Mr. Joe McCord, Director
Department of Financial Institutions
410 State House
Indianapolis 4, Indiana

Dear Mr. McCord:

This is in response to your request for an Official Opinion in respect to the so-called "ready-funds service" now in use in the banking institutions in Indiana, both state and national. We quote from your letter the program, or method of operation of such plans as follows:

"A bank customer files an application with the banking institution under what is known as the ready-funds service agreement. In the application, the bank customer applies for a certain amount of funds to be placed at his disposal and upon which he will write checks as needed. In the event the application is accepted by the banking institution, the customer is given a deposit account in the amount for which the ready-funds application has been approved. The amount advanced is to be repaid to the bank in installments, generally on a monthly plan.

"The customer is charged at the rate of 1% per month on the unpaid balance. In an example used by one of the advertising banks, it is shown that this charge amounts to $6.50 for a $100 loan, repayable in twelve equal monthly installments. Reduced to simple interest rates, this would be somewhere between 12% and 13%, which has raised the question as to whether such charge is in violation of the usury statutes. It is the contention of the institutions using this form that this type of lending is carried on under the Bank Installment Loan Act as enacted by the 1951 General Assembly (Burns' 19-2201 to 19-2206 inclusive)."

The particular question submitted is as follows:

"We would appreciate your official opinion as to whether this type of lending, which may be known as
open-end credit, check-credit, or ready-funds, can be carried on under existing legislation by either state or national banks operating in the State of Indiana."

As noted in your letter, reference should be made to the Instalment Loan Act, which is Acts of 1951, Ch. 159, Sections 1 through 6, as found in Burns' (1959 Supp.), Sections 19-2201 through 19-2206. Burns' 19-2201, supra, reads as follows:

"Any individual loaning money, any bank or trust company organized under the laws of this state, or any national banking association having its principal banking office in this state, may charge, collect and receive in advance or otherwise, a loan charge not in excess of $8.00 per $100.00 per year on the total amount of each loan or forebearance of money which is payable in instalments. Such loan charge may be computed from the date of such loan or forebearance to maturity of its last instalment and for its entire period on the original total amount thereof, which original total amount may include the loan charge and all expenses permitted by this act * * *" (Our emphasis)

From an examination of the information contained in the forms submitted with your letter, it is apparent that the so-called "ready funds service" merely consists of an instalment loan, or series of instalment loans, by the banking institution to the borrower. The "ready-funds service" adds the convenience of advance approved credit of a certain amount which may be loaned to the borrower. I find nothing in the Instalment Loan Act, or in other provisions of the banking laws, which would prevent the establishment of advance credit by banking institutions, nor do I find any prohibition against combining a series of loans into one account as is the procedure here in question.

Your letter points out that the borrower is charged at the rate of one per cent per month on the unpaid balance of the loan, and reduced to simple interest rates, this would be somewhere between twelve and thirteen per cent, which raises the question as to whether such a charge of one per cent per month on the unpaid balance is in violation of the usury
statute. The general usury statute, which provides the legal rate of interest on money, is Acts of 1879, Ch. 24, Sec. 1, as amended, as found in Burns' (1950 Repl.), Section 19-2001. However, I do not believe that a consideration of this statute is necessary in order to answer your question inasmuch as a special statute, Burns' 19-2201 et seq. supra, is a more recent expression of legislative authorization for an instalment loan charge by any individual, bank or trust company organized under the laws of this State, or any national banking association having its principal banking office in this State, and the charge established in this act undoubtedly supersedes Burns' 19-2001, supra, with respect to such loans.

You will note that in Burns' 19-2201, supra, it is stated, in part, as follows:

"* * * Such loan charge may be computed from the date of such loan or forebearance to maturity of its last instalment and for its entire period on the original total amount thereof, which original total amount may include the loan charge and all expenses permitted by this act * * *"

The above language authorizes the add-on method of calculating finance charges and simply entails adding the finance charge to the amount the borrower finances. A statutory add-on maximum of eight dollars per one hundred dollars of the principal amount so financed far exceeds a true interest rate (referred to in your letter as "simple interest" rate) of eight per cent, for the borrower does not have the use of the entire principal balance for the whole year since he is discharging his obligation by monthly payments and has the use on an average of only slightly more than one-half of the original principal balance throughout the year. The true interest rate on an eight per cent add-on charge on a loan repayable in installments is something over fifteen per cent. The true or effective interest rate is sometimes estimated at about twice the add-on rate, but this employs a figure somewhat too high. For a discussion of the various methods used to calculate the true or effective interest rate over the add-on rate, see:

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From the above discussion it is apparent that the charge of one per cent interest per month on the unpaid balance of the amount borrowed, although it actually amounts to a true interest rate of twelve or thirteen per cent, does not exceed the loan charge authorized in Burns’ 19-2201, supra.

In the example stated in your letter, the per year charge for interest reduced to add-on interest is stated to be $6.50 for a $100 loan. This is within the maximum of $8.00 per $100 provided by the Instalment Loan Act and is, therefore, not usurious simply because computed by a per month basis upon the unpaid balance.

In other situations governed by the Instalment Loan Act, the question relating to usury should not be determined by the standard of true interest, but instead, by converting the interest payable to add-on interest charged on the total amount of the loan; using this standard, if the add-on interest does not exceed the maximum loan charge prescribed by Burns’ 19-2201, supra, then such interest is not usurious for such loans by individuals and banking institutions.

In connection with your question, it should be noted that, in consideration of the higher than usual interest allowable under the Instalment Loan Act, the Legislature has imposed the following restrictions with respect to the allowance of any further charges, as found in Burns’ 19-2203, supra, which provides as follows:

“The department of financial institutions is hereby authorized by a majority vote of the members of the department to make, promulgate, alter, amend or repeal rules and regulations prescribing the maximum charges which may be contracted for, received or collected by a lender hereunder for delinquency fees or late charges, prescribing terms and methods of calculating refund to borrowers in case of the prepayment in full of a loan at or before the due date of the instalment immediately preceding the final instalment, and prescribing minimum charges which may be made for a loan hereunder. All such rules and regulations shall have the force and effect of law. In addition to the loan charge authorized by this act and the other charges which may be authorized by the department, no further interest, discount,
or other charge shall be made directly or indirectly for any loan or forebearance of money made pursuant to this act and payable in instalments, except that there may be charged the following expenses: (a) reasonable charges for any health and accident insurance and for insurance which may be obtained on the life of the borrower as security for any loan or loans made to such borrower, under this act, and (b) fees paid public officers for acknowledging, filing, recording and releasing any instrument securing a loan, and reasonable attorneys' fees and costs which are expended in the enforcement of the terms of any instrument evidencing or securing the loan. The department of financial institutions may order any lender making loans under the provisions of this act to desist from any conduct which it shall find to be a violation of the provisions of this act or to be a violation of any rule or regulation of said department promulgated pursuant to this act."

In conclusion, it is my opinion that the general type of "ready-funds service" as described in your question is a form of instalment loan, which is not prohibited by law, if conducted by individuals or banking institutions, nor does the loan charge or interest rate, charged by such banking institutions utilizing the "ready-funds service," as stated in your letter, exceed the lawful loan charge authorized by the provisions of the Instalment Loan Act (Burns’ 19-2201 et seq. supra).

In closing, I wish to note that your question refers to a general type of "open-end credit, check-credit, or ready-funds" plan, as to any of which there may be many variations. Therefore, this opinion is not to be considered as approving the specific plan of any particular banking institution nor as condoning other provisions of such a plan not discussed in this opinion. Each such plan must further adhere to all other requirements of the Instalment Loan Act and rules and regulations adopted pursuant thereto, even though not considered herein.