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ATTORNEY GENERAL OPINION NO. 81-209

Robert L. Elliott  
Consumer Credit Commissioner  
Suite 1114, 535 Kansas Ave.  
Topeka, Kansas 66603

Re: Consumer Credit Code -- Finance Charges -- Additional Charges Not Included Therein

Synopsis: A lender who enters into a consumer loan secured by an interest in land, pursuant to the Kansas Consumer Credit Code, K.S.A. 16a-1-101 et seq., may contract for and receive certain charges which can be excluded from the finance charge computed for that transaction. These additional charges include official fees [K.S.A. 1980 Supp. 16a-1-301 (25), as amended], closing costs [K.S.A. 1980 Supp. 16a-1-301(8), (19), as amended], and additional charges permitted by administrative rule [K.S.A. 16a-2-501(1)(d)]. While it is not required that the latter two items be paid to third parties, they must be bona fide, reasonable in amount and not for the purpose of circumventing or evading the Code. Such a determination is a question of fact to be made by the Consumer Credit Commissioner, pursuant to his authority under K.S.A. 16a-6-101, et seq. Cited herein: K.S.A. 16a-1-101, K.S.A. 1980 Supp. 16a-1-301 (as amended by L. 1981, ch. 93, §5), K.S.A. 1980 Supp. 16a-2-401 (as amended by L. 1981, ch. 94, §3), K.S.A. 16a-2-501, 16a-6-106, 16a-6-108, 16a-6-110, 16a-6-113, K.S.A. 1980 Supp. 84-1-201, 84-1-203, K.S.A. 84-1-205, K.A.R. 75-6-9, 15 U.S.C.A. §1605, 12 C.F.R. §226.4.

\* \* \*

Dear Mr. Elliott:

As Consumer Credit Commissioner for the State of Kansas, you request our opinion on the scope of the term "finance charge,"

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as it is used in the Kansas Consumer Credit Code ("Code"), K.S.A. 16a-1-101 et seq. Specifically, your request goes to those items which may legally be excluded from the finance charge in connection with a consumer loan secured by an interest in real property.

Under the terms of the Code, a lender may contract for and receive a finance charge which is fixed by K.S.A. 1980 Supp. 16a-2-401 (as amended by L. 1981, ch. 94, §3) and which is related to the amount financed. "Finance charge" is defined at K.S.A. 1980 Supp. 16a-1-301(18)(a) (as amended by L. 1981, ch. 93, §5) to include the sum of:

"(i) All charges payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or as a condition of the extension of credit, including any of the following types of charges which are applicable; interest or any amount payable under a point, discount or other system of charges, however denominated; time price differential, service, carrying or other charge, however denominated; premium or other charge for any guarantee or insurance protecting the creditor against the consumer's default or other credit loss; and

"(ii) charges incurred for investigating the collateral or credit-worthiness of the consumer or for commissions or brokerage for obtaining the credit, irrespective of the person to whom the charges are paid or payable, unless the creditor had no notice of the charges when the credit was granted."

However, the term does not include those charges set forth at subparagraph (b), namely:

"(i) Charges as a result of default, additional charges (section 16a-2-501), delinquency charges (section 16a-2-502), or deferral charges (section 16a-2-503), or

"(ii) if a lender makes a loan to a debtor by purchasing or satisfying obligations of the debtor pursuant to a lender credit card and the purchases or satisfaction is made at less than the face amount of the obligation, the discount, or

"(iii) closing costs as defined in section 16a-1-301 (7)." (Emphasis added.)

The effect of these exclusions allows a creditor to make charges for various items and still receive the largest possible amount of money as finance charge within the ceiling imposed by the Code. Were this not the case, the effective rate could be increased through the addition or inflation of items such as "preparation fees," "document costs," etc. As it is clearly one purpose of the Code to require that the stated interest rate be in fact the rate paid, without the addition of hidden charges, it may be presumed that should a charge not be among those specifically excluded, it must be totaled among those making up the finance charge. Clark, The New Kansas Consumer Legislation, 42 J.B.A.K. 147, 194, n. 67 (1973).

As stated in K.S.A. 1980 Supp. 16a-1-301(18)(b) (as amended), "additional charges" set out by K.S.A. 16a-2-501 may be excluded. These charges include, at subsection (1)(a), "official fees," which are further defined at K.S.A. 1980 Supp. 16a-1-301(24)(a) (as amended by L. 1981, ch. 93, §5) to be "[f]ees and charges prescribed by law which actually are or will be paid to public officials for determining the existence of or for perfecting, releasing or satisfying a security interest related to a consumer credit sale, consumer lease or consumer loan." Also included as "additional charges," at subsection (1)(d), are

"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.)

Finally, "closing costs," as defined in K.S.A. 1980 Supp. 16a-1-301(7) (as amended by L. 1981, ch. 93, §5) are excluded, with that term meaning, with respect to a debt secured by an interest in land:

- "(a) Fees or premiums for title examination, title insurance, or similar purposes including surveys;
- "(b) fees for preparation of a deed, settlement statement, or other documents;
- "(c) escrows for future payments of taxes and insurance;
- "(d) fees for notarizing deeds and other documents;

"(e) appraisal fees; and

"(f) credit reports."

Therefore, in order to be excluded from the term "finance charge," a charge must be identifiable as one of the permitted exceptions, of which three of the most common are cited above. We note that while official fees and closing costs are fairly specifically defined, the "charges for other benefits" language of K.S.A. 16a-2-501(1)(d) is rather general in nature. However, in order to be included herein, one requirement for the item is that it be specifically excluded from the finance charge by "rule adopted by the administrator," i.e., the Consumer Credit Commissioner. To date, the following rule has been adopted at K.A.R. 75-6-9:

"(a) The charges enumerated in sec. 16a-2-501 shall be considered as 'additional charges in connection with a consumer credit transaction' if such charges are made under conditions which permit their exclusion from the definition of the 'finance charge' which must be disclosed under the provisions of the federal truth-in-lending act.

"(b) Additional charges shall be deemed to be 'in connection with a consumer credit transaction' as used in section 16a-2-501 and paragraph (a) above if: (i) as it relates to insurance premiums, the creditor or a person related to the creditor receives a commission on any insurance sold on the same day on which the consumer credit transaction was consummated; (ii) as it relates to all other additional charges, such charges are permitted to be excluded from the definition of 'finance charge' under the provisions of the federal truth-in-lending act for goods and/or services rendered within one month prior to or after the consummation of the consumer credit transaction."

When reference is in turn made to the applicable section of the federal Truth-in-Lending Act, 15 U.S.C.A. §§1601 et seq., it is found that this section in fact adds very little. This is due to the wording of 15 U.S.C.A. §1605, which mirrors that of the Code with respect to official fees [at §1605 (d) (1)] and closing costs [at §1605 (e)], as well as other charges such as insurance which need not be discussed here. However, while no additional charges are set out by this section, some

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guidance is provided by the corresponding section of Regulation Z, 12 C.F.R. §226.4, where, at (e), it is stated that an excludable charge must be "bona fide, reasonable in amount and not for the purpose of circumvention or evasion of" the Act, in addition to being specifically listed.

Therefore, given the detailed statutory framework which we have attempted to summarize above, the following conclusions may be drawn. First, the Code does allow a lender to exclude certain charges from the finance charge, even though those charges may be "in house," i.e., not paid to a third party for services such as title examination, notary fees, appraisal fees and so forth. While official fees must in fact be paid to public officials for the rendering of specified services, no such requirement exists for closing costs. However, as required by the Truth-in-Lending regulation quoted above, such charges must nonetheless be bona fide, reasonable in amount and not imposed for the purposes of concealment or for the taking of a secret profile by the lender. See, e.g., George v. General Finance Corp. of Louisiana, 414 F. Supp. 33 (S.D. La. 1976). In any event, the charge would have to be linked with a specific service, i.e., a "document fee" or a preparation fee based on the size of the transaction could not be imposed and yet be excluded from the finance charge.

Second, in our opinion an analogy may be drawn between the terms of the Code and another series of statutes dealing with commercial relationships, namely the Uniform Commercial Code, K.S.A. 84-1-101 et seq. There, the term "bona fide" is defined to mean "good faith" (K.S.A. 84-1-203) and "honesty in fact" [K.S.A. 84-1-201(19)]. Whether a particular charge was "reasonable in amount" would depend upon the current "usage of trade" [K.S.A. 84-1-205(2)] as well as the facts and circumstances of the particular transaction. Clearly a manufactured charge, even though it fits within one of the categories under the code, would not be "bona fide." Also suspect would be a charge, such as a property survey, which is not customary in real estate transactions in the particular area but instead allows the creditor to increase its return. The amount of any such "in-house" fees could be compared with any system or table of rates used in the area; upon the presentation of such, the burden would be on the creditor to justify as excludable fees in excess of those amounts. The same would be true in the case of charges which are not imposed by other lenders in the area during the course of similar transactions.

Given the above considerations, the question of whether a fee may be excluded from the finance charge would appear to be a question of fact to be determined on a case by case basis. In that your office is empowered to conduct administrative investigations (K.S.A. 16a-6-106), issue enforcement orders

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(K.S.A. 16a-6-108), and seek civil relief through injunctions (K.S.A. 16a-6-110) or fines (K.S.A. 16a-6-113), such a determination would be well within your authority.

In conclusion, a lender who enters into a consumer loan secured by an interest in land, pursuant to the Kansas Consumer Credit Code, K.S.A. 16a-1-101 et seq., may contract for and receive certain charges which can be excluded from the finance charge computed for that transaction. These additional charges include official fees [K.S.A. 1980 Supp. 16a-1-301(25), as amended], closing costs [K.S.A. 1980 Supp. 16a-1-301(8), (19), as amended], and additional charges permitted by administrative rule [K.S.A. 16a-2-501(1)(d)]. While it is not required that the latter two items be paid to third parties, they must be bona fide, reasonable in amount and not for the purpose of circumventing or evading the Code. Such a determination is a question of fact to be made by the Consumer Credit Commissioner, pursuant to his authority under K.S.A. 16a-6-101, et seq.

Very truly yours,

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