

Taskforce on Federal Consumer Financial Law

Draft : Competition and Financial Consumer Protection
And appendices
Dodd-Frank Act and Enumerated Statutes on Competition /
History of Competition and Credit

Introduction

In the United States, consumers acquire goods and services in markets. Most familiar are retail markets, where consumers shop for the necessities and comforts of life, from groceries to garments to housing to health care. Less visible are intermediate markets through which the streams of commerce flow as natural resources and human talent are transformed into finished products and services. Every exchange along the way adds a cost to that commerce. The availability and affordability of everything that consumers buy depends not just on the expense of making and improving it, but also on the efficiency of every market through which it passes.

Efficient markets need not look alike. Exchanges as different as weekend farmers' markets, multilevel shopping malls, and worldwide electronic exchanges can all be effective means of matching buyers and sellers. Indeed, the variety of shapes, sizes, and dynamics that markets assume reflects adaptability to the preferences of their participants, another indicator of efficiency. For all the differences, however, efficient markets do have two characteristics in common. In every efficient market there is competition and credit.

Intuition and experience agree with economic theory that markets work best for buyers when they can choose among competing sellers. The same holds true for sellers seeking buyers. A market does not work for a trader who cannot find anyone willing to transact business at any price. Not much better is the market where buyers find just one vendor or sellers encounter only a single customer. A market cannot even begin to work for people who have value to exchange but are excluded from participating. These situations are examples of market failures. It is only when a market attracts buyers and sellers in sufficient numbers to compete for the patronage of one another that it will reward them with fair value in exchange return for what they bring to trade.

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For consumers, credit is the key to the marketplace. They rarely come prepared to barter goods or services in exchange for something they want to buy. Instead, they come with financial instruments that merchants will accept. Those instruments are a form of credit. Without personal credit or currency (the credit of a separate trusted source) that vendors will accept, consumers cannot obtain the goods and services that the most efficient and competitive markets might offer.

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Financial services – the means by which people spend, save, and borrow – reach consumers through markets as well, and the same factors of efficiency and failure apply. A financial market is not working if people who can afford financial instruments cannot acquire them, because the market is closed to them or has failed. Nor is it working when providers of financial services can escape the discipline of competition and charge premiums for the services that are available. Expensive and ineffective financial instruments extract a toll on every transaction in which they are involved.

Consumer protection can enhance the performance of markets and the quality of the goods and services exchanged in them. Deception and abuse are antithetical to efficient markets, all of which rely on voluntary and informed exchange to produce the best outcomes. Law enforcement that suppresses misappropriation, extortion, and other acts of malfeasance therefore improves market performance. It is the goal of consumer protection to prevent this behavior, and to remedy the injuries that occur when such practices harm consumers.

Consumer protection can also reduce the impediments to market performance that stem from mistakes and confusion. Because uncertainties and misunderstandings can accompany transactions, especially those that span months or years, a well-functioning market relies on rules and procedures that deal with unanticipated mistakes, economic distress, and contractual breaches in an efficient manner. Such rules and procedures are an important component of effective consumer protection.

With potential hazards coming in many forms from many sources, no single measure can protect consumers from them all. Likewise, no single solution can remedy every injury that consumers may suffer. Accordingly, a robust regime of consumer protection deploys a combination of approaches and measures. The Dodd-Frank Act gave the Bureau a full complement of consumer protection tools, and these are described in other chapters. This chapter concerns a tool that is often overlooked in discussions of consumer protection and the Bureau's powers – the preservation of competition.

Before the Dodd-Frank Act laid out the powers of the Bureau, the statute described the purpose of the agency and objectives Congress intended it to pursue. A single sentence stated the purpose:

The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.¹

¹ 2 U.S. Code § 5511 (a).

Elaborating on that purpose is a set of Objectives, each of which, implicitly or explicitly, gives a role to competition:

The Bureau is authorized to exercise its authorities under Federal consumer financial law for the purposes of ensuring that, with respect to consumer financial products and services—

- (1) consumers are provided with timely and understandable information to make responsible decisions about financial transactions;
- (2) consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination;
- (3) outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens;
- (4) Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition; and
- (5) markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation.²

These objectives rest on the proposition made explicit in the purpose of the Bureau – that competition is fundamental to consumer protection. The first two objectives are to ensure the flow of information that enables consumers to choose wisely among competing alternatives. The third objective, reducing unwarranted regulatory burdens, removes unnecessary costs, which can impede competition from smaller companies and raise prices beyond consumers' reach. With respect to the fourth objective, the Congressional call for enforcement that gives no advantage to any sector could not be a clearer mandate for fair competition among financial service providers. As for the fifth, the goal of preserving markets that facilitate access and innovation refers to the most recognized aspect of effective competition – expanding quantities and lowering costs of goods and services. This objective also highlights one of the most dynamic aspects of competition in the financial sector. Major advances in the history of consumer finance have been marked by innovations that made credit more convenient, more accessible, and less expensive.³

In emphasizing the importance of competition to the mission of financial consumer protection, Congress drew upon a consensus that has enlightened trade regulation for centuries. The consensus includes a large body of academic research, a century of Federal

² 12 U.S.C. § 5511(b).

³ In addition to the direct objectives assigned to the Bureau, Congress placed a limitation of its authority in order to prevent it from supplanting competition. The Bureau is prohibited from setting interest rates. It is well recognized that allowing supply and demand to determine prices (and the price of credit is no exception) is the mechanism by which markets function, and the res

economic policy, and a comprehensive assessment of consumer finance by a commission Congress created fifty years ago, the National Commission on Consumer Finance. After two years of research into virtually every aspect of consumer finance, the Commission concluded that “a truly competitive consumer credit market, with adequate disclosure of relevant facts to an informed consuming public, together with legislation and regulation to eliminate excesses, will foster economic growth and serve to optimize benefits to the consumer.”⁴ These benefits did not come at the expense of consumer protections. To the contrary, explained the Commission, “Painful as competition may be for the participants, it provides the ultimate protection for most consumers.”⁵

The Report supported its conclusion with the observations that competition enhances consumer welfare more effectively than any other influence on commercial behavior, and is “the best regulator of the consumer credit marketplace.”⁶ Accordingly, the Commission envisioned an important role for antitrust enforcement, which should be “particularly alert to the dominance of consumer credit markets by a few firms, by barriers to entry, and to restrictive arrangements in the credit industry.”⁷ Antitrust enforcement could not be expected, however, to remove competitive impediments that were anchored in regulation. The Commission therefore advocated the repeal of laws that fixed rates or prohibited services that consumers could access in competitive markets, and it urged the removal of legal barriers segregated financial institutions into sectors and prevented lenders in one from serving borrowers in another.⁸

That competition is critical to consumer protection was neither novel nor controversial when the Commission espoused the idea. The best-selling economic textbook of the time (indeed of all time) was teaching the same lesson to college students and demonstrating how that lesson applied to credit markets.⁹ Professor Paul Samuelson, who had won the Nobel Prize in Economics in 1970, explained in his text that year how competition can empower borrowers to obtain credit “at the cheapest possible terms” just as it allows shoppers to get the best prices from butchers.¹⁰ He had made the same point to the Massachusetts legislature in 1969, when he testified on the proposed Uniform Consumer Credit Code:

A great deal of practical experience has accumulated among our various states and from careful comparisons across countries, to show that the consumer is most

⁴ Milstein, Letter to the President and Congress, December 31, 1972.

⁵ NCCF 214

⁶ Id. at 4

⁷ Id. at 3

⁸ Id.

⁹ Samuelson, Economics, 8th Edition (1970) 578-79. The remarkable popularity of the textbook is reported in Elzinga, Kenneth G., “The Eleven Principles of Economics,” Southern Economic Journal, April 1992, 58:4, 861–79.

¹⁰ Samuelson, Economics, at 579.

improved by effective...competition so that a range of alternatives are open to each consumer and so that each lender knows that his monopoly power to exploit the needy borrower is severely limited by these alternative opportunities. The same principles have been found to prevail in the market for small loan finance as in the markets for the necessities of life.¹¹

Samuelson was far from the first economist to recognize the importance of competition, its role in protecting consumers, and its application to finance. Similar observations can be found in the work of Adam Smith, often regarded as the original economist.¹² In a treatise he published in 1776, *The Wealth of Nations*, Smith observed that the market, like an “invisible hand,” would direct sellers’ self-interest to the service of buyers.¹³ His prediction came with a critical caveat, however. The market had to be competitive for buyers to benefit from the invisible hand. Smith concluded that best incentive to keep a seller honest and fair was the fear of losing customers to a competitor. That was the “real and effectual discipline” that “restrains his fraud and corrects his negligence.”¹⁴ And to Smith there was no question whether the principle applied to financial firms. Competition among banks, he said, “oblige[s] all bankers to be more liberal in their dealings with their customers, lest their rivals should carry them away. In general, if any branch of trade, or any division of labor, be advantageous to the public, the freer and more general the competition, it will always be more so.”¹⁵

By 1972, a consensus had formed among economists as to the circumstances that advance competition and the conditions that impede it. The Commission drew upon this consensus and applied the analytical framework to the observations and data from remote and then-recent history of credit markets. For the most part, the conditions that qualified as catalysts of competition and contributors to consumer welfare remain recognized as factors that contribute today. By the same token, the obstacles identified as impediments to competition and costs to consumers have been found again and again in markets across the economy. Those circumstances and their effects – both favorable and unfavorable – will be the focus of this chapter.

¹¹ Statements of Former Senator Paul Douglas and Professor Paul Samuelson on the Uniform Consumer Credit Code, National Conference of Commissioners of Uniform State Laws, January 29, 1969 p. 8.

¹² See Samuelson at 1. The coincidence of Smith’s publication with another notable event in 1776, the Declaration of Independence, was not by chance, said Samuelson: “[P]olitical freedom from the tyranny of monarchy was closely related to the emancipation of free-market pricing from the interfering hand of state regulation.”

¹³ Smith, *Wealth of Nations* (1776) 14. Smith also recalled the butcher in explaining the working of a free market. In one of the most famous passages from the treatise, he wrote, “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.”

¹⁴ *Wealth of Nations* 129.

¹⁵ WON 313 (Smith also explained how competition encouraged prudence, and in a premonition of modern concerns about institutions too big to fail, hypothesized how competition could diminish the risk of financial system failures.)

Nothing in the fundamentals of financial markets suggests they would suffer from a lack of competition. The principal resources – financial and human capital, communication and information technology – are readily available and highly mobile. Financial intermediaries need offices, of course, but not the massive mines and factories of heavy industry to extract raw materials and process them into finished goods. Transportation costs are minuscule for both the inputs that the institutions acquire and the outputs they deliver; funds of any amount move cheaply and easily.

To be sure, financial intermediation – from the acquisition of capital to the delivery of services – requires efficient organizations, talented personnel, and sophisticated business models. Institutions with expertise, and scale are more likely to succeed in obtaining capital at low costs and offering financial services on attractive terms.¹⁶ Some services require national and global networks to be feasible and desirable. Above all, a reputation for integrity and reliability is a critical credential in financial affairs, and a history of honorable behavior confers credibility. Successful incumbents are likely to have advantages over newcomers.

But incumbents with advantages over newcomers are neither unique to financial services nor incompatible with competition. Companies can multiply and industries can grow even when economies of scale and venerable reputations give advantages to familiar firms. Nowhere has this been more evident than with consumer credit, which has seen a proliferation of new lenders and new products, aggregate growth, adaptation of market leaders, and decline or departure of companies that could not keep pace with the others. These are the hallmarks of competitive markets.

Notwithstanding propitious conditions and encouraging indications of competition in credit, the Commission identified numerous problems that prevented financial markets from performing as effectively as a competitive market would be expected to do. Among the impediments to competition were various forms of restrictive licensing, limitations on services that companies could provide, geographical and sectorial barriers between institutions, and other conditions that made credit needlessly expensive to some and entirely unavailable to others. Some of the impediments were imbedded in regulation and legislation. Others stemmed from perceived anticompetitive behavior in the industry.

These concerns warrant reexamination. If such conditions persist today, they could be thwarting or diminishing the forces that would otherwise have given consumers the benefits of better rates, greater access, and more services that robust competition can deliver.¹⁷ Collectively, they could have imposed significant costs on consumers. The

¹⁶ A study performed for the Commission noted relatively modest scale economies for loan offices. CR 286, n.3. Modern scholarship agrees. [cite]

¹⁷ Many of the conditions and controls have been the subject of lobbying, litigation, or legislation. Arguments for the conditions have ranged from appeals for safety and stability to complaints about unfair competition. Whatever the

chapter will first review the historical background to the Commission’s findings and recommendations on the state of competition in consumer finance. The discussion then turns to the findings themselves. Then the chapter describes the evolution of credit markets since the Commission’s report and assesses trends that help explain the competitive circumstances consumers face today in credit markets. Finally, the chapter identifies measures that could improve the quality, quantity, and affordability of financial services available to consumers.

Competition and Consumer Credit Before World War II

The Commission’s Report began with a brief description of the development and structure of consumer credit, and its role in growing American economy. Everyday colonial life depended on credit, because importers needed coins and precious metal to settle international transactions. Farmers bought seeds, supplies, and food on account. Farm debt could accumulate for months as the expenses of plowing, planting, food and shelter mounted, finally to be repaid when the crops came in. City dwellers regularly purchased on credit as well, especially durables like furniture. But credit was not limited to large transactions. With coins scarce, promises to pay became currency – the means of exchange at merchants of all types.¹⁸ By the middle of the 19th century, credit in the form of installment payments became a popular method of purchasing pianos, books, and sewing machines. If a merchant was unwilling to extend credit, most consumers could probably find several others who would.

Merchants remained a ubiquitous source of credit as economic activity gravitated to the urban centers of the industrial revolution, and growing cities presented a variety of alternatives to merchants’ advances. Flourishing markets emerged for small loans as consumers who ran short between paydays found finance companies eager to dispense quick cash at high rates. Pawnbrokers, lenders since antiquity, remained a popular option as well, and entirely new institutions appeared with innovative alternatives. The Commission’s Report noted the arrival of credit unions and Morris Plan Banks around 1910, and it could have noted many others – immigrant banks, industrial banks, thrift institutions, for example. Largely absent from the origins of consumer credit, however, was the commercial bank. With few exceptions, commercial banks did not join the direct competition for consumer finance until it was well developed in the United States.¹⁹ To the contrary, they shunned consumers and focused instead on the demands of businesses and the wealthy clients who owned and ran them. Most consumers of a century ago would be considered unbanked today.

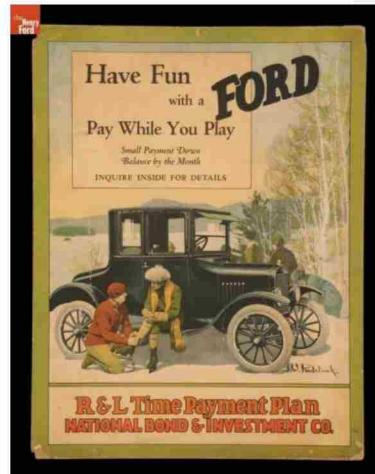
rationale, when competitors in a segment mount campaigns to insulate themselves from competition, it suggests that profits will flow to them if they prevail, and it is therefore worthwhile to assess whether those profits stem from diminished competition that imposes costs on consumers.

¹⁸ See the historical appendix for examples of credit in the colonial economy.

¹⁹ Report at 5. Of course, to the extent that commercial served the companies financing consumer loans, the banks played an indirect role.

Competition for consumer credit thrived without the commercial banks playing a direct role. Perhaps no historical episode illustrates the synergy between credit, competition, and economic growth better than the origins of automobile financing. In the early 20th century, consumer installment loans helped the automobile business evolve from scattered workshops to sprawling factories. Henry Ford built his first car in 1896 and used the \$200 he got from its buyer to work on the next. Recognizing the need for more capital to increase capacity (some thirty manufacturers were producing 2,500 motor vehicles a year by 1899),²⁰ he went into debt, defaulted, and declared bankruptcy. Then he tried again, failed again, and declared again. Undaunted, he took another foray into capital markets, this time with the Ford Motor Company (FMC) in 1903, which he envisioned would “build a motor car for the great multitude...so low in price that no man will be unable to own one.”²¹ The Model T was the result of that vision when it arrived in dealerships with a price tag of \$850 in 1908.

Most working families could not write checks for \$850, worth about \$24,000 in 2020 dollars. The Model T would have remained a rare luxury reserved for the rich, if the average consumer could not borrow the money to buy a car. In an era when personal debt still carried a social stigma (moralists of the day decried “consumptive credit”), Ford declined to become the creditor of his own customers. Instead of financing purchases of the Model T, the company offered a Weekly Purchase Plan, in which buyers could deposit \$5 a week at their dealership until they had saved enough to buy their new cars.²² Most consumers who started a plan never finished it. Ford might have foundered yet again if consumers had not found another way to buy their cars. They did, thanks to finance companies that entered a market Ford had shunned. The Model T succeeded, and Ford led the industrialization of the twentieth century.²³



²⁰ [[HYPERLINK "https://www.history.com/topics/inventions/automobiles"](https://www.history.com/topics/inventions/automobiles)].

²¹ Ford quote available at [[HYPERLINK "https://www.autodesk.com/products/fusion-360/blog/moving-millions-henry-ford-made-automobile-affordable-every-american/"](https://www.autodesk.com/products/fusion-360/blog/moving-millions-henry-ford-made-automobile-affordable-every-american/)].

²² Henry Ford Museum of American Innovation, [[HYPERLINK "https://www.thehenryford.org/collections-and-research/digital-collections/artifact/355541/"](https://www.thehenryford.org/collections-and-research/digital-collections/artifact/355541/)].

²³ Id. at [[HYPERLINK "https://www.thehenryford.org/collections-and-research/digital-collections/artifact/149966"](https://www.thehenryford.org/collections-and-research/digital-collections/artifact/149966)]. Neglecting the demand for consumer finance may have cost Ford. The Motor Company improved efficiency, reduced prices, updated models, and added options, but it steadfastly refused to finance the cars it sold. Its smaller competitor, General Motors, recognized the importance of credit to car buyers and in 1919 created its own financing arm, General Motors Acceptance Corporation. For the next decade, GM customers without enough cash to buy a car

Between 1917 and 1922, according to one study, the number of finance companies making car loans grew from a dozen to a thousand. By 1925, over 1,600 were in the market.²⁴ The competition helped increase automobile ownership from one in thirteen families in 1918 to four in five by 1929, when production reached 5.3 million vehicles,²⁵ three quarters of which were bought on credit.²⁶

The history of credit and cars is hardly unique. Consumer debt rose from an estimated \$3.3 billion to \$ 7.6 billion from 1920 to 1929.²⁷ Automobiles accounted for about half of it in 1926, followed by household furniture (with 19 percent), pianos (7 percent), while sewing machines, phonographs, washing machines, radios, jewelry, clothes, and tractors rounded out the top ten categories.²⁸ Good customers of The Hudson store could obtain a personal charge token, the forerunner of modern credit cards. Marshall Field's strategy was to know its customers personally (sometimes with information from credit reports).²⁹ "By 1930, most appliances, radios and furniture were bought on the installment plan," according to one historian.³⁰

Innovation drove competition in the early decades of consumer credit. The thrift industry, an innovation of the 1800s, became a major source of large consumer loans of the twentieth century. These precursors of savings and loans (known as "building and loans" then) were membership institutions that collected savings from shareholders to finance home purchases. After the first one opened in 1831, they spread to a handful of states before the Civil War, and then to every state in the union by 1890. In 1914, one survey counted 6,600 thrifths nationwide.³¹ Their loans differed from bank mortgages. Thrifts offered longer terms and amortized loans, whereas banks typically collected interest during the term and payment in full at expiration. From all the sources available, one

could choose between GMAC and external financing. They took advantage of the competition, flocked into dealerships and drove out in new cars. Not until 1928, when Ford introduced the Model A, did the company join the credit competition. By then it was too late to prevent GM from overtaking Ford as the nation's top auto maker.

²⁴ Calder, Financing the American Dream, Princeton University Press, (1999) at 192.

²⁵ Mac's Motor City Garage, "The year in Cars: 1929," (2013), available at [[HYPERLINK "https://www.macsmotorcitygarage.com/the-year-in-cars-1929/"](https://www.macsmotorcitygarage.com/the-year-in-cars-1929/)]

²⁶ [[HYPERLINK "https://www.history.com/topics/inventions/automobiles"](https://www.history.com/topics/inventions/automobiles)]

²⁷ Lendol Calder, Financing the American Dream, Princeton University Press (1999), 18.

²⁸ Id. at 203.

²⁹ See historical appendix.

³⁰ Stephen Smith, "The American Dream and Consumer Credit," American Public Media, (2018), [[HYPERLINK "http://americanradioworks.publicradio.org/features/americandream/b1.html"](http://americanradioworks.publicradio.org/features/americandream/b1.html)];

³¹ David Mason, Savings and Loan Industry (U.S.), available at [[HYPERLINK "https://eh.net/encyclopedia/savings-and-loan-industry-u-s/"](https://eh.net/encyclopedia/savings-and-loan-industry-u-s/)]. At the time, according to FDIC, about 25,000 state and national commercial banks were operating in the US. [[HYPERLINK "https://www.fdic.gov/about/history/timeline/1900-1919.html"](https://www.fdic.gov/about/history/timeline/1900-1919.html)] 1911

estimate urban real estate mortgages rose from \$11 billion in 1920 to \$27 billion in 1929.³²

A variation of the thrift model that developed in the early 1800s, specifically for a consumer clientele, was the mutual savings bank, the first of which were founded by charitable organizations. Their original purpose was, as described in an FDIC history, “to help the working and lower classes by providing a safe place where the small saver, then shunned by commercial banks, could deposit money and earn interest.” At first these banks invested very conservatively, confining their portfolios to government bonds and other safe securities. By the turn of the century, they were financing a wider variety of long-term loans, including mortgages, and they grew rapidly, from 10 in 1820 to 637 in 1910. Total deposits grew from \$1 million to more than \$3 billion.³³

Financial innovation accelerated in the early 1900s, with the arrival of two new types of institutions. In 1909, the first credit unions opened, adapting a similar business model that entrepreneurs had established in Europe. The model caught on quickly, on the strength of its organization as a nonprofit entity, which gave them insights into the creditworthiness of their members and cost advantages of tax-free status. These advantages allowed them to offer lower rates on loans. A year later came the first Morris Plan Bank, which offered a financing method that appealed to consumers who could not qualify for legal loans under the usury laws at the time. Morris Plan Banks avoided usury sanctions by dispensing only part of the loan as cash and keeping part in the form of a hypothetical deposit, which had the effect of raising the interest rate on the borrowed cash (and also the benefit of building capital). Sometimes called “industrial banks” because many of their customers labored in mills and factories, Morris Plan Banks obtained specific legislative authorization in many states. By one estimate, over a hundred Morris Plan Banks operating in 142 cities had \$220 million in loans outstanding in 1931.³⁴

A challenge familiar to a large portion of the American population today also confronted their counterparts a century ago. Nearly 30 million Europeans came to America during the so-called Age of Mass Migration. The number of newcomers was remarkable, considering the US population did not pass 100 million residents until the 1920 Census. Between 1870 and 1920, immigration lifted the foreign-born population of the United States to 14 percent (a level not seen again until 2010).

For many immigrants, running low on cash and looking for a job, the steamship agents who had handled their voyages became their first financial institutions. These agents

³² Calder.

³³ Federal Deposit Insurance Corporation (FDIC). 1997. *History of the Eighties: Lessons for the Future*. Vol. 1, *An Examination of the Banking Crises of the 1980s and Early 1990s*. Washington, DC: FDIC. Ch. 6

³⁴ David Mushinski, Ronnie Phillips, “The Role of Morris Plan Lending Institutions in Expanding Consumer Microcredit in the United States,” in G. Yago et al. (eds) *Entrepreneurship in Emerging Domestic Markets* (2008)

opened what came to be known as immigrant banks. Generally unregulated (and therefore difficult to count precisely) the banks kept immigrants' modest savings, provided information in native languages, and offered other services for populations on the path to assimilation in the new economy.³⁵ Among the services offered were personal bonds and remittances back to the old country. The latter became big business for the immigrant banks, which collectively handled an estimated 90 percent of money transfers from naturalized Americans to their families back home. The success of the steamship agents attracted other merchants who combined financial services with sales of consumer goods in ethnic communities. At their peak, thousands of immigrant banks were providing financial services for otherwise unbanked Americans.

For smaller loans, consumers went where people in a bind had long gone – to merchants who sold on account; to small-dollar lenders, pawnshops, friends, and families. Like the general store on the frontier, the twentieth-century store was still an important source of credit. A popular article purportedly revealing “What Every Grocer Knows” reported in 1913 that “there weren’t 15 percent of the people who paid cash and got cash discounts.”³⁶ The popularity of the piece probably owed more to the myths it spread than the authority it cited. The author depicted the frontiersman as a cash customer, and asserted the women who shopped in the city had “no exact idea of money.”

Consumer credit had yet to shake the unsavory reputation of the Victorian era, and the borrowers who bore most of the blame were women. Like their ancestors in the Middle Ages, women often handled family finances and did most of the shopping in America.³⁷ A best-selling novella in 2007, “Keeping Up with Lizzie,” portrayed a woman whose borrowing brings herself, her family, and her community to the brink of ruin. The book inspired a 1921 movie of the same title and a comic strip, “Keeping Up with the Joneses” which delivered regular disdain of conspicuous consumption in the middle class.³⁸

Shoppers who did not have the cash to put food on the table and could not find a merchant who sold on account had other alternatives, and they resorted to them often. A popular option was to patronize one of the many small-dollar lending companies nearby in the neighborhoods. In urban areas of more than 30,000 residents, according to a study in 1911, one worker in five borrowed from a small-dollar lender.³⁹ Another survey of

³⁵ Influence of Immigrant Banks and Agencies in America, available at [[HYPERLINK "https://www.gjenvick.com/Immigration/OtherIssuesAndProblems/1913-InfluenceOfImmigrantBanksAndAgenciesInAmerica.html"](https://www.gjenvick.com/Immigration/OtherIssuesAndProblems/1913-InfluenceOfImmigrantBanksAndAgenciesInAmerica.html)] (quoting, Report of the Commission on Immigration on the Problem of Immigration in Massachusetts, Boston: Wright & Potter Printing Company, State Printers, 1914. GGA Image ID # 149ea7a6d6).

³⁶ “What Every Grocer Knows: Fifteen Years’ Observation of the American Housekeeper by a Grocery Clerk,” *McClures* 41 (September 1913): 125-129 (cited in Calder 216).

³⁷ Jordan, Women and Credit in Pre-Industrial and Developing Societies, (1993).

³⁸ Id.

³⁹ Calder at 118.

New York City's municipal employees that same year found one in three had taken out small loans.⁴⁰ Among these lenders were companies that made "salary loans," the precursors of today's payday loans:

One 1908 study concluded that there were at least thirty known salary lenders operating in New York City, and likely many others whose presence could not be ascertained because they did not advertise publicly....One transportation company employee in New York City estimated that at least 90 percent of his coworkers had taken out salary loans.⁴¹

Data on small-dollar lenders remain elusive because usury laws in many states prohibited the rates they charged, and the most aggressive lenders had reason to be the least conspicuous. Lenders that advertised and operated in prominent locations were easy prey for prosecutors, if any illegal lending was going on. New York brought hundreds of cases against small-dollar lenders (1,000 cases in just five months in 1913). Jail time for usury infractions was a risk that these lenders had to take into account.⁴²

Behind the campaign against finance companies were reformers, like the Charity Organization Society and the Russell Sage Foundation. They monitored the finance companies, gave assistance to the prosecutors, counseled customers against excessive borrowing, and offered loans at legal rates through lending societies that opened offices in several large cities. Even with law enforcement on their side, and lower rates than private lenders, the societies struggled to attract customers and to cover the costs of making small loans at legal rates. The authorities could not stop the influx of finance companies that stepped in as soon as others faced the law.

After years of legal and political battles, the finance companies and charities finally reached a compromise and joined forces to collaborate on small-loan reforms, the primary result of which was the Uniform Small Loan Law. Its primary innovation was to raise the caps on interest rates. Versions of the law were ultimately adopted in half the states, and although the usury ceilings were not high enough to make the smallest loans profitable, the more permissive landscape allowed the established companies to retain a profitable business. At peace with their erstwhile competitors and critics, the finance companies acquired the more successful lending societies, and the sector grew to become a major source of consumer credit throughout the 20th century.⁴³

⁴⁰ Id.

⁴¹ Anne Fleming, "The Borrower's Tale: A History of Poor Debtors in Lochner Era New York City," *Law and History Review*, November 2012, Vol. 30, No. 4 at

⁴² Federal Deposit Insurance Corporation (FDIC). 1997. *History of the Eighties: Lessons for the Future*. Vol. 1, *An Examination of the Banking Crises of the 1980s and Early 1990s*. Washington, DC: FDIC. Ch. 6

⁴³ See, e.g. Anne Fleming, "The Borrower's Tale: A History of Poor Debtors in Lochner Era New York City," *Law and History Review*, November 2012, Vol. 30, No. 4 at 1054 (citing Clarence W. Wassam, The Salary Loan

For the borrower whose need was too small or prospects too dim to interest the classier finance company, credit had to come from somewhere else. A large population fit this description at the turn of the twentieth century:

Poverty remained a fact of life for most working-class families and a condition of existence for many. The slightest disturbance in the balance between income and expenses, whether brought on by illness, unemployment, injury, or ... a relative in need, sent families looking for money. In these situations, children could be put out to work, meals could be cut back, boarders could be taken in, and charity solicited, but sometimes borrowing money was the only way to pay the bills.⁴⁴

Somewhere else for many borrowers was the same source that had served ancient civilizations – the pawnbroker. In twentieth-century America, pawnbrokers grew to an estimated 2,000 in 300 cities by 1911, and they became frequent creditors to consumers who had no attractive alternatives. Pawnbrokers were sometimes weekly financial bridges for homemakers whose bills came due before payday and seasonal support for mechanics who did not need tools when jobs were scarce. In the Bowery of New York, a reporter estimated that almost the entire population held at least one pawn ticket, and most had a dozen or more in the slow winter months.⁴⁵ Other studies offered a range of estimates, most with the caveat that many pawn customers would not admit to their use. Like the buyers on accounts at the stores, the most frequent patrons of pawnshops were women, who typically handled family budgets.

Remedial loan organizations entered the pawn markets as well and brought their model of counseling combined with lending to pawn customers. The Provident Loan Society in New York, for example, attracted customers by offering lower interest rates and nicer surroundings than the typical private pawnshop. Along with these emoluments, however, came more complicated applications and more stringent qualifications for borrowers.⁴⁶ Many customers preferred the convenience of the private pawnbroker. Transactions were simpler. Neighborhood proprietors were familiar. Credit was easier. Charities did not take a large share of the pawnbrokers' trade, although a century later, both types of institutions still compete. Provident Loan Society, for example, operates five pawnshops in New

Business in New York City: A Report Prepared Under the Direction of the Bureau of Social Research, New York School of Philanthropy (New York: Charities Publication Committee, 1908), 25–26.

⁴⁴ Calder at 42, (citing Peter Shergold, *Working-Class Life: the American Standard in Comparative Perspective, 1899-1913*, (Pittsburgh: University of Pittsburgh Press, 1982) (internal citations and quotation marks removed)).

⁴⁵ Id. at 44 (citing Charles Barnard, "Pawnshops and Small Borrowers," *Chautauquan*, 19 (April 1894): 72).

⁴⁶ Wendy Woloson, *In Hock: Pawning in America from Independence through the Great Depression*, University of Chicago Press, 174 (2012)

York City in 2020, as well as an online store.⁴⁷ Yellowpages.com lists over 200 other pawnshops in the City.⁴⁸

Despite its contribution to the rising standard of living in the early twentieth century, and notwithstanding the efforts to rehabilitate its reputation, consumer credit could not cast off its stigma as a symptom of society's moral decay. Too many consumers were borrowing too much, according to moral authorities and charitable organizations. The perceived risk worsened as standards of living rose at increasingly rapid rates and debt outstanding rose with them. Describing the attitude of the time and the crescendo it reached in the mid-twenties, the cultural history, "Financing the American Dream," summarized the moral attitudes and public angst:

As debt levels rose, so did public anxiety over what was disparagingly termed "consumptive" credit. A loud chorus of critics alleged that the installment plan was a grave threat to public morals and a harbinger of economic catastrophe... As it was, many who bought goods on the installment plan felt embarrassed to admit it."⁴⁹

Fear that consumers' profligacy portended catastrophe was unfounded. The resilience of consumer credit was demonstrated convincingly during the worst credit crisis in United States history. The crisis began with the Crash of 1929 and extended into the Great Depression. Both could be traced to global capital flows and monetary policies that were draining the United States of gold as European central banks were increasing their holdings. In order to staunch the outflow, the Fed raised interest rates in 1928 and 1929. Higher US rates would make dollars more desirable to international investors. More expensive credit could also stifle economic activity, but policymakers saw merit in cooling the economy and deflating the credit that was heating it. The rate increases had their intended effects. By mid-1929, flagging economic activity turned investors' optimism to anxiety. The stock market fluctuated widely in September and October, increasing anxiety until it grew into panic. Frantic selling of stocks caused the market to crash, wiping out investors as plummeting prices erased the collateral that had backed their margin loans.

The Crash of 1929 was devastating to thousands of institutions and individuals, but it was not the cause of a decade of despair. By early 1930, stocks had regained half the ground lost in the crash, and more importantly, credit markets were largely intact. As Bernanke found in his seminal study of the Depression, "except for a brief period of liquidation of speculation loans after the stock market crash, credit outstanding declined very little

⁴⁷ [[HYPERLINK "https://providentloan.com/en/"](https://providentloan.com/en/)]

⁴⁸ [[HYPERLINK "https://www.yellowpages.com/new-york-city-ny/pawn-shops?page=7"](https://www.yellowpages.com/new-york-city-ny/pawn-shops?page=7)]. Accessed 11/13/20.

⁴⁹ Id. at 211.

before October 1930—this despite a 25 percent fall in industrial production that had occurred by that time.”⁵⁰ The ruined investors of 1929 were a minority of Americans.

It was not until the credit crisis spread through the banking system that the Great Depression gripped the nation. Shrinking payrolls and growing anxiety sent people to their banks to withdraw funds, some to pay bills, others to hoard cash. In effect, customers were calling loans they had made to banks, and those who stashed their cash profited from falling price levels. But mounting demands for deposits came in as bank reserves were dwindling due to tight monetary policies imposed by the Federal Reserve.⁵¹ The weakest banks ran out of reserves first. When they closed without honoring their obligations, sensational headlines spread the news, and depositors elsewhere rushed to their banks, causing more to fail. The runs came in waves, and the waves crested in panics that overwhelmed thousands of banks in 1930, 1931 and 1932. By 1933, authorities in 37 states had partially or completely closed their banks. In March, just as President Roosevelt was taking office, the tide engulfed the lender of last resort, when the twelve Federal Reserve Banks closed their doors. In less than three years, a third of the nation’s banks had failed, depositors had lost \$1.3 billion, credit had become unaffordable for many – if available at any price,⁵² and falling prices magnified long-term debts, such as mortgages on houses and farms, to unsustainable levels. At the worst of the mortgage crisis, defaults were estimated at around 50 percent in some markets.⁵³

Ironically, however, the debts that dragged the economy down were not loans to consumers. The credit markets that failed were those in which banks, businesses, and investors were the primary participants. In marked contrast to the dysfunction of the credit markets supporting stock speculation was the performance of consumer credit markets. Consumer credit began the 1930s on a more prudential foundation than business borrowing, and competition enabled consumers to find refuge from the turbulence that

⁵⁰ Ben S. Bernanke. “Nonmonetary Effects of the Financial Crisis in Propagation of the Great Depression,” American Economic Review, June 1983, v. 73, pp. 257-76.

⁵¹ A popular monetary theory at the time, which prescribed contracting credit when the economy declined, had adherents at the Fed. The result was a shrinking of the reserves that banks needed to fulfill depositors’ demands. A third of the money supply had disappeared by 1933. Gary Richardson, Alejandro Komai, Michael Gou, and Daniel Park, “Stock Market Crash of 1929, Federal Reserve History, available at [[HYPERLINK "https://www.federalreservehistory.org/essays/stock_market_crash_of_1929"](https://www.federalreservehistory.org/essays/stock_market_crash_of_1929)].

⁵² See, e.g., Milton Friedman and Anna J. Schwartz. A Monetary History of the United States, 1867-1960, Princeton University Press (1963). The panic did not subside until an emergency order, one of the first actions of the newly inaugurated President Roosevelt, temporarily closed all the nation’s banks. They reopened once the government relaxed the restrictions that had contributed to the scarcity credit, in a Presidential order on March 6, 1933 that was ratified by the Emergency Banking Act, three days later.

⁵³ David Wheelock, “The Federal Response to Home Mortgage Distress: Lessons from the Great Depression,” Federal Reserve Bank of St. Louis Review, May/June 2008, 90(3, Part 1), pp. 133-48. (The percentage of defaults that resulted in foreclosures, however, did not reach the levels seen in the financial crisis of 2008), available at [[HYPERLINK "https://files.stlouisfed.org/files/htdocs/publications/review/08/05/Wheelock.pdf"](https://files.stlouisfed.org/files/htdocs/publications/review/08/05/Wheelock.pdf)].

devastated capital markets. Unlike investor debt, installment loans had not reached unsustainable levels in the twenties. In 1930, the average car loan had less than five months of payments remaining. Virtually all were paid off. Auto reposessions in the darkest years of the decade did not exceed 0.5 percent of autos financed. Delinquencies rose at general finance companies as well but remained below the rates on commercial loans. At the two largest finance companies, Household Finance Company charged off only 1.02 percent of its loans in 1930, and Beneficial Finance repossessed collateral on only 0.025 percent of its chattel mortgages that year.⁵⁴ One report could find only two failures of finance companies in 1930, in contrast to over 800 banks in just two months at yearend.⁵⁵

One reason for the different outcomes of commercial credit and consumer credit markets was competition. The dynamics of competition in consumer finance can be seen in the sector's performance as the Depression dragged on. While banks were closing and commercial credit was shrinking, consumer lenders were expanding. In the year after the crash, Beneficial and Household opened 80 offices between them and increased loans by 12.8 and 18.8 percent, respectively, in 1930. One Household office made over 300,000 loans in a year. It also turned away 200,000 applicants, reflecting the poor prospects of many consumers as the Depression was spreading.⁵⁶ But consumers had other alternatives, and they turned to them as well.

Retailers intensified their competitive efforts in the face of the downturn, in part by ramping up consumer lending. In July 1930, Montgomery Ward blanketed the country with advertisements announcing that all items in the catalog (except groceries) would be available on time payments. Sears responded with a rate reduction on its installment sales. Competitors followed suit, and the credit they extended grew sales. Between 1932 and 1937 the four major mail-order retailers quadrupled sales on credit.⁵⁷ Other retailers – department stores, clothiers, furniture stores, and jewelers – likewise increased installment lending.

At the end of the decade, a Census Bureau retrospective on the worst of the Depression observed that “consumers did not repudiate debts en masse....”⁵⁸ One way they were able to avoid default was by borrowing to pay off previous loans. According to NBER, between 25 and 75 percent of personal-finance loans from 1934 to 1937 were made to refinance existing debts. Consumer borrowers fared better, and consumer lenders performed better, than their commercial counterparts did in the Depression.

⁵⁴ Calder at 270 (citing *Business Week*, 11 February 1931, at 14).

⁵⁵ Calder 271.

⁵⁶ Calder at 268.

⁵⁷ Calder at 275 (citing Nugent, *Consumer Credit and Economic Stability* at 110)

⁵⁸Id. (citing, U.S. Bureau of the Census, *Sixteenth Census: 1940 ... Retail Trade: 1939, Part I* (GPO, 1941) at 40.)

Some commercial banks recognized the opportunities that consumer lending offered, and the more enterprising institutions entered the market as well. One of the First was National City Bank in New York, which opened a personal loan department in 1928.⁵⁹ Between 1929 and 1936 the number of commercial banks making consumer loans more than tripled, from 208 to 685.⁶⁰ Business lending continued to lag during the thirties, and a contraction in 1937 erased much of the recovery that had begun in 1933. By the end of the decade, bank balance sheets gave a disappointing reflection of the overall economy. Total bank lending had dropped by more than half, but most of the decline came from business credit. An encouraging exception was the proportion of loans that banks made to consumers, which doubled from 9 percent in 1929 to 20 percent ten years later. Consumer credit had helped stabilize a commercial sector that was struggling to regain momentum.

The entry of commercial banks into the competition for consumer loans gradually displaced another institution. With the federal interest caps on customer deposits (set at zero for demand deposits), commercial banks gained some of the advantages that Morris Plan Banks had used to enhance their returns. No longer unique, the Plans that had entered the market “when there were not adequate institutions to supply consumer credit [departed after] commercial banks had adopted their basic lending practices,”⁶¹ began to exit. In the words of the Commission, “Morris Plan banks paved the way for commercial banks to enter instalment lending and became virtually indistinguishable from those banks whenever they were given the privilege of accepting demand deposits.”⁶² When they became indistinguishable from more efficient alternatives, Morris Plan Banks could not compete. It did not help competitors of commercial banks when regulators outlawed the payment of competitive interest rates on deposits in order to bolster the banks’ profits and stability:

[T]he potential profitability of established banks was improved by the prohibition of paying interest on demand deposits and the delegation of power to the Board of Governors to set maximum time deposit rates, a power which was exercised under Regulation Q. Not surprisingly economic studies of the industry found that substantial rents were earned by banks in the New Deal era. Ignoring the culpability of the Federal Reserve in failing to mitigate the shocks of the early 1930s and thereby driving many more banks to the wall, policy makers and

⁵⁹ NCCR at 93.

⁶⁰ Lendol Calder, *Financing the American Dream*, Princeton University Press (1999) Id. at 285 (citing Nugent, *Consumer Credit and Economic Stability* (1939), at 343; other statistics in paragraph from Calder, Ch. 6).

⁶¹ David Mushinski, Ronnie Phillips, “The Role of Morris Plan Lending Institutions in Expanding Consumer Microcredit in the United States,” in G. Yago et al. (eds) *Entrepreneurship in Emerging Domestic Markets* (2008), 121.

⁶² NCCR at 5.

regulators took the system of unit banking as a given and saw the restriction of competition as a means to ensuring the solvency and profitability of banks.⁶³

Ironically, the rescue of the banking system also put mutual savings banks at a disadvantage. They had been more resilient than commercial banks during the Depression. An FDIC history noted that they were “far less prone to bank runs than either commercial banks or savings and loan associations. Indeed, nearly every year during the 1930s MSBs experienced a net savings inflow...[and] continued to prosper during and long after the Depression.”⁶⁴ From 1930 to 1940, the sector lost less than 10 percent of its institutions, while the numbers of banks and savings and loan institutions each declined by a third. Thrifts, due specialty in mortgages and their relaxation of lending standards, were especially hard hit by falling real estate prices.⁶⁵ Mortgagors had been buying with smaller down payments by 1929. They had little cushion when the deflation of the early 1930s wiped out their equity and slashed farm income. The MSBs had insisted on down payments at traditional levels – around 50 percent. Their reputation for safety and soundness had been a competitive advantage, until the government offered deposit insurance to the other banks and thrifts.⁶⁶

Much of the prosperity of the first half of the twentieth century in the United States, and the worst economic crisis, can be traced to developments in financial markets. When credit was abundant, economic activity advanced and standards of living rose. When credit was scarce, production declined and jobs disappeared. Unfortunately for the nation and its banks, a single source happened to be the lender of last resort. When that source presided over a contraction of credit, the economy suffered the consequences.

Fortunately for consumers, the other sources of credit were plentiful. Thousands of merchants, finance companies, credit unions, and other financial institutions gave consumers the wherewithal to share the wealth of a growing economy. These sources also offered consumers some insulation from tumultuous capital markets that buffeted heavy industries and commercial banks. Financial innovators developed new methods to attract funds and new ways to supply credit to consumers. Financial entrepreneurs entered

⁶³ Eugene White, “Lessons From The History Of Bank Examination And Supervision In The United States, 1863-2008, in Alfredo Gigliobianco and Gianni Toniolo, eds., *Financial Market Regulation in the Wake of Financial Crises: The Historical Experience* (November 2009) available at [[HYPERLINK "https://www.bancaditalia.it/pubblicazioni/collana-seminari-convegni/2009-0001/1_volume_regolazione.pdf"](#)].

⁶⁴ Federal Deposit Insurance Corporation (FDIC). 1997. *History of the Eighties: Lessons for the Future*. Vol. 1, *An Examination of the Banking Crises of the 1980s and Early 1990s*. Washington, DC: FDIC. Ch. 6

⁶⁵ David Wheelock, “The Federal Response to Home Mortgage Distress: Lessons from the Great Depression,” *Federal Reserve Bank of St. Louis Review*, May/June 2008, 90(3, Part 1), pp. 133-48.

⁶⁶ Daniel R. WADHWANI, “Why does the US have a weak mutual savings banks sector?” *World Savings Banks Institute* (2011), [[HYPERLINK "https://www.wsbi-esbg.org/SiteCollectionDocuments/WadhwanWeb.pdf"](#)]

markets and expanded as demand for credit grew. Competition for the consumer was keen. In good times and bad, competition gave consumers access to credit.

During World War II, the factories that consumer credit had underwritten a generation earlier were recommissioned to turn out tanks, planes, and other war materiel. Industrial production finally recovered, and consumers played an important role in the recovery, this time as creditors. Although borrowing for consumer goods declined, consumers' savings became a significant source of the debt that financed the war. Eighty million people (in a population that numbered 132 million in the 1940 Census) bought \$180 billion in War Bonds.⁶⁷

Credit and Competition in the Post World War II Economy

The end of the war and the revival of the consumer economy marked the period that occupies most of Commission's analysis of credit and competition. Defining the terms of that analysis, the Commission resorted to a familiar definition: "when the number of sellers is so large and entry is so easy that no seller has power over price," competition could be expected to make credit affordable and available.⁶⁸ A competitive market could be expected to "lower prices to the lowest level consistent with covering production costs and profitability just sufficient to bring capital into the industry."⁶⁹ Credit availability was measured by "the degree to which creditors are willing to provide credit at the free market rate in a world without imperfections." In other words, the Commission viewed competition to have the most potential to offer the lowest rates for consumers and achieve the greatest access to credit. The Report then assessed the state of that competition and whether it was delivering the expected results.

In most respects, the Commission found competition in consumer finance to be working well in 1970. Interest rates appeared to respond to supply and demand, and consumers seeking credit generally could obtain it at market rates. But the Commission also found differences in access and variations in rates across states and sectors. Depending on where consumers lived or borrowed, some paid higher rates and borrowed less, while others enjoyed lower rates and borrowed more. The disparities could not be attributed to capital costs other fundamentals. However, when credit was expensive and rare, it often coincided with indications of competitive shortcomings. The Commission described what it perceived as the more significant successes and shortcomings.

National Trends

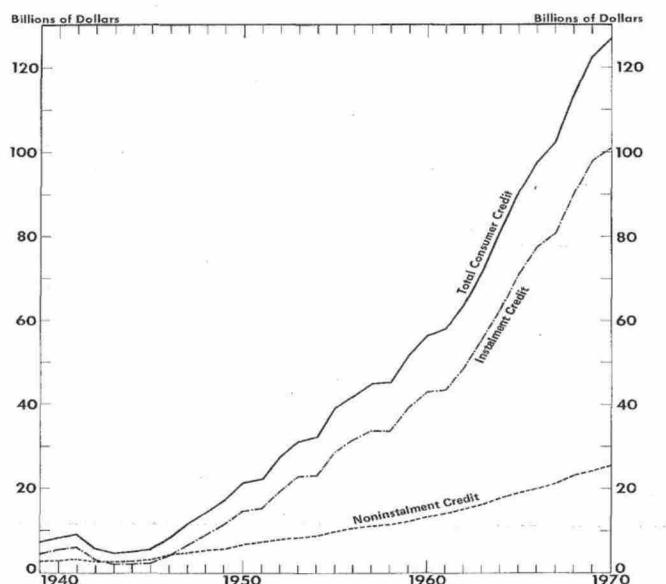
⁶⁷ Corporate Finance Institute, War Bond History, available at [[HYPERLINK](https://corporatefinanceinstitute.com/resources/knowledge/other/war-bonds/) "<https://corporatefinanceinstitute.com/resources/knowledge/other/war-bonds/>"]

⁶⁸ Id. at 109.

⁶⁹ Cite

In a national overview of consumer credit, the Commission focused on different sectors of financial service providers. Some sectors had consolidated, some had disaggregated, and others had seen cycles of both. overshadowing all the sectoral analysis was the dramatic growth in sources of consumer finance. A chart in the Report displayed the trends in consumer credit broken down by repayment methods, either “instalment” or “noninstalment,” the latter including single payment loans, nonrevolving credit, money owed to service providers, and similar debts, and the growth took a dramatic upward turn in 1945, as did the US economy that grew at its fastest sustained pace in a century between 1950 and 1973:⁷⁰

**CONSUMER INSTALMENT AND NONINSTALMENT
CREDIT OUTSTANDING, 1939-1970**



Fueling this growth were tens of thousands of potential competitors in the business of making loans to consumers. Some 13,600 commercial banks held over \$50 billion in

⁷⁰ Report, Exhibit 2-1, at 9; C.I. Jones Stanford GSB, “The Facts of Economic Growth,” in *Handbook of Macroeconomics*, Volume 2A © 2016 Elsevier B.V. ISSN 1574-0048, [[HYPERLINK "http://dx.doi.org/10.1016/bse.hesmac.2016.03.002"](http://dx.doi.org/10.1016/bse.hesmac.2016.03.002)], NBER, available at [[HYPERLINK "http://web.stanford.edu/~chadj/facts.pdf"](http://web.stanford.edu/~chadj/facts.pdf)].

consumer credit in 1970, more than any other segment and about 40 percent of the total outstanding in the United States.⁷¹ Finance companies – about 3,700 in 1965, operating out of an estimated 13,000 to 14,000 offices – accounted for the second largest portion, with 30 percent of the consumer credit outstanding. Outnumbering both banks and finance companies were 23,650 credit unions, although their share of credit outstanding came in lower, at 12 percent in 1970. Probably more numerous than any other sources were retailers, who held about 14 percent of consumer credit outstanding as the 1960s ended, but a precise tally of their number was not available.⁷² Outside these main categories, other lenders (such as savings and loan associations and mutual savings banks) amounted to about 1.5 percent of the credit outstanding.⁷³

Dollar volumes of the holdings of these sectors reflected the dramatic growth of installment credit outstanding – from under \$15 billion to over \$100 billion – over the two decades ending in 1970.⁷⁴ Banks and finance companies each held more than twice as much as all the institutions combined just twenty years earlier. Credit unions and retailers each held almost as much as the entire amount outstanding in 1950.

Exhibit 2-4 of the Commission's Report showed the volumes and shares of installment debt⁷⁵ by institutional sectors in 1950 and 1970.

Amounts outstanding (Dollar amounts in millions)				
	December, 1950		December, 1970	
	Amount	Percent	Amount	Percent
Commercial banks	\$6,798	39.4	\$41,895	41.4
Finance companies	6,315	36.1	31,123	30.8
Credit unions	590	4.0	12,500	12.4
Miscellaneous ^b	102	0.7	1,546	1.5
Retail outlets	2,898	19.7	14,097	13.9
Totals	<u>\$14,703</u>	<u>100.0</u>	<u>\$101,161</u>	<u>100.0</u>

^bMiscellaneous lenders include savings and loan associations and mutual savings banks.
Details may not add to totals because of rounding.

Source: Board of Governors of the Federal Reserve System.

Aggregate growth would bode well for competition, as it is easier for new companies to enter and small rivals to thrive in a market that is expanding. Customers in a market for the first time – like the early automobile buyers choosing between Ford and GM – are

⁷¹ Report at 8.

⁷² Report at 11

⁷³ Id.

⁷⁴ See Table 2-1 in CICO Chapter for a longer series.

⁷⁵ These figures do not include “noninstalment” debt.

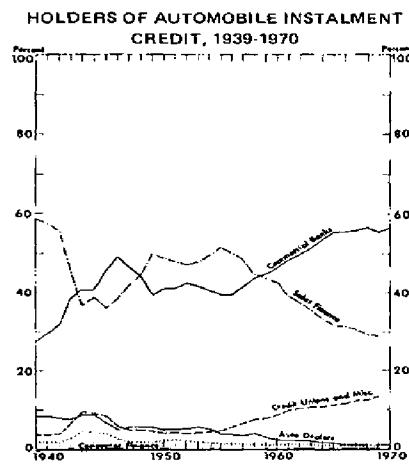
less likely to have developed loyalty to an established firm. And entry itself can accelerate the expansion of a market, as new companies and smaller rivals hustle to establish themselves and grow their businesses.

One indicator of competition is the volatility of shares of the sellers in a market, as credit unions, finance companies, commercial banks, and Morris Plan Banks had demonstrated before the War. Changing shares can reflect rivalry among firms already within a market, entry of new firms into the market, and innovation that disrupts historic patterns. When established firms charge more than necessary to cover the costs of providing the goods and services they sell, the resulting profits invite entry by others. Inferior quality, untapped innovation, and poor service are other signals that alert existing and potential competitors to the prospect of extraordinary rewards for anyone who can improve upon the status quo. New entrants and opportunistic rivals empower consumers to discipline companies who do not perform. Such discipline can manifest itself in the movement of consumers from one seller to another, in the movement of companies to into and out of a market, and in the revitalization of underperforming incumbents. In markets where consumers can shift their allegiance, market power is unlikely to persist for long, if it arises at all.

The Commission tracked shares of the institutional sectors that held consumer credit in the decades ending in 1970. At first glance, shares appeared relatively stable. Banks, with 31 percent in of installment credit 1970, had added two percentage points to their 1950 share of 29 percent. Finance companies and retailers lost about five and six points from their 1950 shares of 36 percent and 20 percent, respectively, while credit unions added eight points, impressive growth on a percentage basis, given the 4 percent that the sector held at the beginning of the period. Still, credit unions remained in fourth place among the four main categories of consumer lenders on a national basis.

The picture changes dramatically when these sectors are examined more closely. In loans for automobiles, home appliances, and home improvement – rapidly growing industries in the post-war economy – institutions gained and lost shares to an extent that belied the

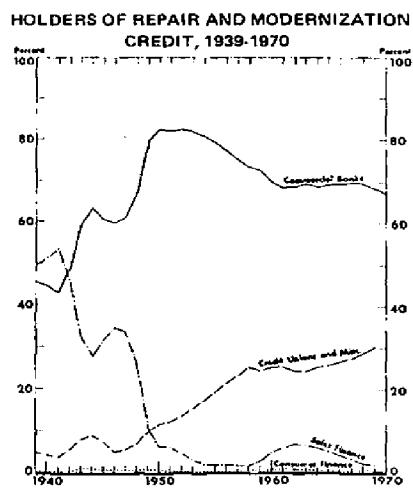
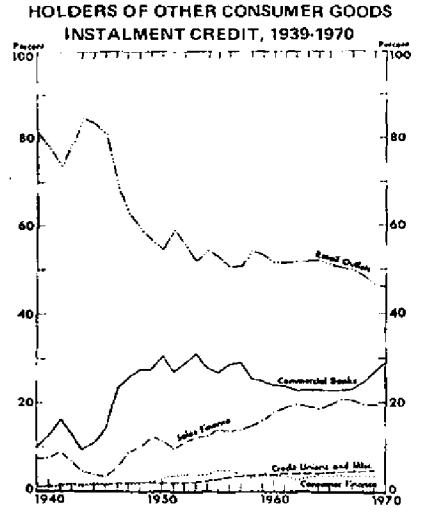
seeming stability of their positions at the beginning and end of the period. For example, sales finance companies (many affiliated with automobile industry) dominated lending for vehicles in 1940, with almost 60 percent of the credit outstanding, twice the share of commercial banks.⁷⁶ The lead did not last long. In just a few years, banks bypassed finance companies and were making about half the overall lending for autos in the late forties. Finance companies recovered just as quickly, overtaking banks and maintaining the lead source of auto loans for most of the fifties. But as the sixties loomed, banks once again had resumed their growth, finishing the decade with almost twice the share of their chief rivals. By 1970, in a much larger market, banks held almost 60 percent of the auto installment credit, twice as much as the finance companies. It was also in the late fifties and sixties that credit unions grew steadily. Over 30% of their loans in 1971, amounting to more than \$3 billion, financed auto purchases.⁷⁷ Meanwhile, the small share attributable to auto dealers nearly disappeared.



⁷⁶ Exhibit 2-5 of the Commission's report illustrated these shifts.

⁷⁷ NCCF at

In the market where consumers sought to finance expensive purchases of appliances, furniture and other items at retail stores, the retailers themselves began the period with a seemingly commanding lead over the other sources of credit, only to take a precipitous fall. In the early forties, retailers held more than 80 percent of installment credit in this category. By 1970, their share had dropped below 50 percent. Commercial banks and sales finance companies more than doubled their shares over the same period, reaching about 25 percent and 20 percent, respectively.⁷⁸



In one category of credit the segment leader virtually disappeared. Sales finance companies held half the outstanding credit for modernization and repair in the early 1940s. Banks were a close second, with credit unions far behind. By 1970, sales finance companies' share was approaching zero. Banks and credit unions each had added 25 points to their 1940 shares and finished the period with almost all the loans for these home improvement projects. Credit unions grew six-fold, from about five percent to 30 percent.⁷⁹

With different types of institutions vying for the same types of loans, and sectors

⁷⁸ Id.

⁷⁹ Id.

taking substantial shares from other sectors, competition was obviously crossing institutional lines. Inside the sectors, the forces the firms faced were likely more turbulent still. New entrants would have posed constant threats to established institutions.

According to NCUA, federal credit unions numbered nearly 6,000 in 1952.⁸⁰ The Commission tallied over 23,000 (likely state and federal) in 1972. Between 1950 and 1970, banks added roughly 20,000 branches. Bank credit cards were growing even more rapidly in 1970. At the end of 1967, 390 banks reported some \$800 million in credit-card debt outstanding. Three years later over 1,200 banks, still a minority, reported \$3.8 billion. Consumers were flocking to new products, new companies, and new offices. Incumbents could not afford to be complacent if they wanted to keep account holders from taking their business elsewhere.

Given the rapid expansion of credit over this period, shrinking shares still may have signified growth, albeit slower growth, but some sectors declined absolutely despite the expansion. Consumers, in numbers large enough to double or decimate sectors in the course of a decade or two, were rewarding companies that offered attractive terms and penalizing those who compared poorly. Later, this chapter describes how the ongoing rivalry among existing lenders and the entry of new sources of consumer credit continued to produce dramatic changes in the nature and structure of the sector since the Commission's report.

Differences Among Institutions and States

If national numerosity alone determined competition, then the thousands of credit sources and their churning market shares might indicate that the balance of power in these markets favored consumers, not lenders. But national trends do not reflect the conditions an individual borrower might face. The markets for most consumer financial services were local or regional in the decades the Commission studied. Retailers offering attractive charge accounts in Pittsburgh or banks with low interest rates in Philadelphia were unlikely to help consumers in Chicago.⁸¹ By the same token, consumers shopping for cars anywhere would have found credit cards and home improvement loans to be poor substitutes for auto loans. To be sure, a customer might have been able to buy an appliance or roof repair on credit in order to set aside cash for a car, but such substitution is less convenient than choosing among competing auto lenders. For reasons such as these, nationwide tallies of financial providers, aggregate shares of debt outstanding, and may not reveal the vigor of competition or the alternatives available when customers are looking for credit.

⁸⁰ See, [[HYPERLINK "https://www.ncua.gov/about-ncua/historical-timeline"](https://www.ncua.gov/about-ncua/historical-timeline)]. Those entrants either brought new customers to consumer finance or took business from other credit unions or financial institutions. Most likely the newcomers did both.

⁸¹ Even commercial customers tended to bank locally, as the Supreme Court observed in an antitrust case that had found New York to be in a different banking market from Philadelphia in 1963. *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963)

The Commission, recognizing that the relevant competition occurred in geographic markets smaller than the entire United States and in product markets narrower than all consumer credit, focused on differences among cities and states, and within sectors, in its analysis of concentration and performance. Geography was typically broken down by states. Lines of business were defined by categories of credit – including automobile loans, retail installment credit, and installment credit for other consumer goods (or OCG) – and comparisons of access and rates in different states. For each category, the Commission assessed quantitative and qualitative evidence bearing on competition. The quantitative factors included structural characteristics – primarily the numerosity and concentration of lenders. Among the qualitative factors were conditions allowing or impeding entry into credit markets, caps on interest rates, and business practices that could restrict competition. These circumstances were checked for potential effects on rates of interest and availability of loans.

Automobiles – The Commission’s cross-sectional analysis of lending in different states found both evidence of competition and indications of market power. In automobile loans, for example, “quantities of credit extended vary inversely with market power” (measured by market concentration of banks).⁸² Also evident was a predictable corollary of lower quantities: where quantities fell, rates rose. The analysis revealed significant correlations between bank concentration and interest rates that car buyers paid across a broad spectrum of states. A comparison of states at the high and low ends of the spectrum exposed the potential costs of the disparities. Consumers who lived in states with more concentrated banks paid an average premium of about 70 basis points, and they paid this premium whether they borrowed from banks or borrowed from dealers who then sold the loans to the banks.⁸³

The difference in interest rates coincided with larger differences in the behavior of borrowers. A significant segment of consumers paid another premium when they took out auto loans in concentrated states, because when banks made fewer loans, dealers filled the gap. In less concentrated states, banks were the leading source of loans, by a wide margin. Direct bank loans accounted for 42 percent of financed sales, almost doubling the 24 percent of the sales financed by dealers (who then sold the loans to banks or finance companies). Where banks were more concentrated, the shares reversed; sales financed by dealers (and indirectly financed by banks) outnumbered sales directly financed by the banks themselves. Dealers extended 37 percent of bank-financed loans, while banks handled 23 percent directly. In other words, dealers’ share of bank-backed financing grew by half, while direct bank lending dropped by almost the same proportion, in concentrated states. For consumers, the shift to dealer financing may have had a greater

⁸² Report at 112 (In addition, in “all but a few states, rate ceilings are inconsequential as a determinant of the market rate.”)

⁸³ Report at 122.

impact than the rise of bank rates in concentrated states, since dealers charged APRs about two points above banks' direct rates across all states.

The practical significance to consumers of 70 basis points or 2.7 percentage points can be illustrated by considering the effects of those premiums on total payments for a typical 1970 auto loan in today's dollars. An increase of 70 basis points – the direct-loan premium that Commission attributed to market power – would cost the consumer an extra \$200 over three years in 2020 dollars for the median loan.⁸⁴ An additional 2.7 percentage points – the difference between rates paid by direct borrowers in competitive states and indirect borrowers in concentrated states – would generate extra interest payments of \$900 in inflation-adjusted dollars over the life of a three year loan.⁸⁵

Commented [S(3): Not sure if you used basis points or percentage to calculate differences below. If used basis points then need to redo the calculations.

It is conceivable, of course, that the consumers who borrowed from dealers would not have qualified for average bank rates, and that some consumers probably preferred to pay for the convenience of borrowing at the dealer. But such explanations do not explain such wide disparities in bank shares and dealer shares of credit extended across states. There is no reason to expect borrowers seeking more convenience or presenting greater risk would cluster in the states where fewer banks charged higher rates.

The Commission cautioned that other factors may have confounded the results.⁸⁶ For example, some of the low-concentration states had lower statutory rate ceilings, high-concentration states often allowed branch banking, and higher costs may have explained some of the interest-rate variations. Thus, even though the reported correlations between concentration of banks and the borrowing patterns were statistically significant, the Commission noted that concentration "does not inevitably result in anticompetitive behavior, nor does branch banking inevitably result in high concentration."⁸⁷

Second, the concentration levels the Commission observed were relatively low, even in the states that fell into the highly concentrated category. In those states, the four largest banks on average accounted for 64 percent of the money lent to finance automobile purchases. Thus, more than a third of the loans were made by at least three other banks, and likely more.⁸⁸ Intuition suggests that seven or more competitors would be enough to

⁸⁴ The premium calculation assumes a loan of \$3,000 in 1970 amortized over three years. Adjusted for inflation, \$3,000 in 1970 is \$20,000 in 2020. The median auto loan in 1971 was \$3048, with a maturity of 34.5 months [NCCFR at 15; CPI Inflation Calculator, [[HYPERLINK "https://www.in2013dollars.com/us/inflation/1970?amount=3000"](https://www.in2013dollars.com/us/inflation/1970?amount=3000)].]

⁸⁵ The calculation assumes a \$3,000 loan amortized over three years in 1970.

⁸⁶ Report at 122-23.

⁸⁷ Id. at 123. (Developments described later in this chapter reveal that the Commission's concern about branch banking was misplaced.)

⁸⁸ For the remainder to be accounted by three banks, each would have had a 12 percent share. If they were not equal in size, and it is rare to find such parity, then the number of additional competitors had to be greater than three.

engage in effective competition. It would be difficult to find academic support and antitrust enforcement to the contrary in the last 50 years.⁸⁹

Third, as the Commission observed, concentration alone does not confer market power, if smaller competitors and new entrants can take business away from established companies that charge monopoly prices. High prices are signals to current and future rivals that extraordinary profits are available in a market. Dominant firms need rivals constrained and entry impeded if they are to succeed in reaping the rewards of market power. In some cases, they enjoyed those conditions, and still do. These are addressed after a review of the other forms of credit in the Commission's report.

Qualified conclusions about the correlations between concentration and competition were warranted. First, as the Commission noted, correlation does not indicate causation. Second, statistical significance does not equate to explanatory power. And third, the quality of the data was questionable. Important measures that were not included could have confounded the results, and aggregate data that was used could be a poor proxy for conditions in local market. A study published in 1975 tested the structure-performance hypothesis with more refined data, and it stressed the importance of qualifying the conclusions. Focusing on local markets for installment loans, Beigley and McCall found statistically significant relationships between market power and various measures of concentration, but that the relationships were not "of a magnitude to be of great operational significance in determining a bank's market power."⁹⁰

Financing Retail Goods – For category of other consumer goods (those mostly bought at retailers), the effect of rate restrictions made credit markets difficult for the Commission to assess. Interest rates varied little from state to state for revolving credit. Rates hovered around 18 percent, not necessarily because of competitive conditions, but due to common usury limits. The rate caps made it difficult to disentangle the effects of competition from the effects of rate ceilings. Where rate ceilings were high or nonexistent, competition kept rates below the ceilings.⁹¹ Competition took other forms in retail credit. Where rate

⁸⁹ The antitrust cases from the 1960s that prevented mergers in industries with numerous competitors were criticized at the time and are no longer followed today. See, e.g. Thomas Kauper, The "Warren Court" and the Antitrust Laws: Of Economics, Populism, and Cynicism, Michigan Law Review, Vol. 67, No. 2 (Dec., 1968), pp. 325-342; Orley Ashenfelter, Daniel Hosken and Matthew Weinberg, Did Robert Bork Understate the Competitive Impact of Mergers? Evidence from Consummated Mergers, The Journal of Law & Economics, Vol. 57, No. S3, The Contributions of Robert Bork to Antitrust Economics (August 2014), pp. S67-S100.

⁹⁰ Beighley and McCall (1975). Market Power and Structure and Commercial Bank Installment Lending. Journal of Money, Credit, and Banking.

(Market power was measured by the Lerner price-marginal cost index, and concentration was measured by inequalities among individual bank market shares, market shares of the leading bank groups, and numbers of commercial banks.)

⁹¹ The Commission looked for large variations in price or supply, which could indicate varying levels of competition, but did not find them in states with high ceilings.

Commented [SS(4): I am not sure that the definition for seven or eight competitors is tight enough to make this statement. Seven to eight competitors of sufficient size such that they could effectively discipline any attempts at anticompetitive behavior. For example, you could have 8 firms with one firm holding 75% of the market, one firm with 20% and then 6 firms splitting the remaining 5%. Maybe add into the sentence before 7 to 8 firms with a sufficient share of the market... I think this is still general enough and would be more accurate.

ceilings were relatively low, however, the Commission detected excess demand for credit; consumers were unable to obtain loans at rates they would have been willing to pay.

Convenience was an important factor for consumers when financing retail purchases. Credit granted at the point of purchase was more attractive than the option of going elsewhere for the funds to buy an expensive appliance or piece of furniture, and consumers took advantage of the opportunity. Banks and credit unions combined for less than 10 percent of such purchases.⁹² Location was an obvious advantage for retailers, who did not face as much competition from other sources as, for example, auto dealers did.

Higher concentration among retailers was associated with fewer goods financed at stores, but retailer concentration varied relatively little from state to state – significantly less than in the banking sector. In the more concentrated category were states where four stores averaged two thirds of sales, meaning more than two (likely many more, since they were smaller) made up the remainder. In less concentrated states, the top four retailers still exceeded half of all sales. Markets with competitors numbering six, seven, and more are generally regarded as unlikely to suffer from market power. Indeed, the Commission recognized that the retail sector was highly competitive, given that it was a business easy to enter and exit, with a history that frequently displayed both.⁹³

Commented [SS(5): Same as comment above. Maybe some language around sufficient share.]

How much consumers actually paid for retail credit was difficult to measure, because interest rates were not the only means by which retailers could recover their costs. If a store could not raise the rate on charge accounts because of an interest cap, it could raise the prices of the goods financed. The Report cited research showing that appliance prices in a market with low rate caps were about 5 percent higher than in nearby markets with high or no caps.⁹⁴ For customers, increased cash prices indicated that everyone might have been paying interest, whether they purchased with credit or cash. Consumers who paid in cash may have subsidized those who paid with credit.⁹⁵ The Commission worried that such a subsidy would have amounted to a regressive transfer from poorer to wealthier consumers, since cash buyers would include those who could not qualify for charge accounts.⁹⁶

Finance Companies and other sources – Finance companies confronted a wide variety of competitive conditions from state to state, and consumers' fortunes in the sector

⁹² Report at 126.

⁹³ Report at 106.

⁹⁴ Report at 106.

⁹⁵ Id. at 107.

⁹⁶ Id. ([T]he burden of subsidy falls primarily on cash buyers, some of whom may have been unable to obtain credit. Thus state laws that put the price of credit below competitive rates are forcing both the wealthy and the less affluent, who do not use or cannot obtain credit, to subsidize the use of credit by others.”)

reflected those variations. Loans were more readily available from finance companies where economies were stronger, concentration was lower, and the companies enjoyed lower labor costs. As in retail revolving credit, competition kept rates below the legal caps in many markets, and credit was widely available in them. But again, the effects of competition on interest rates themselves were difficult to assess because usury limits in some markets often controlled rates that lenders could charge, and the volume of credit demanded at those rates exceeded the volume available. Perhaps for that reason, the correlations between concentration levels and rates were weak, and again the Commission noted that confounding factors may have explained the associations.

Market restrictions across sectors – Across all the sectors, the most serious disparities in consumers' access to affordable credit were associated with restrictions that directly impaired competition. Where the Commission found concentration, it often found barriers to entry and restrictions on credit practices. Restrictive Convenience and Advantage (C&A) licensing, for example, was associated with reduced availability of loans and increased concentration of finance companies.⁹⁷ They were 50 percent more concentrated where entry was impeded, so the entry barriers could explain the observed correlations between concentration and consequences. Concentration may have been a consequence, rather than a cause, of restrictions on competition, just as high interest rates and reduced availability of credit appeared to have been. As the Commission characterized the record:

There is ample evidence indicating that competition is impaired in a number of states by a variety of conditions affecting all of the major types of consumer credit. A common structural condition of these markets is that they tend to be highly concentrated and difficult for newcomers to enter because of relatively slow growth in demand for credit, or legal restrictions on entry, or some other impediment or combination thereof. By comparison many other state markets appear to be fairly competitive, a judgment which is indicated not only by the existence of contrasting structural conditions but also by related measures of better performance.⁹⁸

Consumers suffered costly consequences in states that protected financial institutions from competition. Different ceilings for different lenders created market segments that allowed a few firms to dominate without fear of encroachment from other segments. For example, Commercial banks in New York were confined to a maximum rate of 11.6 percent, which prevented their entry into "the \$500-loan market served by consumer finance companies at 24.8 percent." The Commission noted that borrowers "would have been significantly better off if banks had always been able to charge the same rates permitted licensed lenders." How significant is apparent from a conversion of the

⁹⁷ Report at 130-31.

⁹⁸ Report at 136

amounts into current dollars. Inflation since 1970 has turned the purchasing power of \$500 into \$3,400 today.⁹⁹ Expressed in 2020 dollars, the difference in interest rates (24.8 instead of 11.6) could have cost borrowers as much as an extra \$260 in interest payments on a one-year loan.¹⁰⁰ The disparity would have been greater for loans of longer maturities and for borrowers who would have qualified for lower rates at the banks. It would have been less for borrowers who got better deals at finance companies and those who would not have qualified for the better bank rates.

Banks, for their part, enjoyed protection from finance companies. For example, reported the Commission, “licensed lenders in New York may lend no more than \$1,400 to any one borrower, whereas banks may make consumer loans as high as \$5,000.” Banks could make loans between those amounts without worrying about competition from finance companies. The segmentation created by these restrictions that separated classes of credit grantors, the Commission said, was “blatantly anticompetitive.”¹⁰¹

The consumers who bore the most serious harm may not have been those who paid the higher rates. At least they got loans. Where rate caps were low and entry restrictions high, lenders rationed loans and turned away applicants. By the Commission’s measure, in states with both types of restrictions, people took out fewer loans and smaller loans – about two-thirds as much overall – while rejection rates were almost half again as high as those in states with easier entry.¹⁰² Applicants had little more than a fifty-fifty chance to get a loan in states that regulated rates and entry. The odds were two-to-one in consumers’ favor in less restrictive states. Where entry was restricted but rate ceilings were relaxed, rejection rates for credit applicants still rose and the average size and number of loans still lagged, but not by as much. Adverse consequences of entry barriers thus occurred in states regardless of rate ceilings; only the extent of the damage differed.¹⁰³

Regulations limiting entry and access were not, however, the only source of competitive impairment in the credit sector, the Commission believed. It was concerned with private threats to competition as well. Accordingly, the Report called for vigorous antitrust

Commented [ML(6): Were consumers chances impacted by factors like gender or ethnicity? Basically the statement makes me wonder if all groups of consumers were having the same experience or if some groups were have worse experiences in these environments/

⁹⁹ Inflation conversion from Saving.org, available at [<https://www.saving.org/inflation/>].

¹⁰⁰ At 24.8 percent, interest payments would have added up to \$475 instead of \$215 for the lower rate. A precise comparison would take into account the added expenses of administering smaller loans and poorer credit records of finance-company customers, but it is difficult to dismiss the conclusion that they paid a great deal for the restrictions placed on banks. Interest calculations from Saving.org, at [<https://www.saving.org/calculators/loan-calculator>].

¹⁰¹ Report at 94.

¹⁰² Report at 131.

¹⁰³ Report at 132.

enforcement against restraints of trade, and it identified practices that should be investigated:

Although almost obvious, the Commission recommends that antitrust policy, both Federal and state, be alert to restrictive arrangements in the credit industry. Any hint of agreement among lenders as to rates, discounts, territorial allocations, and the like must be vigorously pursued and eliminated.¹⁰⁴

The Antitrust Division and Federal Trade Commission have challenged and eliminated many agreements among competitors that could have restricted competition. But many such agreements are beyond their reach. Some of the “blatantly anticompetitive” restrictions that the NCCF identified are also the most enduring, because the antitrust lawstypically exempt from prosecution restraints that governments authorize. Against such restraints, advocacy for competition and consumers remains the primary approach for the antitrust enforcers, and the combination of enforcement and advocacy has been effective at “eliminating anticompetitive barriers to competition...and providing consumers with the information they need to take advantage of a competitive marketplace.¹⁰⁵

Restricted competition can be beneficial for the financial institutions, the Commission recognized, because market power meant stability and profitability of the insulated incumbents. Stability and profitability appealed to financial authorities as well, but the Commission criticized regulators for “excessive concern...for the protection of the profitability of existing bank institutions” and disagreed that the restraints served the “needs and convenience” of the public.¹⁰⁶ In the judgment of the Commission, allowing “domination by relatively few firms” of affected markets was not worth the costs.

The Commission could have framed its conclusion more directly in terms of effects on consumers. When regulators allow the welfare of the banks to outweigh the interests of consumers, those who are supposed to benefit from oversight instead pay its costs.¹⁰⁷ For consumers who could get credit despite unfavorable conditions, the costs were higher

¹⁰⁴ Report at 138

¹⁰⁵ United States, “THE INTERFACE BETWEEN COMPETITION AND CONSUMER POLICIES” Contribution to the Global Forum on Competition, OECD (2008) The Antitrust Division and Federal Trade Commission explained: “Because the “state action doctrine” in United States law protects state laws from antitrust challenge in most cases, the FTC and DOJ have focused their efforts on competition advocacy [arguing] that consumers are better protected when they can choose between high cost/high service and low cost/low service providers rather than requiring them to pay for services they may not want or need.” Available at [[HYPERLINK](http://www.oecd.org/unitedstates/39915760.pdf) [“http://www.oecd.org/unitedstates/39915760.pdf”](http://www.oecd.org/unitedstates/39915760.pdf)].

¹⁰⁶ Report at 137.

¹⁰⁷ Id.

rates and smaller loans. For consumers who could not, the costs came in the form of doing without the goods or services that credit would have made available. The most desperate consumers found third way – doing business with illegal lenders. It was well known in the decades the Commission studied that “consumer lending was a standard business activity of criminal organizations operating in many major metropolitan areas across the United States.”¹⁰⁸ Restricting legitimate competition sometimes simply sends it to the underworld, where consumer protection depends on the rules and remedies of juice loans and enforcers.

Numerous findings from the Commission’s assessment of competition bear on the potential for discriminatory practices by lenders. Already noted was the analysis of access in the Report, which found that restrictions on competition frequently reduced the availability of credit, leading to rationing that presumably excluded borrowers of lesser means and lower credit scores. In the data, the Commission looked specifically for indications of gender discrimination and found widespread evidence of it.¹⁰⁹ The Commission also examined the data for signs of racial discrimination but was unable to find sufficient evidence to draw conclusions.¹¹⁰ Elsewhere this report (see Chapter __) considers more recent information on discrimination. Later this chapter considers competition and access in modern credit markets.

These findings led the Commission to favor increased competition “as the best means to assure that most consumers pay a fair price for their credit services.” To improve competition the Commission proposed a menu of policy changes that would expand consumers’ choices and advocated regulations that could improve the wisdom of those choices.¹¹¹ To implement its recommendations, the Commission recommended that legislators, regulators, and enforcers strive to design and implement a sound competition policy for consumer credit. The goals of that policy should be these:

- Promoting and maintaining competition among numerous sources of credit. Competition is the key ingredient “of a finance industry capable of providing an adequate supply of credit at reasonable rates”
- Assuring “access *by all* to these alternate sources”
- Preventing “excesses which the “system” may invoke against the borrower.”¹¹²

¹⁰⁸ Durkin, et.al., at Kindle 362

¹⁰⁹ Report at 160 (For a review of the role women played a prominent role in consumer credit markets from medieval times to the nineteenth century, see the Appendix.)

¹¹⁰ Report at

¹¹¹ Report at 214, See, e.g Ch. 10. The requirements of the Truth in Lending Act and specific protections for vulnerable consumers –

¹¹² Report at 2 (emphasis in original).

Among all the available means to improve competition, the Commission concluded that enhancing the ability of potential competitors to enter credit markets would be the most effective policy. In his communication to the President and Congress, the Commission Chairman explained:

As to our conclusion that free and fair competition is the ultimate and most effective protector of consumers, we have recommended the elimination of restrictive barriers to entry in consumer credit markets by permitting all creditors open access to all areas of consumer credit. We have urged the entry of savings and loan associations and mutual savings banks into the consumer credit market. We have recommended prohibitions on acquisitions that would eliminate potential competition or that would substantially increase concentration in state or local credit markets. We have also urged that rate ceilings which constrain the development of workably competitive markets be reviewed by those states seeking to increase credit availability at reasonable rates.¹¹³

Thus, the critical prescription for competition in the postwar period was to preserve the competitive dynamic that had characterized credit markets in the first half of the twentieth century. Markets that were open to entry and free of constraints that prevented companies from challenging one another were the most likely to remain competitive and protect consumers.

Competition in Credit, 1970 - 2020

The Commission devoted a chapter of its report to predictions the future of consumer credit. Not surprisingly, many of those predictions failed to capture the nature and size of the markets in which credit is exchanged today. For example, the Commission anticipated, “With a slowdown in the rate of increase in consumer credit and with fewer additions to the types of goods and services financed, credit grantors in the future are relatively more likely to rely on price competition than on nonprice competition.”¹¹⁴

Fortunately for consumers, the future exceeded expectations. Price competition continued to reduce costs of credit, but the most remarkable developments in competition came from new products and services. Among the aspects of nonprice competition the Commission did not predict was the rise of automatic teller machines (although the first one had made its appearance in 1969),¹¹⁵ let alone banking by computers and smart

¹¹³ Report at iii.

¹¹⁴ Report at 203

¹¹⁵ History.com, This day in history, [HYPERLINK "https://www.history.com/this-day-in-history/first-atm-opens-for-business" \l "~~:text=On%20September%20202C%201969%2C%20America's,to%20conduct%20basic%20financial%20transactions."]

phones, still far in the future. For virtually every consumer in 1970, withdrawing cash meant going to the bank. Obtaining a loan meant visiting a lender. Getting competing quotes meant visiting several sources. Advertising might help start a search, but narrowing options on the internet was unheard of. The Commission did foresee the growing use of bank-issued credit cards and the value they would deliver to an increasingly mobile population. It did not predict the extent of the growth, or the effect it would have on the competition for consumer credit. Inconceivable at the time was a vast market for consumer finance that involved no visit to any location or meeting with any individual.

As for overall growth, the figures in Table 2-1 and 2-2 of Chapter 2 reveal that consumer credit outstanding has increased *thirty-fold* since the Commission's Report.¹¹⁶ Most of that growth has come from financial services and technologies that were nonexistent or insignificant in 1970. And a good portion of that growth reflects more consumers participating, both absolutely and proportionately, in legal credit markets today than in 1972.

The structure of the consumer finance sector appears to have changed significantly in the fifty years since the Commission's report. At first glance, the traditional sources of credit show consolidation:

- The number of FDIC Insured banks dropped from more than 13,000 to less than 5,000 in 2018.¹¹⁷
- Federally Insured Credit Unions numbered about 5,200 in the final quarter of 2019¹¹⁸ The Commission had tallied over 23,000 in 1972.
- Finance companies, which the Commission estimated at 3,700, have no authoritative census but may have doubled to around 7,800.¹¹⁹

¹¹⁶ To be precise, the Commission predicted that the *rate* of the growth of credit would decline after 1970, and that turned out to be correct. The amount of credit outstanding was so small in 1940 that the \$100 billion increase through 1970 represented a slightly higher annual rate than the \$4 trillion increase since 1970.

¹¹⁷ FDIC, BankFind Suite: Find Annual Historical Bank Data, available at [[HYPERLINK](https://banks.data.fdic.gov/explore/historical?displayFields=STNAME%2CTOTAL%2CBRANCHES%2CNew_Char&selectedEndDate=2018&selectedReport=CBS&selectedStartDate=1934&selectedStates=0&sortField=YEAR&sortOrder=desc) "https://banks.data.fdic.gov/explore/historical?displayFields=STNAME%2CTOTAL%2CBRANCHES%2CNew_Char&selectedEndDate=2018&selectedReport=CBS&selectedStartDate=1934&selectedStates=0&sortField=YEAR&sortOrder=desc"]]

¹¹⁸ NCUA Quarterly Reports, available at [[HYPERLINK](https://www.ncua.gov/newsroom/press-release/2020/ncua-q1-2020-state-credit-union-data-report-now-available) "https://www.ncua.gov/newsroom/press-release/2020/ncua-q1-2020-state-credit-union-data-report-now-available"] (In the eight years from December 2011 and December 2019, 1,800 credit unions exited the business.) CUNA estimated about 5,500 at the end of 2019, down from 11,000 in 1999. See, Monthly Credit Union Estimates, June 2020. [[HYPERLINK](https://www.cuna.org/uploadedFiles/Global/About_Credit_Unions/CUMonthEst_Jun20.pdf) "https://www.cuna.org/uploadedFiles/Global/About_Credit_Unions/CUMonthEst_Jun20.pdf"]].

¹¹⁹ One investors' service reported 7,800, [[HYPERLINK](https://www.crunchbase.com/hub/united-states-finance-companies) "https://www.crunchbase.com/hub/united-states-finance-companies"]]. The industry trade association has 440 members, [[HYPERLINK](https://afsaonline.org/about-afsa/afsa-membership/) "https://afsaonline.org/about-afsa/afsa-membership"]].

Dollar volumes and shares of consumer credit from Table 2-1 allow for comparisons of the major sectors around the time of the Commission's Report to those today. The following table highlights the institutional types then and now:

Consumer Credit by Type of Holder					
Year	Billions	Percent	Billions	Percent	Excluding Government
	1975	1975	2019	2019	2019
Depository Institutions	\$116	56.0%	\$1,771	42.3%	61.7%
Finance companies	\$33	15.9%	\$537	12.8%	18.7%
Credit unions	\$26	12.6%	\$482	11.5%	16.8%
Nonfinancial business	\$33	15.9%	\$40	1.0%	1.4%
Pools of securitized assets	0.5%		\$14	0.3%	0.5%
Federal government	0.0%		\$1,319	31.5%	-----
Nonprofit and ed. inst.	0.0%		\$28	0.7%	1%
	\$207	100%	\$4,191	100%	100%

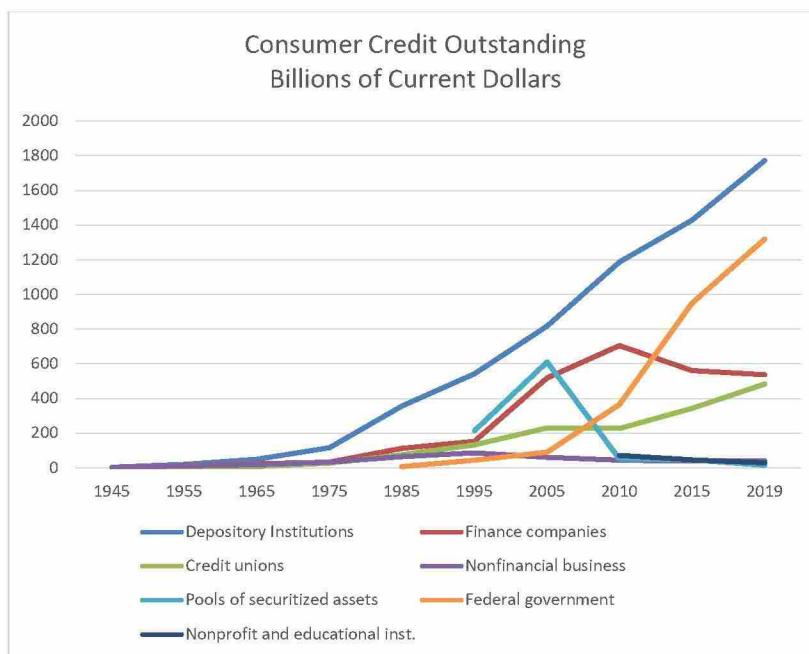
The table reveals an apparent drop in the shares of major types of institutions. For depository institutions (banks, savings, etc.) holdings dropped from 56 percent in 1975 to 41 percent in 2019 (close to their share of in 1972). Finance companies and credit unions also lost share over the period, although their declines since 1975 appeared to be more modest. The share loss of nonfinancial businesses accelerated, dropping from about 16 percent to little more than a single point in 2019.

Declining shares of the top three sources should be viewed in the light of the increase in consumer credit overall and the emergence of the Federal government as a major holder. It was the growth of government-held student loans that reduced the shares of the other sources despite the dramatic growth of the private sector. The Federal government did not hold enough credit to warrant tracking at the time of the Commission's Report, and its share still rounded to zero in 1975. Today, the government is the second largest creditor of consumers, after depository institutions. If its holdings were subtracted from the table, the shares of the traditional institutions would all increase by half. Banks (and savings institutions) would rise to around 60 percent, while finance companies and credit unions would approach 20 percent apiece, all above their shares in the early 1970s.

Expanding aggregate credit has translated into increased holdings for each of the major sectors since 1975. Even nonfinancial institutions, with one tenth of their 1975 share, hold more dollars of consumer credit than they did forty-five years ago (although

adjusting for inflation would show a decline). Finance companies and credit unions have reached about half a trillion dollars, while depository institutions are well above a trillion.

Although less severe than the wide shifts in the first half of the century, the variations apparent in the chart continue to suggest inter-sector competition. Some sources of credit have nearly vanished. For example, pools of securitized assets rose from minuscule levels and fell back just as quickly in less than two decades. Banks and credit unions continued their long rise. The latter are now closing in on finance companies, whose shares have fallen over the last ten years. Figure __ [Consumer Credit Outstanding] shows these trends.

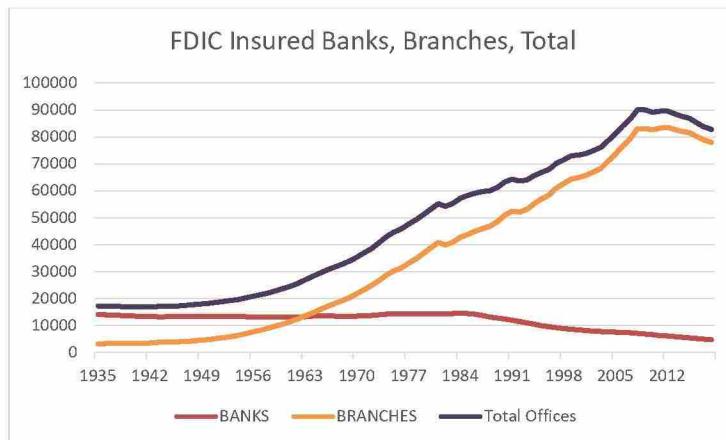


A closer examination reveals forces that have reshaped each sector, and how competition has evolved. Institutions have entered, exited, repositioned, and fought within and across sector borders

Banks

[PAGE * MERGEFORMAT]

Growing aggregate shares combined with stable or declining numbers of institutions imply that concentration in consumer credit has increased above the levels the Commission observed. It is a matter of simple arithmetic. Fewer institutions will account for higher percentages of the whole. Beneath the aggregates, however, is a different picture. While the number of banks did drop by half, the number of branches tripled, from about 25,000 in 1972 to 78,000 today, putting the number of total offices above 80,000. Although the count of total bank offices has declined slightly from its peak of about 90,000 in 2008, the proliferation of outlets remains near historic highs. The chart below illustrates the trends.¹²⁰



Overall, the trends show that headquarters of financial institutions have declined while total storefronts have expanded, and for consumers, the storefronts matter. Like gas stations and grocery stores, local offices vie for the consumer's business.

Competition in the banking sector is monitored by both the Department of Justice and the Federal Reserve, which share responsibility for reviewing potential competitive effects of bank mergers. To facilitate that effort the Fed collects and publishes structural data on banks and thrifts in markets across the United States. Concentration is measured by an

¹²⁰[HYPERLINK "<https://banks.data.fdic.gov/explore/historical?displayFields=STNAME%2CTOTAL%2CBRANCHES%2CNew Char&selectedEndDate=2018&selectedReport=CBS&selectedStartDate=1934&selectedStates=0&sortField=YEAR&sortOrder=desc>"]. The same source shows the number of federally insured S&L's declining from over 3,500 to less than 700 between 1984 and 2018.

index, called the Herfindahl Hirschman Index, or HHI, which can range from near zero for a market with thousands of small competitors to 10,000 for a market dominated by one company. The Fed gives close scrutiny to mergers that would significantly increase the index in any market to levels of 1,800 or higher.¹²¹ Mergers that do not move concentration above the threshold and small mergers above it typically do not raise concerns. Consumers have plenty options at HHI levels around 2,000.

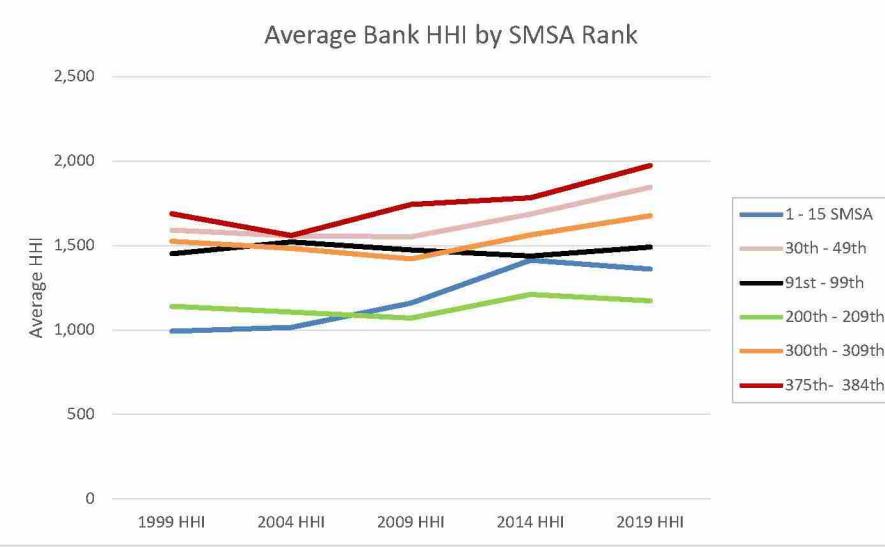
A few examples of larger and smaller markets illustrate the conditions at different points on the HHI scale. The market that includes Houston, Texas has an HHI near 2,300, indicating concentration well above the threshold of scrutiny. Yet the market has 92 commercial banks, which suggests that customers have a plethora of choices. It is because the top four banks have around 70 percent of total deposits that the HHI is relatively high. Columbus, Ohio has a level around 2,100, reflecting 48 banks and 9 thrifts.¹²² In Fargo, North Dakota, where the level is just under 1,800, customers can choose from 34 banks. El Paso, Texas, with a similar HHI, hosts 14 banks.

Larger markets can accommodate more banks and tend to generate lower scores. The New York City market, for example, with an HHI of 1300, contains 170 banks and 45 thrifts. Chicago, where customers can find 135 banks and 24 thrifts, has an HHI around 950. Even in small metropolitan areas, however, concentration typically remains below 2,000 on the HHI scale. The following chart shows average indexes by size of SMSAs, from the smallest areas to the largest in the Fed's database. Concentration remains below 2,000 for banks and thrifts in most markets.

Commented [SS(7): You mention at the beginning of the paragraph that DOJ and FR reviews these mergers but you do not describe DOJ analysis either in text or footnote. You could drop in the footnote references to the DOJ criteria of concentration. Also, does the Fed use a delta at all? The DOJ concentration criteria rely not only on the HHI but also the Delta. If Fed uses a delta it would be good to mention at least in a footnote.

¹²¹ The Herfindahl Hirschman Index (or HHI), which is the sum of the squares of the percentage shares of the companies in a market. For example, ten companies, each with a share of 10 percent, would result in an HHI of 1,000. The square of 10 is 100, and 100 added ten times equals 1,000. A market comprising five firms of equal size yields an HHI of 2,000 (20 squared x 5). Branches are aggregated by institution, not counted individually. See, e.g., [[HYPERLINK "https://cassidi.stlouisfed.org/index"](https://cassidi.stlouisfed.org/index)].

¹²² Thrift institutions are discounted by 50% in HHI calculations, in light of their more limited services compared to banks. [[HYPERLINK "https://www.justice.gov/sites/default/files/atr/legacy/2014/10/09/308893.pdf"](https://www.justice.gov/sites/default/files/atr/legacy/2014/10/09/308893.pdf)]



123

Some indications of the future of competition in banking may be evident from the trends in concentration. Figure ___ shows that in both the larger and smaller markets, concentration was relatively stable between 1999 and 2009, but then rose noticeably in the five years between 2009 and 2014. Over the last five years the rise reversed in some of the largest markets but has continued in smaller population centers.

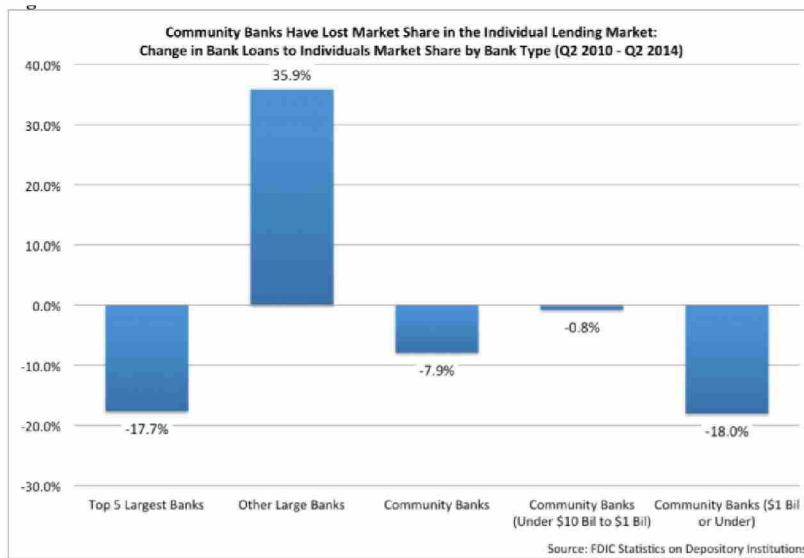
Within the largest metropolitan markets, the trends in consolidation are unlikely by themselves to suggest potential anticompetitive effects. Banking in big cities has become more concentrated, but not to the point that raises risks that competition may be suffering. On the other hand, the smaller markets have reached levels that suggest further consolidation could face resistance from competition authorities – if that consolidation occurs by merger. There is little the competition authorities can do to prevent

¹²³ 1-15 Avg Population	7,240,113
32-49 Avg Population	1,591,927
90-99 Avg Population	622,387
200-210 Avg Population	224,861
300-310 Avg Population	134,483
376-384 Avg Population	67,358

[PAGE * MERGEFORMAT]

concentration from increasing by attrition, for example when a bank simply exits a market. Both consolidation and attrition are occurring in small markets.

An insight into how the changes in concentration can affect the consumer market was described in a 2015 study on community banks.¹²⁴ The authors cited Bureau research that had found community banks “can be a lifeline to hardworking families paying for education, unexpected medical bills, and homes.”¹²⁵ Business pressure, however, was causing these banks to pull back from consumer lending and focus on commercial loans to local companies. Small banks, research has found, have a comparative advantage over large institutions by virtue of the closer customer relationships that the local setting allows. Despite the advantage, the prospects for those banks remain in doubt as well. A chart from the study depicts a shift in lending to individuals:¹²⁶



The Chairman of the FDIC put it more bluntly:

¹²⁴ Marshall Lux, The State and Fate of Community Banking February 9, 2015, available at [[HYPERLINK "https://www.lks.harvard.edu/sites/default/files/centers/mrcbg/files/Final_State_and_Fate_Lux_Greene.pdf"](https://www.lks.harvard.edu/sites/default/files/centers/mrcbg/files/Final_State_and_Fate_Lux_Greene.pdf)]

¹²⁵ Id. (citing Consumer Financial Protection Bureau, Community Banks and Credit Unions, [[HYPERLINK "http://www.consumerfinance.gov/small-financial-services-providers/"](http://www.consumerfinance.gov/small-financial-services-providers/)] (accessed January 10, 2015))

¹²⁶ Id., Figure 12, at 19.

Small banks like these are slowly disappearing from America's landscape. Today, 627 counties are only served by community banking offices, 122 counties have only one banking office, and 33 counties have no banking offices at all.¹²⁷

It bears repeating that structure is just part of a competition analysis. Factors other than concentration can compound or alleviate initial concerns that the census and measure of firms in a market may raise. In sectors where competitors can increase capacity quickly, as is the case in consumer credit, concentration measures exaggerate the significance of large firms. Another ambiguity in bank indexes stems from their units of measurement. HHIs are based on total deposits, which are at best loosely correlated with the various financial services that banks and thrifts provide.¹²⁸ Because banks can readily reallocate funds from one investment to another – for example from business finance to consumer credit or from mortgages to auto loans – their ability to compete for consumers is not tied tightly to their total assets. As described earlier, banks facing diminished commercial demand during the Great Depression opened new consumer credit departments, emulating smaller finance companies that were expanding their own operations. Such flexibility means that concentration measures do not fully capture the competitive threat that small rivals or small operations present to established institutions. The structure of a market at any given moment provides a helpful context to an assessment of competition, and trends in structure can be even more revealing, but neither is sufficient to draw conclusions about competition.

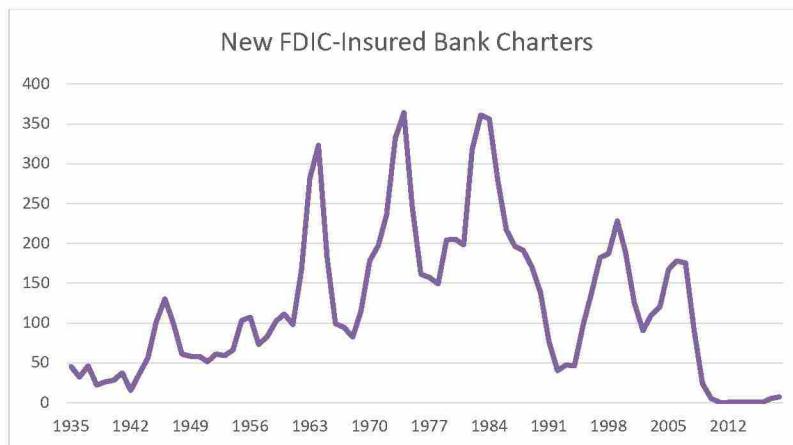
After identifying the contours of a market and the qualifying the participants in it, a competition analysis typically turns to the conditions of entry. Consolidation, decline, and even the failure of firms may have little impact on competition if new companies can fill the voids left by companies that decline or depart. Finance companies that opened offices a century ago while authorities were closing others illustrated this phenomenon. Mutual savings banks, which were slow to innovate and have declined as a result, offer another example.¹²⁹ Competitive analysis must therefore consider conditions of entry, as it is a powerful antidote to anticompetitive performance and unsatisfied demand.

¹²⁷ Jelena McWilliams, "BankThink/We can do better on de novos," *American Banker*, December 06, 2018, [[HYPERLINK "https://www.americanbanker.com/opinion/fdic-chairman-jelena-mcwilliams-we-can-do-better-on-de-novos"](https://www.americanbanker.com/opinion/fdic-chairman-jelena-mcwilliams-we-can-do-better-on-de-novos)].

¹²⁸ A Fed study noted that "HHI is a measure of concentration for the base good, a bank account measured by deposits, and less of a measure of competition for the aftermarkets. Since most bank fees stem from aftermarket good purchases, the standard relationship between concentration and... fees need not apply." Available at [[HYPERLINK "https://www.federalreserve.gov/econres/feds/files/2017054pap.pdf"](https://www.federalreserve.gov/econres/feds/files/2017054pap.pdf)].

¹²⁹ Daniel R. WADHWANI, "Why does the US have a weak mutual savings banks sector?" World Savings Banks Institute (2011), [[HYPERLINK "https://www.wsbi-esbg.org/SiteCollectionDocuments/Wadhwan/Web.pdf"](https://www.wsbi-esbg.org/SiteCollectionDocuments/Wadhwan/Web.pdf)]. (citing reluctance to introduce new products and expand across state lines).

Here the evidence is disconcerting for the banking sector. As is apparent in the trends of new charters for FDIC-insured banks, entry of banks has dropped to the lowest levels in eighty years. After averaging over a hundred a year from 1960 to 2010 – often exceeding two hundred and more – roughly two charters a year have issued in United States since 2010. The phenomenon could be driven by diminished interest in entering the sector, higher costs of doing so, or a combination of both. It may be that an FDIC-insured charter is not as important an asset as it once was in the provision of financial services. If so, that could explain a declining demand for the charters. An alternative hypothesis is that insured banks remain an important component in the competitive environment, but that entry has become so costly that efficient providers are discouraged from taking the opportunity. The most recent data suggest a rise in new banks applying for FDIC the last few years, with the annual openings averaging half a dozen in the 2017 to 2019. The pace prompted the Chairman of the FDIC to observe that “never before has the level of new banks been so low for so long — only two new startup banks opened between the end of 2010 and the end of 2016, and just 11 have opened since the end of 2009, most in the past 18 months.”¹³⁰



One more charter could have changed the concentration of depositories dramatically. Walmart has long struggled, without success, to enter the sector for years. In the 1990s, it tried to become a thrift holding company, which would have allowed it to open in thousands of American stores. The Bank Holding Company Act imposed restrictions on companies engaged in nonbank businesses from owning banking subsidiaries, but the

¹³⁰ Jelena McWilliams, “BankThink/We can do better on de novos,” *American Banker*, December 06, 2018, [[HYPERLINK "https://www.americanbanker.com/opinion/fdic-chairman-jelena-mcwilliams-we-can-do-better-on-de-novos"](https://www.americanbanker.com/opinion/fdic-chairman-jelena-mcwilliams-we-can-do-better-on-de-novos)]

option for Walmart to own a subsidiary operating a thrift had a venerable precedent; it was the model that Ford Motor Company, Household International, and Sears Roebuck had used to offer financial services their customers. Before Walmart could execute the plan, Congress passed the Gramm-Leach-Bliley Act of 1999, blocking the move. A decade later, Walmart tried again, taking advantage of another innovation from the early twentieth century. It obtained a charter to operate an industrial loan company (the institutions that specialized in blue collar customers). Those charters allowed a commercial to own a financial institution that could take deposits and make loans. This time the FDIC blocked the move by denying Walmart deposit insurance, the application for which was “fiercely opposed” by bank lobbies.¹³¹ Walmart withdrew its application in 2007. Any prospect of reconsideration, for Walmart or another company like it, was suspended in 2010, when Dodd-Frank imposed a three-year moratorium on deposit insurance for any new industrial loan company.

Walmart’s four thousand stores, which serve customers who are more likely to be unbanked or underbanked, and which serve communities where banks are more likely to be scarce, have not been able to surmount the barriers to entry that banks have persuaded regulators to build around their business. Walmart offers a variety of financial services, including smart phone checking with affiliated institutions, but as of 2014, the stores do not present the bundle of services available at a typical bank or thrift. Consumer Reports compared Walmart’s services to a bank and rated the bank superior.¹³² Academic research described below finds that branch banks bring valuable benefits to underserved areas and populations. The costs of these barriers Walmart could not overcome are likely significant.

Entry conditions in banking merit more attention.

Better data, more sophisticated statistical techniques, and improvements in economic analysis enable more direct assessments than the Commission could make of the intensity of competition. The banking sector is especially amenable to analyses that go beyond inferences drawn from differences in concentration across states. Numerous studies of bank competition have been published in recent years, the results of which indicate a business where competition has been keen. Reviewing the literature in 1994, Shaffer found that most U.S. banking markets “behave quite competitively at the bankwide level,

¹³¹ See, Lawrence J. White, “Walmart and Banking: It’s Time to Reconsider,” *Money and Banking* (May 15, 2017), available at [[HYPERLINK "https://www.moneyandbanking.com/commentary/2017/5/13/walmart-and-banking-its-time-to-reconsider"](https://www.moneyandbanking.com/commentary/2017/5/13/walmart-and-banking-its-time-to-reconsider)].

¹³² “Should Walmart be your next bank?” November 2014 [[HYPERLINK "https://www.consumerreports.org/ero/magazine/2014/11/should-walmart-be-your-bank/index.htm"](https://www.consumerreports.org/ero/magazine/2014/11/should-walmart-be-your-bank/index.htm)].

even where highly concentrated,” although there may be some exceptions in some individual product lines, such as consumer deposit accounts.¹³³

In a recent study that tracked the performance of the banking sector from 1984 to 2016, Mendenhall found that its performance exceeded competitive equilibrium levels.¹³⁴ He found output of the banks to be “supercompetitive,” greater than that expected from competitive markets, and competition did not suffer from the trend of increasing concentration. To the contrary, the evidence pointed toward improving competition. For example, the spread between cost of funds and interest charged actually declined, from 3.3 percent at the beginning of the period studied to 2.9 percent at the end.

Most of the competition studies assess banks’ overall business, which includes both commercial and consumer lines. Commercial customers are well equipped to impose competitive discipline; they can take their business anywhere in the country and to sources overseas. Whether consumers realized the benefits of competition that these studies have found requires examination of the services they purchase in the market.

There is no question that consumer choices have expanded since the time of the Commission’s Report. Already mentioned are the branches, which grew by the tens of thousands and brought banking to underserved communities and closer to consumers in larger markets. Beyond brick and mortar, innovation has provided a growing volume and variety of banking services. The Automatic Teller Machine first appeared in 1969. Now ubiquitous, these outlets have grown to an estimated 470,000 in 2018.¹³⁵ Banks were the original owners and proprietors of ATMs. Today, fewer than half are bank machines; the remainder are operated by independent companies. Whether owned by the user’s bank, another bank, or nonbank institution, ATMs connect consumers with their banks and many of the services their banks provide. Among the aspects that distinguish independent ATMs: they are more likely to locate in areas with higher unemployment, lower incomes and lower housing values. Like the consumer lenders of a century ago, independent institutions have brought financial services to communities where banks are relatively rare.¹³⁶

These developments were made possible by changes in the legal environment of consumer finance, and some of the changes track the recommendations in the Commission’s Report. Restrictions the Commission criticized have been amended, repealed or rendered obsolete. Antitrust enforcement has reduced anticompetitive

¹³³ Shaffer, Bank Competition in Concentrated Markets, *Business Review*, March/April 1994.

¹³⁴ Mendenhall, Commercial Bank Competition, Riegle-Neal, and Dodd-Frank,

August 4, 2017, [[HYPERLINK "https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2967998"](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2967998)].

¹³⁵ The Locational Study of ATMs in the U.S. by Ownership, available at [[HYPERLINK "http://www.akleg.gov/basis/get_documents.asp?session=31&docid=22687"](http://www.akleg.gov/basis/get_documents.asp?session=31&docid=22687)]

¹³⁶ And the higher transaction fees that independents charge have inspired efforts to cap them. *Id.*

practices. The developments are especially relevant to barriers between institutional segments, geographic markets, interest rate flexibility, loan availability, lender and servicer performance, and discrimination among borrowers.

The opening of geographic markets and the competition between institutions would have been impossible without legal reforms of the sort that the Commission advocated. Pivotal events included a Supreme Court decision in 1978, which settled the question as to which state laws would apply to interstate banks, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, which lifted restrictions that states had imposed on banks crossing borders, and the Gramm-Leach-Bliley Act of 1999, which expanded the financial services banks could offer.¹³⁷ The reduction of these barriers unleashed the proliferation of branches described above, as banks quickly crossed the borders that previously had confined them.

A summary of the literature on barriers and whether their relaxation affected competition in banking found that the spread of branches had been painful for some local banks, especially in rural areas, but beneficial for consumers.¹³⁸ Empirical analysis documented some of the effects on access to credit:

We first establish the positive effect of interstate branching deregulations on the density of bank branches in poor counties. We find that the density of bank branches increases by around 30% in poor counties after a state fully deregulates.

Second, we show that interstate branching deregulation is associated with a significant drop in the rate of unbanked households among low-income populations. [Illustrative is] the change in the likelihood of holding a bank account in the years before and after deregulation relative to a control group of states that do not deregulate. We observe a significant increase in the share of banked households following deregulation.¹³⁹

Another study found similar effects. Branches that spread after banks were allowed to cross state lines reduced the percentage of unbanked populations in poor communities.¹⁴⁰ The effect was stronger for populations that were likely to be rationed by banks, “such as

¹³⁷ Marquette Nat. Bank v. First of Omaha Svc. Corp., 439 U.S. 299, 99 S. Ct. 540; 58 L. Ed. 2d 534 (1978) (interpreting the National Bank Act of 1864); H.R.3841 - Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, 103rd Congress (1993-1994).

¹³⁸ [[HYPERLINK "https://www.federalreserve.gov/pubs/feds/2007/200751/200751pap.pdf"](https://www.federalreserve.gov/pubs/feds/2007/200751/200751pap.pdf)]

¹³⁹ Bank Branch Supply and the Unbanked Phenomenon, available at [[HYPERLINK "https://pdfs.semanticscholar.org/e9b6/f210629419b5ec6f53f8227448a29dae61f0.pdf?_ga=2.249876995.461538237.1596483228-41928408.1596483228"](https://pdfs.semanticscholar.org/e9b6/f210629419b5ec6f53f8227448a29dae61f0.pdf?_ga=2.249876995.461538237.1596483228-41928408.1596483228)]

¹⁴⁰ Claire Celerier and Adrien Matray, “Bank Branch Supply and the Unbanked Phenomenon,” Draft, October 17, 2016

black households living in "high racial bias" states, or for households living in rural areas where branch density is initially low."

Legislation and regulations that increase costs or reduce opportunities can compound the challenges facing institutions on the margin of profitability. Considering pressure on banks and credit unions in smaller communities, the US Treasury identified potential effects:

Community financial institutions' business models have come under pressure from a slow economic recovery and low interest rate environment, additional competition (e.g., internet banks and nonbank lenders), and added compliance costs from new regulations. Together such factors have contributed to a difficult operating environment and the ongoing consolidation of smaller banks and credit unions....The impact of consolidation has been particularly profound on smaller banks as the number of institutions with assets less than \$100 million declined by 85% between 1985 and 2013. Similarly, the total number of credit unions in the country has declined..., with the impact mostly concentrated among smaller credit unions. Feedback provided to Treasury suggests that the cumulative effects of regulatory requirements weigh heavily on community banks and credit unions.¹⁴¹

The concerns expressed by the Treasury are reflected in the findings of academic research. Lux summarized research that found bank consolidation increasing after regulatory and legislative changes made operations more costly. Researchers were typically careful to note the difficulty of finding causal links between events and subsequent developments, but the number of studies finding correlations between different regulatory initiatives and changes in banking markets led the author to suggest that regulation was causing consolidation.

Evidence is beginning to emerge on potential competitive effects of Dodd-Frank. A 2014 survey reported that over a quarter of banks with less than \$10 billion in assets planned to hire new compliance or legal personnel, while over a third of banks had already hired new staff to deal with new CFPB regulations.¹⁴² A Minneapolis Fed study that year identified the personnel costs of complying with regulations at banks with less than \$50 million in assets. Lux described the findings and a Fed Governor's reaction:

¹⁴¹ US Treasury, A Financial System That Creates Economic Opportunities - Banks and Credit Unions, 56-57. Available at [[HYPERLINK "https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf"](https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf)] (footnotes omitted).

¹⁴² Lux, (citing Hester Peirce, Ian Robinson & Thomas Stratmann, "How Are Small Banks Faring under Dodd-Frank?" (Working Paper 14-05, The Mercatus Center at George Mason University, February 2014)).

At these institutions, the study found that hiring two additional personnel reduces median profitability by 45 basis points, resulting in one-third of these banks becoming unprofitable. As Fed Governor Tarullo has noted, “Any regulatory requirement is likely to be disproportionately costly for community banks, since the fixed costs associated with compliance must be spread over a smaller base of assets.”¹⁴³

A decade of experience under Dodd Frank has begun to generate more direct evidence of effects on competition, allowing analysts to examine whether the concerns were justified. Mendenhall examined the effects of two major reforms – the Riegle-Neal Act and the Dodd-Frank Act – and he found that bank competition clearly increased after Riegle-Neal allowed interstate banking, and appeared to increase after Dodd-Frank added regulatory costs, although the findings with respect to the latter were only marginally significant.¹⁴⁴

Never far from the subject of competition in financial markets is the question whether competition is consistent with safety and soundness.¹⁴⁵ On one hand is the concern that competition will cause banks to make excessively risky loans. On the other is the expectation that competition will better serve consumers.

Empirical research offers some insight. For example, one study found that “increased competition induces banks to become more specialized and efficient” but also induces banks to extend credit to riskier borrowers and suffer higher default rates. However the author did not reach a definitive conclusion as to soundness. Her qualified conclusion was that that the competition was “possibly creating a less stable financial system.”¹⁴⁶

Another study found that in competitive mortgage markets, local banks lowered their lending standards by twice as much as those in concentrated markets, but the pressure did not appear to affect standards at national banks.¹⁴⁷ Implications about soundness were accordingly qualified.

¹⁴³ Id., (citing, Tarullo (speech at the Federal Reserve Bank of Chicago Bank Structure Conference, May 8, 2014)).

¹⁴⁴ Mendenhall, Commercial Bank Competition, Riegle-Neal, and Dodd-Frank, August 4, 2017, [[HYPERLINK "https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2967998"](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2967998)].

¹⁴⁵ The debate was joined by Adam Smith in 1776. (See appendix.)

¹⁴⁶ Gissler, et al., The Effects of Competition in Consumer Credit Markets, WP 12-24, Consumer Finance Institute, (2018) available at [[HYPERLINK "https://doi.org/10.21799/frbp.wp.2018.24"](https://doi.org/10.21799/frbp.wp.2018.24)].

¹⁴⁷ Xiaochen Feng (2018). Bank Competition, Risk Taking and their Consequences: Evidence from the U.S. Mortgage and Labor Markets. IMF Working Papers. [[HYPERLINK "https://www.imf.org/en/Publications/WP/Issues/2018/07/06/Bank-Competition-Risk-Taking-and-their-Consequences-Evidence-from-the-U-S-46034"](https://www.imf.org/en/Publications/WP/Issues/2018/07/06/Bank-Competition-Risk-Taking-and-their-Consequences-Evidence-from-the-U-S-46034)]

A third study found that both national and local banks reacted to changes in competitive conditions.¹⁴⁸ Using the event of OCC's preemption of state regulations, the authors compared mortgage lending in formerly restrictive states to lending in states that had imposed more limited rules. After the lifting of restrictions, national banks increased originations of riskier loans – for example with deferred amortization or interest-only payments. Local banks followed suit, but only in counties where OCC banks were more concentrated. The changes resulted in lower interest rates for some borrowers and new credit to borrowers would not have qualified for mortgages before the regulatory change.

Easing standards does not necessarily imply imprudent lending. Loans may be just as sound even though extended to applicants who may not have qualified under stricter standards, if the more accessible standards are based on superior efficiency and risk assessment. Competitive discipline can instill both, as one study found. It analyzed direct evidence of prudential concerns and found competition positively correlated with financial stability.¹⁴⁹ Banks in competitive states were less likely to be targeted for regulatory enforcement and less likely to fail. Banks facing more competition earned lower interest margins, made fewer high-risk investments, had lower profitability, and held less cash and Tier 1 capital than banks facing less competition.

For these reasons, the implications of consolidation continue to merit careful consideration. Competition could be a cause, a consequence, or both, of consolidation. Likewise, consolidation could be salutary, neutral, or deleterious to competition. It is important to detect the distinctions and directions of causation, if any, in order to avoid false diagnoses and prescriptions that could fail to remedy problems or, worse, exacerbate them. It is even more important to discern as directly as possible the intensity and effect of competition itself, and to assess the external conditions that can affect it.

Credit Unions

As for credit unions, despite the shrinkage of Federally Insured entities to 5,200, the Bureau of Labor Statistics counted 17,000 total establishments in 2019, much closer to the 1972 tally in the Commission's Report.¹⁵⁰ Like banks, credit unions have increased

¹⁴⁸ Di Maggio, Kermani, and Korgaonkar (2018). Partial deregulation and competition: Effects on Risky Mortgage Origination. *Management Science*, 10.1287/mnse.2018.3060 [[HYPERLINK "https://www.researchgate.net/profile/Sanket_Korgaonkar2/publication/327834191_Partial_Deregulation_and_Competition_Effects_on_Risky_Mortgage_Origination/links/5ba80a8b45851574f7e19b11/Partial-Deregulation-and-Competition-Effects-on-Risky-Mortgage-Origination.pdf"](https://www.researchgate.net/profile/Sanket_Korgaonkar2/publication/327834191_Partial_Deregulation_and_Competition_Effects_on_Risky_Mortgage_Origination/links/5ba80a8b45851574f7e19b11/Partial-Deregulation-and-Competition-Effects-on-Risky-Mortgage-Origination.pdf)]

¹⁴⁹ Akins et al. (2016). Bank Competition and Financial Stability: Evidence from the Financial Crisis. *Journal of Financial and Quantitative Analysis*, 1-28. [[HYPERLINK "https://doi.org/10.1017/S0022109016000090"](https://doi.org/10.1017/S0022109016000090)].

¹⁵⁰ Bureau of Labor Statistics, Quarterly Census of Employment and Wages, available at [[HYPERLINK "https://data.bls.gov/cew/apps/table_maker/v4/table_maker.htm"](https://data.bls.gov/cew/apps/table_maker/v4/table_maker.htm)]
"type=1&year=2019&qtr=4&own=5&ind=522130&supp=0"]

lending significantly over the last fifty years, even though the number of institutions has dropped. And as with banks, a simple institutional census of credit unions underestimates their competitive presence. Branching has kept the number of offices near their 1970 levels, and credit unions have become closer alternatives to banks and thrifts for consumer services. Credit unions take deposits, lend to consumers, issue cards, and finance purchases. Not surprisingly, studies find evidence of this competition in the rates that the institutions charge when they operate nearby one another. One study found that when credit unions were more prevalent in a market, credit card loan rates fell.¹⁵¹ Another study, looking at regulation that allowed credit unions to compete more closely with banks, found that the increased competition was especially beneficial for low-income borrowers.¹⁵² The cost of borrowing fell, banks became more efficient, and both banks and nonbank lenders extended more credit to riskier borrowers.

By the critical measure of the price of services, credit unions often beat banks, as they did when the Commission studied the sector fifty years ago. Interest rates on credit cards averaged between 11 and 12 percent at credit unions, lower than average bank-card rates.¹⁵³ Other loans tend to be cheaper at credit unions as well. These advantages help explain why credit unions have seen their holdings of consumer credit grow faster than banks. Membership in credit unions passed 120 members in 2019, an increase of about 50 million in twenty years.¹⁵⁴

Some sizeable differences in the institutions play a role in the competition between the sectors. In credit unions' favor is their tax status. They are non-profit entities, owned by their members, and therefore have lower tax expenses. In banks' favor is scale. They hold three times as much consumer credit on average as credit unions do, and credit unions are restricted to the consumer channel. The limitation means that commercial banks have the benefit, and of course bear the risk, of other holdings as well. Credit unions tend to be more regional and limited to members of identified organizations, although they do vary

¹⁵¹ Feinberg, R., Credit Unions: Fringe Suppliers or Cournot Competitors? *Review of Industrial Organization*, 20(2), 105-113, (2002).

¹⁵² Gissler, et al., The Effects of Competition in Consumer Credit Markets, WP 12-24, Consumer Finance Institute, (2018) available at [[HYPERLINK "https://doi.org/10.21799/fibp.wp.2018.24"](https://doi.org/10.21799/fibp.wp.2018.24)].

¹⁵³ Credicards.com, Credit Union and Regional Bank Credit Cards, available at [[HYPERLINK "https://www.credicards.com/credit-union/"](https://www.credicards.com/credit-union/)]. (The biggest advantage of a credit union credit card? It likely has significantly lower interest, possibly even offering rock-bottom interest on cash advances. In November 2018, the average interest rate offered by credit unions for credit cards was 11.1%, a steady figure over the last 10 years. That compares to the national average rate of 17.08% in March 2020."); See, also, [[HYPERLINK "https://www.spglobal.com/marketintelligence/en/about/"](https://www.spglobal.com/marketintelligence/en/about/)].

¹⁵⁴ Cuna.org, Monthly Estimates (June 2020) available at [[HYPERLINK "https://www.cuna.org/uploadedFiles/Global/About_Credit_Unions/CUMonthEst_Jun20.pdf"](https://www.cuna.org/uploadedFiles/Global/About_Credit_Unions/CUMonthEst_Jun20.pdf)].

in size and geography. Large credit unions operate through branches, ATMs, and online across the country.

Banks and credit unions routinely measure themselves against one another. The institutions conduct annual surveys, which make headlines in the trade press. The most recent survey released by the American Bankers Association announced that for the first time, banks had beaten credit unions in customer satisfaction scores. The headline read, “Banks Outpace Credit Unions in Consumer Satisfaction.”¹⁵⁵ It was the first time in the history of the survey that banks had won the competition. They did especially well with consumers’ ratings of staff, mobile apps, and speed of in-branch transactions. The best of all were regional and community banks, which outscored nationwide banks. While these results support the proposition that banks and credit unions compete closely with one another, they also demonstrate that the bundle of services both provide, from personal relations to branch locations, gives them a significant advantage in retaining customers. Consumers may change credit cards, open new accounts elsewhere, or shop nationwide for loans and mortgages, but the established relationships with banks and credit unions are not often abandoned.

Competition between banks and credit unions is also apparent in the rivalry of their respective organizations. The two sectors are frequently at odds over public policies that treat them differently. Bankers’ associations have opposed allowing credit-union acquisitions of banks, expanding credit-union loans to businesses, and other extensions that threaten traditional bank services.¹⁵⁶ The banking sector criticizes as unfair the tax advantage of credit unions and cites it as a justification to limit their activities. Credit unions chafe under restrictions such as caps on commercial lending, which would allow them to enter more areas of competition with banks. It is not necessary to take a position on these arguments to conclude that the debate itself reveals potential competition between the two sectors – potential that has not been fully realized or battle between the sectors would not be worth waging. The barriers against credit-union expansion harken back to those that the Commission deemed anticompetitive fifty years ago.

Finance Companies

¹⁵⁵ Release, Banks Outpace Credit Unions in Consumer Satisfaction, ABA Banking Journal, November 20, 2019, available at, [[HYPERLINK "https://bankingjournal.aba.com/2019/11/banks-outpace-credit-unions-in-consumer-satisfaction/"](https://bankingjournal.aba.com/2019/11/banks-outpace-credit-unions-in-consumer-satisfaction/)].

¹⁵⁶ See, e.g. By Melissa Angell, Banks decry CU lobbying while beefing up own during coronavirus May 18, 2020, available at [[HYPERLINK "https://www.americanbanker.com/creditunions/news/banks-decrys-cu-lobbying-while-beefing-up-own-during-coronavirus"](https://www.americanbanker.com/creditunions/news/banks-decrys-cu-lobbying-while-beefing-up-own-during-coronavirus)]; Carrie Hunt, “The difference between banks and credit unions could not be clearer.” The Hill, 02/05/19, available at [[HYPERLINK "https://thehill.com/opinion/finance/428546-the-difference-between-banks-and-credit-unions-could-not-be-clearer"](https://thehill.com/opinion/finance/428546-the-difference-between-banks-and-credit-unions-could-not-be-clearer)]..

Finance company establishments numbered just under 16,000 in 2019¹⁵⁷ – ahead of the 13,000 to 14,000 offices estimated by the Commission in 1970. For decades, with portfolios of direct and indirect loans, finance companies comprised the second most important sector of consumer credit. They offer a variety of loans for the same purposes that sends consumers to banks, credit unions, and retail lenders.¹⁵⁸ Although the chart on sector growth indicates that this sector has lost share,¹⁵⁹ the sector does not appear to be in a secular decline. To the contrary, according to a report from Experian that tracks personal finance, it is the fastest growing type of credit, having increased by 50 percent in the last five years. For 2019, the report estimated that 11 percent of the population held 34.8 million different accounts and 6 million new accounts at finance companies.¹⁶⁰

Innovation is driving this growth. Fintech lenders, continuing to offer new products and experiences, “have more than doubled their market share of unsecured personal loans in the past four years, from 22.4% in 2015 to 49.4% in 2019....” By 2022, Fintech lenders are expected to increase those loans by another 50 percent.

With half the loans coming from Fintech sources, the competitive significance of offices and branches may be declining. But even if the finance companies are new, consumers’ borrowing patterns bear a strong resemblance to the loans in middle of the last century. Consumers reported that 28 percent had used their personal loans for large purchases, 26 percent for debt consolidation, 17 percent for home improvements, and 9 percent to refinance existing debt. In one important respect, consumers clearly have gained on past generations. The average annual percentage rate of 9.4 percent in 2019 was less than half the finance-company rates the Commission observed in 1972 (when prime rates were comparable). APRs found in this survey beat the rates that the Commission found credit unions and banks charging fifty years ago.¹⁶¹

Like banks, finance companies range from smaller, local establishments to cross-country networks. Many, including industry leaders, extend credit entirely online. They offer

¹⁵⁷ Bureau of Labor Statistics, Quarterly Census of Employment and Wages, available at [[HYPERLINK](https://data.bls.gov/apps/table_maker/v4/table_maker.htm) "https://data.bls.gov/apps/table_maker/v4/table_maker.htm"]

["type=1&year=2019&qtr=4&own=5&ind=522291&supp=0"]

¹⁵⁸ CCAE at 25.

¹⁵⁹ Statistical Release, Finance Companies (June 2020), available at [[HYPERLINK](https://www.federalreserve.gov/releases/g20/current/g20.pdf) "https://www.federalreserve.gov/releases/g20/current/g20.pdf"]. (Note to Tom D –numbers in the statistical release don’t agree with Table 2-1)

¹⁶⁰ Matt Tatham, “Personal Loan Debt Continues Fast-Paced Growth,” October 14, 2019, available at [[HYPERLINK](https://www.experian.com/blogs/ask-experian/research/personal-loan-study/) "https://www.experian.com/blogs/ask-experian/research/personal-loan-study/"].

¹⁶¹ NCCR at 128. (In 1972, credit unions charged - 11.76%, banks - 13.04%, and finance companies - 25.88%. The prime rate fluctuated around 5% in both 1972 and 2019.)

personal loans, mortgages, auto loans and other types of credit. Banks regard them as attractive acquisitions.

A century ago, banks began to offer products that emulated finance-company loans. In 1972, the Commission reported on banks' buying finance companies in order to extend loans that regulations prevented banks from offering. Today, the finance-company sector remains an inviting business for entry from the banking sector. In September 2020, the appeal of finance-company acquisitions was reported in the American Banker, which revealed that "card networks, along with PayPal and Citi, are responding to competition from the likes of Affirm, Afterpay and other "buy now, pay later" lenders. Should traditional credit card lenders be worried?"¹⁶² The answer to this rhetorical question was not necessary to report. For personal finance loans at least, product distinctions do not raise a high barrier between the sectors. Enthusiasm among banks for finance-company acquisitions remains high, and the reason is the ability of finance companies to take business away from other types of institutions.

Competition in Credit from the Consumer's Perspective

Competition for the Borrower

The assessment of competition typically begins with a definition of the market, which means taking the perspective of customers and determining what they would regard as suitable substitutes for a product or service they desire.¹⁶³ Because financial services facilitate the consumption of something else, demand for those services is shaped by the ultimate purposes a consumer has in mind. Chapter 3 explains that for both borrowing and saving, a significant consideration is the time horizon – how long a consumer wants the use of a loan or when a consumer wants to retrieve funds deposited for future spending. Short-term loans and time deposits are more likely to be the leading options for consumers with temporary needs or seasonal shopping. Longer terms likely work better for home mortgages and retirement savings. Other aspects of a financial transaction bear on substitutability as well. Price, convenience, and customer service may make dissimilar products more or less appealing to a shopper with a particular purpose in mind. When significant time is not involved, for example when financial services simply facilitate payments the most important features are likely to be reducing the costs and enhancing the efficiency of transactions.

¹⁶² Kevin Wack, "Why Visa and Mastercard are suddenly keen on installment lending," American Banker, September 02, 2020, available at [[HYPERLINK "https://www.americanbanker.com/tag/consumer-lending"](https://www.americanbanker.com/tag/consumer-lending)].

¹⁶³ The process of market definition is described in merger guidelines issued by enforcement agencies. See Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, (2010), available at [[HYPERLINK "https://www.justice.gov/atr/horizontal-merger-guidelines-08192010"](https://www.justice.gov/atr/horizontal-merger-guidelines-08192010)].

Consumers use some financial services that they do not choose directly. While they select their lenders and depository institutions, the services they consumer include components that the vendor has chosen. Just as a car owner may not know who produced the mechanics or body parts of automobile she has just purchased, borrowers may not be aware of the companies who sell services that support a loan they have just taken out. A borrower does not select the credit reporting agency that provides information on his credit history or the loan servicer who collects payments. Nonetheless the costs and quality of these services affect the price and availability of the loan. Accordingly, the chapter will consider competition in services provided in markets where financial institutions shop.

There are few (if any) clear distinctions among the lengths that loans can run. Some credit needs expire in days, while others may extend for weeks, months, or years. Likewise, some credit products are designed for shorter or longer periods, while others can meet needs of almost any duration. Terms, of course, are not determinative. A longer loan at a lower rate may be a good substitute for a shorter loan at a higher rate. Accordingly, a competitive analysis should not conclude until all potentially relevant aspects of financial services are taken into account.

Because credit is fundamentally about accelerating or postponing purchases, this analysis will begin with the time dimension and then consider the other factors. The analysis will consider three general categories – short-term, medium-term, and long-term credit. We expect to find that borrowers in the market for short term credit will look at products designed to meet those needs. A loan to repair the car until the next paycheck will likely come from a short-term or medium-term source. A loan to finance a house or car purchase will likely come from a provider of multi-year loans. Within each category, the analysis will consider the offers available to consumers and the competition among providers extending those offers. It is possible that the evidence will reveal that some products within each group do not compete in all respects with one another, and equally conceivable that the products in some groups compete with other products outside the groups.

Even within the groupings, different products offered by different institutions may be sufficiently distinct that they do not compete meaningfully with one another. As the Commission observed, loans from remote sources may not provide a competitive constraint on convenient outlets, even when the loans may have similar features. Second mortgages can and do finance car purchases, for example, but the vast majority of cars are financed by automobile loans.¹⁶⁴ Consumers can and do reallocate debt by delaying a payment to one creditor to obtain funds for another purpose, but those options may

¹⁶⁴ Melinda Zabritski, State of the Automotive Finance Market, Q4 2019, Experian(85% of new cars; 55% of used cars financed) available at [[HYPERLINK](#) "<https://www.experian.com/content/dam/marketing/na/automotive/quarterly-webinars/credit-trends/2019-q4-state-of-the-automotive-finance-market.pdf>"].

impose greater costs. In most cases, however, the leading edge of competition will come from providers more closely situated within categories.

Financial services are among the most customized products or services that consumers acquire. Terms depend on the information that both borrowers and lenders bring to the transactions, their respective bargaining skills, economic expectations, credit history, and attitudes toward risk. All these contribute to an assessment of the likelihood that the borrower will repay the loan. Because borrowers vary widely on that spectrum, and because financial services are personal transactions, terms and services can be tailored to individual borrowers.

The most important influences on affordability and availability are the credit histories and credit scores of borrowers. The tables below list consumers within each FICO group. Creditors are more likely to lend and more likely to give favorable terms to consumers in better risk categories. Borrowers with poorer FICO grades will find fewer choices in the marketplace. Borrowers with the poorest scores or insufficient credit history to generate any score at all, will have even fewer choices.

According to one study, about a third of Americans have a FICO® Score below 669, often considered "subprime" scores by lenders, and about half of them are classified as "very poor" (although that lowest category is no longer publicized). For comparison, the

67 percent of consumers who hold credit cards and the 62 percent who have retailers' cards have average scores in the low 700s.¹⁶⁵

Table XX

Percent of Americans by FICO® Grades and Scores 2019¹⁶⁶		
FICO Grade	Score	Share of Total
Poor	300-579	16%
Fair	580-669	18%
Good	670-739	21%
Very good	740-799	25%
Exceptional	800-850	20%

Retail Credit Product Groupings		
Short Term	Medium Term	Longer Term
Pawns / Title Loans	Credit Cards	Auto Loans
Small Dollar Loans Payday Loans	Installment loans	Installment loans
Overdraft Protection	Overdraft Line of Credit	Mortgages
Credit Cards		

Credit scores rise with the age of consumers. A breakdown by cohorts was reported by Experian, using VantageScore – a joint product of the three national credit bureaus, which is comparable to the FICO score. For Gen Z the average is 656, Gen Y – 658, Gen X – 676, Boomers – 716, and the Silent Generation – 729.¹⁶⁷ In other words, two generations of Americans have yet to raise their cohorts' average credit risk to good or better, and of course every generation has at any time some members struggling with credit status. Because below-average grades limit borrowers' options in the market for financial services, the competition they encounter can vary substantially.

¹⁶⁵ Matt Tatham, "2019 Consumer Credit Review," Experian, January 13, 2020 (The [[HYPERLINK](https://www.experian.com/blogs/ask-experian/state-of-credit-cards/) ["https://www.experian.com/blogs/ask-experian/state-of-credit-cards/"](https://www.experian.com/blogs/ask-experian/state-of-credit-cards/)] for Americans reached \$6,194 in 2019, as balances increased 3% compared with 2018, according to Experian data. The average FICO® Score for consumers with a credit card is 727, and 67% of Americans carried a credit card in 2019.) [[HYPERLINK](https://www.experian.com/blogs/ask-experian/consumer-credit-review/) ["https://www.experian.com/blogs/ask-experian/consumer-credit-review/"](https://www.experian.com/blogs/ask-experian/consumer-credit-review/)].

¹⁶⁶ FICO, "MyFICO," available at [[HYPERLINK](https://www.myfico.com/credit-education/credit-scores) ["https://www.myfico.com/credit-education/credit-scores"](https://www.myfico.com/credit-education/credit-scores)].

¹⁶⁷ Stefani Wendel, State of Credit 2020: Consumer Credit During COVID-19, Available at [[HYPERLINK](https://www.experian.com/blogs/insights/2020/10/state-credit-2020/) ["https://www.experian.com/blogs/insights/2020/10/state-credit-2020/"](https://www.experian.com/blogs/insights/2020/10/state-credit-2020/)]. VantageScore breaks the bottom range into two categories – deep subprime (or bad credit) from 300 to 499 and poor credit from 500 to 600.

Short-term loans – overdrafts, payday loans, pawnshops, personal loans

Most borrowers need not look for short term loans, because they have alternatives available from numerous sources, and can tap them as easily as swiping a credit card. Anyone who has a credit card can obtain an advance for fifteen days, a few months, or a few years, and people with FICO scores in the mid-600s or above can typically qualify for cards. Their options for short-term loans are virtually unlimited.

For consumers with the lowest scores or thinnest files, however, the options are more likely limited to short-term, small-dollar loans. The poorest credit risks, like their predecessors a century ago, often unbanked or underbanked, may have to choose among the lenders who specialize in short-term credit. These are the businesses that make installment loans, pawn loans, vehicle title loans, and payday loans. As noted in Chapter 3, these products together amounted to about \$75 billion in recent years, a small fraction of the \$4 trillion in consumer debt outstanding. Similarly small is the proportion of households using these loans; it is under two percent for each type.

Nonetheless, the providers are abundant, counting in the tens of thousands, and the sector is sometimes criticized for being *too* competitive. A common comment about the estimated 18,000 payday lenders is that they are more ubiquitous than McDonald's or Starbucks.¹⁶⁸ Indeed, a payday loan office requires less capital and fewer employees than a typical McDonalds restaurant. However, regulatory restrictions have eliminated entry where it might have occurred by imposing interest rate limits that make such loans unprofitable even at the modest cost of a strip-mall storefront. Restrictions aside, entry barriers are nonexistent, which explains why the number of providers, like their counterparts in the early twentieth century, remains high.

In addition to payday lenders, borrowers with few other options have access to some 10,000 pawnshops according to the National Pawnbrokers Association. Significant overlaps in product characteristics and prices among pawnshops, payday lenders, and overdraft protection services. Some research has found rates to be comparable,¹⁶⁹ which suggests the three may be in one market. Casting doubt on these implications are surveys that indicate payday borrowers seldom consider pawnshops.¹⁷⁰ The ability of banks to compete for small-dollar, short-term loans may have been hampered by regulations from both OCC (on the direct front) and CFPB (with overdraft rules) in their efforts to enter. P2P and personal networks may be available to those who cannot access any of these

¹⁶⁸ NGPF, [<https://www.ngpf.org/blog/question-of-the-day/which-business-has-the-most-physical-locations-in-the-us-mcdonalds-payday-lenders-or-starbucks/>] .

¹⁶⁹ Not found in the resources reviewed to date is an accounting for the cost of convenience of the three options. Payday convenience for example, may be worth more than the difference interest payments, while security forfeitures, if factored into interest rates, would increase borrowing costs at pawnshops.

¹⁷⁰ Cite.

sources. These sources are too new and too difficult to measure to allow for confident predictions.

On the question whether payday loans compete with other types of loans, Durkin, et al. report that significant interinstitutional competition arose after the relaxation of rate ceilings and other restrictions in the 1980s and 1990s.¹⁷¹ Evidence for that competition was described in a 2013 article:

Competition benefits consumers in the alternative consumer credit markets just as it does in any other market, providing consumers with the opportunity for lower prices, innovation, and higher-quality service. Although prices seem high for both payday loans and overdraft protection, there is no evidence that either product generates sustainable economic profits (as opposed to normal economic returns). Payday loan prices generally reflect underlying risk and operating costs. There is no evidence of supranormal economic (or monopoly) returns to firms in the payday lending industry, indicating the competitive nature of the market. Barriers to entry in the payday lending market appear to be low.¹⁷²

Competition between payday lenders and less expensive sources of credit might be more robust, but for barriers that prevent entry into the payday space. Since 2003, OCC has discouraged banks from offering short-term, small-dollar loans. When banks tried to compete anyway, for example by offering overdraft protection, the Fed restricted those efforts with additional restrictions in 2009. The effects were immediate, according to Evans, Litan, and Schmalensee, who found, “within days” of the Fed’s announcement of its new overdraft rules, banks started scaling back access to free checking, imposed new fees, and eliminated services for consumers.¹⁷³

Some banks still offer overdraft protection and direct-deposit-advance products that may compete with small-dollar lending.¹⁷⁴ Consumers who opt in to such services tend to be credit constrained: compared to others, they have lower credit scores, are less likely to have a general-purpose credit card, and more likely to have low limits on cards they do

¹⁷¹ CCAE at 506-509.

¹⁷² Clarke and Zywicki, PAYDAY LENDING, BANK OVERDRAFT PROTECTION, AND FAIR COMPETITION AT THE CFPB, Review of Banking & Financial Law, Vol. 33, No. 1, pp. 235-281, at 258 (2013).

¹⁷³ Id. at 263 (citations omitted).

¹⁷⁴ CFPB, CFPB Study of Overdraft Programs: A White Paper of Initial Data Findings (June 11, 2013), available at [[HYPERLINK "https://files.consumerfinance.gov/f/201306_cfpb_overdraft-practices.pdf"](https://files.consumerfinance.gov/f/201306_cfpb_overdraft-practices.pdf)]. (“Between 20% and 27% of accounts opened in 2011 had one or more overdraft or NSF transaction. ...Between 13.5% and 27.8% of accounts with at least one overdraft or NSF transaction had at least 10 such transactions.”)

have.¹⁷⁵ Payday borrowers display similar profiles. In markets where banks offer these products, borrowers may benefit from the additional competition. And some credit unions offer payday alternative loans, or PALs, which typically run for longer terms at lower rates.¹⁷⁶

Online information available to consumers suggests that pawns, personal loans, and payday loans may be alternatives to one another. According to Credit Karma, the average pawnshop loan is \$150, and pawnshops are no longer confined to inconspicuous storefronts and strip malls. Online sites will pawn items worth hundreds (or, they claim, millions) of dollars. For consumers considering a pawnshop, however, Credit Karma, a marketer that combines advertising with advice, suggests peer-to-peer options, negotiating extensions with current creditors, and approaching neighbors and friends. In a clue that a payday loan is another alternative to these sources, Credit Karma cautions against it because they are “terribly costly.”¹⁷⁷ With the advice comes advertising for numerous short-term and medium-term loans for the consideration of the potential payday shopper. Information about products and providers eager to offer them is plentiful on the site, one of many that borrowers can check for alternatives to payday loans.

Payday loans may be costly, but cost depends on context and by itself reveals little about competition. Starbucks and McDonalds cost more than other chains and home preparation, and much less than full-service restaurants, all of which contend with constant competition. None would make economic sense to consumers as a sole source for food. Neither would a hotel room, which has dropped below an average of \$100 in 2020 under pressure from home rentals and depressed travel. A \$100 nightly rate is a bargain by historical standards, translates into an annual rate of \$36,500. A seemingly exorbitant annual cost of a product or service that is acquired for occasional use does not indicate misguided consumers or malfunctioning markets.

Surveys of small-loan borrowers found that they considered various options to obtain short-term credit, including skipping payments to existing creditors, borrowing from family, overdrawing their bank account, and taking out a small-dollar loan.¹⁷⁸ Academic research described in Chapter 10 has found that bans on payday loans cause customers to shift to these options; and in states that ban the loans consumers also cross borders to borrow if neighboring states permit them. That consumers resort to these options does not

¹⁷⁵ CFPB, Data Point: Frequent Overdrafters (Aug. 4, 2017), available at [[HYPERLINK "https://www.consumerfinance.gov/documents/5126/201708_cfpb_data-point_frequent-overdrafters.pdf"](https://www.consumerfinance.gov/documents/5126/201708_cfpb_data-point_frequent-overdrafters.pdf)].

¹⁷⁶ Liz Weston and Amrita Jayakumar, “What Is a Payday Alternative Loan?” Nerdwallet, December 3, 2019 available at [[HYPERLINK "https://www.nerdwallet.com/article/loans/payday-alternative-loan-pal"](https://www.nerdwallet.com/article/loans/payday-alternative-loan-pal)]

¹⁷⁷ Anna Baluch, “Is a pawn shop loan a good idea for quick cash?” Credit Karma, Updated July 19, 2019, [[HYPERLINK "https://www.creditkarma.com/personal-loans/i/pawn-shop-loans/"](https://www.creditkarma.com/personal-loans/i/pawn-shop-loans/)].

¹⁷⁸ Advance America, “CFPB Small Dollar Rule and Consumer Choice,” [[HYPERLINK "https://www.advanceamerica.net/news/consumer-issues/cfpb-small-dollar-rule-and-consumer-choicee"](https://www.advanceamerica.net/news/consumer-issues/cfpb-small-dollar-rule-and-consumer-choicee)]

itself indicate that they are all good substitutes. When a service is unavailable altogether, consumers may settle for inferior options they would not have chosen in a competitive market. A survey commissioned by the industry lends some support to the superiority of payday loans over their closest alternatives. Almost 75 percent of the small-loan or payday borrowers surveyed said they could not find an alternative when they took out their last loan.¹⁷⁹ These are borrowers who either had reached their credit limits or could not secure credit cards, installment loans, second mortgages and other loans offering more attractive terms. For people in these circumstances, like the small-dollar borrowers of a century ago, competition within the sector may be the last line of consumer protection available.

Medium Term Credit – Credit Cards, Lines of Credit, Installment Loans

For consumers who are considered good to excellent credit risks, the marketplace for loans is vast. The largest contributor to the growth of consumer credit held by banks has been the bank credit card. At the time of the Commission's report, revolving credit at retailers far exceeded the amount on bank cards. Today the positions are reversed. Numerous factors explain these trends, starting with convenience. Consumers who once carried cards for gas stations, department stores, travel companies, and specialty retailers have gradually lightened their load of plastic to a few favorites – commonly including a bank card that could substitute for the other accounts.

Most of the products in this category can substitute for products in the other two. Consumers who qualify for any of the medium-term loans are likely to be sufficiently creditworthy to avail themselves of any of the options in the category as well as any of the short-term options FICO scores. Marketing makes it clear that banks and finance companies are competing across their sector boundary and offering consumers alternatives to credit-card debt. Comparative advertising is often an indication of products that are likely substitutes for one another, and such advertising is plentiful. As an example, one of the top online lenders makes an appeal to card holders that leaves little doubt that an installment loan is an alternative to credit card balances.¹⁸⁰

Commented [ML(8): This does not mention or address the issue frequently raised by advocates about the excessive fees and rates that often lock a payday borrower into a lengthy high cost cycle they can't get out of, where what they were looking for was a simple short term solution.

¹⁷⁹ PR Newswire, Payday Borrowers Are Far More Favorable Toward and Informed About Payday Loans than Voters without Payday Loan Experience (March 14, 2016), [[HYPERLINK "https://www.prnewswire.com/news-releases/new-survey--payday-borrowers-are-far-more-favorable-toward-and-informed-about-payday-loans-than-voters-without-payday-loan-experience-300235446.html"](https://www.prnewswire.com/news-releases/new-survey--payday-borrowers-are-far-more-favorable-toward-and-informed-about-payday-loans-than-voters-without-payday-loan-experience-300235446.html)]

¹⁸⁰ Rocket Loan Home Page, [[HYPERLINK "https://www.rocketloans.com/"](https://www.rocketloans.com/)] Accessed on September 3, 2020.
[PAGE * MERGEFORMAT]

Rocket Loans Personal Loan		High-Interest Credit Cards	
Loan Amount	\$10,000.00	Loan Amount	\$10,000.00
Monthly Payment	217.42	Monthly Payment	217.42
Origination Fee	500.00	Origination Fee	N/A
Interest Rate	11.00%	Interest Rate	12.99%
APR	13.26%	APR	16.00%
Time to Pay Off	5 years	Time to Pay Off	6 years
Finance Charge	\$3,545.45	Finance Charge	\$5,594.23
-\$2,548.78 Less in interest		+\$2,548.78 More in interest	

It is conceivable that a comparison of alternative sources of credit could determine that credit cards would not qualify as a market solely on the basis of consumer demand for loans. Nonetheless because bank cards have gained such a large share of consumer credit, it is useful to consider the competition just among credit cards. Different cards offer a wide variety of interest rates and other terms. Cards from credit unions routinely offer better rates. The industry makes hundreds of millions of offers a year, enticing consumers to try new cards with lower fees, lower interest rates, more bonuses, and other attractive features. Merchants still take advantage of the opportunity at checkout to offer charge accounts. Consumers routinely acquire new cards to pay off more expensive debts.

Installment Loans

The National Installment Lenders Association stresses differences between installment, payday, and title loans – an indication of competition across the short-term and mid-term categories of credit:

These products are about as different as two products could be. [P]ayday companies do not test the ability to repay the loan from cash flow...loans are typically of two weeks or one month's duration, and are payable in one lump sum....Data on these loans is not accepted by any major credit bureau. By contrast, Traditional installment lenders do test the ability to repay, and the loans are payable in equal installments of principal and interest, giving the borrower a clear and manageable roadmap out of debt. Installment loans are reported to the

credit bureaus, enabling responsible borrowers to build or repair their credit.”¹⁸¹

Credit Karma – an information and search engine for credit services returns four companies with eleven options to an inquiry for a personal loan.¹⁸² The APRs for a shopper (presumably anonymous and unscreened) ranged from 18% to over 30%. Clicking a link for a lender allows one to apply for a loan. The ease of searching for loans, comparing offers, and securing funds with an online session, at rates approximating credit card rates, is an indication of competition, especially for those consumers with lower credit scores and in need of short-term cash.

That installment loans attract multiple grades of borrowers and multiple sources of lenders suggests that they present alternatives for consumers considering many purposes. Characterized by one study as credit for the non-prime working classes, but better risks than payday borrowers, the business has grown dramatically. Non-prime borrowers owe an estimated \$50 billion on installment loans, borrowed from lenders that have avoided the public opprobrium and regulatory backlash that payday lenders have attracted.¹⁸³

Long Term Products – Automobiles, Mortgages

Lending for automobile purchases was found competitive by the Commission in 1970, and it appears to be so today. Auto loans may constitute a relevant market, given the maturities and securities involved. Car buyers may cross sector borders and borrow funds from other sources of secured loans (such as second mortgage lenders), but unsecured loans are likely to be significantly more expensive than a loan backed by the security of a lien on the vehicle. Auto loans can come from banks, credit unions, thrifts, manufacturers, and the dealers themselves (although auto dealers typically act as middlemen for other institutions that provide credit). Academic research reflects what is obvious from ubiquitous advertising – consumers have abundant choices for auto credit, and knowledge of options and prices is relatively high.

Some studies that have focused on the effects of borrower qualifications and demand characteristics have found that opportunities for exploiting customers arise in the personal negotiations that attend an automobile purchase. One study concluded that consumers are more sensitive to maturity and payment size than interest rates, which means that some end up paying more than others with similar qualifications.¹⁸⁴ A 2010

¹⁸¹ [[HYPERLINK "https://nilaonline.org/fundamentals/"](https://nilaonline.org/fundamentals/)] (internal notations deleted).

¹⁸² [[HYPERLINK "https://www.creditkarma.com/shop/personal-loans"](https://www.creditkarma.com/shop/personal-loans)] "newloans"]

¹⁸³ Profile from Payments Journal, The Ugly Side of Lending: Online Installment Loans [[HYPERLINK "https://www.paymentsjournal.com/the-ugly-side-of-lending-online-installment-loans/"](https://www.paymentsjournal.com/the-ugly-side-of-lending-online-installment-loans/)]

¹⁸⁴ Bronson Argyle, Taylor Nadauld, Christopher Palmer, Monthly Payment Targeting and the Demand for Maturity, NBER Working Paper No. w25668 19 Mar 2019 MIT Sloan; National Bureau of Economic Research (NBER)

study of negotiations for auto loans found that search costs, incomplete information, and distaste for bargaining leave consumers worse off.¹⁸⁵ The authors estimated better informed consumers captured 15% of the average dealer margin from selling an automobile. Nonetheless a substantial group of consumers did not arm themselves with the information that would have saved them that money. Whether and to what extent the results stemmed from aversions to negotiating was beyond the scope of the study, but the persistently higher dealer rates for auto loans cited in the Commission's report suggests that consumer preferences may have played a role.

The longest terms that consumers consider for loans are typically in mortgages loans for the homes they buy. Recent studies of mortgage loans describe an unconcentrated sector experiencing dynamic activity and compressed profits. Independent mortgage bankers are gaining market share, and profit margins are declining across the board, according to one study.¹⁸⁶ A Note by economists at the Fed found the relevant markets for mortgages to be nationwide and mortgage rates to be unrelated to local concentration, which itself was low in most areas.¹⁸⁷ Consumers do not place much importance on the location of a mortgage lender, according to the Fed's Surveys of Consumer Finances, and over half of the mortgages are originated by nonlocal lenders. Perhaps most striking about the state of competition in the mortgage market is that online and independent companies have displaced traditional sources as the leading lenders. Table __ shows the top 25 in 2019. The largest originator of home purchase and refinance loans is an online company, and 15 of the top 25 are independents. Twenty five lenders in a national market would suggest a low level of concentration; in fact the top 25 do not account for half of all originations. In short, mortgage lenders compete in a market that appears to be competing vigorously.

¹⁸⁵ i. Economics of Auto Loans – Scott Morton, F., Silva-Risso, J. & Zettelmeyer, F. What Matters in a Price Negotiation: Evidence From the U.S. Auto Retailing Industry. Quant Mark Econ (2011) 9: 365. doi:10.1007/s11129-011-9108-1, available at [[HYPERLINK "https://link.springer.com/article/10.1007/s11129-011-9108-1"](https://link.springer.com/article/10.1007/s11129-011-9108-1)]

¹⁸⁶ Michael Fratantoni, "Mortgage Market Dynamics: Competition and Evolution," The Journal of Structured Finance Winter 2019, 24 (4) 34-42, Available at, <https://jsf.pm-research.com/content/24/4/34>.

¹⁸⁷ Dean Amel, Elliot Anenberg, and Rebecca Jorgensen, "On the Geographic Scope of Retail Mortgage Markets," June 15, 2018

Table . Top 25 respondents in terms of total originations, 2019¹⁸⁸

		Institution type	Total originations (thousands)	Total purchases (thousands)	Number (thousands)	Percent Sold
1.	QUICKEN LOANS INC.	Ind. mort. co.	541	2	134	99.9
2.	UNITED SHORE FINANCIAL SERVICES, LLC	Ind. mort. co.	339	0	152	100.0
3.	Wells Fargo Bank, National Association	Large bank	232	349	112	70.3
4.	JPMorgan Chase Bank, National Association	Large bank	168	152	65	78.3
5.	FAIRWAY INDEPENDENT MORTGAGE CORPORATION	Ind. mort. co.	147	0	94	99.9
6.	LOANDEPOT.COM, LLC	Ind. mort. co.	146	0	52	99.8
7.	CALIBER HOME LOANS, INC.	Ind. mort. co.	136	78	71	99.2
8.	Bank of America, National Association	Large bank	134	13	62	18.3
9.	FREEDOM MORTGAGE CORPORATION	Ind. mort. co.	110	59	24	94.5
10.	U.S. Bank National Association	Large bank	94	96	38	68.5
11.	GUARANTEED RATE, INC.	Ind. mort. co.	86	1	49	99.9
12.	GUILD MORTGAGE COMPANY	Ind. mort. co.	85	2	47	99.9
13.	Nationstar Mortgage LLC	Ind. mort. co.	84	87	12	77.9
14.	Flagstar Bank, FSB	Large bank	75	34	37	92.5
15.	MOVEMENT MORTGAGE, LLC	Ind. mort. co.	69	0	47	76.4
16.	NAVY FEDERAL CREDIT UNION	Credit union	68	0	46	58.5
17.	Mortgage Research Center, LLC	Ind. mort. co.	66	0	51	100.0
18.	USAA Federal Savings Bank	Large bank	64	0	41	99.5
19.	PRIMELENDING, A PLAINSCAPITAL COMPANY	Affiliated mort. co.	59	1	41	100.0
20.	BROKER SOLUTIONS, INC.	Ind. mort. co.	57	0	29	95.5
21.	PNC Bank, National Association	Large bank	53	1	15	73.2
22.	HOMEBRIDGE FINANCIAL SERVICES, INC.	Ind. mort. co.	53	0	20	99.0
23.	CROSSCOUNTRY MORTGAGE, LLC	Ind. mort. co.	51	0	33	99.8

¹⁸⁸ CFPB, “Data point: 2019 mortgage market activity and trends,” JUN 24, 2020, Table 11.

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24.	FINANCE OF AMERICA MORTGAGE LLC	Ind. mort. co.	49	0	26	99.9
25.	Citizens Bank, National Association	Large bank	49	48	25	83.7
	Top 25 institutions	...	3,015	922	1,322	88.1
	All Institutions	...	8,111	2,072	3,738	84.7

Information – Credit Reports and Credit Scores

A consistent theme that runs through the history of credit is the importance of information. For the creditor, information about the borrower governs whether to lend and how much to charge. For the borrower, information about creditors is the catalyst that triggers competition among them. The benefit of knowledge that results from repeat business explains the resilience of pawnbrokers. Merchants were pioneers of credit, thanks to their familiarity with customers. Human relationships explain the rise of immigrant banks, credit unions, Morris Plan Banks, and other institutions that thrived when commercial banks concentrated on companies and wealthy clientele.

The advantages of information continue to accrue today. A recent study found that “payments generate roughly 90 percent of banks’ useful customer data.”¹⁸⁹ Another study demonstrated that banks can mitigate risk on their customers’ credit cards by using information from those customers’ other accounts. The banking relationship is an advantage that other card issuers do not share.¹⁹⁰

Regardless of relationship, a lender or merchant will see only a fraction of the economic activity of a prospective customer, and millions of credit decisions are made without the benefit of any prior relationships. For these reasons, the demand for information on creditworthiness has existed for centuries and has supported a thriving market since before the Civil War. Credit reporters, including the predecessors of Dunn & Bradstreet, were big businesses in the middle of the nineteenth century. The Bureau described the functions and importance of the modern credit reporting industry in a 2012 Review:

In most of the markets for consumer credit, including credit cards, auto loans, mortgages, and student loans, lenders use credit reports as part of their evaluation of a consumer’s application for credit. Companies use credit reports and credit scores derived from the information in credit reporting files to assess a consumer’s likelihood of repaying the loan.... Underwriting processes stipulated

¹⁸⁹, McKinsey (2019)

¹⁹⁰ Sumit Agarwal, Souphala Chomsisengphet, Chunlin Liu, Changcheng Song, Nicholas S. Souleles, “Benefits of relationship banking: Evidence from consumer credit markets,” Journal of Monetary Economics Volume 96, June 2018, Pages 16-32, available at [HYPERLINK “<https://www.sciencedirect.com/science/article/abs/pii/S0304393218300928>”].

by the FHA, VA, Fannie Mae, and Freddie Mac require mortgage lenders to obtain credit reports from a nationwide credit reporting agency (the NCRAAs) before these federal agencies and government-sponsored enterprises will insure, guarantee, or purchase their loans. For each of these forms of credit and origination channels, credit reports are used by lenders to help set interest rates and other key credit terms, or determine whether the consumer is offered credit at all. Of 113 million credit card and retail card accounts, auto loans, personal loans, mortgages, and home equity loans originated in the United States in 2011, the vast majority of approval decisions used information furnished by credit reporting agencies.¹⁹¹

Writing in 1972 when computers and data storage were expensive, primitive and rare, the NCCF worried that providers of credit information might need to be regulated as public utilities. The theory was that competition would be no more likely to work in credit reporting than in telephone service; one company per region would be more efficient.¹⁹² Technology proved the Commission wrong, both for telephones and for credit reports. Advances in data processing and reductions in the cost of data have given plenty of room for competition to work in the sector. How well competition has worked is the question we consider next.

With respect to the collection and reporting of information, the performance of the sector has generated mixed reviews and frequent complaints. A 2012 Federal Trade Commission study found that 26 percent of consumers surveyed had identified potentially material errors in their credit reports. When the errors were corrected, half of those consumers (13 percent of all surveyed) saw a change in their credit score, and nearly half of them saw enough of a change to improve the terms they could get for loans.¹⁹³ The Commission conducted a follow-up study in 2015, and it found that two thirds of the consumers who had disputed information in their reports were still in their disputes. This prompted the recommendation that the CRAs improve their dispute-

¹⁹¹ CFPB, Key Dimensions and Processes in the U.S. Credit Reporting System: A review of how the nation's largest credit bureaus manage consumer data, (2012), available at [[HYPERLINK "https://files.consumerfinance.gov/f/201212_cfpb_credit-reporting-white-paper.pdf"](https://files.consumerfinance.gov/f/201212_cfpb_credit-reporting-white-paper.pdf)].

¹⁹² It appears to the Commission that in the long run the credit reporting industry has the ingredients of a public utility. It is as uneconomical to have three credit bureaus in town as it is to have three telephone companies. The necessity for accurate and comprehensive credit data, tile technology, the mobility of the population, and the emergence of the multiparty credit card · all argue for a single credit reporting agency for each metropolitan area linked with similar agencies throughout tile nation." Report at 213.

¹⁹³ Release, In FTC Study, Five Percent of Consumers Had Errors on Their Credit Reports That Could Result in Less Favorable Terms for Loans, February 11, 2013, available at [[HYPERLINK "https://www.ftc.gov/news-events/press-releases/2013/02/ftc-study-five-percent-consumers-had-errors-their-credit-reports"](https://www.ftc.gov/news-events/press-releases/2013/02/ftc-study-five-percent-consumers-had-errors-their-credit-reports)]

resolution procedures.¹⁹⁴ At the Bureau, credit and consumer reporting generate the most complaints of any category, twice as many as debt collectors, and four times as many as credit cards in 2019.¹⁹⁵ Consumer lawsuits have forced the CRAs to change practices.¹⁹⁶

In the context of 1.3 billion monthly tradelines coming in from 10,000 sources and populating files on over 200 million consumers, the numbers of complaints about inaccuracies may reflect a sector performing well or revealing room for improvement. Inaccuracies are inevitable, and the sheer volume of data means that a vanishing fraction of mistakes will still add up. What is missing from these large databases may be more revealing. In 2010, 26 million consumers (11 percent of the adult population) had no credit records at the NCRAAs. Another 19 million (8.3 percent) had credit files that were too thin to generate a reliable credit score.¹⁹⁷ The proportions are higher among blacks, Hispanics, and residents of poorer neighborhoods. It well recognized that the credit invisibles engaged in economic activity that generates useful information on creditworthiness. Their problem is that the information is not reaching the NCRAAs, so it is not generating reports that could put millions of consumers on the path to better credit.¹⁹⁸ That untapped information known as alternative data, and it appears to be an opportunity that competitors would seize to gain an advantage in the marketplace.

That some competitive improvement might be attainable is suggested by the competitive structure and dynamics in the sector. Three firms dominate the collection and reporting of consumer information. For general credit decisions, customers typically purchase reports from all three, diminishing the incentive of any to underbid or outperform the others. For the lender, a second or third report about a borrower can be expected to unearth some marginal information that the first one or two did not contain, but the benefit of that additional information is not likely to be large, so the marginal report will command a correspondingly marginal price.

It is in specialized applications involving expensive transactions that competition intensifies, because lenders pay premiums to CRAs for reports that are customized to the

¹⁹⁴ See, Release, “FTC Issues Follow-Up Study on Credit Report Accuracy January 21, 2015, available at <https://www.ftc.gov/news-events/press-releases/2015/01/ftc-issues-follow-study-credit-report-accuracy>.

¹⁹⁵ CFPB, Consumer Response Annual Report, available at https://files.consumerfinance.gov/f/documents/cfpb_consumer-response-annual-report_2019.pdf.

¹⁹⁶ FDIC, New Standards for Credit Report Accuracy May Help Consumers, FDIC Consumer News – Winter 2018, available at, [[HYPERLINK "https://www.fdic.gov/consumers/consumer/news/cnwin18/creditreports.html"](https://www.fdic.gov/consumers/consumer/news/cnwin18/creditreports.html)].

¹⁹⁷ Office of Research, CFPB, “ Data Point: Credit Invisibles,” available at [[HYPERLINK "https://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf"](https://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf)]

¹⁹⁸ Release, “CFPB Explores Impact of Alternative Data on Credit Access for Consumers Who Are Credit Invisible,” FEB 16, 2017, available at <https://www.consumerfinance.gov/about-us/newsroom/cfpb-explores-impact-alternative-data-credit-access-consumers-who-are-credit-invisible/>.

lenders' markets. Alternative data that could create distinctions among basic reports may create opportunities for rivalry among CRAs to break out.

While the national credit reporting market would be considered highly concentrated, the structure of the market does not approach the concentration that characterizes the provision of credit scores. The dominant provider of credit ratings, FICO, boasts that it has been used in 90% of transactions. It cites a release from the Mercator Advisory Group,¹⁹⁹ which reported:

New research from Mercator Advisory Group has found that in the United States, FICO® Scores were in 2016 used in more than 90% of lending decisions, including credit cards, mortgages, and automobile financing. In addition, Mercator performed a study of the frequency in 2016 and 2017 of FICO Score usage in the securitization process for U.S. asset-backed securities (ABS) backed by automobile leases, credit cards, prime auto loans, and subprime auto loans. *The study found that ABS securitizations in those four verticals almost universally cite the FICO Score.*

A 90 percent share of a market is considered a monopoly. By itself, a monopoly does not suggest a failure of competition. A dominant firm could be the result of a competition in which it has won its share by dint of superior performance. However, reasons to question this explanation arise from the nature of information and litigation involving efforts by FICO to prevent entry by others into the credit scoring business. There is no inherent reason why a single rating service should command universal allegiance. In other industries, ratings have gained and lost favor; some of the market leaders today did not exist with the FICO score was introduced: Open Table (1998), Rotten Tomatoes (1998), Yelp (2004), for example.

A potential contender to FICO has had less success. In 2006, the NCRAAs formed a joint venture to introduce VantageScore, and offered it to key lenders at a reduced price to build momentum for the alternative to the FICO score. FICO sued them that same year, claiming that they had violated the antitrust laws and violated its trademark relating to the bounds of its score, "300-850". The litigation lasted five years, until a court of appeals affirmed a summary judgment that the antitrust laws did not prohibit the NCRAAs from competing with FICO and affirmed a jury verdict that the trademark was invalid, because it was descriptive and obtained by fraud on the US Patent and Trademark Office.²⁰⁰

¹⁹⁹ Although not clear, the study appears to be sponsored by FICO [[HYPERLINK "https://www.mercatoradvisorygroup.com/Press_Releases/FICO%C2%AE_Scores_Used_in_Over_90_of_Lending_Decisions_According_to_New_Study/"](https://www.mercatoradvisorygroup.com/Press_Releases/FICO%C2%AE_Scores_Used_in_Over_90_of_Lending_Decisions_According_to_New_Study/)] (emphasis added)

²⁰⁰ Fair Isaac Corporation, et al v. Experian Information Solutions, et al, 332 F.3d 1150 (8th Cir. 2011).

That defeat did not end the legal disputes between FICO and the CRAs. In more recent litigation, competitors and customers have alleged that FICO has used exclusionary agreements in order to maintain a monopoly in credit scoring.²⁰¹ A court has ruled in one case that FICO's contracts prohibiting CRAs from selling ratings with metrics similar to its score and penalizing customers from buying competitors' ratings, were adequate to allege illegal monopolization.²⁰² This year FICO announced that the Antitrust Division of the Department of Justice has opened an investigation, into "potential exclusionary conduct."²⁰³

Entry into the credit rating business has been hindered by government policy and actions. Fannie Mae, Freddie Mac, and CFPB have favored the dominant supplier. Until recently a prerequisite for selling a loan to a Government Sponsored Entities was a FICO score, which gave FICO a virtual lock on mortgage markets and may explain why numerous companies have offered ratings, but none has gained significant market share. The most likely entrants, the National Credit Reporting Agencies, which individually offer ratings as well as their joint VantageScore, were sued by the CFPB for advertising (allegedly deceptively) that their scores were comparable to FICO.²⁰⁴ Since the cases settled, the record does not reveal whether the differences were material to consumers.

More recently, Fannie Mae and Freddie Mac have softened their resistance to ratings from FICO competitors, but it is too soon to tell if the new policy will introduce more competition. Concentration at monopoly levels, allegations about exclusionary conduct by the dominant provider, and regulatory actions that impeded entry contribute to significant concerns about competition in this sector.

As the courts weigh the merits of competitive practices in the markets for credit information, markets themselves face disruption as potential entrants from the technology sector take advantage of data from their own customer relationships. The Bank for International Settlements (BIS) sees preliminary indications that big-tech firms are threatening both banks and CRAs:

²⁰¹ [HYPERLINK "<https://www.eutimes.com/2020/05/12/credit-unions-sue-fico-for-alleged-antitrust-violations/?slreturn=20201015230658>"]
"...text=Three%20credit%20unions%20are%20suing%20the%20Fair%20Isaac,which%20harmed%20businesses%20and%20led%20to%20higher%20prices"]; Complaint, *Holmes County Bank and Trust Company v. Fair Isaac Corporation*, N.D. Ill. Case: 1:20-cv-03395 Document #: 1 Filed: 06/09/20 Page 1 of 41 PageID #:1, available at <https://classactionsreporter.com/wp-content/uploads/Fair-Issac-FICO-Credit-Scores-Antitrust-Compl.pdf>.

²⁰² *Fair Isaac Corporation v. Trans Union, LLC*, 1:2017cv08318 - Document 97 (N.D. Ill. 2019).

²⁰³ [HYPERLINK "<https://www.politico.com/news/2020/03/13/justice-fair-isaac-antitrust-129204>"] "FICO Statement Regarding Antitrust Investigation," March 15, 2020, available at [HYPERLINK "<https://www.fico.com/en/newsroom/fico-statement-regarding-antitrust-investigation>"].

²⁰⁴ See, Release, CFPB Orders TransUnion and Equifax to Pay for Deceiving Consumers in Marketing Credit Scores and Credit Products / Credit Reporting Companies Misstated the Cost and Usefulness of the Credit Scores and Products They Sold, Lured Consumers into Costly Recurring Payments (Jan 03, 2017).

[B]ig techs can have a competitive advantage over banks and serve firms and households that otherwise would remain unbanked. They do so by tapping different but relevant information through their digital platforms. For example, Ant Financial and Mercado Libre claim that their credit quality assessment and granting of loans typically involve more than 1,000 data series per loan applicant. Recent BIS empirical research also suggests that big techs' credit scoring applied to small vendors outperforms models based on credit bureau ratings and traditional borrower characteristics (Box III.B). All this could represent a significant advance in financial inclusion and help improve firms' performance.²⁰⁵

Deposits and payments

In 1972, the most elementary financial transaction meant a trip to a teller. In that respect, the experience fifty years ago did not differ from the beginning of the twentieth century (except that the teller would have been in an institution other than commercial bank). Today, consumers no longer need to travel to a bank, a branch, or even an ATM to access sophisticated financial services. According to the American Bankers Association,²⁰⁶ 70 percent of U.S. consumers used a mobile device to manage their bank account at least once in September 2019, and a third of U.S. adults used a mobile app to make a payment or transfer money in the year. More often than not, the app they chose did not come from their bank. Payment volume on PayPal and Venmo outpaced activity on the banks' apps. Apple Pay and Starbucks were also well established as alternative payment providers. The advent of these technologies is allowing a new type of bank to enter the market, a bank without any physical retail locations. One survey estimated that 30 percent of the US population either has opened or plans to open an account at an online-only bank.²⁰⁷

Competition authorities and experts have examined payment systems and expressed concern that the markets have not kept up with the demands of consumers. The OECD, for example, published the results of a 2012 roundtable on competition and payment systems.²⁰⁸ The assembly saw need for improvement but was uncertain about how to proceed:

²⁰⁵ BIS, Annual Economic Report 2019 at 65 (internal citations omitted), available at [[HYPERLINK
"https://www.bis.org/publ/arpdf/ar2019e.htm"](https://www.bis.org/publ/arpdf/ar2019e.htm)].

²⁰⁶ Release, Survey 95 Percent of Consumers Give High Marks to Digital Banking, November 13, 2019, available at [[HYPERLINK
"https://www.aba.com/about-us/press-room/press-releases/Survey-95-Percent-of-Consumers-Give-High-Marks-to-Digital-Banking"](https://www.aba.com/about-us/press-room/press-releases/Survey-95-Percent-of-Consumers-Give-High-Marks-to-Digital-Banking)].

²⁰⁷ Liz Kneueven, Online banking isn't just for millennials anymore — it's quickly becoming the norm Nov 14, 2019, available at [[HYPERLINK
"https://www.businessinsider.com/personal-finance/online-banking-gaining-popularity-united-states"](https://www.businessinsider.com/personal-finance/online-banking-gaining-popularity-united-states)].

²⁰⁸ OECD Policy Roundtables / Competition and Payment Systems (2012) available at [[HYPERLINK
"http://www.oecd.org/competition/PaymentSystems2012.pdf"](http://www.oecd.org/competition/PaymentSystems2012.pdf)]
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The ongoing shift from cash and paper towards electronic payment systems potentially brings large economic benefits. But card payments in particular have remained expensive for merchants, and regulation may have unintended consequences. There is no consensus among economists and policymakers on what constitutes an efficient fee structure for card-based payments, and it is not clear if payment competition might do the trick. Regulation should be geared towards removing barriers of entry in payment markets and banning merchant (pricing) restrictions. The discussion reviewed recent countries' experiences on developments regarding all non-paper based forms of payment such as debit and credit cards, and E-payments (through internet, mobile phones etc.). Many members are investigating these markets, and EU jurisdictions are implementing the EU payments service directive, which aims to provide a single market for payments.

Some of those investigations had resulted in enforcement actions. In the United States, credit cards were found to constitute relevant markets for the payment services they provide. One court held that Visa and MasterCard had restrained competition in those markets,²⁰⁹ and the government secured an order designed to restore competition. The Department of Justice released this description of the case:²¹⁰

Credit card acceptance costs U.S. merchants approximately \$35 billion each year. Those costs are collected from merchants in the form of a “swipe fee” they pay every time a credit card is used.... Merchants pass on these billions of dollars in fees to all their consumers in the form of higher retail prices. By preventing merchants from rewarding consumers when they use less expensive credit cards to make a purchase, American Express, MasterCard and Visa have inhibited merchants’ ability to reduce card acceptance costs, and therefore their retail prices to consumers.

The proposed settlement requires Visa and MasterCard to allow merchants to offer discounts, rebates, or discounted products and services to consumers for using other

²⁰⁹ United States v. Visa USA, Inc., 163 F. Supp. 2d 322 (S.D.N.Y. 2001) (“The proof demonstrates that [Visa and Mastercard] do weaken competition and harm consumers by: (1) limiting output of [rival] cards in the United States; (2) restricting the competitive strength of [rivals] by restraining their merchant acceptance levels and their ability to develop and distribute new features such as smart cards; (3) effectively foreclosing [rivals] from competing to issue off-line debit cards..., and (4) depriving consumers of the ability to obtain credit cards [with] different qualities, characteristics, features, and reputations.); See also, **Ohio v. American Express**, 585 US ___ (2018).)

²¹⁰ Release, Justice Department Sues American Express, Mastercard and Visa to Eliminate Rules Restricting Price Competition; Reaches Settlement with Visa and Mastercard, October 4, 2010, [[HYPERLINK "https://www.justice.gov/opa/pr/justice-department-sues-american-express-mastercard-and-visa-eliminate-rules-restricting"](https://www.justice.gov/opa/pr/justice-department-sues-american-express-mastercard-and-visa-eliminate-rules-restricting)].

networks, lower-cost cards, or other forms of payment. Other provisions of the order add incentives for competition to improve. The growth of rival payment systems since 2010 is an indication that competition in payment systems has emerged, and the evidence from mobile payments indicates that new systems can catch on quickly. When banks in Singapore introduced a new mobile payment technology, researchers found:

In the first year subsequent to the QR code introduction, the number of consumers who signed up (used) mobile payment increased by 53.8% (304%). The average monthly growth rate of mobile payment's share of total consumer spending also rose from 7.1% in the year before the technology shock to 21.1% in the year after.²¹¹

Consumer banking services have attracted interest from some of the world's largest companies. According to Business Insider, "Google is planning to break into banking with new checking account offerings"²¹²

"...We think legacy banks are unlikely to feel the sting from Google in these early days — and that Google's bank partners will likely stand to benefit from the tie-up. Incumbent banks have huge customer bases and a wealth of expertise in navigating the regulatory complexities of the banking sector, which big tech companies like Google lack — hence its partnerships with incumbents."

If the regulatory challenges can be overcome, BIS sees significant competition coming from the technology sector:

Big techs' low-cost structure business can easily be scaled up to provide basic financial services, especially in places where a large part of the population remains unbanked. Using big data and analysis of the network structure in their established platforms, big techs can assess the riskiness of borrowers, reducing the need for collateral to assure repayment. As such, big techs stand to enhance the efficiency of financial services provision, promote financial inclusion and allow associated gains in economic activity.²¹³

Echoing an objective of the Bureau, BIS advised regulators to ensure a level playing field between big techs and banks.

The sequel to Walmart's efforts to compete for the business of the banking sector has begun. The major players are likely to be Fintech companies that did not exist when the

²¹¹ Sumit Agarwal, Wenlan Qian, Yuan Ren, Hsin-Tien Tsai, and Bernard Yeung, "The Real Impact of FinTech: Evidence from Mobile Payment Technology," October 2020. Available at [[HYPERLINK
"https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3556340"](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3556340)]

²¹² Gregory Magana (Nov 14, 2019), [[HYPERLINK
"https://www.businessinsider.com/google-will-begin-offering-checking-accounts-2019-11"](https://www.businessinsider.com/google-will-begin-offering-checking-accounts-2019-11)]

²¹³ BIS, Annual Economic Report at 55.

Commission issued its report in 1972. However, it is too soon to count out the pioneers that saw in consumer credit the means to finance mass production a century ago.

According to a recent report, General Motors is considering the formation of an industrial bank that would accept deposits and make loans to finance the sales of automobiles. The company that tapped consumer credit to overtake Ford as the largest automaker in the United States may once again engage consumers in the financing of another industrial revolution. This time the effort would underwrite the technology that is displacing the internal combustion engine. However, the barriers may be more formidable than the social stigma of consumer credit in 1920. The twenty-first century has a cautionary history of efforts by other businesses to enter the banking sector. As the report recalled, "More than a decade ago, a wave of opposition led by the banking industry pushed retailers Walmart Inc. and Home Depot Inc. to abandon their attempts to secure industrial-loan charters."²¹⁴ How the next chapter will conclude remains to be seen.

In short, there are signs of progress, but a history of failed attempts to offer banking services counsels caution along with optimism. The proportion of the population without a bank account remains significant. Payments are still dominated by bank cards. Whether these characteristics stem from indifference on the part of consumers or barriers to competition for banking and payment services is worth continued examination.

Competition and Access

Ranking consumers and customizing products are forms of discrimination. When based on sound business reasons – such as the risk that a loan will be repaid – such discrimination can enhance lending efficiency, consumer welfare, and system stability. Ignoring such distinctions, on the other hand, can increase the incidence of debtor default and raise the cost of credit. In extreme cases – like the the Crash of 1929, the Savings and Loan Crisis of the 1980s, and the Global Financial Crisis of 2007-2008 – inadequate attention to creditworthiness can compromise financial markets and threaten entire sectors of institutions.

When discrimination is unrelated to legitimate business considerations, it can cause consumer harm. Equal credit opportunity laws and regulations have identified some of the most serious harms and have prohibited the discrimination that inflicts them. The protection of consumers from prohibited discrimination is the subject of other chapters.

Commented [ML(9): Does this mean that **discrimination** would sometimes be related to legitimate business considerations? You might consider rewording this.

²¹⁴ Orla McCaffrey and Mike Colias, "GM Plans to Seek Banking Charter to Grow Auto-Lending Business, Wall Street Journal, Nov. 27, 2020, available at [[HYPERLINK "https://www.wsj.com/articles/gm-plans-to-seek-banking-charter-to-grow-auto-lending-business-11606501125"](https://www.wsj.com/articles/gm-plans-to-seek-banking-charter-to-grow-auto-lending-business-11606501125)].

Here it is worth considering whether competition plays a role in and if so whether the influence of competition is beneficial or detrimental.

As a matter of theory, when buyers in a marketplace have numerous choices with whom to deal, they can penalize providers that discriminate by patronizing competitors that do not. Numerous studies of various industries have confirmed the theory with evidence that the discipline of competition does reduce discrimination. While the general literature is beyond the scope of this chapter, it is worthwhile to consider some studies and reports that have explored credit markets. These tend to confirm the hypothesis that competition inhibits illegitimate discrimination. In an extensive study of bank branches, for example, Lux, et al found that increasing competition benefits populations that have been disproportionately denied loans:

[T]he effect of intensified bank competition is stronger for populations that are ex ante more likely to be rationed by banks, which reinforces the identification of supply effects. First, we find that black households benefit more from branching deregulations than do non-black households only in states with a history of discrimination. For the same level of income, black households are indeed 20% less likely than white households to hold a bank account in states with a history of discrimination, but this gap narrows to only 15% after deregulation, to the level observed in states with no history of discrimination. Second, the effect of branching deregulations increases when the level of income decreases.²¹⁵

In mortgage markets, competition from the new wave of digital lending has taken business away from traditional sources and given more of that business to nontraditional customers. One of those lenders, Better.com, saw Hispanic clients increase by over 500 percent, African Americans by over 400 percent, and L.G.B.T.Q clients ten-fold, according to a recent New York Times article reporting that “Discrimination is falling, and this trend corresponds to the rise in competition among various lenders.”²¹⁶ CFPB data report on the trends, which show Black or African American and Hispanic shares of mortgages up 10 percent since 2010.²¹⁷

Borrowers interviewed for the New York Times article said they faced fewer obstacles dealing online than in person, and their experiences were consistent with the findings of a

²¹⁵ Marshall Lux, The State and Fate of Community Banking February 9, 2015, available at [[HYPERLINK "https://www.hks.harvard.edu/sites/default/files/centers/mrebgs/files/Final_State_and_Fate_Lux_Greene.pdf"](https://www.hks.harvard.edu/sites/default/files/centers/mrebgs/files/Final_State_and_Fate_Lux_Greene.pdf)]. (including a survey of the literature).

²¹⁶ Jennifer Miller, “A Bid to End Loan Bias,” New York Times, September 20, 2020, at Business 4. [[HYPERLINK "https://files.consumerfinance.gov/f/documents/cfpb_2019-mortgage-market-activity-trends_report.pdf"](https://files.consumerfinance.gov/f/documents/cfpb_2019-mortgage-market-activity-trends_report.pdf)]

²¹⁷ CFPB, Data Point: 2019 Mortgage Market Activity and Trends, available at: https://files.consumerfinance.gov/f/documents/cfpb_2019-mortgage-market-activity-trends_report.pdf .

study published by the National Community Reinvestment Coalition, earlier this year.²¹⁸ In the study, testers with different races but similar credit profiles received disparate treatment in statistically significant numbers while inquiring about Paycheck Protection Plan loans at Washington, D.C. banks.

Another study considered settings where competition may be attenuated and found that opportunities for discrimination increased. One situation that has been the subject of research and regulation is the market for automobile loans, many of which are made in a private negotiation in the dealership. A study of that sector found that competitive markets did not drive the lowest prices for consumers, because poor transparency in the market allowed dealers to create better deals for themselves than for consumers.²¹⁹ In these loans, according to the authors, credit worthiness of the individual borrower and the details of the auto loan (term length, payment-to-income ratio, etc.) significantly influenced price. The study also found, however, that prices paid by consumers varied widely even after controlling for credit worthiness, and minority borrowers paid more than their relative risk and other legitimate factors justified:

A majority of consumers paid no ‘markup’ over the credit-based buy-rate, while a small percentage of consumers paid thousands of dollars in additional markup. Moreover, minority borrowers were found to be highly over-represented in the category of those paying significant markups.²²⁰

Chapter 9 explores how the market has responded to situations such as these, and how competition through innovation could protect future consumers.

Conclusions & Recommendations

The preliminary conclusions from the foregoing review of competitive conditions today are consistent with those described in the NCCF Report and with observations from historians who have studied the credit sector throughout its development. The most important ingredient of competition – ease of entry – remains essentially free of intrinsic impediments in credit markets. The number of suppliers available to serve consumers’

²¹⁸ “LENDING DISCRIMINATION WITHIN THE PAYCHECK PROTECTION PROGRAM,” July 15, 2020, available at [[HYPERLINK "https://nerc.org/lending-discrimination-within-the-paycheck-protection-program/"](https://nerc.org/lending-discrimination-within-the-paycheck-protection-program/)]

²¹⁹ Cohen (2012). Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation. *Review of Law and Economics*.

²²⁰ Id. A study of mortgages analyzed FHFA data for evidence of discrimination against minority borrowers relative to white borrowers in more concentrated markets. The results “fail to reject the null hypothesis of no noneconomic discrimination.” James A. Berkovec, Glenn B. Canner, Stuart A. Gabriel and Timothy H. Hannan, Discrimination, Competition, and Loan Performance in FHA Mortgage Lending, *Review of Economics and Statistics*, Volume 80 | Issue 2 | May 1998 p.241-250 (Posted Online March 13, 2006 [[HYPERLINK "https://doi.org/10.1162/003465398557483"](https://doi.org/10.1162/003465398557483)]).

demand for credit, across a wide variety of credit products and services, far exceeds levels considered adequate for robust competition. There appears to be no intrinsic barrier to competition in lending.

Nonetheless, some sectors display worrisome symptoms of competitive impairments. Two sectors stand out. The first is the supply of small loans to borrowers with below-average credit qualifications – populations that are disproportionately poor, unbanked, and in great need. Consumers in this sector often resort to inferior options, because better options have been restricted or eliminated by regulation. The second sector is the supply of information, particularly credit ratings and credit reports. That competition among information providers to the sector might be less than robust is ironic, given the rapid advances in information technology over the last fifty years. Information is plentiful and cheap. Monopoly power in this sector would be especially disquieting given that information is indispensable to credit transactions. If information is more expensive, more restricted, or less accurate, it is likely to raise the cost and reduce the availability of loans and other financial services to consumers.

The impediments to competition in credit markets are not unique to the sector. Nor is the source of the problems. To the contrary, it is commonplace in antitrust experience. Providers of credit have attempted to insulate themselves from competition. Sometimes exclusionary behavior by dominant providers can suffice to deter rivals. Sometimes insulation comes in the form of standards that competitors collectively develop. The most effective barriers are those that become ossified in the amber of laws and regulations. In the case of credit, those barriers can take the form of enforceable interest rate caps, licensing restrictions, territorial and product limitations, and outright prohibitions of competition.

With respect to entry and barriers to it, the NCCF made a recommendation that could apply in many areas:

The effect of the present fractionalized legislation and regulation upon consumers should be reviewed as well as the progress of efforts to enact state consumer credit legislation. Enactment of consumer credit legislation of the type recommended in this report...should be also reviewed to determine whether any added amendments inhibit the basic aim of ensuring free entry of firms and fair treatment of all consumers. Should this research demonstrate that the states are not fostering an environment in which consumers have access to a wide variety of competitive financial services, that progress of consumer credit legislation at the state level is too slow, and that overall Federal legislation is deemed infeasible, then the Commission recommends that Congress undertake Federal chartering of finance companies in a manner, designed to remedy these deficiencies in the market for consumer credit.

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Fifty years later, Clarke and Zywicki saw in the CFPB a potential fulfillment of the Commission's vision:

The creation of the CFPB as a consolidated national regulator of consumer credit products provides a historic opportunity to establish a more coherent regulatory framework that can integrate enforcement, supervision, regulation, and research tools into one regulatory agency.²²¹

Two and a half centuries of economic scholarship have refined the definitions and explanations of competition, but the fundamental descriptions remain much the same as they did when Smith first articulated them and when Samuelson's text taught them to a generation of students. Effective competition drives prices down to the costs of providing goods and services. The same principle applies to markets where consumers shop, markets where retailers go to buy supplies, and markets where companies go to procure resources. In other words, competition puts pressure on sellers up and down the stream of commerce to find the best deal they can get and to offer the best deal they can give. It is, as the Commission noted, painful for the participants on the selling side. But it is beneficial to everyone on the buying side. Fortunately for consumers, including consumers of financial services, they are the buyers who benefit from competition.

²²¹ Clarke and Zywicki, PAYDAY LENDING, BANK OVERDRAFT PROTECTION, AND FAIR COMPETITION AT THE CFPB, *Review of Banking & Financial Law*, Vol. 33, No. 1, pp. 235-281, at 243 (2013).

Appendix A

I. Summary of Statutory References to Competition and Efficiency

- The DFA mentions “competition” in four places:
 - Section 1021(a) (12 U.S.C. § 5511(a))—identifying the Bureau’s statutory purposes, including to ensure “that markets for consumer financial products and services are fair, transparent, and competitive.”
 - Section 1021(b)(4) (12 U.S.C. § 5511(b)(4))—identifying five objectives for which the Bureau may exercise its authorities, including to ensure that “Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition.”
 - Section 1031(c) (12 U.S.C. § 5531(c))—stating that the Bureau may not declare an act or practice to be unfair unless it has a reasonable basis to conclude that the act or practice causes or is likely to cause substantial injury and that “such substantial injury is not outweighed by countervailing benefits to consumers or to competition.”
 - Section 1100(f)(2) (12 U.S.C. § 5107(f)(2))—identifying factors that the Bureau must consider when promulgating rules to implement the SAFE Act, including “the need to ensure a competitive origination market that maximizes consumer access to affordable and sustainable mortgage loans.”
- The DFA mentions “efficient” markets, regulations, or enforcement in three places:
 - Section 1021(b)(5) (12 U.S.C. § 5511(b)(5))—identifying five objectives for which the Bureau may exercise its authorities, including to ensure that “markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation.”
 - Section 1013(c) (12 U.S.C. § 5493(c))—identifying the functions of the Bureau’s Office of Fair Lending and Equal Opportunity, which include “coordinating fair lending efforts of the Bureau with other Federal agencies and State regulators, as appropriate, to promote consistent, efficient, and effective enforcement of Federal fair lending laws.”
 - Section 1013(g)(3)(E) (12 U.S.C. § 5493(g)(3)(E))—identifying the duties of the Bureau’s Office of Financial Protection for Older Americans, including to “coordinate consumer protection efforts of seniors with other Federal agencies

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and State regulators, as appropriate, to promote consistent, effective, and efficient enforcement.”

- At least three of the eighteen enumerated consumer laws identify ensuring competition or efficiency as among their purposes:
 - FCRA section 602(a)(1)) (15 U.S.C. § 1681(a)(1))—listing Congressional findings, including that, “Inaccurate credit reports directly impair the efficiency of the banking system.”
 - FDCPA section 802(e) (15 U.S.C. § 1692(e))—identifying the FDCPA’s purposes, including “to insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged.”
 - TILA section 102(a) (15 U.S.C. § 1601(a))—listing Congressional findings, including that, “The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit.”
- By comparison, the FTC Act explicitly prohibits unfair methods of competition:
 - Section 5 (15 U.S.C. § 45)—prohibiting unfair methods of competition and empowering and directing the FTC to prevent persons from using unfair methods of competition.

II. Statutory Text

- Below are the relevant statutory provisions from the Dodd-Frank Act, FCRA, FDCPA, TILA, and FTC Act.
- References to competition are highlighted in yellow.
- References to efficiency are highlighted in blue.

Dodd-Frank Act

DFA section 1021 (12 U.S.C. § 5511). Purpose, objectives, and functions.

(a) Purpose. The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.

(b) Objectives. The Bureau is authorized to exercise its authorities under Federal consumer financial law for the purposes of ensuring that, with respect to consumer financial products and services—

- (1) consumers are provided with timely and understandable information to make responsible decisions about financial transactions;
- (2) consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination;
- (3) outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens;
- (4) Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition; and
- (5) markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation.

DFA section 1031(c) (12 USC 5531(c)). Prohibiting unfair, deceptive, or abusive acts or practices.

...

(c) Unfairness.—

(1) **In General.** The Bureau shall have no authority under this section to declare an act or practice in connection with a transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service, to be unlawful on the grounds that such act or practice is unfair, unless the Bureau has a reasonable basis to conclude that—

- (A) the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers; and
- (B) such substantial injury is not outweighed by countervailing benefits to consumers or to competition.

(2) **Consideration of Public Policies.** In determining whether an act or practice is unfair, the Bureau may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not serve as a primary basis for such determination.

DFA section 1100 (12 U.S.C. § 5107). Bureau of Consumer Financial Protection backup authority to establish loan originator licensing system.

...

(f) Regulation Authority.—

(1) In General. The Bureau is authorized to promulgate regulations setting minimum net worth or surety bond requirements for residential mortgage loan originators and minimum requirements for recovery funds paid into by loan originators.

(2) Considerations. In issuing regulations under paragraph (1), the Bureau shall take into account the need to provide originators adequate incentives to originate affordable and sustainable mortgage loans, as well as the need to ensure a competitive origination market that maximizes consumer access to affordable and sustainable mortgage loans.

DFA section 1013 (12 U.S.C. § 5493). Administration.

...

(c) Office of Fair Lending and Equal Opportunity.—

(1) Establishment. The Director shall establish within the Bureau the Office of Fair Lending and Equal Opportunity.

(2) Functions. The Office of Fair Lending and Equal Opportunity shall have such powers and duties as the Director may delegate to the Office, including—

(A) providing oversight and enforcement of Federal laws intended to ensure the fair, equitable, and nondiscriminatory access to credit for both individuals and communities that are enforced by the Bureau, including the Equal Credit Opportunity Act and the Home Mortgage Disclosure Act;

(B) coordinating fair lending efforts of the Bureau with other Federal agencies and State regulators, as appropriate, to promote consistent, efficient, and effective enforcement of Federal fair lending laws;

(C) working with private industry, fair lending, civil rights, consumer and community advocates on the promotion of fair lending compliance and education; and

(D) providing annual reports to Congress on the efforts of the Bureau to fulfill its fair lending mandate.

...

(g) Office of Financial Protection for Older Americans.—

(3) Duties. The Office shall—

(A) develop goals for programs that provide seniors financial literacy and counseling, including programs that—

(i) help seniors recognize warning signs of unfair, deceptive, or abusive practices, protect themselves from such practices;

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- (ii) provide one-on-one financial counseling on issues including long-term savings and later-life economic security; and
 - (iii) provide personal consumer credit advocacy to respond to consumer problems caused by unfair, deceptive, or abusive practices;
- (B) monitor certifications or designations of financial advisors who advise seniors and alert the Commission and State regulators of certifications or designations that are identified as unfair, deceptive, or abusive;
- (C) not later than 18 months after the date of the establishment of the Office, submit to Congress and the Commission any legislative and regulatory recommendations on the best practices for—
 - (i) disseminating information regarding the legitimacy of certifications of financial advisers who advise seniors;
 - (ii) methods in which a senior can identify the financial advisor most appropriate for the senior's needs; and
 - (iii) methods in which a senior can verify a financial advisor's credentials;
- (D) conduct research to identify best practices and effective methods, tools, technology and strategies to educate and counsel seniors about personal finance management with a focus on—
 - (i) protecting themselves from unfair, deceptive, and abusive practices;
 - (ii) long-term savings; and
 - (iii) planning for retirement and long-term care;
- (E) coordinate consumer protection efforts of seniors with other Federal agencies and State regulators, as appropriate, to promote consistent, effective, and efficient enforcement; and
- (F) work with community organizations, non-profit organizations, and other entities that are involved with educating or assisting seniors (including the National Education and Resource Center on Women and Retirement Planning).

Fair Credit Reporting Act

FCRA section 602 (15 U.S.C. § 1681). Congressional findings and statement of purpose.

(a) Accuracy and fairness of credit reporting. The Congress makes the following findings:

- (1) The banking system is dependent upon fair and accurate credit reporting. Inaccurate credit reports directly impair the efficiency of the banking system, and unfair credit reporting methods undermine the public confidence which is essential to the continued functioning of the banking system.

- (2) An elaborate mechanism has been developed for investigating and evaluating the credit worthiness, credit standing, credit capacity, character, and general reputation of consumers.
- (3) Consumer reporting agencies have assumed a vital role in assembling and evaluating consumer credit and other information on consumers.
- (4) There is a need to insure that consumer reporting agencies exercise their grave responsibilities with fairness, impartiality, and a respect for the consumer's right to privacy.

Fair Debt Collection Practices Act

FDCPA section 802 (15 U.S.C. § 1692). Congressional findings and declaration of purpose.

- (a) **Abusive practices.** There is abundant evidence of the use of abusive, deceptive, and unfair debt collection practices by many debt collectors. Abusive debt collection practices contribute to the number of personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of individual privacy.
- (b) **Inadequacy of laws.** Existing laws and procedures for redressing these injuries are inadequate to protect consumers.
- (c) **Available non-abusive collection methods.** Means other than misrepresentation or other abusive debt collection practices are available for the effective collection of debts.
- (d) **Interstate commerce.** Abusive debt collection practices are carried on to a substantial extent in interstate commerce and through means and instrumentalities of such commerce. Even where abusive debt collection practices are purely intrastate in character, they nevertheless directly affect interstate commerce.
- (e) **Purposes.** It is the purpose of this subchapter to eliminate abusive debt collection practices by debt collectors, to insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged, and to promote consistent State action to protect consumers against debt collection abuses.

Truth In Lending Act

TILA section 102 (15 U.S.C. § 1601). Congressional findings and declaration of purpose.

- (a) **Informed use of credit.** The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this subchapter to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices.

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(b) Terms of personal property leases. The Congress also finds that there has been a recent trend toward leasing automobiles and other durable goods for consumer use as an alternative to installment credit sales and that these leases have been offered without adequate cost disclosures. It is the purpose of this subchapter to assure a meaningful disclosure of the terms of leases of personal property for personal, family, or household purposes so as to enable the lessee to compare more readily the various lease terms available to him, limit balloon payments in consumer leasing, enable comparison of lease terms with credit terms where appropriate, and to assure meaningful and accurate disclosures of lease terms in advertisements.

Federal Trade Commission Act

FTC Act section 5 (15 U.S.C. § 45). Unfair methods of competition unlawful; prevention by Commission.

(a) Declaration of unlawfulness; power to prohibit unfair practices; inapplicability to foreign trade.

(1) Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.

(2) The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations, except banks, savings and loan institutions described in section 57a(f)(3) of this title, Federal credit unions described in section 57a(f)(4) of this title, common carriers subject to the Acts to regulate commerce, air carriers and foreign air carriers subject to part A of subtitle VII of Title 49, and persons, partnerships, or corporations insofar as they are subject to the Packers and Stockyards Act, 1921, as amended [7 U.S.C. § 181 et seq.], except as provided in section 406(b) of said Act [7 U.S.C. § 227(b)], from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.

(3) This subsection shall not apply to unfair methods of competition involving commerce with foreign nations (other than import commerce) unless—

(A) such methods of competition have a direct, substantial, and reasonably foreseeable effect—

(i) on commerce which is not commerce with foreign nations, or on import commerce with foreign nations; or

(ii) on export commerce with foreign nations, of a person engaged in such commerce in the United States; and

(B) such effect gives rise to a claim under the provisions of this subsection, other than this paragraph.

If this subsection applies to such methods of competition only because of the operation of subparagraph (A)(ii), this subsection shall apply to such conduct only for injury to export business in the United States.

(4)—

- (A) For purposes of subsection (a) of this section, the term “unfair or deceptive acts or practices” includes such acts or practices involving foreign commerce that--
- (i) cause or are likely to cause reasonably foreseeable injury within the United States; or
 - (ii) involve material conduct occurring within the United States.

(B) All remedies available to the Commission with respect to unfair and deceptive acts or practices shall be available for acts and practices described in this paragraph, including restitution to domestic or foreign victims.

* * *

Appendix B

[History of Credit and Competition]

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*Preliminary and pre-decisional
Attorney work product*

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