Colorado Opt Out: Dead On Arrival?

June 9, 2023

On June 5, 2023, the Governor of Colorado signed into law House Bill 23-1229 which contains a purported "opt out" of federal preemption made available to state chartered, FDIC insured institutions. It appears aimed at least in part to online lenders making loans to Colorado residents. Whether this action will trigger additional states to attempt a similar move or whether this legislation is even valid will likely end up in litigation, teeing up another potential battle on federal preemption vs. states rights and likely leaving Colorado borrowers in limbo for some time to come. Of note, the opt-out does not become effective until July 1, 2024.

History

Prior to the 1970's most lending was local. With the advent of credit cards, lending became national in scope and with that national banks began charging customers interest and fees uniformly on a national basis regardless of where they lived.[1] That practice was challenged unsuccessfully and the Supreme Court determined that a national bank may "export" the rates it is allowed to charge where the bank is located nationwide, and preempting more restrictive state laws.[2] But that decision only applied to national banks. State banks had no similar statutory authority. During an inflationary period when interest rates were rising this put state banks at a competitive disadvantage. Congress stepped in and enacted a law placing state banks on equal footing as national banks.[3] While state banks could also export financial terms nationwide, that law also gave states the right to "opt out" of this federal preemption for loans made "in the state" that was opting out. The opt out right was never codified per se in federal law or regulation and only appeared as a footnote in 12 USC 1730g – part of the National Housing Act. While a few states opted out initially – including Colorado – most opted back into the law – including Colorado – so that prior to this recent development, only Iowa and Puerto Rico have opted out of this preemption applicable only to state banks and not applicable to national banks.

But, the plot thickens. In 1989, enactment of another federal law repealed 12 USC 1730g – including the only statutory reference to the opt out.[4]

Is Colorado's Legislative Action Invalid?

One threshold hurdle this legislation has to overcome is whether its enactment is void from the outset. If in fact the provision of federal law referring to the opt out has been repealed – then can the Colorado legislature even enact this law at all?

An added problem is that early on, a Colorado appellate court ruled that the opt out provision had been repealed.[5] There, the plaintiff argued that Colorado's opt out meant that the plaintiff could only be charged amounts allowable under the Colorado Uniform Consumer Credit Code ("UCCC"). The Colorado court explicitly stated that the opt out provision was only effective until it was repealed in 1989 and any charges after that time are subject to federal preemption.

Given this precedent it may be hard to find the current legislative proposal to be valid.

Federal vs. State Conflict: Where is the Loan Made?

Even so, the opt out right originally afforded to states only applied to loans made in that state. Thus the next legal question is when is a loan made in Colorado to determine whether the opt out (assuming arguendo its validity) is to be applied. Simply stated, Colorado can only opt out of loans made in Colorado. The FDIC indicates that a loan is made based on the choice of law provisions found in a loan agreement and where certain non-ministerial functions

are performed – those being where the credit decision is made, where the credit decision is communicated and where funds are disbursed.[6] Thus for federal purposes, loans made by an out of state bank meeting those criteria would not be made in Colorado and would not be subject to the opt out or Colorado UCCC rate and fee limitations.

But again, the plot thickens. Colorado's UCCC states that a loan is made in Colorado if "*A consumer who is a resident of this state enters into the transaction with a creditor who has solicited or advertised in this state by any means, including but not limited to mail, brochure, telephone, print, radio, television, internet, or any other electronic means.*"[7]

Thus we have a classic federal vs. state conflict and confrontation that would need to be resolved before determining whether the opt out applies or not – likely only to be decided within the context of litigation.

What's Next?

Given that the opt out would not even become effective until July 1, 2024, rational minds would hope that the stakeholders and the state would come up with a more reasonable approach to legislation and address these significant hurdles as to whether an opt out can even occur at this time. Nor does the legislation solve the problem since national banks are free to do what Colorado attempts to restrict state banks from doing. That only results in an uneven playing field which reduces competition and disadvantages state chartered institutions.

Further, Colorado may suffer the same fate other jurisdictions have seen when imposing rate caps and other lender restrictions – and consumers will be the ones who are hurt the most – being denied access to competitive products and credit access, often to those who need it the most. This action is reminiscent of more recent times when the Colorado Attorney General sued online market lending platforms and lenders withdrew from the state and investor appetite for Colorado loans diminished and dried up. If this becomes effective in July 2024 even those affected by the settlement in that Attorney General action will face more restrictions and lower rates than are in effect now.

Let's only hope that better legislation and not litigation is called upon to resolve these issues. And that other states do not blindly fall into these legal traps that will generate that litigation and market uncertainty.

For More Information

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1 12 USC Sec. 85.

2 *Marquette Nat'l Bank v. First Omaha Service Corp.,* 439 U.S. 299 (1978).

3 Depository Institutions Deregulation and Monetary Control Act (codified at 12 USC Sec. 1831d(a).

4 Section 407 of the FINANCIAL INSTITUTIONS REFORM, RECOVERY, AND ENFORCEMENT ACT OF 1989, PL 101–73, August 9, 1989, 103 Stat 183.

5 *Stoorman v. Greenwood* Tr. Co., 888 P.2d 289, 293 (Colo. App. 1994), *aff'd,* 908 P.2d 133 (Colo. 1995).

6 FDIC General Counsel Opinion No. 11 (1998).

7 Colo. Rev. Stat. Ann. § 5-1-201(1)(b).