



Cosigning – Is It Ever a Good Idea?

By Susan Peters, Legal Hotline Volunteer Attorney

There is nothing new about the idea of cosigning a loan. Among family and friends the practice is especially widespread and often can provide an appropriate means of helping those we care about get started or weather a financial setback. However, it can also lead to unanticipated personal and financial problems when such agreements are not entered into with the proper analysis and planning. If cosigning a loan for a close relative or friend is something you are considering, there are several safeguards you can put in place to protect yourself against common pitfalls.

If you are entertaining the idea of cosigning a loan be sure you understand the risks involved. You would, in essence, be making a loan that those in the business of making loans have declined. Before you accept this liability carefully consider the following:

*Can you afford to pay for this debt if the borrower does not? In addition to liability for the total loan obligation you may also be charged late fees, interest and collection costs.

*Your credit rating could be significantly and adversely affected.

*Liability for such a loan could affect your ability to secure other credit even if the loan is not in default.

*Where there is default the lender needn't go after the borrower first. Lenders can seek collection directly from cosigners and frequently do. A collector is going to be inclined to "follow the money" when deciding who to pursue the most aggressively.

*Where a lender files and wins a collection suit, your wages and property may be subject to garnishment and other means of collection.

*If the borrower's debt is discharged in bankruptcy, you remain obligated unless you declare bankruptcy, as well.

The Michigan Attorney General's office estimates that in some types of loan agreements, the default rate by the original borrower is as high as 75%. Do you want to guarantee a loan and take the risk of being on the receiving end of a lawsuit with odds like this?

In Michigan, the law provides some protections for individuals who enter into co-signing relationships. To protect the cosigner when he or she may not know the status of the loan and if it is in default, the lender must do certain things before alerting a credit reporting agency or taking any other collection related action against a cosigner. The lender must send the cosigner notice of delinquency or default on the part of the borrower as well as assert the cosigner's liability for

the loan. The cosigner must be given 30 days in which to respond to the notice by either paying the amount due or making other mutually agreeable arrangements with the lender. Where lenders and cosigners are able to resolve matters in this way the lender may not contact a credit reporting agency. The result is the cosigner's credit is protected.

Because of the risks involved with cosigning a loan, Federal law requires lenders to provide a printed notice in the loan agreement, advising potential cosigners of risks, including liability for the debt if not paid by the borrower, that the lender can collect the debt from either borrower or cosigner in no particular order and that the default on the debt can affect the cosigner's credit record. The notice warns the cosigner to "think carefully" before agreeing to guarantee the debt of another.

Other suggestions for a pro-active approach to avoiding problems involve careful planning in structuring the terms of your agreement -- both with the lender and with the borrower. Taking the time before signing to ensure a clear understanding of terms and conditions by all parties is the best policy and the best insurance against later problems. As with the signing of any other agreement, make sure you carefully read any agreement before signing. Be especially careful to make sure you are just a cosigner; callers to the Hotline have reported they thought they were just a cosigner but later discovered they were the sole party to

the loan. You may wish to negotiate the specific terms of your liability with the lender. Perhaps you want to limit your obligation to the principal balance -- excluding late fees, court costs, etc. Maybe you want timely notice of the borrower's payment record. You could request that the lender calculate specific amounts you might owe so as to prevent any surprises in the event of default. All negotiated terms should be in writing and included as part of your signed agreement. You should also obtain copies of all important papers such as the loan contract, Truth in Lending documents, and warranties. Don't be hesitant about contacting the lender for periodic updates on the status of the loan and timeliness of payments.

Thoroughly discuss and set forth in writing your rights of reimbursement against the borrower should you be forced to pay after a default. By law, in such situations, a cosigner is entitled to all rights, remedies, and securities which were available to the creditor. In addition, any and all terms of your agreement as cosigner with the borrower should be in writing and included with the loan document. Treat cosigning as a business arrangement with its attendant risks and benefits. Doing so encourages all concerned to behave responsibly and thereby lessens the likelihood of problems later on.

Just because you have the right to pursue the principal borrower after a default doesn't ensure you will be reimbursed. If the borrower defaulted on the

loan, he or she probably lacks resources you can collect against, or, as mentioned previously, may go bankrupt leaving you holding the bag.

For further information or assistance regarding cosigning and a variety of other issues, seniors can contact the Legal Hotline for Michigan Seniors at (800) 347-5297. In addition, the Michigan Attorney General's office is a good source of information and assistance on this topic and can be contacted at:

Consumer Protection Division

P.O. Box 30213

Lansing, MI 48909

517-373-1140

Fax: 517-241-3771

Toll free: 877-765-8388

www.michigan.gov/ag (online complaint form)

You can call the Legal Hotline weekdays 9-5 and set an appointment to have an attorney call you back, usually the same day. There is no charge for the Hotline's help.