November 16, 2016

Bret Afdahl, Director
Division of Banking
South Dakota Department of Labor and Regulation
1601 N. Harrison Avenue, Suite 1
Pierre, SD 57501

Re: Clarification regarding Initiated Measure 21 and vehicle finance transactions

Dear Director Afdahl:

I write on behalf of the membership of the American Financial Services Association ("AFSA")[1] to request confirmation from the Division of Banking ("Division") that the substantive provisions of Initiated Measure 21 ("Measure") do not apply to retail installment sales contracts purchased by licensed money lenders and to request clarification regarding the charges and fees that will be included in and the method that the Division will use in the rate calculation to determine compliance with the new 36 percent rate limitation.

We respectfully request that the Division consider this analysis and confirm that the Measure does not apply to retail installment transactions. We also request that the Division clarify whether the Measure applies to lenders that originate and service commercial loans.

Although the Measure applies to money lenders licensed under the Money Lending Licenses Act, S.D. Codified Laws §§ 54-4-36 *et seq.* ("Chapter 54-4"), applying the substantive provisions of the Measure to money lender licensees servicing, acquiring, or purchasing retail installment contracts would be inconsistent with other state laws, including the Consumer Installment Sales Contracts Act, S.D. Codified Laws §§ 54-3A-1 *et seq.* ("Chapter 54-3A"), and previous positions accepted by the Division. Due to these inconsistencies and ambiguities, some of our members have ceased doing business in the state. Immediate clarification from the Division is necessary in order for companies to continue to operate in South Dakota in compliance with state laws. Specifically, AFSA requests the following: confirmation that the rate cap imposed by the Measure does not apply to licensees that service, acquire, and purchase retail installment contracts; identification of what specific ancillary products, services, charges, and fees are "incident to the extension of credit" and therefore, included in the annual rate calculation; and an explanation of the annual rate calculation method that will be used by the Division to determine compliance with the 36 percent rate cap.

Financial institutions that service, acquire, and purchase retail installment contracts are required to hold money lender licenses pursuant to S.D. Codified Laws § 54-4-52. While such financial institutions are licensed under Chapter 54-4, the substantive requirements of the chapter apply only to loans—which do not include retail installment contracts, as defined—and are thus not applicable. The retail installment sales transactions themselves are separately regulated under Chapter 54-3A.

[1] The American Financial Services Association is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA member financial institutions offer vehicle financing, payment cards, personal installment loans and mortgage loans. The Association encourages and maintains ethical business practices and supports financial education for consumers of all ages.

Chapter 54-3A does not contain licensing requirements, but contains a number of substantive requirements applicable to consumer installment sales contracts, including its own rate authority provision:

> *Notwithstanding the provisions of any other law*, a creditor may contract for and receive, pursuant to an ***installment sales contract***, a finance charge at a rate as agreed upon by the creditor and the consumer by written agreement.

S.D. Codified Laws § 54-3A-3 (emphasis added).

Applying the substantive provisions of the Measure, which caps the interest rate on loans made under Chapter 54-4, to retail installment contracts lawfully originated under Chapter 54-3A creates a direct conflict and is illogical.

As further evidence that it is illogical to interpret the Measure as applying to retail installment sale contracts, we note that the originators of such financing contracts, the sellers of the goods and services are exempt from the Measure and from licensing as money lenders. S.D. Codified Laws § 54-4-64 ("The provisions of [Chapter 54-4] do not apply to any person selling goods or services and providing financing for such goods or services."). Clearly the Measure was not intended to apply to sellers who provide financing for the goods and services they sell in the form of a retail installment sale contract. It would be a hollow exemption for them if they were forced to comply with the Measure to preserve the market for selling their contracts. It is also inconsistent with the long-standing common-law governing the assignment of a contract (i.e., the assignee steps into the shoes of the assignor.) Furthermore, this interpretation would create a serious competitive imbalance in the ability of non-bank finance companies to purchase retail installment sale contracts from motor vehicle dealers and other sellers of goods and services versus banks and other financial institutions that are exempt from the Measure with whom they actively compete.

We respectfully request that the Division confirm that ancillary products and services also sold in connection with cash transactions and charges and fees that are assessed equally in cash transactions are not "incident to the extension of credit," and that the Division identify any other specific products, services, charges or fees that must be included in rate calculation.

To the extent that some of our members may originate direct loans to consumers secured by motor vehicles and other personal property that are subject to the Measure, we also seek clarification regarding the Measure's requirement that the finance charge include charges for any ancillary product or service and any other charge or fee incident to the extension of credit. For example, such transactions might include vehicle service and maintenance contracts, official fees and taxes, guaranteed asset protection (GAP) waivers, and credit life or accident and health insurance.

Please confirm that the cost of optional ancillary products is not "incident to the extension of credit"—and therefore, not required to be included in the calculation of the finance charge subject to the 36% annual limitation—if the ancillary product might also be sold in connection with a cash sale (for example, service and maintenance contracts). Similarly, please confirm that charges and fees that are assessed equally in both cash and credit transactions (for example, sales taxes, title fees, exclusive of lien registration fees, and dealer documentary fees) are not "incident to the extension of credit" and therefore, not required to be included in the calculation of the finance charge subject to the 36% annual limitation. Both conclusions are consistent with the long-time

understanding of what it means for a charge to be "incident to an extension of credit" under both Truth-in-Lending and Chapter 54-3A, which expressly authorize the sale and financing of such fees and products.

As the Measure includes the vague and broad category of "ancillary products and services or other charges and fees," AFSA member companies would benefit from additional clarification regarding any specific products, services, charges or fees that the Division believes are subject to inclusion in Measure's finance charge calculation.

We respectfully request that the Division clarify the method used to determine the 36 percent annual rate in the Measure.

We further request clarification of the method used to determine the 36 percent rate referenced in the Measure. The provision simply states "…finance charges in excess of an annual rate of thirty-six percent…" with no specific guidance on the method used to compute that rate. An effective rate that represents a dollar finance charge is by no means generic or universal in nature. In particular, the parameters for charge accrual and determination of time periods can produce distinctly different effective rate values for a given dollar and cent finance charge. For instance, an effective rate value for a specific lender's interest accrual parameters may differ from the Regulation Z annual percentage rate computed by the required parameters of the regulation's Appendix J.

AFSA members use origination and/or servicing systems that have been configured to calculate finance charge in the manner provided under Regulation Z, including the exclusions for certain ancillary products as described above. To the extent that the Division maintains that the finance charge under the Measure is computed under different parameters than Regulation Z or includes certain charges that are excluded under Regulation Z, the systems AFSA members will use to validate compliance with the Measure will require modification. AFSA respectfully requests the Division provide ample time for members to design, test, and implement system enhancements that will allow for accurate measurement of finance charge under the Measure for any covered transactions.

Thank you for your timely consideration. We believe the clarifications requested will allow AFSA member companies to continue to operate in South Dakota in compliance with all applicable state laws. If you have any questions or would like to discuss this further, please do not hesitate to contact me at 952-922-6500 or dfagre@afsamail.org.

Sincerely,

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