SIOUX FALLS AREA
CHAMBER OF COMMERCE
Progress is everyone's business

ISSUE BRIEF:

Payday and Short-term Lending — Constitutional Amendment U and Initiated Measure 21

August 2016

Approved by the Executive Committee: Aug. 15, 2016
Approved by the Board of Directors: Aug. 17, 2016

The Sioux Falls Area Chamber of Commerce encourages a "NO" vote on Constitutional Amendment U on the 2016 general election ballot.

The Sioux Falls Area Chamber of Commerce will remain "NEUTRAL" on Initiated Measure 21 on the 2016 general election ballot.

Background

There are two ways in South Dakota to propose an amendment to the State Constitution. The first is by majority vote, whereby the Legislature can endorse a joint resolution to put an issue on the ballot. The second option requires an initiative process with valid signatures equaling at least 10 percent of the vote total from the prior gubernatorial election. Likewise, the citizenry can initiate statutory changes by obtaining valid signatures equaling at least 5 percent of the vote total from the prior gubernatorial election. Constitutional Amendment U and Initiated Measure 21 both deal with the payday loan industry and both met the signature requirements needed to be included on the ballot. Opponents to CA-U and IM 21 submitted a challenge with the South Dakota Secretary of State's Office to question the number of valid signatures. However, Secretary of State Shantel Krebs affirmed that in each case, the minimum number had been met. Thus, the 2016 general election ballot includes both Constitutional Amendment U and IM 21. To amend the constitution or enact the law will require a majority vote.

Constitutional Amendment U would do the following

- It would prohibit the use of interest rate caps (usury ceilings) by either the state legislature or the people of South Dakota by amending the constitution. It does this by adding two new sections to Article VI (Bill of Rights).
- The first section creates an 18 percent rate cap on interest rates, but only on verbal loans. If the parties to the loan agree in writing to higher interest rate terms, there is no cap. This would allow payday, car title, and installment lenders to continue business as usual.
- The second section states that any law setting interest rates for loans would become invalid if it does not give the lender and borrower the ability to agree to a different rate. It also asserts that if law establishes an interest rate, it must apply to every type of lender. This means that any usury ceiling passed must apply not only to payday loans but also to credit cards, home mortgages, auto loans, etc.
- Since these changes are being made to the constitution any attempt to repeal this new constitutional amendment would require a two-thirds vote in both houses of the legislature and require the Governor's signature.

Initiated Measure 21 would do the following

- It would cap interest rates for payday, car title, and installment lending in our state at 36 percent where the calculation of the annual percentage rate includes interest, fees, and other charges.
- It makes a violation a misdemeanor and would nullify the loan contract and deem any principal, fee, interest or charge as uncollectible.
- It would not impact state or nationally chartered banks, interest charged by businesses that finance the goods and services they sell, or anything other than payday, auto title, and installment loans.

Clearly these are competing proposals. Here are the scenarios that could play out:

1. Both fail: no change in law and the status quo is retained.
2. Both pass: this would result in the constitutional amendment superseding the initiated measure and prohibit the imposition of any future interest rate caps on any financial products.
3. Amendment U passes and IM 21 fails: this would amend the constitution as outlined above and prohibit the imposition of any future interest rate caps on any financial products.
4. Amendment U fails and IM 21 passes: this would implement 36 percent interest rate caps on payday, car title and installment loans as outlined above.

A discussion of the proponent and opponent arguments on IM 21 seems appropriate since this is the baseline issue that has been legislated in the past and caused Amendment U to be brought forward as well.

Proponent Rationale

Those supporting IM 21, and capping finance charges on payday loans, have documented that these loans are very expensive and frequently trap consumers into debt payment cycles they cannot manage. Proponents also express their argument in terms of the calculated annual percentage rate for these loans. For example, on their website, South Dakotans for Responsible Lending[i] assert:

Payday lenders in South Dakota target working families and seniors. They charge an average interest rate of 574 percent. Every year thousands of hard-working South Dakotans become trapped in a cycle of debt by payday, car title, and installment lenders. These lenders offer a defective financial product intentionally designed to be a debt trap. The average payday loan borrower repays about $800 on a $300 loan because most borrowers simply cannot repay these short-term loans on time. As a result, borrowers are forced to take out another loan (and then another) just to pay the interest on their original loan. We believe families, seniors, and others who are economically vulnerable should be protected from greedy lenders charging 574 percent interest rate (or more).

According to the PEW Charitable Trusts, the average rate on payday loans in South Dakota is 574 percent. The Center for Responsible Lending reports that annually, South Dakotans spend over $81 million in interest and fees on payday loan and car title loan products ($34 million for payday loans and $47 million in auto title loans).

Research by the U.S. federal government supports the assertions of proponents. In June 2016, the Consumer Financial Protect Bureau proposed a rule to end payday debt traps by requiring lenders to make provisions to ensure consumers have the ability to repay their loans (payday loans, auto title loans, deposit advance products and certain high-cost installment and open-end loans) when they are due and still meet basic living expenses and major financial obligations. CFPB reported these loans are problematic because of four main characteristics[ii].

- **Repeat short-term borrowing:** Within a month, almost 70 percent of payday loan borrowers take out a second payday loan. And, one in five new borrowers ends up taking out at least 10 or more loans, one after the other. With each new loan, the consumer pays more fees and interest on the same debt.
- **Penalty fees:** Online lenders' repeated attempts to debit payments from a borrower's checking account can add significant costs to online payday loans. Our research found that half of online borrowers are charged an average of $185 in bank penalties.
- **Auto seizure:** Auto title loans often have issues similar to payday loans, including high rates of consumer reborrowing, which can create long-term debt traps. A borrower who cannot repay the initial loan, which typically lasts 30 days, must reborrow or risk losing their vehicle. If the loan is repaid, the title is returned to the borrower. However, we found that one in five short-term auto title borrowers lose their vehicle because they fail to repay the loan.
- **High default rates for long-term installment loans:** Over one-third of payday installment loan sequences default, sometimes after the consumer has already refinanced or reborrowed at least once. Nearly one-third of auto title installment loan sequences end in default and 11 percent end with the borrower's car seized by the lender.

Proponents of IM 21 also attest that many needy people end up seeking charitable or taxpayer-funded assistance, in part, because they are spending an enormous share of their monthly budget on interest and fees. This ultimately results in hunger, homelessness and unnecessary stress on low-income families. As a result of these concerns for the poor the South Dakota Synod of the Evangelical Lutheran Church in America (ELCA), South Dakota Conference United Church of Christ, the Dakota Annual Conference of the United Methodist Church and the Presbytery of South Dakota have all passed resolutions favoring an interest rate cap. South Dakota AARP has also lent support to this measure because of concerns for the ways in which predatory lenders target the elderly.

The primary proponents of Initiated Measure 21 are former Republican Legislator Steve Hickey and Democratic activist and Josiah's Coffeehouse & Café Proprietor Steve Hildebrand.

Opponent Rationale

Opponents of IM 21 note that there are likely cases where these loans are taken for the wrong reasons and managed poorly so that people are hurt. They also note, however, access to cash like this for some people is needed under certain circumstances. For example, $200 to fix a car so the individual can get to work to keep a job may well be a good reason for these loans.

Opponents also point out that bank overdraft charges, for example, can often have a much greater impact and a much higher calculated APR. For example if you write an NSF check for almost any amount, your fee at one bank we looked at is $33 per item/check. In other words, your fee could exceed the overdraft. They also highlight that pawn shops are not included in this law and that imputed finance charges in those transactions are very high. Finally, some argue that shutting down the industry in the state could do more harm than good for those who need access to cash and may force borrowers into the online market to meet their needs.

It is also argued that small dollar loans help provide a jolt to the economy because when consumers have more money, they will spend it on goods and services. According to the Community Financial Services Association of America (CFSAA), this industry provides an estimated 50,000 jobs nationwide, generating more than $2.6 billion in federal, state and local taxes.

It is interesting to note that those who vote "No" on IM 21 could easily vote "No" on Amendment U also. There seem to be two reasons. First, they simply do not believe we need to regulate this market as proposed in IM 21 and if it loses then Amendment U is unnecessary. Or, second, they simply believe putting language like Amendment U into our state's constitution under the Bill of Rights is an unwise thing to do.

The primary opponent and financial contributor to IM 21 and proponent of Constitutional Amendment U is Rod Aycox a Georgia millionaire and owner of Select Management Resources that owns North American Title Loans in South Dakota.

Note: Detailing "Proponents" and "Opponents" rationale is designed to provide the reader with an understanding of the opinions and talking points from each perspective. They are not intended to reflect any position of the Sioux Falls Area Chamber of Commerce.

Chamber Position, *Constitutional Amendment U* : (Adopted Aug. 17, 2016)
The Sioux Falls Area Chamber of Commerce encourages a "NO" vote on Constitutional Amendment U on the 2016 general election ballot.

Rationale: *The Board of Directors feels that this sort of lending and regulatory language is not an appropriate constitutional amendment. We believe banking laws do not belong in the constitution per se plus changing or amending the constitution is much more difficult than changing or amending state statutes and that is where lending laws need to be. Further, while CA-U would limit the rate cap to 18 percent on verbal loans, it has no cap whatsoever if both parties agree in writing. Thus, it really is no cap at all.*

Chamber Position, Initiated Measure 21: (Adopted Aug. 17, 2016)
The Sioux Falls Area Chamber of Commerce is "NEUTRAL" on Initiated Measure 21 on the 2016 general election ballot.

Rationale: *While we understand the arguments on this issue from the perspective of the proponents who seek to protect borrowers, there are also arguments supporting access to short-term loans for those who need them. Therefore, the Board of Directors has chosen a neutral stance on this issue.*

Sources

[i] The South Dakotans for Responsible Lending website, http://www.captheratesd.com, was accessed July 18, 2016.

[ii] See David Silberman, June 2, 2016 article on the website titled, "We've proposed a rule to protect consumers from payday debt traps: New data shows payday and similar loans lead to consumers trapped in debt and our proposed rule aims to help those consumers." http://www.consumerfinance.gov/about-us/blog/weve-proposed-rule-protect-consumers-payday-debt-traps/.