're going to have to have something bad happen in the industry for more regulation to be the result. We had Dodd-Frank as a result of the financial crisis and I think right now we are benefitting from...aside from the issues at Lending Club which seem to be somewhat limited to Lending Club, we don't seem to have a flurry of unhappy borrowers or unhappy investors and the leading driver of regulation are complaints. So that's kind of one process.

The other process here is that this industry is largely being regulated now by class action lawsuit and we can go to Washington, we can talk to regulators and have coffee and discuss these issues, but to the extent there are lawyers out there that are willing to make arguments and judges that agree with these arguments about the nature of these transactions, about challenging whether Web Bank is real as we saw in the Bazoon case, whether you have a true lender relationship, whether a national bank can preempt state usury law, these are all settled issues, you know 150 year statutes that are now being reviewed again. So to the extent that there is traction on the litigation side, that's going to drive investor behavior and when it drives investor behavior, it's going to drive platform behavior and origination. Ultimately, It's going to result in constraints on credit availability.

One of the big outcomes of the Treasury report is that they actually want to see more access to credit. We've become a society of FICO 640 and up and FICO sub 640 and one of the things we heard Secretary Lew say in Washington last summer was that 600 used to be a decent credit score, not a stellar credit score, but one where you could get a car, you could get a house for the right rate. Everything would be priced into it provided you were working and had a steady income. We've now become a market where the access to credit has been very shut off to people who have had hard times or had negative events happen to them and that's going to be harder to get back to than we think. So I think that to the extent we're investor driven and to the extent that people are worried about these class action cases, I'm actually more worried about that than the California DBO and the Fed and the OCC which I think are all looking at this from a collaborative process.

Peter: Okay, well there's much more to talk about, but we've gone over time so I have to let you go. I really appreciate you coming on the show today, Brian, thanks so much.

Brian: Thanks for having me.

Peter: Okay, see you.

You know I've been talking to people in Washington more and more lately, whether they're people at the CFPB or the FTC or Treasury or what have you. The thing that I've noticed is that everybody is really positive about this industry on the whole. Now they want to make sure consumers are protected and they feel like… for the most part they are, and they want to encourage innovation, they like the fact that this is bringing innovation and their focus obviously is, as Brian mentioned, is on expanding credit. That's what the Treasury wants, that's what many people want, they want to be able to make access to credit more available in a sustainable, in a responsible way. So I think if we can do that as an industry which I think we are, particularly on the small business side, I think we are not going to see regulation that is really stifling for the industry. Of course it's unknown, if it just takes a big blow up as Brian said, then things may change pretty quickly, but I am hopeful that we won't see anything that is too draconian that will really stop the innovation that's happening here.

Anyway on that note, I will sign off. I very much appreciate you listening and I'll catch you next time. Bye.

(closing music)