FORM 5F.3 CONSUMER PROMISSORY NOTE (FIXED AND VARIABLE RATES)

Comments: The following form is a simple interest (not precomputed) Promissory Note. This Note may be used to document a loan transaction that incorporates a fixed interest rate or a variable interest rate, for either unsecured or secured loans, including real estate transactions. We have marked the optional language by use of brackets {*the italics spell out the purpose of the option*}. The remaining language in the brackets is the optional language that may be used in the form. This form has been designed to meet the requirements of your specific loan transaction(s). Additionally, if there are several options that may be selected, the optional language is preceded by an option box . Finally, we have set forth below our cautions or concerns in situations where state laws may vary; these areas should be reviewed with local counsel.

Variable Rate or Fixed Rate

The provisions included in the Promissory Note are identical, except for the paragraphs entitled "FIXED INTEREST RATE" or "VARIABLE INTEREST RATE." Select the correct paragraph for your particular transaction.

> ***Caution*:** When using a variable rate, we urge you to select an "Independent Index" instead of the Lender's Prime Rate Index, since some states have disallowed use of the Lender's Prime Rate Index. The general public interpretation is that a "Lender's Prime Rate Index" is under the lender's control, which is often perceived to be unfair to the borrower. An "Independent Index" is an index established by a third party, for example, the "Wall Street Journal Prime Rate" index. This common index is the base rate on corporate loans posted by at least 75 percent of the nation's 30 largest banks, which is not controlled by a specific lender; therefore, it is driven by market forces.

The information you need for the Variable Rate is set forth below:

- The type of Index: For example, Prime Rate; Independent Index; or Other Index.
- Name of the Index: For example, US Treas. Securities (1 Yr.); Wall Street Journal Prime Rate.
- Index Based on: Enter a complete description, for example, the Weekly Average Yield on United States Treasury Securities, adjusted to a constant maturity of 1 (One) Year.
- Period the Rate Is Adjusted: For example, daily, weekly, monthly, quarterly, annually, or other.
- Current Index Rate: ____________%.
- Margin: Percentage over under the Index Rate _________________________%.
- The Interest Rate for the Note, which is the Current Index _____________% plus the Margin: ____________%.
- Interest Rate Ranges: Notwithstanding the foregoing provisions, under no circumstances shall the interest rate on this Note be less than _______________ percent per annum or more than the lesser of _________________ percent per annum or the maximum rate allowed by applicable law.

Demand Clause

A demand clause in the Promissory Note permits the lender to compel full payment of the obligation. Some lenders use demand language in their Promissory Notes; however, several states have prohibited demand language in consumer credit transactions.

> ***Caution:*** A demand clause may conflict with the events of default in the Promissory Note or the events of default in the Collateral Security Agreements in this transaction, which may create an ambiguity resulting in dispute or litigation when the lender exercises the demand clause in the transaction. See *N.W.I. International, Inc. v. Edgwood Bank,* 684 N.E. 2d 401 (Ill. App. 1st Dist. 1997).

Typically, the normal demand language appears in the Payment paragraph on the Promissory Note. One possible solution to avoid this potential ambiguity between the demand clause and the events of default is to include the normal demand language and then add a demand clause in the events of default in the Promissory Note. While we do not recommend using a demand clause in a secured loan, if the drafter desires to include the demand language in a secured loan, you should consider adding a similar demand clause in the event of default in the Collateral Security Agreements. However, to our knowledge, this specific approach has not yet been tested in the courts.

Insecurity Clause

An Insecurity clause in the Promissory Note permits the lender to compel full payment of the obligation, subjective to the lender's perception that the borrower does not have the ability to pay. Some lenders use Insecurity language in their Promissory Note; however, several states have prohibited Insecurity clause language in consumer credit transactions.

> ***Caution:*** If the Promissory Note contains the Insecurity clause, the lender should consult with local counsel before exercising any rights under the Insecurity clause to avoid any dispute or litigation.

If the Insecurity clause sits in the body of the Promissory Note, the drafter should also include this Insecurity clause as an event of default in the documents. If the drafter desires to include the Insecurity clause in a secured loan, you should consider adding a similar Insecurity clause in the event of default in the Collateral Security Agreements.

Cure Provisions

The Promissory Note contains "Cure Provisions," which are set forth in the Default paragraph. Typically, this paragraph may be used in real estate transactions. Many lenders will establish the curable default time as 10 or 15 days; however, several states may require that the curable default period be 30 days. For example, see Kansas's statute, K.S.A. 16A-5-111, which prohibits lenders from accelerating the maturity or taking possession of collateral until 20 days after notice of a consumer's right to cure, where the default consists only of failure to pay.

Attorneys' Fees

Typically, most Promissory Notes have a provision authorizing the lender to recover costs and expenses to enforce and collect the obligation. In the form, the language is located in the Lender's Rights paragraph. Several language variations for attorneys' fees. You should confirm with local counsel specific state law requirements for appropriate language that would enable a lender to recover costs and expenses as it enforces and collects the obligation.

Setoff Provisions

If an individual maintains a deposit account in a depository institution and owes money to the institution, and the borrower fails to pay the obligation, the institution may "set off" against the individual's deposit account. Generally, under common law in the 50 states, the depository institution has the right to setoff against the individual's deposit account. A setoff provisions paragraph is not required in the Promissory Note; however, some lenders desire to include a contractual provision authorizing the setoff. Several states require special language in the setoff provisions paragraph, for example, the state of Massachusetts.

We have included a setoff provision in this Promissory Note. This is not considered a security interest in the deposit account. To establish a security interest in the deposit account, the lender should use an Assignment of Deposit Account Agreement.

> ***Caution*:** The lender should not use the right to setoff against the individual's deposit account if the loan is secured by a real estate security interest in California. If the loan is made under California law and is secured by real estate, the lender should not include a setoff provision in the Promissory Note.

Uniform Consumer Credit Code (UCCC)

As discussed in the Chapter 5A, "What is Consumer Credit?," there are many states that have adopted the Uniform Consumer Credit Code (UCCC), which governs consumer credit. In preparing a Promissory Note, you should consider this item. Below is a typical final disclosure for a UCCC loan in Iowa.

Beginning of the Note

If the loan is covered by the UCCC, many UCCC states require that the form contain the following disclosure below the title of the form.

THIS IS A CONSUMER TRANSACTION

Default Provisions

If the loan is covered by the UCCC, the Events of Default provisions in the Promissory Note vary from the non-UCCC loan. For example, below is a typical Events of Default provision for a UCCC loan:

> DEFAULT. I will be in default if: (a) Payment Default. I fail to make a payment within ten (10) days of when it is due; or (b) Other Defaults. I fail to observe any other covenant of this Note, the breach of which materially impairs

the condition, value, or protection of or Lender's right in any collateral securing the Indebtedness, or materially impairs my right to pay amounts due under this loan.

Disclosures/Notices

If the loan is covered by the UCCC, the final disclosure above the signature in the Promissory Note varies from the non-UCCC loan. Below is a typical final disclosure for a UCCC loan in Iowa and the brackets indicate variable language depending the transaction {{ variable language}}.

> PRIOR TO SIGNING THIS NOTE, I, AND EACH OF US, READ AND UNDERSTOOD ALL THE PROVISIONS OF THIS NOTE, {{INCLUDING THE VARIABLE INTEREST RATE PROVISIONS}}. I, AND EACH OF US, AGREE TO THE TERMS OF THE NOTE AND ACKNOWLEDGE RECEIPT OF A COMPLETED COPY OF THE NOTE AND ALL OTHER DOCUMENTS RELATING TO THIS DEBT.
>
> This Notice is required by the State of _______ law. In this Notice the term "you" means the Borrower named above.
>
> NOTICE TO CONSUMER: 1. Do not sign this paper before you read it. 2. You are entitled to a copy of this paper. 3. You may prepay the unpaid balance at any time without penalty and may be entitled to receive a refund of unearned charges in accordance with law.

Disclosures/Notices — Specific Balloon Loans

In making a balloon loan covered by the UCCC, there are required Balloon Loan Disclosures/Notices which would be printed above the signature line, similar to the disclosures shown above. Check applicable state law for requirements related to specific balloon disclosures.

Collateral Reference, if Any

Many lenders include a description of the collateral securing the Promissory Note. Generally, state law does not require a reference to the collateral securing the Promissory Note; however, there are several states requiring a specific reference to the collateral if the collateral securing the Note is real estate. This Promissory Note has two collateral paragraphs; one is the real estate collateral reference paragraph and the other is a paragraph that "alerts" that the Note is secured by collateral.

Real Estate Loans

As discussed above, if the Promissory Note is secured by real estate, you may need to include a collateral paragraph referencing the real estate collateral in the Promissory Note, which is required by several states, for example, the state of California. Additionally, in loans secured by real estate, you may also need to comply with requirements under CEBA (Competitive Equality Banking Act of 1987), which would set forth a maximum interest rate for the transaction within the consumer credit contract language in the Promissory Note.

CEBA Language

Federal Reserve Regulation Z, truth in lending, requires the lender to include a maximum interest rate in the consumer credit contract (generally the promissory note or open-end revolving line of credit agreement) for certain types of loans or open-end plans. This requirement originated with the enactment of CEBA. For a loan to be subject to this requirement, the following characteristics must be met: (a) the loan or plan is subject to the disclosure requirements of Regulation Z; in other words, the purpose of the loan is for personal, family, or household purposes as defined by Regulation Z, and (b) the transaction contains provisions for interest rate increases that can occur after consummation in the case of closed-end credit or, in the case of open-end credit, the interest rate may increase during the plan or loan.

In some cases, even a fixed interest rate loan transaction may be subject to CEBA requirements. For example, CEBA disclosures are required if the loan has a demand clause or contains a preferred fixed rate. An example of a preferred fixed rate transaction is a loan to a borrower who has automatic payments deducted from his or her account, and wherein the interest rate is subject to increase upon termination of the automatic deductions.

Cosigner Provisions

If the lender desires a cosigner in the loan transaction, Regulation AA requires that any cosigner of an obligation receive a notice/disclosure containing language specifically addressing the obligations of the cosigner. The notice/disclosure may be included in the Promissory Note or it can be provided on a separate form. See 5D Section 1 commentary and Form 5D.1.

Some states have enacted legislation to add more information to the required federal notice/disclosure.

If the loan is made under California law you must provide a "bilingual cosigner form," which includes the Regulation AA notice/disclosure in both English and Spanish. The notice/disclosure may be included in the Promissory Note or it can be provided on a separate form. See Form 5D.2 and comments to that form.

If the loan is made under the UCCC, you must provide state specific language on the form, which includes the Regulation AA notice/disclosure in both English and Spanish. The notice/disclosure may be included in the Promissory Note. See Form 5D.3 and comments to this form.

FTC Notice

A Lender who, in the ordinary course of business, lends money to a consumer to purchase goods or services on deferred payments must include the FTC Preservation of Consumers' Claims and Defenses notice/disclosure. Failure to include this FTC notice/disclosure in the consumer contract can be interpreted as an unfair or deceptive act or practice. 16 CFR Sec. 433.1.

A financial institution making direct loans to a borrower for goods or services as a purchase money transaction must include the FTC Preservation of Consumers' Claims and Defenses on the Promissory Note if there is a business arrangement between the financial institution and the seller to finance the purchase of the goods or services. One or several lending transactions will not trigger this requirement to include the FTC notice/disclosure; however, a cooperative or concerted activity with the particular seller to finance sales of goods and services for consumers will trigger the requirement to include the FTC notice/disclosure. See the required notice/disclosure language as set forth at the bottom of the Promissory Note.

The Promissory Note in this section contains the FTC Notice.