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March 17, 1986

ATTORNEY GENERAL OPINION NO. 86- 42

Judith K. Stringer, Commissioner
Office of Consumer Credit Commissioner
217 SE Fourth Street, 4th Floor
Topeka, Kansas 66603

Re: Consumer Credit Code -- Property and Liability
Insurance -- Property Insurance; Damage to Property
Unrelated to Credit Transaction

Synopsis: 1986 Senate Bill No. 454 would amend a section of the Kansas Uniform Consumer Credit Code [K.S.A. 16a-4-301(a)] to permit a lender to contract for or receive a separate charge for insurance against loss of or damage to property "all or part of which" is related to the credit transaction. The stated purpose of the bill is to allow a consumer to purchase credit property insurance on all of the consumer's household goods. If a loss occurred on goods insured pursuant to K.S.A. 16a-4-301(a) which are not listed on the security agreement, the consumer might or might not receive the proceeds from the insurance claim, depending on whether the lender was named as loss payee. Further, a lender may already sell credit property insurance under the provisions of K.S.A. 16a-2-501, subject to the restrictions of K.A.R. 75-6-9. Cited herein: K.S.A. 16a-1-102; 16a-2-501; 16a-4-301; K.A.R. 75-6-9.

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Dear Ms. Stringer:

As Consumer Credit Commissioner for the State of Kansas, you request our opinion on a question concerning 1986 Senate Bill No. 454, an act involving credit property insurance, which amends K.S.A. 16a-4-301. Specifically, you ask whether, in the event of a loss and a claim paid by an insurance company for household goods not listed on the security agreement, the creditor or the insured should receive the proceeds from the claim. Further, you ask whether a lender who is interested in selling such insurance may sell credit property coverage under the existing provisions of K.S.A. 16a-2-501.

The bill reads in part, as follows:

"Be it enacted by the Legislature of the State of Kansas:

"Section 1. K.S.A. 16a-4-301 is hereby amended to read as follows: 16a-4-301. (a) A creditor may not contract for or receive a separate charge for insurance against loss of or damage to property unless:

"(a) The insurance covers a substantial risk of loss of or damage to property all or part of which is related to the credit transaction;

"(b) the amount, terms, and conditions of the insurance are reasonable in relation to the character and value of the property insured or to be insured; and

"(c) the term of the insurance is reasonable in relation to the terms of credit." (Added language is underscored.)

Absent the inclusion of a loss payee clause in the consumer's contractual agreement with the lender, the proceeds of the insurance would be received by the insured for replacement of the lost items. The contract to purchase insurance would be considered a wholly separate and distinct contractual agreement from the credit transaction. Therefore, if a loss occurred, the insured would receive the insurance proceeds. Further, given the intent of the code to encourage fair and economically sound credit practices [K.S.A. 16a-1-102(2)(e)], we question whether a lender could be named a loss payee in the case of damage done to property previously owned by the

consumer which is not in any way related to the credit transaction. However, this question remains open under the bill as it now reads.

Under the present code, a lender may sell credit property insurance pursuant to K.S.A. 16a-2-501. K.S.A. 16a-2-501 allows a lender to impose certain additional charges for consumer credit sales, including charges for insurance and provides, in part, as follows:

"(1) In addition to the finance charge permitted by the parts of this article on maximum finance charges for consumer credit sales and consumer loans (parts 2 and 4), a creditor may contract for and receive the following additional charges in connection with a consumer credit transaction.

"(a) Official fees and taxes;

"(b) charges for insurance as described in subsection (2);

"(c) annual charges, payable in advance, for the privilege of using a lender credit card which entitles the user to purchase goods or services from at least one hundred (100) persons not related to the issuer of the lender credit card, under an arrangement pursuant to which the debts resulting from the purchases are payable to the issuer;

"(d) charges for other benefits, including insurance, conferred on the consumer, if the benefits are of value to him and if the charges are reasonable in relation to the benefits, are of a type which is not for credit, and are excluded as permissible additional charges from the finance charge by rule adopted by the administrator. (Emphasis added.)

Though a lender may sell credit property insurance pursuant to this section, it is important to note that the benefits conferred on the consumer as a result of the sale must be "of value" to the consumer and "reasonable" in relation to the benefits. [See K.S.A. 16a-2-501(d).] We additionally note that the sale of insurance is further restricted by K.A.R.

75-6-9. In light of this existing statute, the bill could be viewed as redundant.

In addition to answering your specific questions regarding 1986 Senate Bill No. 454, we feel constrained to comment on the potential effect of this legislation on the Kansas consumer. The stated purpose of the bill is to allow a borrower to purchase credit property insurance on all of his household goods. (See minutes of the Senate Committee on Financial Institutions and Insurance, February 5, 1986). Passage of this legislation could easily result in the consumer becoming a victim of "packing", a lucrative practice in which a lender adds payments for "optional insurance" and other products to the amount of the loan without the customer's requesting them. Legislation like the Federal Truth-in-Lending statute and the Kansas Consumer Credit Code, K.S.A. 16a-1-101 et seq., were established to insure the consumer a real choice in his decision to purchase credit insurance. However, according to John M. Sheffey, 8 Fl. St. Univ. L. Rev., 463, 490 (1980):

"It would be naive to assume that most or even many customers make a conscious decision concerning the desirability and price of the insurance, and, on the basis of their conclusions, inform the creditor whether to include or exclude the insurance from the transaction. This possibility is even more remote when consumers must make their decisions quickly and in the presence of lenders."

Sheffey goes on to note that such transactions are inherently coercive in nature because many consumers erroneously view the insurance purchase as a condition for obtaining credit. From the standpoint of the consumer, it is an "implied consent" method of closing a loan. The coercive nature of the transaction is compounded by the fact that, by the time the consumer receives the insurance disclosures, it is likely that the consumer has already decided to make the purchase and is unlikely to forego the credit merely because they do not like the credit terms disclosed. (Sheffey, supra at 489.)

On many occasions, the creditor neglects to make the consumer's choice obvious because the creditor will make a substantial profit from the sale of credit insurance. According to Sheffey:

" . . . the creditor stands to make a significant profit from the sale of credit insurance. The creditor has none of the usual acquisition costs associated with insurance, because potential insureds need not be sought out. They are already attracted to the creditor by the prospect of borrowing money or financing a purchase." (Id. at 466.)

Finally, it is the opinion of this office that the potential effect of 1986 Senate Bill No. 454 on consumers is contrary to the purpose for which the UCCC was established. As noted above, K.S.A. 16a-1-102 sets forth the intent and purpose of the code, and provides:

"(1) K.S.A. 16a-1-101 through 16a-9-102, and amendments thereto, shall be liberally construed and applied to promote its underlying purposes and policies.

"(2) The underlying purposes and policies of this act are:

. . . .

"(c) to further consumer understanding of the terms of credit transactions and to foster competition among suppliers of consumer credit so that consumers may obtain credit at reasonable cost;

"(d) to protect consumer buyers, lessees, and borrowers against unfair practices by some suppliers of consumer credit, having due regard for the interests of legitimate and scrupulous creditors;

"(e) to permit and encourage the development of fair and economically sound consumer credit practices;
(Emphasis added.)

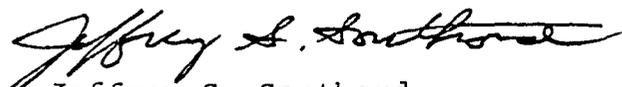
This office believes that the amendment to K.S.A. 16a-4-301 contained in 1986 Senate Bill No. 454 contains the potential to conflict with the stated purpose of the Kansas Consumer Credit Code, i.e. further consumer understanding of credit transactions, protect consumers against unfair practices by suppliers of consumer credit, and encourage sound credit practices. For example, if a consumer borrowed money to

purchase a stereo, he could also obtain property insurance on the stereo and a previously purchased television on which he owed no money, with the lender named as loss payee. If the television was destroyed, the insurance proceeds could be applied to the stereo, thus protecting the lender but leaving the consumer without something he already had.

In conclusion, 1986 Senate Bill No. 454 would amend K.S.A. 16a-4-301(a) to permit a lender to contract for and receive a separate charge for insurance against loss or damage to property "all or part of which" is related to the credit transaction. If a loss occurred on goods insured pursuant to K.S.A. 16a-4-301(a) which are not listed on the security agreement, the insured might or might not receive the proceeds from the insurance claim, depending on whether the lender was named as loss payee. Further, a lender may already sell credit property insurance under the provisions of K.S.A. 16a-2-501, subject to the restrictions of K.A.R. 75-6-9. Finally, the bill contains the potential to conflict with the stated purposes of the Kansas Uniform Consumer Credit Code, as set forth in K.S.A. 16a-1-102(2).

Very truly yours,


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Jeffrey S. Southard
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RTS:JSS:crw