South Dakota Voters Approve 36% Rate Cap on Money Lender Licensees

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On November 8, 2016, the United States elected Donald Trump to be our next president. In South Dakota, voters also approved a ballot measure imposing a 36% rate cap on persons licensed under South Dakota's Money Lending Licenses Act. Both results are sure to have a significant impact on the consumer credit industry.

For creditors in South Dakota, the adoption of the new rate cap is a significant departure from South Dakota's business-friendly regulation, which historically authorized licensed money lenders to contract for and receive interest charges and other fees at rates, amounts, and terms as agreed to by the parties and specified in the contract.

Many are asking how this happened. In an effort to curb alleged abuses by the payday lending industry, South Dakotans for Responsible Lending campaigned for Initiated Measure 21, which would cap short-term lending interest rates at 36%, to be included on the ballot. Payday lenders fought the initiative, claiming that the ballot language was misleading because it did not explain that the Measure would effectively eliminate short-term consumer loans. The South Dakota Supreme Court upheld the ballot explanation, and on November 8, 2016, 76% of South Dakota voters approved the Measure.

The Measure amends the rate authority provision under the MLLA by adding the following limitation: "No licensee may contract for or receive finance charges in excess of an annual rate of 36%, including all charges for any ancillary product or service and any other charge or fee incident to the extension of credit. . . . Any loan made in violation of this section is void and uncollectable as to any principal, fee, interest, or charge." According to the South Dakota Division of Banking's website, this limitation applies to all loans originated, refinanced, rolled over, renewed, or flipped after November 15, 2016.

For short-term lenders, the new "all-in" 36% rate cap does not cover the cost of extending credit. As a result, many short-term lenders have already ceased doing business in South Dakota. Others are looking to change their business plan.

Traditional installment lenders face a different challenge of determining which fees and charges must be included in the rate calculation for purposes of determining compliance with the new 36% cap. In a memorandum dated November 22, 2016, the Division of Banking advised that the types of services, products, charges, or fees that are to be included in annual rate calculations for

purposes of the 36% rate limitation “may, depending on the circumstances, include vehicle service and maintenance contracts, official fees and taxes, guaranteed asset protection waivers, sales taxes, title fees, lien registration fees, dealer documentary fees, returned check fees, attorney fees, and credit life or accident and health insurance.” This guidance still leaves several unanswered questions. For example, is a licensee required to include a charge for a product or service that is sold for the same price in a cash transaction? What about fees that are assessed equally in both cash and credit transactions?

One question the Division did not leave unanswered regards the applicability of the new rate cap to money lender licensees who service, acquire or purchase retail installment contracts. Although, as the Attorney General’s Statement about the Measure explained, retail sellers, including motor vehicle dealers, who finance the goods they sell are expressly exempt from the MLLA, the Division unequivocally advised that licensees servicing, acquiring or purchasing retail installment contracts must comply with the provisions of Measure 21, and the other substantive requirements of the MLLA.

This position reflects a tortured statutory analysis under which the Division deems retail installment contracts to be “installment loans” for purposes of the MLLA, even though they are separately regulated as “installment sales contracts” under South Dakota’s Consumer Installment Sales Contracts Act. This is also a reversal of the Division’s prior interpretations of the MLLA, which have historically concluded that the substantive provisions of the MLLA apply only to loans, and not to retail installment contracts. And, the Division’s enforcement of Measure 21 against licensees who service, acquire or purchase retail installment contracts is likely to cause seemingly unintended consequences in the automotive finance space. For example, such enforcement could have a chilling effect on the consumer credit industry in South Dakota by limiting competition between non-bank finance companies who purchase retail installment sale contracts from motor vehicle dealers and other sellers of goods and services and banks and other financial institutions exempt from the Measure with whom they actively compete.

Nevertheless, the voters (and the South Dakota regulators) have spoken. As a result, there is a shifting regulatory environment in South Dakota and the United States generally. While regulation at the federal level may ease under the Trump administration, it is possible that states will step up their regulatory efforts. In this time of regulatory change, it is incumbent on creditors to continue to monitor legislative and regulatory developments to ensure compliance.