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December 9, 1983

RE: Review of University Long Term Loan Promissory Note

Dear

As you requested in your letter of October 26, 1983, I have reviewed the promissory note which is to be used in connection with the University program known as the University Long Term Loan Program. Please understand that the advice offered in this letter is not an opinion of the Attorney General but is advice offered pursuant to the Attorney General's responsibility as Administrator of the Iowa Consumer Credit Code. In determining whether the Note complies with Iowa statutes, the focus should be on the Iowa Consumer Credit Code, Chapter 537 of the 1983 Code. The ICCC regulates any credit transaction which is for an amount under $25,000 and the purpose of which is for personal, family, or household use. For the transaction to be included under the ICCC, it is also necessary that the credit be extended by one who is regularly engaged in the business of making loans. The following advice is premised on the assumption that University is "regularly engaged in the business of making loans."

A major area of concern for any creditor who must comply with the ICCC is that § 537.3201 of the ICCC also requires the creditor to give the necessary federal truth-in-lending disclosures to the consumer. As you may know, some student loans, specifically those which are "made, insured, or guaranteed pursuant to a program authorized by" § 1070 et seq. of Title 20 are exempted from federal truth-in-lending requirements as of October 15, 1982. Since the funds used in the Long Term Loan Program come from private donations, the exemption for loans which are made, insured, or guaranteed pursuant to Title 20 would

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not apply, therefore the Note would have to meet the federal truth-in-lending disclosure requirements.

The general truth-in-lending disclosure requirements such as those which were set out in 15 U.S.C. § 1632 provide that in the disclosure statement the terms "annual percentage rate" and "finance charge" must be more conspicuously displayed than other terms. You may therefore wish to make the term "annual percentage rate" more conspicuous than it is now in the Note and Disclosure Statement. The more specific disclosure requirements for open-end credit such as this type of open-end loan program are set out in 15 U.S.C. § 1637 and Regulation Z, 12 C.F.R. § 226.18 (copies enclosed).

Obviously the language of the federal Truth-In-Lending Act is not perfectly suited to an open-end loan program where the time for repayment is indeterminate. Since § 1637 nevertheless requires the creditor to disclose "to the extent applicable" the conditions under which a finance charge shall be imposed, the Note should preferably define the meaning of "ceases to be at least a half-time student" (as used in paragraph III-2 of the Note) since this appears to be the central factor which determines when the finance charge will be imposed.

As regards disclosure requirements of the ICCC, the University should take care that the Note complies with § 537.3203 (Notice to Consumer), and § 537.3211 (Notice of Consumer Paper). The language on page one of the Note which reads:

> THIS IS A CONSUMER CREDIT TRANSACTION
> NOTE AND DISCLOSURE STATEMENT.

complies with § 537.3211 and the language on page three of the Note which reads:

> NOTICE TO CONSUMER - DO NOT SIGN THIS PAPER BEFORE YOU READ IT. YOU ARE ENTITLED TO A COPY OF THIS PAPER. YOU MAY PREPAY THE UNPAID BALANCE ANYTIME WITHOUT PENALTY AND MAY BE ENTITLED TO RECEIVE A REFUND OF UNEARNED CHARGES IN ACCORDANCE WITH § 537.2510 OF THE IOWA CODE.

complies with § 537.3203.

An additional disclosure requirement of both the federal and state law is that the interest rate must be stated in terms of the annual percentage rate (APR). The Note makes several references to interest, all of which use the phrase "annual percentage rate." As regards the interest rate or finance charge, one change which might be made in the Note is to make an explicit reference to the fact that the loan is not a precomputed loan, but is instead a simple interest, or interest-

bearing loan. This change could be made by means of a "box" being checked indicating interest-bearing or precomputed. While the ICCC does not require this distinction, it may help to avoid confusion on the part of the consumer as to whether or not they are entitled to a rebate for prepayment under § 537.2510. Only in precomputed consumer credit transactions is it required that a rebate of unearned interest or other charges be made (See: § 537.2510 and § 537.1301[33]).

The interest rate of five percent (5%) APR provided in the Note is in compliance with the ICCC since the University as a lender making consumer loans which is neither a supervised nor a licensed lender (See: § 537.2301 on authority to make supervised loans and § 537.1301[41] and § 537.1301[42] on definitions of supervised loans and supervised lenders) may not charge more than the "floating" interest rate provided in § 535.2(3)(a) of the 1983 Code. This assumes that the floating rate will never drop below 5% APR. Another point concerning disclosure of the interest rate or finance charge is that the service charge referred to in paragraph II(2) of page two of the Note must be included in calculating the finance charge for purposes of disclosure to the consumer and for purposes of determining compliance with finance charge or interest ceilings. (See: § 537.1301[19][a] for the definition of finance charge.)

The language in the Note in paragraph V page two which provides for default procedures should be clarified. Firstly, the University may also declare the consumer/debtor in default for reasons other than failure to pay within ten days of the due date. If the University has no intention of exercising these options allowed it by § 537.5109 to declare a default for a breach which materially impairs the consumer's prospect to pay amounts due, then paragraph V of the Note should state that failure to pay is the only ground for default.

In the event that a student defaults, the University may not, as is stated in paragraph V(1) of the Note, declare the "entire unpaid indebtness...immediately due and payable." The University must first comply with the Cure of Default provisions at § 537.5110 of the ICCC which provides at subsection four that:

> If the consumer has a right to cure a default:
> a. A creditor shall not accelerate the maturity of the unpaid balance of the obligation...or otherwise attempt to enforce the obligation until 20 days after a proper notice of right to cure is given.

Where appropriate, a creditor can elect to use attachment proceedings under Chapter 639 of the Iowa Code in lieu of using the Notice of Right to Cure. In summary, the default section of the Note should be modified to advise the consumer that the University may not accelerate the Note unless the ICCC default provisions have been complied with.

The provisions in paragraph VIII page three of the Note for delinquency charges comply with ICCC requirements. However, it should be noted that § 537.2502 (delinquency charges) provides for delinquency charges on precomputed consumer credit transactions. A delinquency charge on an interest-bearing consumer loan is not provided for by the ICCC.

The Note at page three provides that it is made without security and without endorsement except in cases where the maker is a minor. If the University in such cases intends to use co-signers or guarantors, then the Note or accompanying documents would have to meet the requirements of § 537.3208 (Notice to Co-signers & Similar Parties). Failure to provide the necessary notice to the co-signer means that the co-signer is not obligated on the Note.

The preceding discussion has focused primarily on the content of the Note and not the actual form of the Note. Since the document is to serve as both Note and Disclosure Statement, the federal Truth-In-Lending Act disclosure requirements for the form or format of the document must be taken into consideration. As stated previously, it is assumed that the loans in question are not made pursuant to Title 20 U.S.C. § 1070 et seq. and that accordingly they are not exempt from the federal Truth-In-Lending Act.

Neither the ICCC nor the federal Truth-In-Lending Act mandates that the creditor use certain forms, although Regulation Z, the implementing regulation for the federal Truth-In-Lending Act, does provide model forms. A copy of the sample or model form for a closed-end installment loan is enclosed. (See: Regulation Z, Appendix H, Form H-11.) Please note, Regulation Z does not provide forms for open-end installment loans, nor as previously stated, does it provide for loans which have indeterminate starting dates and payments. Nevertheless, to the extent that it is applicable, the disclosure statement should have a format similar to the "box" setup used in the enclosed model form.

If you or your staff have any questions concerning the advice set out above, please feel free to contact me by phone or letter and we may further discuss the matter. I hope this advice is of use to your office.

Sincerely,

Linda T. Lowe

LINDA THOMAS LOWE
Assistant Attorney General

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