Holland & Hart

George H. Singer

Partner
303.290.1093
Denver
ghsinger@hollandhart.com

What's At Stake In New Colo. Consumer Lending Bill

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"*No man of ripe years and of sound mind, acting freely, and with his eyes open, ought to be hindered, with a view to his advantage, from making such bargain, in the way of obtaining money, as he thinks fit: nor, (what is a necessary consequence) anybody hindered from supplying him, upon any terms he thinks proper to accede to."[1]*
—Jeremy Bentham

Consumer credit is an integral part of the American economy. Nevertheless, federal and state government institutions have struggled with the dual needs of facilitating the extension of credit and making it accessible to consumers while simultaneously protecting some of the most vulnerable individual debtors from onerous obligations.

Interest rate and fee regulations have developed over time based on an underlying belief that consumers don't understand the full implications of their credit decisions and need protection from predatory lenders. Most states, for example, have established transparency requirements and interest rate ceilings, i.e., usury laws, for consumer credit transactions.

Colorado's Recent Action

On March 27, Colorado lawmakers introduced H.B. 23-1229 to amend the Colorado Uniform Consumer Credit Code.

The bill proposes to opt Colorado out of federal banking laws that allow federally insured, state-chartered banks and credit unions to charge Colorado residents the same interest rate allowed in the bank's home state. The Colorado House of Representatives passed the bill on April 11 by a vote of 44-18, largely along party lines, and it has now been introduced in the Senate.

If the proposed legislation becomes law, state institutions located outside of Colorado can no longer be able to rely on federal interest preemption to continue charging home-state interest on credit products offered to Colorado consumers.

The law would also restrict partnering relationships and reduce consumers' credit options by limiting access to state-chartered credit providers that will

be subject to a different set of limitations than federal counterparts.

History of Federal Preemption and Interest Rate Exportation

It is important to understand the context of the proposed change to Colorado law. In the 1978 decision of Marquette National Bank v. First Omaha Service Corp., the U.S. Supreme Court interpreted existing federal legislation as authorizing nationally chartered banks to charge the highest interest rate allowed in the state where the bank is located to borrowers located not only in that state, but also to borrowers located in any other state.[2]

In other words, national banks could charge interest up to the maximum rates allowed in the bank's home state without regard to any conflicting — or more restrictive — laws of the state where a borrower is physically located.

The rule in Marquette is the foundation of the federal preemption practice followed for the last 45 years that allows a national bank to "export" the interest rates of its home state in interstate lending transactions. This approach is favored by national banks because it reduces banks' need to comply with individual state usury laws, resulting in lower compliance costs, and creates a uniform experience with national program offerings both for the lender and the borrower.[3]

It also incentivized financial firms to establish or relocate their headquarters to states with the most industry-friendly regulations.[4]

Shortly after the Supreme Court's decision in Marquette, Congress enacted the Depository Institutions Deregulation and Monetary Control Act of 1980, or DIDMCA.[5] The legislation was enacted to expand the flow of credit and increase competition among lenders.

The DIDMCA authorizes state-chartered, insured depository institutions to export interest rates permitted by their home state — creating parity with national banks.[6] It also preempts state usury laws with respect to some, but not all, lenders, transactions and practices that might otherwise lead to illegal overcharges.

The equality between federal and state institutions in terms of interest rates, disclosures and other consumer protections creates consistency and enhances the competitive environment that the DIDMCA was designed to foster.

In recent years, mainstream financial institutions have reshaped traditional banking products, such as credit cards and reward programs, to increase their level of participation in consumer credit markets. Partnerships and private lending have also emerged to increase access to credit through credit card programs, payday loans, and other short-term consumer financing transactions.

Right of States to Opt Out

Congress did give states the right to "opt out" of the DIDMCA's federal

preemption and rate exportation rules through specific state action.[7] In the exercise of this right, states had a mechanism to restore their own rate structures, but this restoration, or override right, is only effective with respect to loans made by state-chartered institutions that make loans in the state.

Notably, only Iowa and Puerto Rico are currently opt-out jurisdictions with respect to the federal legislation that has been in place now for more than 43 years.

Shortly after the DIDMCA was enacted, Colorado originally opted out, but later repealed the opt-out. H.B. 23-1229 then represents the third time Colorado legislators have addressed the exact same issue and, this time around, restoring the original opt-out.

House Bill 23-1229

Sponsors of the bill stress that the legislation tries "to conform Colorado law to be in line with what Colorado voters' clear preferences are when it comes to predatory lending."[8]

The bill seeks to protect low- and moderate-income families that find themselves in moments of economic crisis and targeted by lenders offering expensive financing products. The bill amends the Colorado Consumer Credit Code by adjusting fee amounts and conditions for alternative charge loans related to short-term, small-dollar consumer loans.

It also opts out of federal preemption and requires all state-chartered institutions to adhere to Colorado's interest rate and fee restrictions on loans made in Colorado to state residents.

As online and alternative lending organizations become increasingly prevalent, the legislation purports to offer what legislators believe are additional solutions to protect the most vulnerable Colorado consumers from costly financing programs.

Rather than allowing free markets to set the terms and availability of credit, the bill seeks to ensure that alternative lenders are subject to the state's usury statutes and other laws. A value judgment by lawmakers is then made with respect to what's "good" and what's "bad" and, therefore, protection by the state constitutes a cornerstone of the bill.[9]

Opponents of the legislation, by contrast, believe that the bill, although well-intentioned, will remove valuable credit opportunities and resources from those that the legislation is trying to help. They argue "not everyone is victim," and imposing undue restrictions on access to credit threatens to create a so-called forced market by taking away sources of capital from those who need it most.

With respect to the restoration of the opt-out that Colorado lawmakers long ago repealed, the availability of credit that the DIDMCA sponsored could be restricted, and the parity achieved for state-chartered institutions will be lost in Colorado.

The bill will restrict partnering relationships and reduce competition by limiting access to state-chartered credit providers that will be subject to a different set of limitations than federal counterparts.

Unintended Consequences of Good Intentions

A system of laws works best when it is predictable, consistent and not subject to change based on which party controls the legislative process. Abrogating decades of experience under a federal preemption scheme that continues to serve the purpose of enhancing competition to return to a patchwork system of state-by-state variations and related adjudications regarding a loan's interest rate threatens the fluidity and availability of credit.

A goal of modern financial services should be to provide all consumers with affordable choices and access to financial products without regard to geographic location. A free-market system creates efficiencies based on competition, certainty, supply and demand. The lending markets and consumer credit profiles should determine interest rates.

The bill isolates out-of-state, chartered banks that partner with supervised lenders to provide credit to Colorado residents in favor of national banks and unlicensed providers.

As recently noted by Jennifer Waller, the president of the Colorado Bankers Association, returning to an opt-out could have lasting repercussions and make Colorado a less efficient place for out-of-state banks to do business.[10] The accompanying danger is that gaps in the availability of credit will emerge through decreases in competition, and access to credit will become more restricted, particularly for low-income consumers.

George H. Singer is a partner at Holland & Hart LLP.

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[1] Chris Peterson, Failed Markets, Failing Government, or Both? Learning from the Unintended Consequences of Utah Consumer Credit Law on Vulnerable Debtors, 2001 Utah L. Rev. 541 (quoting Jeremy Bentham, Defense of Usury (1787) (parenthetical included from original)).

[2] 439 U.S. 299 (1978) (freeing nationally chartered banks to offer credit cards to anyone in the United States by finding that state anti-usury laws regulating interest could not be enforced against nationally chartered banks based in other states).

[3] An approach that allows a bank to offer uniform programs is beneficial to consumers who are assured of uniform terms without regard to their residence.

[4] Matthew Sherman, A Short History of Financial Deregulation in the United States, Center for Economic & Policy Research (July 2009) (noting that South Dakota legislators eliminated usury ceiling statutes in the state in a single day in order to attract the credit card operations of Citibank).

[5] Pub. L. No. 96-221, 94 Stat. 161 (1980) (codified throughout Title 12 of the United States Code).

[6] Congress' expressed its intention in giving this authority to state banks was to "level the playing field" (see, e.g., 126 Cong. Rec. S3164 (daily ed. March 27, 1980)) and "to prevent discrimination against State-chartered insured banks . . . with respect to interest rates." (12 U.S.C. § 1831d(a)).

[7] See Pub. L. No. 96-221, § 501(b)(2); 12 U.S.C. § 1735f-7, Historical Note.

[8] Statements of Rep. Javier Mabrey (bill sponsor), House Finance Committee Hearing (2023).

[9] The bill "provides responsible lending options to individuals" and securing access "to capital with measured interest rates is important." The Denver Foundation, 2023 Policy Positions (Supporting). It is viewed as important to "help ensure individuals with low incomes can pay their bills, manage financial emergencies, and prevent financial penalties for expenses that lead to long-term cycles of debt and poverty." Id.

[10] Analisa Romano, Colorado lawmakers drop higher dollar loans from the lending bill, Denver Bus. J. (Apr. 7, 2023) (citing statements of Jennifer Waller, President, Colorado Bankers Association).

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