Cosigning a Loan

The Office of the
Minnesota Attorney General
helping people afford their lives and live with dignity, safety, and respect

Not everyone can access credit when they need it. In particular, younger people—who may have limited employment or credit report history—sometimes find it difficult to obtain a loan from a financial institution. Since credit can be important to people who are trying to purchase a home or car, or finance a college education, parents, grandparents, other relatives, and even friends may be asked to cosign a loan that the lender won't make to the main borrower alone.

Although you may want to help a loved one get a start in life, there are significant legal effects for cosigners that you should be aware of.

What Happens When You Cosign?

When you cosign a loan, you become *legally obligated to repay the loan* if the borrower doesn't pay it. Most cosigners believe when they sign the papers that the borrower will be able to repay the loan on his or her own. But even if the borrower has the best intentions to meet his or her obligations under the loan, unpredictable things can happen to derail these plans, such as a loss of employment, inability to find a job, divorce, or unexpected illness.

The Attorney General's Office has heard from grandparents living on fixed incomes who are hounded by debt collectors because a grandchild cannot find a job after graduation to pay back a student loan, from parents who cosigned a loan to help a child's boyfriend or girlfriend only to be on the hook to repay the loan years after the couple has split up, and co-workers who cosigned loans for people they no longer work with.

The bottom line is this: cosigning a loan is a generous act with potentially serious financial consequences. You generally should only cosign a loan if you have the ability and willingness to pay off the loan in the event the borrower defaults.

Risks of Cosigning a Loan—What You Need to Know

- If the borrower does not repay the loan, you may be forced to repay the whole amount of the loan, plus interest and any late fees that have accrued. With most cosigned loans, the lender is not required to pursue the main borrower first, but can request payment from the cosigner any time there is a missed payment.
- Your credit can be impaired. Even if the borrower only experiences temporary financial troubles and misses just a payment or two, then cures the loan and comes current, this payment history may affect the cosigner's credit, making it harder or more expensive to refinance his or her own mortgage or obtain other credit. If the borrower defaults, the lender will probably report this to the credit bureaus, which could substantially lower your credit score.
- Even if the borrower doesn't default, cosigning a loan could still affect your credit. Lenders will view the main borrower's loan as your own. This could affect your ability to get a loan of your own.
- Many loan agreements with a cosigner include auto-default clauses. Auto-default clauses provide the lender with the right to demand full repayment of the loan under certain circumstances. For example, many loans state that if the main borrower dies or files bankruptcy, the lender may accelerate the loan and ask the cosigner to repay the full amount at once.

Before You Cosign, Become Informed

- Read the fine print and the terms and conditions of the loan. Make sure you understand what you are signing up for. You may want to have a trusted advisor review the terms to make sure you fully understand your obligations under the loan.
- Before you pledge property, such as your car, to secure the loans, make sure you understand the

consequences. You could end up losing any pledged items if the borrower defaults.

- Ask the lender to calculate the amount of money you might owe. The lender isn't required to do this but may do so if asked.
- Research whether other sources of credit are available to the borrower that do not require you to cosign a loan. For example, a student who needs a loan to afford college may qualify for federal student loans that do not require a cosigner.

Stay On Top of the Loan

If you do cosign a loan, stay on top of it:

- Ask the lender to agree to notify you if the borrower misses a payment. This will give you time to deal with the problem or make missed payments without having to repay the entire amount immediately.
- Make sure you get copies of all important papers, such as the loan contract, the Truth in Lending Disclosure Statement, and warranties if you are cosigning for a purchase. You may need these documents if there is a dispute between the borrower and the seller. You may have to get copies from the buyer.
- Get duplicate statements sent to your home or online access to the account. If you are able to do this, you won't have to rely on the lender to notify you about missed payments.
- Get online access to the account. This will give you the most immediate and up-to-date information and allow you to keep track of the payments in real time.
- Contact the lender at the first sign of trouble. This may help you avoid expensive collection costs.

If the Loan Goes into Default

If the main borrower is unable to make payments on the loan, the responsibility of repayment falls to the cosigner. You may also be responsible for late charges, penalties, and collection costs. The lender may take legal action against you, pursue you through debt collection agencies, or sell the debt to a "debt buyer" to try to collect the money that is owed on the loan if the borrower does not pay or defaults on his or her repayment obligations.

The Attorney General's Office has published flyers on debt collection and debt buyers, which are available online at *www.ag.state.mn.us*. The Fair Debt Collection Practices Act (the Act) outlines specific rights that consumers have when dealing with collection agencies. For instance, the Act allows consumers to dispute a given debt in writing within 30 days from the initial contact on the part of the collection agency. If you dispute a debt in writing, the debt collector may not continue collection efforts until you receive verification of the debt. Furthermore, the Act requires that a debt collection agency must stop calling and/or writing to you, if you request in writing that it cease such activities. This Office suggests that you make such requests by certified mail through the United States Postal Service, keeping a copy of the request for your records.

Cosigner Release

You may wish to investigate whether the loan you cosigned allows you to be released from any further obligations under the loan. Some (but not all) loans allow a cosigner to be released or removed from the loan entirely. Under a cosigner release option, the main borrower usually must make a satisfactory repayment agreement, usually of a number of consecutive monthly payments. Loan servicers will perform a credit check to verify the borrower's individual ability to repay the loan. If the lender determines the borrower is able to continue to make monthly payments, the lender *may* release the cosigner of any further loan repayment obligations. You may wish to review the loan agreement you signed or contact your lender to determine if this is an option available to you.

A Special Word about Student Loans

A common type of loan that may require a cosigner is private student loans. This is because students often have no track record of employment or financial solvency. Before you cosign a student loan, investigate whether cheaper and less risky loan products are available, including whether the student qualifies for federal student loans. According to one federal study, over 40 percent of the students who take out private student loans at some schools may qualify for federal student loans, which do not require cosigners and have lower rates.

If you have cosigned a student loan and are now facing collection activity because the student cannot repay the loan, please review the Attorney General's publication *Student Loan Handbook*, available at *www.ag.state.mn.us*. It has more information on how to navigate student loan repayment problems.