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The Co-Signed Loan

The business of negotiating and securing approval for a consumer loan is a reasonably uncomplicated process. You visit the financial institution of your choosing to complete an application form or undergo an in person interview; and based upon your “worthiness” of the amount you’re requesting, you wait for a response.

You can also apply for credit on line or by completing a mail-in application. Whatever the means, you will hear by mail or be told in person a pretty straight “Yes” or “No”.

If an application for credit is declined, there is usually a pretty sound reason. Typically it will be because the consumer either; (a) can’t pay – your income is not adequate to assure payment by you is possible each month; or (b) won’t pay – you’ve defaulted or otherwise failed to pay one or more items of credit you’ve had in the past and therefore you are at risk to do the same with this new account. Most people walk away if declined. But on occasion, particularly if the need for the credit is critical, we can get an approved from the financial institution if we can find a so-signer or a co-maker; both mean the same thing.

Many of us live in fear of being asked to co-sign a loan. I’ve heard it compared to a request for an organ. This is somewhat an overstatement. It’s not the kind of request made of a passing acquaintance or a barely known co-worker. We’re terrified because the question usually comes from someone we’re close to, like a family member or life long or best friend. Many people are unwilling to help this way. But they don’t know how to say no and they proceed anyway. So enters significant stress into their life, and they live in fear that their financial world might come tumbling down at any time. Many times it does.

So what exactly are you doing by co-signing a loan for a relative or friend? Before giving an answer, be sure you understand just what it is you're taking on. Be sure the person asking for the favour understands too!

By co-signing a loan you are guaranteeing a debt. You're not guaranteeing a single or several payments, you're assuring the full monty, principle and interest; hook line and sinker!

If the prime borrower – that's the friend or relative you've decided to help – gets into financial problems and fails to make payments on the loan, in all likelihood, by the time the financial institution actually contacts you to let you know you're on the hook, a pile of collection costs and other fees for being late have also accumulated.

As well, a lending institution can (and often will), choose to use the same means of collecting from a co-signer as they would from anyone in default on an account. The fact that you have not personally benefited from the financial transaction is a non-issue and does not give you any preferred status in the creditors eye. You can expect collection notices, difficult phone calls and possibly, legal proceedings against you, which have a potential to see your wages attached or your property seized. The real shocker, is the fact that the default can become part of your permanent credit record even though you're not the actual person in default.

Co-signing is a risky business. If you agree to co-sign, you're in effect accepting a risk that the financial institution opted to decline. We've also seen a number of situations over the years where the lending institution actively and aggressively pursues the co-signer, even before soft collection methods against the people who actually borrowed the money in the first place.

In spite of the preceding points, the reality is that upon reflection many people will go ahead and co-sign. You should ask yourself a few sobering questions just the same. Consider for example:

- If there's a default here, and I end up paying or having my credit rating damaged, what will be the effect on my personal relationship with the people I'm signing for?
- Do I have enough money in savings to promptly pay this loan in full if a default occurs?
- This co-signed loan will be a liability for me. If I proceed, am I limiting my own credit availability for things my family and I may require?
- Has the prime borrower considered other possibilities, has he considered other borrowing options or approaches to his or her current financial need?
- Has the prime borrower ever defaulted on a co-signed loan in the past?
- What is the prime borrower's credit history like, and why is the lending institution only willing to give him a loan with a co-signer?

Typically, it would not be unusual for Mom and Dad to be asked to help "launch" their sons and daughters financial life by cosigning their first consumer loan. In these instances, the reason for the request is quite obvious and the risk is somewhat smaller. The borrower has no credit rating and their employment situation is relatively new. Most of us can relax if we choose to help in these situations. But with any other request to co-sign, we need to exercise significant and sober, second thought; long and hard second thought. And if we take long enough, the request to co-sign might just disappear. There's nothing like a subtle hint!

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