DEPARTMENT OF FINANCIAL INSTITUTIONS: Whether certain practices of banks are usurious.

December 26, 1942.

Hon. H. C. Sauvain, Secretary,
Commission for Financial Institutions,
State House,
Indianapolis, Indiana.

Dear Sir:

I have before me your letter in part as follows:

"We find that certain banks, both state and national, operating in the State are as a consistent practice engaged in making loans of which the following is a description of a typical loan, to-wit:

"The note is executed for a period of one (1) year, payable at maturity, and 8% interest is charged discounted at the time of the making of the loan; at the same time the bank requires as a condition of the making of the loan that the borrower subscribe for a savings account in a maturity value equal to the amount of the loan, but payable in weekly or monthly installments over the same period as the life of the loan; upon full payment of the maturity value of the savings account the proceeds are used in repayment of the loan at the maturity thereof. * * *"

You submit the following questions:

"1. Is the above transaction a violation of the usury statute?

"2. In some cases the savings account is hypothecated to secure the loan and in some cases it is not. Would your answer to the first question be affected if the savings account is hypothecated?

"3. If the answer to the first question be in the affirmative, would the amount of interest paid on such savings account be offset against the interest charged on such a loan in determining the effective rate of interest charged on the loan?"
Section 19-2001 of Burns' Indiana Statutes Annotated (1933), being Section 1 of Chapter 24 of the Acts of 1879 as amended in 1929, provides as follows:

"The interest on loans or forebearance of money, goods, or things in action, shall be as follows:

(a) When the parties do not agree on the rate, interest shall be at the rate of six dollars ($6.00) per year per one hundred dollars ($100);

(b) By agreement in writing signed by the party to be charged thereby, and not otherwise, any obligor other than a corporation may lawfully agree to pay any rate of interest not in excess of eight dollars ($8.00) per year per one hundred dollars ($100);

(c) By agreement in writing duly signed by it, and not otherwise, any corporation may lawfully agree to pay any rate of interest whatever.

Interest', as used in this and the succeeding sections of this act, shall include discount, and may be paid and collected in advance."

Burns' Indiana Statutes Annotated (1933), Section 19-2001.

(It will be noted that a corporation, by agreement in writing signed by such corporation, may lawfully agree to pay any rate of interest. For that reason, in the consideration of your question, corporate borrowers are eliminated.)

I now desire to call your attention to Section 19-2004 of Burns' Indiana Statutes Annotated (1933), being Section 4 of Chapter 24 of the Acts of 1879 as amended in 1929, which is as follows:

"When a greater rate of interest than is hereby allowed shall be contracted for, the contract shall be void as to the usurious interest contracted for; and, if it appears that interest at a higher rate than eight (8) percent has been, directly or indirectly, contracted for by an obligor other than a corporation, the excess of interest over six (6) percent shall be deemed usurious and illegal, and, in an action on a contract
affected by such usury, the excess over the legal interest may be recouped by the debtor, whenever it has been reserved or paid before the bringing of the suit.” (Our italics.)

Burns’ Indiana Statutes Annotated (1933), Section 19-2004.

I think that the use of the words “directly or indirectly” in the above quoted paragraph is significant. It undoubtedly requires in determining whether usurious charges are being made or contracted for, that the form used is not to be taken as conclusive; but that the actual result of any transaction is to be the basis for the determination of the question. Using this rule, I think the answers to your questions become quite simple. When, in the case assumed by you, one year’s interest at the rate of eight (8) percent is charged for a term of one year, the maximum charge under the statute has been made. Upon the payment of this charge, however, the borrower is entitled to the use of the money borrowed in its entirety for the entire year except in cases where the charge is collected in advance, in which case the borrower is entitled to the full amount of his loan less such discount for the entire year.

Any agreement for the repayment of the principal in monthly or weekly installments, of course, has the effect of depriving the borrower of the use of all the money borrowed for the entire period of the loan; notwithstanding the fact that the interest charge, which was the maximum, was upon the basis of the entire amount for the entire period. It seems to me that it is very clear that such a charge, or rather such a method of repayment, is more than the statute on the subject of usury permits. Such a method undoubtedly operates as a charge for the use of money in excess of the maximum allowed by the statute; at least “indirectly” it amounts to an excessive charge. I think your first question should be answered in the affirmative.

In answering your second question, I do not think it makes any difference as to whether the account is hypothecated to secure the loan or not. If the opening of such an account is required as a condition for the making of the loan, the benefit to the bank constitutes an excessive charge. My answer to
the first question is not affected by whether the savings account is hypothecated or not.

The first question being answered in the affirmative, your third question requires an answer. Of course, if interest was paid on the savings account that fact and that amount could be considered in determining whether more than eight (8) percent per annum is being charged; but, if it is determined that the interest charged is usurious the statute provides that the excess of interest over six (6) per cent per annum shall be deemed usurious and illegal. I think, however, the interest paid on the savings account should still be considered in determining how much over and above six (6) per cent has been actually received by the lender.