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SPRINGFIELD

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FILE NO. 82-024

FINANCIAL INSTITUTIONS:
Revolving Credit Agreements

Michael E. Fryzel
Director
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Dear Mr. Fryzel:

I have your predecessor's letter in which he inquired whether subsection 4.3(ii) of "AN ACT in relation to the rate of interest and other charges in connection with sales on credit and the lending of money" (Ill. Rev. Stat. 1981, ch. 17, par. 6409(ii)) applies to credit unions and, if so, whether it prohibits credit unions from taking a security interest in any collateral for a loan made under an open end/revolving plan unless and until the debtor is in default or has otherwise breached some provision of the underlying loan agreement. For the reasons hereinafter stated, it is my opinion that sub-

section 4.3(ii) of the Act does not apply to a revolving credit agreement entered into between a debtor and a credit union.

Section 4.2 of "AN ACT in relation to the rate of interest and other charges in connection with sales on credit and the lending of money" (Ill. Rev. Stat. 1981, ch. 17, par. 6407), authorizes certain lenders, including credit unions, to receive or contract to receive and collect interest in any amount or at any rate agreed upon by the parties to a revolving credit agreement:

> "On a revolving credit which complies with sub-paragraphs (a), (b), (c), (d) and (e) of this Section 4.2, it is lawful for a state or national bank with its main office in this State, a state or federal savings and loan association with its main office in this State, a state or federal credit union with its main office in this State, or a lender licensed under the Consumer Finance Act, the Consumer Installment Loan Act or the Sales Finance Agency Act to receive or contract to receive and collect interest in any amount or at any rate agreed upon by the parties to the revolving credit arrangement. It is lawful for any other lender to receive or contract to receive and collect interest in an amount not in excess of 1 1/2% per month of either the average daily unpaid balance of the principal of the debt during the billing cycle, or of the unpaid balance of the debt on approximately the same day of the billing cycle. * * * "

Section 4.1 of the Act (Ill. Rev. Stat. 1981, ch. 17, par. 6405) defines "revolving credit" as follows:

> "The term 'revolving credit' means an arrangement, including by means of a credit card as defined in Section 17-1 of the Criminal Code of 1961, between a lender and debtor pursuant to which it is contemplated or provided that the lender may from time to time make loans or advances to or for the account of

> the debtor through the means of drafts, items, orders for the payment of money, evidences of debt or similar written instruments, whether or not negotiable, signed by the debtor or by any person authorized or permitted so to do on behalf of the debtor, which loans or advances are charged to an account in respect of which account the lender is to render bills or statements to the debtor at regular intervals (hereinafter sometimes referred to as the 'billing cycle') the amount of which bills or statements is payable by and due from the debtor on a specified date stated in such bill or statement or at the debtor's option, may be payable by the debtor in installments."

Section 4.3 of the Act (Ill. Rev. Stat. 1981, ch. 17, par. 6409) provides that provisions for the taking of security, by a lender, in a revolving credit agreement, shall be unenforceable under certain conditions:

> "Whenever interest received or contracted to be received by the lender on a revolving credit as defined in Section 4.1 hereof is lawful only under the provisions of Section 4.2 hereof, any provision contained in any contract or agreement respecting a revolving credit or in any draft, item, order for the payment of money, evidence of debt or similar written instruments which is used in connection with such revolving credit which
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> (ii) provides for the taking of security to the lender for any amounts owing on the revolving credit prior to any breach or default by the debtor;
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> (iv) * * * shall not be enforceable."

The Appellate Court of Illinois had distinguished between two types of revolving credit agreements: (1) revolving charge accounts for the purchase of goods or services on

credit and (2) revolving credit agreements involving credit cards used solely to make loans or advances in lender-debtor transactions. (Johnson v. Sears Roebuck & Co. (1973), 14 Ill. App. 3d 838, 848.) A bank credit card is an example of the latter type of revolving credit agreement. In Harris Trust & Savings Bank v. McCray (1974), 21 Ill. App. 3d 605, 607-608), the court briefly discussed the nature of a bank credit card system:

" * * *

> The bank credit card system involves a tripartite relationship between the issuer bank, the cardholder, and merchants participating in the system. The issuer bank establishes an account on behalf of the person to whom the card is issued, and the two parties enter into an agreement which governs their relationship. This agreement provides that the bank will pay for cardholder's account the amount of merchandise or services purchased through the use of the credit card and will also make cash loans available to the cardholder. It also states that the cardholder shall be liable to the bank for advances and payments made by the bank and that the cardholder's obligation to pay the bank shall not be affected or impaired by any dispute, claim or demand by the cardholder with respect to any merchandise or service purchased.
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> The merchants participating in the system agree to honor the bank's credit cards. The bank irrevocably agrees to honor and pay the sales slips presented by the merchant if the merchant performs his undertakings, such as checking the list of revoked cards before accepting the card. * * *
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> These slips are forwarded to the member bank which originally issued the card. The cardholder receives a statement from the bank periodically and

> may then decide whether to make payment to the bank in full within a specified period, free of interest, or to defer payment and ultimately incur an interest charge.
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The court concluded that this type of revolving credit was a loan:

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> We believe that money advanced to a merchant in payment for merchandise received by the defendant constitutes a loan. The defendant promised to repay the bank for money it paid to the merchant for her benefit. The credit card allowed defendant to make use of the resources of the issuer bank, and the merchant is in the same financial position as if he were receiving cash from the bank at a small discount for its service. Under this arrangement, the bank assumed the risk that the cardholder would not pay the debt and has no recourse against the merchant.
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There is no basis for assuming that a different interpretation would apply to a similar system established by a credit union.

Subsection 13(5) of The Illinois Credit Union Act (Ill. Rev. Stat. 1981, ch. 17, par. 4414(5)) gives credit unions the power to make loans to its members:

> "General Powers. A credit union may: * * *
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> (5) Lend its funds to its members and otherwise as hereinafter provided;
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> "

Section 50 of the Act (Ill. Rev. Stat. 1981, ch. 17, par. 4451)

permits a credit union to offer its members self-replenishing lines of credit:

> "A credit union may grant a self-replenishing line of credit to a member up to a stated maximum amount. The terms and conditions upon which a line of credit is extended to any member may be different from the terms and conditions established for another member. Where a line of credit has been approved, no additional loan applications are required as long as the total outstanding advances under the line of credit do not exceed the maximum amount as stated in the line of credit agreement."

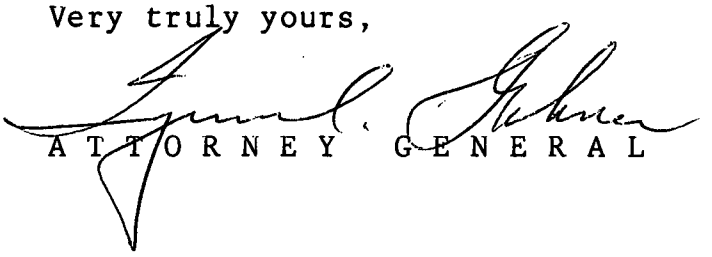
The amount of interest that a credit union may charge for loans made to its members is provided for in subsection 46(1) of the Act (Ill. Rev. Stat. 1981, ch. 17, par. 4447(1)):

> "(1) A credit union may make loans to its members for such purpose and upon such security and terms, including rates of interest, as the Credit Committee, credit manager, or loan officer approves.
> * * *
> * * * "

On the basis of the above discussion, it is my opinion that a credit union may collect interest on a revolving credit agreement under both the provisions of section 4.2 of "AN ACT in relation to the rate of interest, etc." and the provisions of subsection 46(1) of The Illinois Credit Union Act. Therefore, subsection 4.3(ii) of "AN ACT in relation to the rate of interest, etc." does not apply to credit unions. Since subsection 4.3(ii) of the Act does not apply to credit unions, the

issues raised in your predecessor's second question need not be addressed.

Very truly yours,



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