

Bankruptcy Process – Dealing With Credit Unions and Cross Collateralization Agreements

By Arizona Bankruptcy Attorney John Skiba

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Credit Unions – Good Cop/Bad Cop

When times are good your credit union can seem like they are your best friend. However, if times get bad, the credit union may be your most unforgiving creditor. Credit unions have different rules to abide by as compared to banks, and when it comes to the bankruptcy process the loans they give and the credit cards they issue can present unique problems. Specifically, the cross collateralization agreements that most credit unions include in their loan documents can create real problems for you in your bankruptcy case.

So what is a cross collateralization agreement? First, it is rarely an agreement. It is usually a term in the fine print of your checking account agreement or credit card documents or loan agreement. The cross collateralization agreement essentially states that all of your accounts/loans with that particular credit union are connected, and, if you default on your credit card or your loan that your checking account is collateral for that loan/card and they can invade your checking account without your permission and take your money.

Cross Collateralization Agreements in Bankruptcy

This big issue that this creates in bankruptcy is how we classify a particular debt. Whether a debt is classified as secured (i.e. there is collateral backing the loan) or unsecured (i.e. credit cards, medical bills, etc.) makes a huge difference on whether you have to pay the debt after the bankruptcy filing. For example, almost all credit cards are unsecured, and because of this pretty much across the board credit card debt is discharged or eliminated through a bankruptcy filing.

Well, if there is a cross collateralization agreement associated with your credit card, the bank will likely allege that what looks like a typical unsecured credit card is actually a secured debt that is backed by your checking account and possibly a car loan that you have with the credit union. Secured debts generally have to be paid, even after bankruptcy. For instance, if you don't pay your car payment (a secured debt) after bankruptcy, they can take your car. So, if based upon the cross collateralization agreement your credit card is a secured debt, you would be required to pay that debt or risk losing the collateral associated with the credit card (usually the money in your credit union checking account).

Ways of Working Around the Cross Collateralization Agreement in Bankruptcy

During the bankruptcy process this can become a problem because even after the bankruptcy court issues a discharge of your debt the credit union may claim that because of the cross collateralization clause that even they credit card debt you had with them wasn't discharged in

the bankruptcy. One way that I have dealt with this in prior cases is to negotiate with the credit union to release any alleged security they may be claiming on the credit card.

If you have a car loan with your credit union you will be required to submit a reaffirmation agreement. The bankruptcy court typically won't approve the reaffirmation agreement unless the credit union agrees to give up something, whether that is a lower interest rate, lower principal balance, or, if they are willing to void the cross collateralization agreement and thus allowing you to discharge the credit card debt with the remaining unsecured debt.

So, what do you do if you believe you have a cross collateralization issue? First, you should meet with a bankruptcy attorney and have an evaluation done as to whether a cross collateralization agreement is actually in place. Federal law has very specific requirements for there to be a valid cross collateralization agreement. If such an agreement is in place, it does not mean you can't file for bankruptcy, it just means that there is going to be some extra negotiating with your creditors by your bankruptcy attorney.

I offer a free bankruptcy consultation where we can discuss your specific situation.

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