The Impact of Colorado Ending Equal Competition between State and National Banks

J Howard Beales III
Andrew Stivers
18 October 2023
About the Authors

Dr. Beales is an Affiliated Academic in NERA’s Communications, Media, and Internet Practice and Professor Emeritus of Strategic Management and Public Policy at George Washington School of Business. He was Director of the Federal Trade Commission’s Bureau of Consumer Protection from 2001 to 2004, where he was instrumental in refocusing the Commission’s privacy protection program on preventing adverse consequences from information use. During his tenure, the Commission proposed and implemented the National Do Not Call Registry. He also served at the FTC in various capacities from 1977 to 1986 and as Branch Chief in the Office of Information and Regulatory Affairs in the Office of Management and Budget in 1986 and 1987. He taught in the GW Business School from 1988 to 2019.

Dr. Stivers is a Director in NERA’s Antitrust Practice. He was Deputy Director for Consumer Protection in the Bureau of Economics at the Federal Trade Commission from 2014-2021, where he led the Commission’s economic analysis of liability and harm from alleged privacy violations and general consumer protection matters. He also served at the Food and Drug Administration overseeing a variety of public health information and data projects for the food program and evaluating costs and benefits of regulatory initiatives. Prior to his service in the federal government, Dr. Stivers was an assistant professor of economics at Oregon State University, where he researched the regulation of information.

The authors are grateful to the Online Lenders Alliance for their sponsorship. The views expressed are exclusively the authors’ and do not necessarily represent those of any of the institutions with which they are affiliated.
Contents

I. Introduction .................................................................................................................. 1
II. Coloradans Currently Have Less Access to Credit than Consumers in Other States ................................................................. 2
III. Legislative Limits on Competition Will Exacerbate Negative Effects on Colorado’s Citizens most in Need of Access to Credit......................... 4
IV. Blocking Partnerships Between Out of State Banks and Innovative Fintech Lenders Will Decrease Competition and Hurt Consumers...... 5
V. Conclusion.................................................................................................................. 6
I. Introduction

In June 2023, Colorado enacted legislation that, effective July 1, 2024, would “opt out” of the federal law provision that was enacted to create competitive equality between state chartered and national banks. National banks, which are chartered by the federal government, enjoy federal preemption – they must comply only with federal requirements and with the requirements of their home state. Thus, national banks can offer products in all states, without having to adapt their products to state law in the other forty-nine states. In 1980, Congress granted the same flexibility to state-chartered banks, which otherwise would have to comply with the laws of each state in which they offer products. It allowed states, however, to “opt out” of this provision, in which case banks chartered in other states would have to conform to the law of each “opt out” state in which they operate. Although a number of states (including Colorado) initially opted out, all except Iowa and Puerto Rico later reversed that decision. Colorado has now decided to rejoin the opt out group.

Although there is substantial doubt about the legal validity of Colorado’s opt out,¹ we consider the impact of the opt out legislation if it were to go into effect. As detailed below, the evidence is clear that Colorado consumers currently have less access to credit, particularly small dollar installment loans, than consumers in other, more permissive states. If the opt out takes effect, the data indicates that credit is likely to be even more constrained in Colorado, particularly for consumers with low credit scores and those with too little credit history to score.

Competition in consumer lending provides more options, lowers costs, expands access to credit, while encouraging innovation that lowers the costs of finding consumers and providing services. Lower barriers to entry for new firms entering a market further increases competition and its benefits to consumers.

Because of those benefits, competition is a current focus for policymakers. President Biden issued an executive order in 2021 that “reasserts as United States policy…the promotion of competition and innovation by firms small and large, at home and worldwide.”² One result of that executive order was a close look by the U.S. Treasury at the potential benefits of innovative, online consumer financial firms, often called Fintech, that often partner with more traditional lenders to reach new markets and consumers. That report found that Fintechs increased competition and promised a variety of benefits to consumers.³

If the “opt out” legislation goes into effect, a significant source of competition will be closed off. State-chartered banks outside of Colorado that currently compete to provide credit for Colorado customers will be highly restricted to do so, and new potential competitors will face likely insurmountable new barriers to entry.


II. Coloradans Currently Have Less Access to Credit Than Consumers in Other States

Over the last few years, Colorado has adopted a number of restrictions that have reduced the availability of consumer credit. In 2010, it required all “payday” loans, limited to $500 or less, to have a minimum term of 6 months. A study of the impact of that law found that the number of consumers who received loans fell 15%, and the volume of new loans fell 70% from 2009 to 2012. Because the term of the loans was longer, outstanding balances at year end increased 30%. Consumers apparently wanted shorter loans than the required six-month minimum; the average loan was repaid in 100 days.4

In 2018, Colorado enacted a 36% rate cap on payday loans. In 2021, the legislature provided funds for a study of the availability of safe and affordable credit. The result was a January 2023 report, “The Availability of Safe and Affordable Credit from Non-Depositories in Colorado,” prepared for the Attorney General by the Financial Health Network (FHN).5 This report constitutes the best available evidence of the state of credit in Colorado. The report focused on two types of loans from nondepositories: small dollar loans of $1,000 or less, and larger installment loans. It excluded mortgage loans, auto loans, and student loans. Although it used other data sources, the primary analysis was based on credit report data on loans originated in two separate periods in 2017-2019. It compared loans in Colorado to two other states, Missouri and Utah, that do not have interest rate caps. It also examined data for two other restrictive states, Iowa, and New York.

The study found that for all but superprime and prime borrowers, small dollar loans are less available in Colorado than in the comparison states without rate caps (Missouri and Utah).6 Overall, 0.71% of Colorado borrowers obtained small dollar loans, less than half the 1.69% who did so in Missouri. The differences were especially large for those with worse credit. For deep subprime borrowers, 5.14% of borrowers obtained small dollar loans in Missouri, compared to only 1.47% in Colorado; for subprime borrowers, the penetration rate7 was 4.22% in Missouri, compared to 1.38% in Colorado. The report found that “small dollar loans of the type that are reported to the credit bureaus are less available in Colorado than in the comparison states without usury limits.”8

6 FHN at 40, Table 2.3.
7 The penetration rate is the number of consumers who received a loan divided by the average of the number of consumers in that credit category at the beginning of each quarter in the observation period. See FHN at 40.
8 Id. at 40.
Small dollar credit was even less available in Iowa, the only state that has opted out of preemption for state-chartered banks. Iowa lagged all other states studied in all credit score tiers; only 0.16% of Iowans obtained small dollar loans.\(^9\)

Small dollar loans are often a source of liquidity credit, used to bridge gaps between often variable income (e.g., an Uber driver or a construction worker) and unexpected expenses (e.g., a dental expense or an unexpected auto repair). Absent a small dollar loan, consumers may fall behind on other obligations.

Consistent with this use of small dollar credit, subprime and deep subprime Missouri borrowers were less likely to have experienced a major delinquency (60 days or more past due) in either the first or second year after the loan than were Colorado borrowers. After one year, 69.2% of subprime and deep subprime Missouri borrowers had experienced no major delinquencies, compared to 63.4% of Colorado borrowers. After two years, 68% of subprime and deep subprime Missouri borrowers had no major delinquencies, compared to 62.1% of Colorado borrowers.\(^10\)

In addition to the reduced availability of small dollar credit, Colorado borrowers who are subprime, deep subprime, or unscored are less likely than Missouri or Utah borrowers to obtain unsecured larger installment loans from nondepositories.\(^11\) Combining secured and unsecured loans, penetration rates are lower in Colorado than in Missouri or Utah. The report concluded: “at least for consumers in these bottom tiers, comprising just over 20% of the population in Colorado …, credit for larger installment loans is less available in Colorado from non-depositories than in these other states.”\(^12\) Again, Iowa appears to be even worse.\(^13\)

There are limitations of the Colorado FHN report that likely lead it to understate the impact of the Colorado law on credit availability. First, the report only observes consumers who obtained credit. It does not observe those who do not get credit, either because they found it completely unavailable, or because they were rejected. Second, many of the most relevant credit products (particularly payday loans) that are available in the comparison states of Missouri and Utah, and became unavailable in Colorado because of the rate cap, are not reported to the traditional credit reporting agencies. Thus, the report likely understates the reduction in credit available to Coloradans due to the rate cap.

Nevertheless, its finding of reduced availability of small dollar loans is consistent with the significant negative effects on consumers that have been shown in related work. For example, a recent working paper studying rate caps found that “the Illinois interest-rate cap of 36 percent significantly decreased the availability of small-dollar credit, particularly to subprime borrowers, and worsened the financial well-being of many consumers.”\(^14\) The study also reported the results of a survey of consumers who had previously borrowed from lenders who

\(^9\) Id. at 40, note 101.

\(^10\) Id. Panel B.

\(^11\) Id. at 54, Table 3.6, Panel B.

\(^12\) Id. at 55.

\(^13\) Id. at note 132.

left the state after the rate cap was adopted. Most had been unable to borrow when they needed to do so, and 79% wanted the option of returning to their previous lender.\textsuperscript{15}

The opt out law may also affect the ability of state-chartered banks to sell or transfer loans. When a federal appeals court ruled that preemption did not apply to loans that had been sold to a nonbank, a careful empirical study found that in affected states the decision “reduced credit availability for higher risk borrowers.”\textsuperscript{16} Another study of the same decision found “a persistent rise in personal bankruptcies following the verdict and a decline in marketplace lending, particularly among low-income households.”\textsuperscript{17} These adverse effects led the Federal Deposit Insurance Corporation to adopt rules to fix the problem.\textsuperscript{18} The fix, however, would not apply in Colorado if it opts out.\textsuperscript{19}

\textbf{III. Legislative Limits on Competition Will Exacerbate Negative Effects on Colorado’s Citizens Most in Need of Access to Credit}

Robust competition protects consumers and improves access to, and value of, the products that they purchase. For that reason, competition has been an increasing, bipartisan focus of policymakers in recent years. For example, in announcing the creation of a new office at CFPB focused on competition issues, Director Rohit Chopra noted that “[c]ompetition is one of the best forms of motivation. It can help companies innovate and make their products better, and their customers happier. We will be looking at ways to clear obstacles and pave the path to help people have more options and more easily make choices that are best for their needs.”\textsuperscript{20}

Studies by Federal Reserve economists have shown that more competition and entry is associated with lower costs and a greater supply of credit. A study of the effects of changes in financial regulation that allowed greater entry in some consumer credit markets showed that increased competition increased deposit rates and decreased borrowing costs for riskier loans.\textsuperscript{21} A historical study of regulatory barriers to entry in local markets showed that “incumbent banks operating in less competitive markets increase their loans and deposits

\begin{footnotesize}
\textsuperscript{15} Id.
\textsuperscript{17} Piotr Danisewicz and Ilaf Elard, “The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy” (July 5, 2018). Available at SSRN: https://ssrn.com/abstract=3208908 or http://dx.doi.org/10.2139/ssrn.3208908
\textsuperscript{18} FDIC, Federal Interest Rate Authority, 85 Federal Register 44146 (July 22, 2020).
\end{footnotesize}
portfolio at a rate 22 percentage points lower than their peers in more competitive markets.”

Their results are consistent with the idea that banks with more market power restrict rather than increase credit provision. If Colorado opts out of equal competition for national banks and banks chartered in other states, it will only reduce the number of potential competitors in the Colorado market, to the benefit of incumbent banks and at the cost of consumers.

**IV. Restrictions on Out of State Banks Will Decrease Competition and Hurt Consumers**

Banks (especially community banks) have employed innovative technology developed by fintech service providers, allowing banks to expand their services to more communities and reach more customers than they could on their own. These bank-fintech relationships, and the fintech service providers themselves, are subject to rules and oversight through the banks’ regulators. In addition, the growing use of third-party fintech service providers has led the Federal Reserve, OCC, and FDIC to publish detailed guidance as to how banks should manage and supervise these relationships. The inability of a bank chartered in a state other than Colorado to rely on its home state law will greatly complicate, if not fundamentally eliminate, these partnerships. It will no longer be possible to offer Colorado borrowers many of the same products that are available to consumers in other states.

Banks that work with fintech service providers have reduced the cost of financial services in underserved communities. They have been willing to extend credit to riskier consumers, and to offer better terms to borrowers who would be classified as subprime by traditional criteria. Compared to other banks and credit unions, they are more likely to reach out and offer credit to nonprime customers. They are more likely to serve underserved communities. These benefits – which were articulated by the Colorado Attorney General after a settlement with Fintech companies in 2020 – would be lost to Colorado consumers if this untargeted legislation takes effect and Colorado opts out.

---


The potential of Fintech innovation to improve competition in consumer lending prompted the White House Competition Council to request a study by the Treasury on the effect of these new entrants. The result of that request, a Treasury Report titled “Assessing the Impact of New Entrant Non-Bank Forms on Competition in Consumer Finance Markets,” notes that while their entry makes measuring competition more difficult, “…there are indications that new entrant firms are adding competitive pressures in those markets.” Reported improvements to consumer financial services included “(i) expanded access to credit through alternative approaches to underwriting, (ii) greater access to payments solutions through more user-friendly and accessible payments tools, and (iii) increased access to low-cost transaction accounts through digital banks, among other developments.” This increased access is an important factor in understanding the effects of competition. While some studies have noted that competition can result in higher observed interest rates, this result likely occurs because lenders open access to riskier populations.

V. Conclusion

As discussed in Section III, the most in need Coloradans appear to have been hurt by the current restrictive regulatory environment and resulting lack of access to credit. The possibility of new entry by innovating firms has been shown to be an important pathway for expanding credit. Competition regulators around the world have been increasingly concerned about preserving and promoting competition. Blocking or disincentivizing entry by out of state banks will not only worsen the already low availability of credit for the deep subprime consumers in Colorado with demonstrated credit needs but may also prevent those banks from profitably competing to provide services to any Colorado borrower. Coloradans, like all Americans, benefit from technological innovation and robust competition. States should make it easier, not harder, for their residents to experience these benefits.


30 Ibid.
