

SUBJECT: Debt Collection in Wisconsin

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INTRODUCTION

This release applies to all credit unions, state and federal. It addresses selected issues under Wisconsin and federal law regarding debt collection activities. The ii Release does not treat each of these issues in depth. In many cases it introduces a topic, but refers the reader to another release with more detail.

EXECUTIVE SUMMARY

As explained in this ii Release, the federal Fair Debt Collection Practices Act does not typically apply to credit union staff conducting their own internally staffed collection program. That law will apply to external collectors and attorneys engaged in collections on the credit union behalf.

Wis. Stats. Chapter 427, a part of the Wisconsin Consumer Act, is the state law regulating debt collection in Wisconsin. It applies to conduct and practices in connection with the collection of consumer transactions. It applies to the credit union when collecting its own Wisconsin Consumer Act transactions. It also applies to the credit union's third-party debt collectors. Please note that agricultural loans are exempt from most provisions of the Wisconsin Consumer Act (e.g., the notice of right to cure default) but are not exempt from Chapter 427. See *ii Release No. B054 – Agricultural Lending*.

Each credit union should develop a collection program appropriate for its size, complexity, field of membership, and lending area. The program should have definite, measurable goals (e.g., follow up on missed promise to pay within 24 hours.)

Collection programs usually share the following common characteristics:

- **Prompt action.** Early collection efforts enhance the success rate of collecting delinquent loans (e.g., within a few days of the first missed payment, long before the loan appears on the monthly delinquent loan list);

- *Repeated contacts.* A collection effort should consist of a series of payment requests, beginning with a gentle reminder and ending with a firm demand for repayment. Collection staff should record all collection contacts, and the results of those contacts, on a collection card or computer system collection-working file;
- *Varied action.* A collection program that combines letters and personal telephone calls can prove quite effective. Collection staff should determine the "intent" of the delinquent member as early as possible. If delinquent members cannot make balloon payments, they should reach agreement with the credit union to make regular, partial payments. As a minimum, the borrower should initiate and maintain regular contacts with the credit union. If the borrower does not establish "good faith" or "good intent," the credit union should take stronger collection action;
- *Prompt follow up on failed promises.* If borrowers do not follow through with their promise to pay, the credit union should follow up within a maximum of 48 hours;
- *Follow through.* If the credit union does not follow through with its threatened action, delinquent borrowers may believe they can ignore the credit union; and
- *Proper paperwork.* Although not considered part of a collection program, staff must properly complete paperwork to maximize its collection right and reduce the likelihood of legal action against the credit union.

FINANCIAL COUNSELING

One helpful method of controlling loan delinquency is financial counseling. This should be done for many members at the time they apply for a loan. There are those delinquencies where financial counseling is the only method of assisting member/debtor to repay.

Contact the delinquent member and have them come in to the credit union office to discuss the problem loan.

As a financial counselor, review the loan, the application, the account and look at the possible problems: increasing debts, poor financial management, personal problems, employment or income source problems, and dishonesty. If the delinquent debtor will work with the credit union and come in for financial counseling, a cooperative solution to the delinquency problem may be possible. Possible solutions include:

- Refinancing to set payments at a level more appropriate to the ability to repay,
- Deferring a payment on the debt,
- Developing a budget for the debtor,
- Establishing a payment plan for all legitimate creditors,
- Voluntary surrender or repossession of collateral, and
- Sale of the collateral by the member perhaps with substitution of one of lesser value as collateral on the loan with the difference applied to the delinquent loan.

With financial counseling, other solutions may be found. The goal is to provide the debtor with an ability to pay the credit union debt, as well as to control future indebtedness and provide for the essentials of life.

COLLECTION SYSTEM

An important part of limiting delinquency problems is to maintain an effective collection system, so that any missed payments are promptly sought and collected.

A sound collection system consists of three elements:

- *Policies and procedures.* The board of directors, president, and appropriate staff, should develop effective lending and collection policies. These policies are to reflect the legal requirements and needs of the credit union.

Access *PolicyAid* through the League's website, for sample policies such as

- Collections and Workout Policy;
- Charge-off Policy;

- Loan Workout, Nonaccrual, and Troubled Debt Restructuring Policy; and
- Repossession Policy.

Please keep in mind that *PolicyAid* is a nationwide vendor, so cannot address the requirements of state law. It is up to the credit union to adapt their policies to address issues under Wisconsin law, such as those described in this release.

- *Recognizing when a loan becomes delinquent as set forth in the loan agreements.* Taking immediate action will greatly increase your chances of collecting on the loan.
- *Follow-up.* Upon becoming aware of a missed or insufficient payment, it is necessary to contact the delinquent member in short order, certainly not later than 15-20 days after the missed payment date. The board of directors should set policy on the follow-up time period. The sooner the member is notified that he or she is behind in payments, the better the chances are of receiving payment.

PRIVACY, CONFIDENTIALITY, SAFEGUARDING OF MEMBER INFORMATION

Credit unions and their employees have strict requirements under the bylaws, oath of office, and the CFPB's Privacy of Consumer Financial Information rule (Regulation P) to maintain confidentiality about a member's financial affairs. See *ii Release No. 0152 - Reg. P - Privacy of Consumer Financial Information*. In addition, the NCUA's Safeguarding of Member Information rule requires the credit union to strive to protect that information from disclosure or security breaches. See *ii Release No. 0155 - NCUA Guidelines for Safeguarding Member Information & Responding to Unauthorized Access*.

Collection staff must observe these rules and cannot freely share information with employers, spouses, and neighbors about the member's financial affairs.

The credit union cannot share personally identifiable financial information except as disclosed to the borrower in the credit union's privacy disclosure in accordance with Regulation P. Personally identifiable financial information includes nearly any personal information collected in the debtor's dealings with the credit union or gathered from other sources. Even the fact that a person has loans or accounts with the credit union is confidential. The following are example of personally identifiable financial information:

- Information a consumer provides to you on an application to obtain membership, a loan, credit card or other financial product or service;
- Account balance information, payment history, overdraft history, and credit or debit card purchase information;
- The fact that an individual is or has been one of your members or has obtained a financial product or service from you;
- Any information about your consumer if it is disclosed in a manner that indicates that the individual is or has been your consumer;
- Any information that a consumer provides to you or that you or your agent otherwise obtain in connection with collecting on a loan or servicing a loan; and
- Information from a consumer (e.g., credit) report.

If, in your credit union's privacy disclosures, you have previously notified the borrower that, among other things, the credit union makes disclosures of nonpublic personal information as permitted by law, you may disclose nonpublic personal information to the extent necessary to enforce a your rights in collection the consumer's loans or other debts where the disclosure is required or is one of the lawful or appropriate methods to enforce the credit union's rights. Thus, you may accurately report a person's debts and repayment status to the credit bureau. You may provide confidential information to the extent necessary in court documents in legal actions to collect on a loan or to enforce rights in collateral. But you should not give more information than is required. In recognition of privacy rights many court filings now require redaction of certain sensitive information that is unnecessary, such as Social Security Numbers and account numbers.

The privacy rule permits the credit union to disclose nonpublic personal information to another lender when contacted to help it try to collect a bad loan, if the credit union's privacy notice said it makes disclosure of nonpublic personal information as permitted by law. However, you must be aware of the possibility that the party requesting the information may be attempting to obtain that information about your customer through false or fraudulent statements to you (pretext calling). You must ensure that you are really dealing with a party entitled to the information. This is a duty under the Safeguarding of Member Information rule. See *ii Release No. 0155 - NCUA Guidelines for Safeguarding Member Information & Responding to Unauthorized Access*.

SIMPLE INTEREST DEFERRAL AND EXTENSION AGREEMENTS, AND OTHER LOAN MODIFICATIONS

Sometimes a credit union is willing to modify the terms of a loan in some way in order to help the borrower and increase the change of collecting the balance. This may take the form of a loan modification or a complete refinancing of the loan. Some modification agreements are extensive. Comparatively simple modifications may include deferral or extension agreements. According to the NCUA and federal banking regulators:

- *Extension* means extending monthly payments on a closed-end loan and rolling back the maturity by the number of months extended. The account is shown current upon granting the extension. If extension fees are assessed, they should be collected at the time of the extension and not added to the balance of the loan.
- *Deferral* means deferring a contractually due payment on a closed-end loan without affecting the other terms, including maturity, of the loan. The account is shown current upon granting the deferral.

ii Release No. B037 - Simple Interest Deferral and Extension Agreements describes simple interest deferral and extension agreements and many of the important issues that may be involved with them.

Any credit union using a deferral or extension agreement should consider the implications, if any, under its loan workout policy, non-accrual policy and the regulatory reporting requirements for troubled debt restructured (TDR) loans. See NCUA Rules & Regs. 12 CFR Part 741 App. B.

A deferral agreement is often used when there is an extraordinary, temporary reason why a borrower cannot make scheduled payments on time. Examples include illness or layoff where the borrower's income is expected to be restored in a short time.

Deferral agreements are not commonly used on open-end credit lines, such as R.E.A.P.®, Kwik-Cash, or credit cards. In those cases, many lenders follow Reg. Z guidance on notification requirements for “skip payments.” Another approach is a customized waiver or modification agreement used on a case-by-case basis, as with a borrower facing a hardship. The League’s Wisconsin Open-End Credit Payment Waiver agreement (WCUL #83004) allows the credit union and borrower(s) to agree to waive the payment requirements on one or more specified due dates on a WCUL Kwik-Cash line of credit form or a R.E.A.P. ® home equity line of credit form. The form specifies the date when the regular payment schedule resumes. As a result, no other notification is required by Truth in Lending or the Wisconsin Consumer Act. However, a credit union will normally bill the borrower in advance on their monthly statement, stating the upcoming due date and minimum monthly payment. The form cannot be used to make other changes, such as to the interest rate, payment level, draw period, etc. *ii Release No. B046 - Consumer Kwik-Cash Loans* and *ii Release No. B064 - R.E.A.P. & Home Equity Lines of Credit* each describe use of the form, include an image of it, and provide the line-by-line instructions.

A deferral or an extension agreement is not used when any terms of the loan, other than payments, are changed. Deferral and extension agreement forms do not have the proper language to address the other changes. Another suitable loan modification agreement may meet the credit unions needs if it is carefully drafted to make the desired changes and designed to work with the note being modified in a legally sound manner.

ii Release No. B037 describes The League’s Wisconsin Simple Interest Loan Modification Agreement form (#83002), for use with WCUL closed-end loan agreements. The form provides for the deferral of remaining payments on the loan. Three repayment options are available for the repayment clause:

- (a) additional monthly payments required after the original final payment due date, extending the maturity of the loan;
- (b) a larger “balloon” payment required, retaining the original final payment due date;
- (c) the monthly payment amount increased, sufficient to retain the original final payment due date.

Since repayment option (a) extends the maturity of the loan, it may create complications for mortgage loans. Options (b) or (c) may avoid those complications. *ii Release No. B037* includes an image of the form sold by The League, general guidance, and line-by-line instructions for completion.

Another approach to payment relief for a borrower is a loan modification with a lower interest rate and a corresponding reduction in the payments. *ii Release No. B081* describes the WCUL Loan Modification Agreement - Interest Rate and Payment Reduction (WCUL #83003) form, for use with The League’s simple interest, closed-end loan forms. It allows the credit union and borrowers to agree to a lower interest rate on a loan, with a corresponding reduction in the payments. This

specific approach can avoid the need for new Truth in Lending disclosures. *ii Release No. B081* includes an image of the form sold by The League, as well as line-by-line instructions for completion.

NCUA EXPECTATIONS

The NCUA Examiner's Guide includes the agency's overview of what a collection program should look like, and some particular issues examiners may review. In addition, the NCUA sets important standards for all federally-insured credit unions in an Interpretive Ruling and Policy Statement (IRPS), found in *NCUA Rules & Regs., Part 741 App. B*. The IRPS establishes requirements for:

- Management of loan workout arrangements,
- Regulatory reporting of troubled debt restructured loans (TDRs), and
- Loan nonaccrual.

NCUA Examiner's Guide

Chapter 10 of the NCUA Examiner's Guide offers this overview of collection procedures:

Each credit union should develop a collection program appropriate for its size, complexity, field of membership, and area. The program should have definite, measurable goals (e.g., follow up on missed promise to pay within 24 hours.) Collection programs usually share the following common characteristics:

- *Prompt action.* Early collection effort enhances the success rate of collecting delinquent loans (e.g., within a few days of the first missed payment, long before the loan appears on the monthly delinquent loan list);
- *Repeated contacts.* A collection effort should consist of a series of payment requests, beginning with a gentle reminder and ending with a firm demand for repayment. Collection staff should record all collection contacts, and the results of those contacts, on a collection card or computer system collection-working file;
- *Varied action.* A collection program that combines letters and personal telephone calls can prove quite effective. Collection staff should determine the "intent" of the delinquent member as early as possible. If delinquent members cannot make balloon payments, they should reach agreement with the credit union to make regular, partial payments. As a minimum, the borrower should initiate and maintain regular contacts with the credit union. If the borrower does not establish "good faith" or "good intent," the credit union should take stronger collection action;
- *Prompt follow up on failed promises.* If borrowers do not follow through with their promise to pay, the credit union should follow up within a maximum of 48 hours;
- *Follow through.* If the credit union does not follow through with its threatened action, delinquent borrowers may believe they can ignore the credit union; and
- *Proper paperwork.* Although not considered part of a collection program, staff must properly complete paperwork to reduce the likelihood of legal action against the credit union.

Examiners should review the loan loss ratio and the delinquent loan ratio when evaluating collection procedures. These ratios show the credit union's past loss experience and its current potential loss position. The adequacy of the collection program and the credit union's level of compliance with it provide an indication of the future direction of delinquency. The composition of delinquency can also indicate whether problems are recent or older.

Examiners should discuss deficiencies in the collection program, policies, or practices with the appropriate officials. When encountering weak collection procedures, examiners may document their review by completing the Collection Program questionnaire in AIREs.

Examiners may also review previously charged-off loans. Often, credit unions assign these loans to outside collectors. These outside collectors should issue periodic status reports to the credit union. If these reports indicate a lack of follow up, officials must take appropriate action.

An "inverted" delinquency (more delinquent loans in the 6 to 12 and 12 months and over range than in the 2 to 6 months range) may indicate a problem in the collection program. The examiner should review the reasons for the inversions and, if necessary, reach agreements with the board to improve the collection practices. Inversion can also indicate the credit union does not charge off loans in a timely manner.

In a "normal" delinquency condition, more loans exist in the 2 to 6 months range than in the 6 to 12 months and 12 months and over ranges. Examiners may analyze the loans 1 to 2 months past due to determine if a weakness in the collection program is beginning to surface.

Erratic trends in delinquency, such as increasing delinquency followed by a sudden decrease that does not relate to loan charge-offs, can indicate potential abuse (e.g., due date bumping or fictitious loans.) Examiners may expand the review if they note unusual trends.

Management of loan workout arrangements

Loan workout arrangements should consider and balance the best interests of both the borrower and the credit union. The lack of a sound written policy on workouts can mask the true performance and past due status of the loan portfolio. Accordingly, the credit union board and management must adopt and adhere to an explicit written policy and standards that control the use of loan workouts, and establish controls to ensure the policy is consistently applied.

The loan workout policy and practices should be commensurate with the credit union's size and complexity, and must be in line with the credit union's broader risk mitigation strategies.

The policy must define eligibility requirements (i.e., under what conditions the credit union will consider a loan workout), including establishing limits on the number of times an individual loan may be modified. The policy must also ensure credit unions make loan workout decisions based on the borrower's renewed willingness and ability to repay the loan.

See Exhibit A of *ii Release No. B072* for the NCUA's detailed guidance on this requirement.

Regulatory reporting of troubled debt restructured loans (TDRs)

The past due status of all loans must be calculated consistent with loan contract terms, including amendments made to loan terms through a formal restructure. Credit unions must report delinquency on the Call Report consistent with this policy, focusing data collection on loans meeting the definition of TDR under GAAP.

The IRPS eliminates the past discrepancies between NCUA's definition of troubled debt restructuring (TDR) and that used in GAAP. The NCUA does not intend anything in the IRPS to change the Financial Accounting Standards Board's definition of TDR in any way. In addition to existing agency policy, the IRPS sets NCUA's supervisory expectations governing loan workout policies and practices and loan accruals.

Troubled Debt Restructuring is as defined in GAAP and means a restructuring in which a credit union, for economic or legal reasons related to a member borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. (*FASB ASC 310-40, "Troubled Debt Restructuring by Creditors."*) The restructuring of a loan may include, but is not necessarily limited to:

- The transfer from the borrower to the credit union of real estate, receivables from third parties, other assets, or an equity interest in the borrower in full or partial satisfaction of the loan,
- A modification of the loan terms, such as a reduction of the stated interest rate, principal, or accrued interest or an extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk, or
- A combination of the above.

A loan extended or renewed at a stated interest rate equal to the current market interest rate for new debt with similar risk is not to be reported as a restructured troubled loan.

See Exhibit B of *ii Release No. B072* for the NCUA's detailed guidance on this requirement.

Capitalization of interest

Prior to July 30, 2021, NCUA rules required each federally insured credit union's (FICU's) policy to prohibit additional advances to finance unpaid interest and credit union fees. Now, Appendix B to Part 741 of the NCUA Rules *has been amended* to remove the prohibition on the capitalization of interest – the addition of accrued but unpaid interest to the principal balance of a loan – in connection with loan workouts and modifications. The change applies to workouts of all types of member loans, including commercial and business loans. FICUs still may not capitalize credit union fees and commissions; however, they may continue to make advances to cover third party fees to protect loan collateral, such as force-placed insurance or property taxes.

In making the change the NCUA noted:

Modifications of loans that result in capitalization of unpaid interest are appropriate only when the borrower has the ability to repay the debt in accordance with the modification. At a minimum, if a FICU's loan modification policy permits capitalization of unpaid interest, the policy must require each of the following:

1. Compliance with all applicable consumer protection laws and regulations, including, but not limited to, the Equal Credit Opportunity Act, the Fair Housing Act, the Truth In Lending Act, the Real Estate Settlement Procedures Act, the Fair Credit Reporting Act, and the prohibitions against the use of unfair, deceptive or abusive acts or practices contained in the Consumer Financial Protection Act of 2010. (The Board notes that FICUs are also expected to comply with applicable State consumer protection laws that, in some instances, may be more stringent than Federal law, prohibiting, for example, the charging of interest on interest, subject to any case-by-case Federal preemption determinations that may be appropriate.)
2. Documentation that reflects a borrower's ability to repay, a borrower's source(s) of repayment, and when appropriate, compliance with the FICU's valuation policies at the time the modification is approved.
3. Providing borrowers with documentation that is accurate, clear, and conspicuous and consistent with Federal and state consumer protection laws.
4. Appropriate reporting of loan status for modified loans in accordance with applicable law and accounting practices. The FICU shall not report a modified loan as past due if the loan was current prior to modification and the borrower is complying with the terms of the modification.
5. Prudent policies and procedures to help borrowers resume affordable and sustainable repayments that are appropriately structured, while at the same time minimizing losses to the credit union. The prudent policies and procedures must consider:
 - i. Whether the loan modifications are well-designed, consistently applied, and provide a favorable outcome for borrowers.
 - ii. The available options for borrowers to repay any missed payments at the end of their modifications to avoid delinquencies or other adverse consequences.
6. Appropriate safety and soundness safeguards to prevent the following:
 - i. Masking deteriorations in loan portfolio quality and understating charge-off levels;
 - ii. Delaying loss recognition resulting in an understated allowance for loan and lease losses account or inaccurate loan valuations;
 - iii. Overstating net income and net worth (regulatory capital) levels; and
 - iv. Circumventing internal controls.

Loan nonaccrual

Credit unions must ensure appropriate income recognition by placing loans in nonaccrual status on loans that are past due by 90 days or more, reversing or charging-off previously accrued but uncollected interest, complying with the criteria under GAAP for Cash or Cost Recovery basis of income recognition, and following the specifications in the IRPS regarding restoration of a nonaccrual loan to accrual status.

Credit unions must adopt written nonaccrual policies that specifically address the discontinuance of interest accrual on loans past due by 90 days or more, as well as the requirements for returning such loans (including member business loan workouts) to accrual status.

See Exhibit B of *ii Release No. B072* for the NCUA's detailed guidance on this requirement.

KNOW YOUR LOAN DOCUMENTATION

The loan note and the security agreement or mortgage are the credit union's agreements with the member regarding the terms of the loan and the collateral. Those documents govern the rights and responsibilities of each party, in compliance with the law. It is important for the debt collector to be familiar with those terms and conform its actions to the rights granted. Errors may be costly.

Pay close attention not only to the terms of the loan documentation, but also who signed it. An individual is normally liable for payment on a loan only if they personally signed the loan agreement – typically a “note” or a “credit agreement” – as a borrower or coborrower. The loan agreement includes the promise to pay the debt, agreed payment schedule, definition of default, interest rate, etc.

A person can also become liable if they sign a personal guarantee for a loan. Unless they have *also* signed the note or a personal guarantee, the following individuals are *not* normally personally liable on a loan:

- A non-signing spouse (even if a court orders the non-signing spouse to assume payments upon divorce or legal separation),
- A person who signs a security agreement or mortgage to provide collateral for the loan,
- A person who is a joint owner on a deposit account,
- A person who receives an Explanation of Personal Obligation or Notice to Cosigner,
- A person who has homestead rights or receives a notice of right to cancel,
- An owner of a corporation or LLC that obtains a loan.

If an individual in the list above has not signed a loan agreement or personal guarantee, they cannot normally be reported to the credit bureau or sued for a money judgment on the note. However, the credit union can still:

- Name a non-signing spouse in a court action to the extent necessary to reach their interest in marital property (e.g., garnishment) on a loan granted in the interest of the marriage or family. This ability is limited to marital property under the Wisconsin Marital Property Act. Its viability as a remedy may be limited by divorce, court order, marital property agreement, removal from the state, etc.
- Name the owner of collateral or the holder of homestead rights in a legal action for repossession or foreclosure of that property if the credit union has a valid lien on the property, with appropriate signatures.

What cross-collateral rights are given?

A security agreement or mortgage sometimes includes a cross-collateral clause, saying it secures certain other loans - sometimes even certain future loans. This can enable the credit union to recover on another debt that was otherwise undersecured, or unsecured, such as a credit card - Kwik Cash, etc. Look closely at the mortgage or security agreement. What note(s) or loan agreement(s) does the security document say it secures? For example, who signed the mortgage with a cross-collateral clause, saying that the property may secure other debts that they may owe to the credit union?

Never attempt to enforce cross-collateral rights without a careful review of the documentation to be sure the cross-collateral clause applies in the particular case. A cross-collateral clause is often drafted to avoid inadvertently securing a loan in a way that would trigger the right of rescission, take a prohibited lien on household goods, transform a normal credit card into a home-secured HELOC, trigger flood insurance rules, or other compliance complications. This may result in cross-collateral rights not being available in some cases when you would have liked it. The cross-collateral clause may disclaim that it is secured by such collateral, in order to avoid the same types of compliance complications.

KNOW WHICH LAWS APPLY

There are many different laws and regulations that may apply to different loans. Some affect the rights and duties of the credit union, including collections. They may even override some terms of the loan agreement. The collector needs to be alert to which state and federal laws apply to a particular loan under the circumstances, and what their impacts are. Many such laws are discussed in this release, often briefly, with a cross reference to another release for more in-depth treatment.

Credit unions collecting on loans to residents of other states should also be mindful that they may sometimes be required to comply with applicable laws of the other state. This is a complex issue and not necessarily resolved by statements in loan documents saying that an action is governed by Wisconsin law. This is an issue to explore with your legal counsel.

WISCONSIN MARITAL PROPERTY ACT

Passage of the Marital Property Act (MPA) created Wis. Stats. Ch. 766 and made Wisconsin a community property state in 1986. None of the states surrounding Wisconsin, or any of those east of the Mississippi River, are community property states. This makes a profound difference in underwriting, documentation, and collection of loans in Wisconsin as opposed to most other states.

The principal feature of the MPA is that, by operation of law, both spouses have an equal ownership interest in certain property – which generally includes property acquired by either or both spouses during marriage, such as income. This is “marital property.” There are some exceptions, such as gifts or inheritances, which are the individual property of the spouse who receives them. Under the MPA, the name on title to property does not determine who owns it. It does help determine, however, who has a right to control the property – that is, whether one spouse, acting alone, can pledge an item of property as collateral, sell it, or otherwise deal with it.

Couples are free to make agreements between themselves that change whether property is classified as individual or marital. Such an agreement can reduce the types of property that may be available to a credit union to satisfy a bad loan – but only if the agreement was made known to the credit union before the loan was made.

The MPA provides that any obligation incurred by a spouse during marriage (i.e., until the date a court grants a final judgment for divorce or legal separation), is *presumed* to be incurred “in the interest of the marriage or the family.” This is sometimes called a “family purpose” obligation. If a spouse applies for credit during marriage, and the debt will be incurred in the interest of the marriage or the family, then the credit union *must* determine the applicant’s creditworthiness based on *all* marital property available to satisfy that debt, in the same way that it would consider the property that is available to satisfy an unmarried applicant’s debt. This requires the credit union to consider the incomes of both spouses. For example, a spouse who does not work outside the home may apply for credit without the other spouse and still claim the other spouse’s income, and all of their marital property, on the credit application. A credit union that fails to consider all available marital property in this situation may be fined up to \$1,000.

But if only one spouse incurs a debt, who can the credit union collect from in case of a default?

- *Family Purpose Obligations.* An obligation incurred in the interest of the marriage or the family may be satisfied from all marital property, no matter which spouse holds the property, and from all other property of the incurring spouse (regardless of how titled). The non-obligated spouse’s individual property and pre-determination date property is not available (regardless of how titled). As explained above, a non-applicant spouse does not become personally obligated just because the other spouse incurs a debt in the interest of the marriage or family. But his/her income, if it is marital property, can be garnished.
- *Pre-Marriage Obligations.* An obligation incurred by a person before marriage (whether or not in the interest of the marriage or family) may be satisfied from: i) property of that spouse that is not marital property and from ii) that part of the marital property that would have been property of that spouse but for the marriage. The obligation cannot be satisfied from the non-incurring spouse’s individual property or that part of the marital property that would have been the non-incurring spouse’s but for the marriage (regardless of how titled). Thus, none of the non-incurring spouse’s wages can be reached. These rules also apply to obligations incurred during the marriage that are attributable to an obligation arising before the marriage or to an act or omission occurring before marriage.
- *Pre-MPA Obligations.* If a debtor/creditor relationship existed for a married person in Wisconsin when the MPA became effective (January 1, 1986), but enforcement is sought after that date, (even if the obligation was incurred in the interest of the marriage or family) a creditor can recover only from i) property of the obligated spouse that is not marital property and from ii) that part of marital property which would have been the property of that spouse but for enactment of the MPA. The obligation cannot be satisfied from the non-incurring spouse’s individual property or that part of the marital property that would have been the non-incurring spouse’s but for the passage of the MPA (regardless of how titled). Thus, none of the non-incurring spouse’s wages can be reached.
- *Other Obligations.* This category includes obligations incurred after a couple’s determination date for a purpose other than in the interest of the marriage or family. It should be rare for a married person to incur an obligation that is not in the interest of the marriage or family.

One example may be a spouse who guarantees the debt of a third party outside the family.

But even this is still subject to the presumption that it is incurred in the interest of the marriage or family. These obligations may be satisfied from any property of the incurring spouse that is not marital property and from the incurring spouse's 50% interest in marital property, *in that order*.

- *Who Can Be Sued?* Under Wisconsin law (§ 803.045), if the obligation was incurred in the interest of the marriage or family, a credit union can bring an action against the non-incurring spouse if it cannot obtain jurisdiction over the incurring spouse. For all other classifications of debt, a credit union can bring an action against the spouse who incurred the obligation or against both spouses. It is usually preferable to name both spouses. In any case, after a credit union obtains judgment, it can proceed against either spouse to recover marital property.
- A credit union that has obtained a judgment can conduct what is known as a supplementary examination, in which the debtor is questioned, under oath, regarding sources of income, assets, etc. The credit union can docket the judgment, which may then, to some extent, become a lien on the debtor's property. The credit union may also be able to garnish wages and financial accounts. Even if the underlying loan was unsecured, a credit union can try to "execute" on the judgment, a process by which the county sheriff can seize certain kinds of property from the debtor to satisfy the judgment. Credit unions should consult with their own counsel regarding collection options, or contact the League's Legal Affairs Department for more information.

Of course, when a loan is secured by collateral, that collateral is available to satisfy the debt no matter which spouse holds it. And if both spouses are parties to a loan, all of their individual and marital property is available to satisfy the debt. Generally, though, a credit union cannot require both spouses to sign when only one has applied for a loan.

Reporting delinquencies to a credit reporting agency

As explained above, a non-applicant spouse does not become personally obligated just because the other spouse incurs a debt in the interest of the marriage or family. It only means that the credit union can reach the couple's marital property – no matter which spouse holds it – for collection purposes. Because of the differences in personal liability, it appears that a delinquency would be reported to a credit-reporting agency under the incurring spouse's name only, and not under the non-incurring spouse's name.

Changes in status of spouse

If either or both spouses move out of Wisconsin, or they divorce, or a spouse dies, the credit union's collection rights may be affected. For example, after divorce, the incomes the spouses earn are no longer considered marital property. So, if one spouse incurs a debt in the interest of the marriage or the family during the marriage, the other spouse's income cannot be garnished after a divorce to satisfy the debt. There are exceptions to this rule, depending on the way the divorce court divides responsibility for the spouses' debts.

Change in Domicile. Marital property that is removed to another state maintains its classification and continues to be available to creditors. Marital property maintains its classification even if either or both spouses are no longer domiciled in Wisconsin.

However, property acquired by spouses *after* either or both are no longer domiciled in Wisconsin is governed by the law of the new domicile. If one of the spouses establishes domicile outside Wisconsin, the Act no longer applies to the marriage. This can have a practical effect on a credit union's recovery rights that arose while the spouses were domiciled in Wisconsin. A creditor who relied on the earned income of the non-incurring spouse in granting credit may have substantially diminished rights if both spouses or the spouse generating the income moves to a common law property state.

Divorce and Legal Separation. The rights of creditors to recover marital property do not change simply because spouses start a divorce action, even if they are living apart. But a final judgment of divorce or legal separation can have a significant impact on the pool of assets a creditor can pursue to collect a marital obligation. After divorce (just as during marriage), an obligation incurred in the interest of the marriage or family during the marriage may still be satisfied from all marital property and from all other property of the incurring spouse.

However, the incomes earned by the former spouses after a divorce are no longer considered marital property. So, the income the non-incurring spouse earns after a divorce is no longer available (i.e., it cannot be garnished) to satisfy family purpose obligations the other spouse incurred during the marriage. This rule has an exception: A final judgment for divorce or legal separation usually divides responsibility for obligation incurred during the marriage, ordering each ex-spouse to pay certain debts. If the judgment provides that the non-incurring spouse is responsible for particular obligations to the credit union, then the credit union can also recover from the non-incurring spouse's post-divorce income (i.e., by garnishing it) and from any other property as if both spouses had incurred the obligation.

If a non-incurring spouse is assigned former marital property assets under a final judgment of divorce or legal separation, that property can be recovered by creditors just as it was during the marriage, but only “to the extent of the value” the property had on the date of judgment. Any post-judgment appreciation belongs to the spouse who receives the assets.

Death of Spouse. In general, upon the death of a spouse:

- The surviving spouse retains his or her undivided one-half interest in each item of *marital property*. The surviving spouse’s share in each item of marital property is not subject to probate.
- The decedent’s ownership rights in *survivorship marital property* vest solely in the surviving spouse (without probate) and the property then belongs wholly to the surviving spouse.

The MPA makes an important distinction in the way it treats a non-incurring spouse’s income after the other spouse dies vs. after divorce. For obligations incurred in the interest of the marriage or family by the deceased spouse from a creditor who regularly extends credit (which includes credit unions), the subsequent income of the surviving spouse can be garnished to satisfy the obligation. By contrast, after a divorce or legal separation, the MPA prohibits a creditor from garnishing the income of the nonincurring spouse, unless the final judgment of divorce or legal separation provides otherwise.

Other effects of the death of a spouse can be complex. The result varies depending on the classification of the obligation and whether it is the incurring or non-incurring spouse that dies first. For more information, contact the League’s Legal Affairs Department.

More information

ii Release No. B005 provides more detailed guidance on the Marital Property Act. A compliance checklist is attached to that release as Exhibit A. Exhibit B is a chart showing Property Available to Satisfy Obligations Incurred by One Spouse, (in addition to any collateral).

COLLECTION DOCUMENTATION

A collection system must document the delinquent amount, the term of delinquency and the follow-up on delinquent loans. This system can be as simple as a 4" x 8" card or can be sophisticated software. It may have spaces or fields for the name, address and change of addresses, security, date of the loan, type of loan, interest rate, place of employment or source of income, and date of last payment, etc. The collection history should include telephone calls made, agreements reached, letters written, legal action initiated, results of action, and settlement if any, etc.

TELEPHONE COLLECTIONS

The telephone is a most important collection tool. In making these calls, some pointers may be helpful. Remember, the object is to receive a payment and an agreement on future monthly payments until the balance is paid in full:

- Be sure you have the right person, the debtor (or the debtor’s spouse), on the telephone. Don’t discuss the debt with anyone else. Talk to the debtor using their name. Don’t rush the opening comments.
- Give the reason for calling. Describe the delinquent status simply and clearly.
- Make strategic pauses. This will shift the conversation burden to the delinquent debtor. Make the debtor explain the cause of the delinquency.
- Ask questions about repayment, including why the payments have been neglected. This should prompt responses indicating the debtor’s ability to repay. Ask questions about current employment, use and condition of the collateral, and its location. A payment plan should address how repayments are to be brought up-to-date, without the need for repossession or court action. Often there is not so much a request for prompt payment in full, but regular payments of an agreed amount.
- Prepare the payment plan. Set specific payments to be made as agreed upon. Set the time periods that each payment is to be made.
- Close the call, summarize the details of the plan for repayment, and thank the debtor.
- If the member lapses in keeping a commitment made to the collector, contact the member on the very next day to determine the next step.

Telephone Consumer Protection Act

The Federal Communications Commission (FCC) has rules that enforce the federal Telephone Consumer Protection Act (TCPA). Among other things, the TCPA restricts the use of automatic telephone dialing systems (i.e., autodialers) and artificial or prerecorded voice messages. The FCC's TCPA rules also limit calling hours, require the transmission of caller-ID information, restrict abandoned calls, and regulate the sending of unsolicited faxed advertisements.

Because of the broad way the rules define what an autodialer system is, these rules likely impact a credit union's collections calls to borrowers, and in some cases can require prior express consent. For details, see The League's *ii Release No. 0162 – "Telemarketing and Related Consumer Protections."*

TCPA violations can be very costly. The TCPA provides a private right of action for violations and statutory damages in the amount of \$500 for each violation; and up to \$1,500 for each willful violation. When these numbers are multiplied, potential damages can be quite significant.

WISCONSIN CONSUMER ACT

(Wis. Stats. Chs. 421-427)

The Wisconsin Consumer Act (WCA) applies to many loans to Wisconsin consumers, even many real estate-secured loans. It provides many consumer protections, some of which are important to the collection process. It is important for collection staff to understand which loans are subject to the Wisconsin Consumer Act and what those protections are.

The WCA generally applies to any loan, lease, or credit sale (including refinancings, consolidations, deferrals and other modifications) made in Wisconsin to a consumer for a personal, family, or household purpose unless any of the following exceptions apply:

1. The amount financed on closed-end credit exceeds \$25,000 ([increased to \\$50,000 as of Jan. 1, 2027](#)). For open-end credit, [this](#) threshold does not apply to any meaningful extent.
2. All borrowers on the loan are organizations.
3. The loan is secured by a first mortgage (or equivalent security interest¹).

Exhibits A and B of *ii Release No. B001* provide flow charts illustrating the scope of the Wisconsin Consumer Act:

- Exhibit A - Closed-End Flow Chart for Determining Wisconsin Consumer Act (WCA) Coverage
- Exhibit B - Open-End Flow Chart for Determining Wisconsin Consumer Act (WCA) Coverage:

A loan is also subject to the Wisconsin Consumer Act if the documentation includes language by which the parties agree that the Act will apply. Some credit unions choose to use Wisconsin Consumer Act forms even when the Act would not otherwise apply, when they believe that approach will be more efficient or reduce compliance risk.

The Wisconsin Consumer Act is found in the Wisconsin Statutes, in the following chapters:

- Ch. 421. *Consumer transactions — General provisions and definitions.*
- Ch. 422. *Consumer credit transactions.*
- Ch. 423. *Consumer approval transactions and other consumer rights.*
- Ch. 424. *Consumer transactions — Insurance.*
- Ch. 425. *Consumer transactions — Remedies and penalties.*
- Ch. 426. *Consumer transactions — Administration.*
- Ch. 427. *Consumer transactions — Debt collection.*

The WCA addresses many issues, including but not limited to the following:

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| <ul style="list-style-type: none"> • Additional charges, including open-end late fees (422.202), • Delinquency charges (422.203), • Deferral charges (422.204), • Advances to perform agreements of customer, e.g., payment of insurance, taxes on collateral (422.207), • Right to prepay (422.208), • Rebate upon prepayment (422.209), | <ul style="list-style-type: none"> • Receipts, accounting, evidence of payment (422.306), • Authorization to confess judgment prohibited (422.405), • Interlocking loans (422.408), • Attorney fees (422.411), • Limitation on default charges (422.413), • Notice of termination of liability (422.415), • Restrictions on security interests (422.417), |
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| <ul style="list-style-type: none"> • Accrual of cause of action, default (425.103), • Notice of customer's right to cure default (425.104) • Cure of default (425.105), • Voluntary surrender of collateral (425.204), • Action to recover collateral (425.205), | <ul style="list-style-type: none"> • Restriction on deficiency judgments (425.209), • Computation of deficiency (425.210), • Nonjudicial enforcement limited (with limited exception for vehicles using a Notice of Right to Cure Default/Take Possession) (425.206). |
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Some, but not all of the above issues are covered later in this ii Release or in separate releases.

The following ii Releases address compliance issues under the WCA:

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| <ul style="list-style-type: none"> 0066 – Payroll Deduction Forms 0110 – Consumer Approval Transactions B002 – Variable Rate Adjustment Notices B005 – Wisconsin's Marital Property Act B007 – Credit Practices Rule B010 – Open-End Credit Application Disclosure B013 – Credit Union Setoff Checklist B024 – Tax Refund Anticipation Loans B025 – Voluntary Surrender of Collateral; Right to Redeem B030 – Adjustable Rate Mortgage Lending Programs B031 – Right to Cure Default B035 – Single Payment Loans B037 – Simple Interest Deferral and Extension Agreements | <ul style="list-style-type: none"> B046 – Consumer Kwik-Cash Loans B049 – Interlocking Loans B051 – Off-Site Sales B053 – Real Estate Mortgage Lending B054 – Agricultural Lending B055 – Wisconsin Consumer Act Registration B062 – High-Cost Mortgage Loans Under HOEPA B063 – FTC Rule on Preservation of Consumers' Claims and Defenses B064 – R.E.A.P.® & Home Equity Lines of Credit B066 – Self-Help Repossession of Motor Vehicles B081 – WCUL Loan Modification Agreement – Interest Rate and Payment Reduction |
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Debt collection - prohibited practices

(Wis. Stats. § 427.104)

As mentioned earlier, Wis. Stats. Chapter 427, a part of the Wisconsin Consumer Act, is the state law regulating debt collection in Wisconsin. It applies to conduct and practices in connection with the collection of consumer transactions. It applies to the credit union when collecting its own Wisconsin Consumer Act transactions. It also applies to the credit union's third-party debt collectors. Please note that agricultural loans are exempt from most provisions of the Wisconsin Consumer Act (e.g., the notice of right to cure default) but are not exempt from Chapter 427. See *ii Release No. B054 – Agricultural Lending*.

The Wisconsin Consumer Act claims broad jurisdiction, such as that its rules apply:

- to consumer transactions made in this state and to modifications including refinancings, consolidations and deferrals, made in this state, of consumer credit transactions wherever made.
- to any debt collection activity in this state, including debt collection by means of mail or telephone communications directed to customers in this state.
- if the customer is a resident of this state at the time of a consumer transaction and the parties then agree that the law of this state applies.

In attempting to collect a debt arising from a consumer transaction (including those for an agricultural purpose), a debt collector is not permitted to:

1. Use or threaten to use force or violence to cause physical harm to the debtor or the debtor's dependents or property;
2. Threaten criminal prosecution;
3. Disclose or threaten to disclose information adversely affecting the debtor's reputation for creditworthiness with reason to know that the information is false;
4. Initiate or threaten to initiate communication with the debtor's employer prior to obtaining final judgment against the debtor. Exceptions to this rule are made: (1) in connection with a wage assignment, (2) to verify employment status or earnings, or (3) where an employer has an established debt counseling service or procedure;

5. Disclose or threaten to disclose to a person other than the debtor or the debtor's spouse information affecting the debtor's reputation, with knowledge or reason to know that the other person does not have a legitimate business need for the information. This does not prohibit the disclosure of information permitted by statute;
6. Disclose or threaten to disclose information concerning the existence of a debt known to be reasonably disputed by the debtor, without disclosing the fact that the debtor disputes the debt;
7. Communicate with the debtor or a person related to the debtor with such frequency or at such unusual hours or in such a manner as can reasonably be expected to threaten or harass the debtor;
8. Engage in other conduct which can reasonably be expected to threaten or harass the debtor or a person related to the debtor;
In a 1983 case, the Wisconsin Court of Appeals ruled that 69 calls to the debtor over a 19-month period was not harassment.
9. Use obscene or threatening language in communicating with the debtor or a person related to the debtor;
10. Claim, attempt or threaten to enforce a right with knowledge or reason to know that the right does not exist;
(It is not a violation of this provision to merely send a billing statement to, or collect the amount due from, the spouse of the debtor, if a "tattle-tale" notice has been provided to the spouse under the Marital Property Act.)
11. Use a communication which simulates legal or judicial process or which gives the appearance of being authorized, issued or approved by a government, governmental agency or attorney-at-law when it is not;
12. Threaten action against the debtor, unless like action is taken in regular course or is intended with respect to the particular debt; or
13. Engage in conduct in violation of a rule adopted by the Administrator of the Consumer Act after like conduct has been restrained or enjoined by a court in a civil action by the administrator against any person pursuant to the provisions on injunctions against false, misleading, deceptive or unconscionable agreements or conduct (§§ 426.109 and 426.110)

GPS/Starter interrupter devices

Credit unions should exercise caution in use of global positioning system (GPS) and "starter interrupter devices" – as collection tools. Starter interrupter devices are mechanisms installed on motor vehicles that can be activated by remote control to prevent them from starting. The Wisconsin Department of Financial Institutions (DFI) website says:

Installation of GPS and/or Starter Interrupt Technology on a Vehicle

Written January 26, 2016

Installation of a GPS and/or a device that is designed to remotely disable a vehicle is not illegal. However, use of this technology must comply with the Wisconsin Consumer Act in addition to any other laws that may govern the usage in a particular situation.

This statement supersedes and replaces any previous statements or positions by the department on this issue.

Nonetheless, the DFI's previous statements gave examples of the compliance issues that may be raised. In a 2012 interpretive opinion, the DFI said, "The use of such devices is prohibited." The DFI gave three reasons:

- Starter interrupters violate Wisconsin Consumer Act limits on unfair collection practices (Wis. Stats. §427.104), since preventing a consumer from moving a vehicle could lead to parking tickets, towing costs, or the inability to use a driveway or garage.
- The devices also violate Wisconsin insurance law (Wis. Stats. § 218.0116(1)(f)), since it would be unreasonable to require a borrower to maintain insurance coverage on a vehicle but prevent him/her from using the vehicle.
- In addition, the DFI said that using such devices "has the same result as taking possession of the vehicle" and "is the equivalent of a repossession." Therefore, a lien holder disabling a vehicle before it would have the right to take possession (as through a replevin action in court or a self-help repossession) would violate section 425.206 of the Wisconsin Consumer Act.

The credit union should consider risks such as the above when using GPS and starter interrupter devices for collection purposes.

Notice of right to cure default

(Wis. Stats. § 425.104)

Upon default of a Wisconsin Consumer Act transaction, the credit union may mail to the member and any other obligors, a written notice of right to cure default as required by law, giving 15 days to take whatever steps are necessary to cure the default. If the default is properly cured within the 15-day period, the member's rights shall be restored as if no default had occurred. See *ii Release No. B031* for important details, including the complexities involved in determining whether a Wisconsin Consumer Act loan is, in fact, in default.

A generic notice default is typically provided in connection with loans not subject to the Wisconsin Consumer Act if required by the credit agreement. Even if not explicitly required by the agreement, it may be necessary to "accelerate" the maturity of payments on a delinquent loan, to call the entire outstanding loan balance due.

Be sure to review the particular loan documents in question regarding any definition of default on the loan, and any notice or right to cure requirements that have been agreed to by the borrower.

Recovery of collateral

The credit union may use only legal means to recover collateral. No collateral for a Wisconsin Consumer Act transaction may be repossessed without a replevin judgment except where allowed by law:

- The owner of collateral may voluntarily surrender his/her own collateral at any time. Credit union staff may advise members of this right but may not demand surrender of collateral on consumer loans unless any Right to Cure Default has expired. A form such as the *Statement of Surrender and Acknowledgment of Receipt of Collateral* (WCUL #82052) is recommended to document the transaction. If it is titled collateral, the owner(s) must also actually carry out the transfer of ownership by signing the title over to the credit union. See *ii Release No. B025*.
- When a motor vehicle is collateral for a consumer loan (or when a motor vehicle consumer lease is involved), the credit union may be able to send a "Notice of Right to Cure Default/Take Possession" of the motor vehicle, since this is not considered a "demand" for return of the collateral. The credit union may also use this right to recover the vehicle without a judgment. See *ii Release No. B066* for details on the proper use of this procedure and its limitations.

Limitation on default charges

(Wis. Stats. §§ 422.411, 422.413)

Under §422.413 of the Wisconsin Statutes (part of the Consumer Act), a loan agreement can only authorize the credit union to recover "reasonable expenses incurred in the disposition of collateral." Paragraph (2g) of that section then goes into specifics, listing expenses that the credit union may recover when it repossesses cars, trailers, snowmobiles, boats, airplanes or mobile homes after a default. (In all cases, expenses can only be recovered if they are "reasonable and bona fide.")

The list starts by allowing the recovery of expenses related to actually picking up the collateral. The types of allowable expenses differ, depending on whether the job is done by a third party (e.g., a repo agent) or the credit union's own staff:

- (a) Expenses of taking and holding the collateral if paid to persons not related to the creditor.
- (b) Travel and transportation expenses of the creditor or the creditor's employees in taking possession of the collateral.

In addition, subsection (c) also lets the credit union recover certain expenses – but only if they're paid to a third party. There are two options: sub. 1 and sub 2. The credit union can recover the greater of these two:

1. All of the following expenses of preparing the collateral for sale if paid to persons not related to the creditor:
 - a. Expenses for cleaning and restoring the appearance of the collateral, not to exceed \$100.
 - b. Expenses for repair of damage to the collateral if covered by insurance, not to exceed the lesser of any deductible amount or \$250.
 - c. Expenses for mechanical repairs to the collateral, not to exceed \$200.
2. Expenses for any repair to the collateral which increase the selling price of the collateral, not to exceed the amount by which the selling price is increased because of the repairs, if paid to persons not related to the creditor. The selling price of the collateral before repairs shall be established by any reasonable method, at no cost to the customer.

Notice that this list does not include credit union default charges or collection agency fees or commissions. They are not permitted even if the loan agreement provides for them.

Attorney fees

Attorney fees are not listed in the Wisconsin Consumer Act statute as permissible default charges. A separate section of the Wisconsin Consumer Act, Wis. Stats. §422.411(1) says that except for first-lien mortgages, "with respect to a consumer credit transaction no term of a writing may provide for the payment by the customer of attorney fees." This means that in loans subject to the Consumer Act, the loan agreement cannot include language that says the credit union may recover its actual attorney fees from defaulted borrowers.

Instead, the Wisconsin Statutes allow courts to award the parties to a lawsuit a token amount of what are called "statutory" attorney fees. Wis. Stats. §814.04(1) says:

- When the amount recovered or the value of the property involved is more than you can sue for in small claims court (\$10,000), attorney fees are \$500.
- When it is between \$1,000 and the maximum you can sue for in small claims, attorney fees are \$300.
- When it is less than \$1,000, attorney fees are \$100.
- In other cases where you may not be seeking a monetary judgment, attorney fees are \$300.

If the credit union gets a judgment by default (i.e., the debtor doesn't file an answer or appear in court), the statute says that the court will only award it half the attorney fees listed above. No attorney fees are permitted on behalf of the credit union unless it is represented in court by an attorney-at-law.

The statutes also provide that the court can add certain costs to the judgment, including service of process fees, postage, photocopying, express delivery, deposition costs, fees for expert witnesses, etc.

Advertising, auction fees

What about recovery of advertising costs or other charges, like fees paid to an auctioneer, to the balance when incurred in the disposition of collateral? Our Legal Affairs archives include a 1985 "Annual Report to the Governor and Legislature on the Wisconsin Consumer Act" prepared by the Commissioner of Banking. It explains that the commissioner then construed a phrase from §422.413 – "reasonable expenses incurred in the disposition of collateral" – to include "auction expenses [and] expenses incurred in advertising the collateral for sale." As far as we know, that reading hasn't changed over the years. So, it seems that advertising and auctioneer fees are likely still among the repossession costs that a credit union can recover.

FAIR DEBT COLLECTION PRACTICES ACT (15 USC § 1692)

The Fair Debt Collection Practices Act (FDCPA) is the federal law regulating debt collection activities. It imposes many more requirements, relating to:

- Acquisition of location information;
- Communication with consumers and third parties in connection with debt collection;
- Harassment or abuse;
- False or misleading representations;
- Unfair practices;
- Validation of debts;
- Multiple debts;
- Legal actions by debt collectors; and
- Furnishing certain deceptive forms.

Fortunately, the FDCPA does not apply to the credit union when collecting its own loans and using its own name. Just the Wisconsin rules apply in that case. However, the FDCPA does apply to collection agencies or attorneys collecting debts on behalf of the credit union. Consult the FDCPA for the additional requirements if the credit union collects the debts of another creditor or collects debts under another name.

UDAAP CONCERNS

Credit union collections should be aware that certain activities could raise concerns under various state and federal statutes and regulations that bar unfair, deceptive, or abusive acts or practices.

Prohibition of unfair, deceptive, or abusive acts or practices in the collection of consumer debts

The CFPB warns of possible collection violations in CFPB Bulletin 2013-07 “*Prohibition of Unfair, Deceptive, or Abusive Acts or Practices in the Collection of Consumer Debts*” (July 10, 2013).

The bulletin describes certain acts or practices related to the collection of consumer debt that could, depending on the facts and circumstances, constitute UDAAPs prohibited by the Dodd-Frank Act. Whether conduct like that described in this bulletin constitutes a UDAAP may depend on additional facts and analysis. The examples described in this bulletin are not exhaustive of all potential UDAAPs. The CFPB may closely review any covered person or service provider’s consumer debt collection efforts for potential violations of Federal consumer financial laws.

Depending on the facts and circumstances, the following non-exhaustive list of examples of conduct related to the collection of consumer debt could constitute UDAAPs. Accordingly, the CFPB will be watching these practices closely.

- Collecting or assessing a debt and/or any additional amounts in connection with a debt (including interest, fees, and charges) not expressly authorized by the agreement creating the debt or permitted by law.
- Failing to post payments timely or properly or to credit a consumer’s account with payments that the consumer submitted on time and then charging late fees to that consumer.
- Taking possession of property without the legal right to do so.
- Revealing the consumer’s debt, without the consumer’s consent, to the consumer’s employer and/or co-workers.
- Falsely representing the character, amount, or legal status of the debt.
- Misrepresenting that a debt collection communication is from an attorney.
- Misrepresenting that a communication is from a government source or that the source of the communication is affiliated with the government.
- Misrepresenting whether information about a payment or nonpayment would be furnished to a credit reporting agency.
- Misrepresenting to consumers that their debts would be waived or forgiven if they accepted a settlement offer, when the company does not, in fact, forgive or waive the debt.
- Threatening any action that is not intended or the covered person or service provider does not have the authorization to pursue, including false threats of lawsuits, arrest, prosecution, or imprisonment for non-payment of a debt.

Restricting electronic account access

The League’s *ii Release No. 0183 – “Denial of Services”* – explains our recommendation that credit unions should not suspend electronic account access (including suspending debit cards) as a collection strategy to prompt payments or communications from delinquent borrowers. Our recommendation is based on a 2016 Consumer Financial Protection Bureau (CFPB) *Consent Order* against Navy Federal Credit Union. The CFPB cited Navy Federal for “unfair, deceptive or abusive” acts or practices (UDAAP) involving a variety of debt collection practices, including improperly restricting members’ electronic account access.

According to the Consent Order, between 2013 and 2015 Navy Federal froze electronic account access and disabled electronic services for about 700,000 accounts after consumers became delinquent on Navy Federal loans or had overdrawn deposit accounts. Navy Federal “violated the UDAAP protections of the Consumer Financial Protection Act of 2010 by unfairly restricting consumers’ electronic account access – blocking debit cards, ATM usage, and online account functions – when the consumers had an overdrawn deposit account or delinquent credit account,” the Consent Order said. Navy Federal’s restrictions prevented consumers from “managing their accounts online,” “accessing online or mobile platforms to check account balances” and “adding travel alert[s] to the consumer’s account through mobile platforms.”

The Consent Order left many questions unanswered about 1) what level of electronic account access restrictions, if any, might have been appropriate and 2) what disclosures might have been appropriate. Unless/until the CFPB issues additional guidance, The League cannot say what level of electronic account access restrictions is allowed under UDAAP or what

notices/disclosures should be given before a credit union imposes such restrictions. Credit unions should take care to review their policies and procedures, their disclosures, and any system of restricting electronic account access for delinquent borrowers. *Consider dropping any practices to suspend electronic account access (including suspending debit cards) for delinquent borrowers until we know what disclosures and practices regulators would treat as satisfying UDAAP.*

Other unfair collection practices cited

The CFPB's Consent Order also cited Navy Federal for various other collections practices it said were unfair or deceptive:

- Threatening legal action and wage garnishment against borrowers unless they made payments, though the credit union seldom took such actions;
- Threatening to contact borrowers' commanding officers to pressure service members to repay, when the credit union in fact had no intention to do so; and
- Telling borrowers that failing to pay would impact their credit scores, though the credit union had not analyzed borrowers' credit histories to substantiate their claims.

All of these activities would likely violate Wisconsin's statutory restrictions on consumer loan collections, as explained earlier in the section titled "Prohibited Practices, § 427.104."

The CFPB's Consent Order applies UDAAP language from the Consumer Financial Protection Act (CFPA) of 2010. Although only credit unions with more than \$10 billion in assets are directly subject to CFPB oversight and examination, credit unions should be aware that a similar statute prohibiting "unfair or deceptive" acts or practices applies to state-chartered credit unions of any size, and the Federal Trade Commission issues implementing regulations under that statute.

Credit unions should train collections staff against unfair or deceptive collections practices, including those barred by federal UDAAP laws and state consumer protection laws.

CFPB: LOSS MITIGATION PROVISIONS

(12 CFR § 1024.41)

The loss mitigation provisions of the CFPB's Mortgage Servicing Rules generally require credit unions to:

- Work with borrowers to complete timely applications for loss mitigation options.
- Evaluate complete and timely loss mitigation applications within 30 days for all loss mitigation options available to the borrower. If you require documents or information not in the borrower's control to determine if loss mitigation options are available, you will be required to provide the borrower with a notice that informs the borrower of, among other things, the specific information you are missing.
- For complete and timely applications, inform borrowers of whether the servicer will offer the borrower a loss mitigation option and, if the borrower is denied a loan modification option, of the specific reasons for the denial.
- Evaluate timely appeals submitted by eligible borrowers. The appeals must be reviewed by independent personnel, that is, not the same personnel who initially evaluated the loss mitigation application.
- Refrain from beginning or completing the foreclosure process in certain circumstances, as set forth below, when a borrower is being evaluated for loss mitigation options as required under the rule.

The rule does not require the credit union or the owner of a mortgage loan to offer any specific loss mitigation option. Nor does it mandate any particular eligibility criteria.

However, the credit union must maintain policies and procedures reasonably designed to, for example, properly evaluate the application for all loss mitigation options for which the borrower may be eligible pursuant to any requirements established by the owner or assignee. In addition, policies and procedures must address how you will apply any specific thresholds for eligibility for a particular loss mitigation option. Subject to certain limitations, you must evaluate borrowers for all loss mitigation options the owner or assignee makes available, whether or not the individual borrower is ultimately eligible for any particular loss mitigation option. See "*Properly evaluating loss mitigation applications*" in Section 10.4.2 for more information on loss mitigation evaluation policies and procedures.

The loss mitigation provisions, as well as the continuity of contact rule described below, apply to federally related mortgage loans secured by the borrower's principal residence, but has some exceptions, including but not limited to HELOCs and reverse mortgages.

Is there a small servicer exemption to the loss mitigation rule? Small servicers are exempt from the majority of the loss mitigation requirements. However, several prohibitions apply to small servicers. Small servicers shall not:

- Make the first notice or filing required to foreclose unless a borrower's mortgage loan obligation is more than 120 days delinquent, the foreclosure is based on a borrower's violation of a due-on-sale clause, or the servicer is joining the foreclosure action of a superior or subordinate lienholder
- Make the first notice or filing required to foreclose if a borrower is performing pursuant to the terms of a loss mitigation agreement
- Move for foreclosure judgment or order of sale, or conduct a foreclosure sale, if a borrower is performing pursuant to the terms of a loss mitigation agreement

See *ii Release No. B075*, particularly the CFPB Mortgage Servicing Rule Small Entity Compliance Guide in Appendix A, for more information.

Continuity of contact rule

(12 CFR § 1024.40(a))

In general, the CFPB's Mortgage Servicing Rules require credit unions to maintain policies and procedures reasonably designed to provide delinquent borrowers with access to personnel who can assist them with loss mitigation options where applicable.

Those credit unions that are "small servicers" as defined in the CFPB's Mortgage Servicing Rules are exempt from the continuity of contact rule.

What is continuity of contact? The credit union must design policies and procedures to ensure, among other things, that:

- It assigns personnel to delinquent borrowers by the time the credit union sends the written notice required by the early intervention requirements, but, in any event, by the 45th day of the borrowers' delinquency.
- Borrowers can reach the assigned personnel by phone and that such personnel can respond to borrower inquiries and, as applicable, help them pursue loss mitigation options, including by advising them about the status of any loss mitigation application and applicable timelines.
- Credit union personnel can retrieve, in a timely manner, the complete record of the borrower's payment history and all of the written information the borrowers provide in connection with a loss mitigation application and, when appropriate, provide such information to other persons responsible for evaluating a borrower for available loss mitigation options.
- Personnel can provide a timely live response to borrowers who call and have to leave a message when they cannot reach a live person.

Credit union policies and procedures must be reasonably designed to ensure that the personnel assigned to delinquent borrowers provide them with accurate information about:

- The specific loss mitigation options made available to them by the owner or assignee
- How to submit a complete loss mitigation application, get it evaluated and, if applicable, how to appeal an application that is denied
- The status of a borrower's submitted loss mitigation application
- The circumstances under which you may refer borrowers to foreclosure
- Loss mitigation deadlines set by the loan's owner or assignee or the provisions of the Mortgage Servicing Rules
- How to submit a written "notice of error" or "information request." (See *ii Release No. B075*, particularly the CFPB Mortgage Servicing Rule Small Entity Compliance Guide in Appendix A, for more on error resolutions and information requests.)

The credit union's policies and procedure must be reasonably designed to ensure that personnel are able to retrieve certain information in a timely manner, including:

- A complete record of the borrower's payment history

- All written information the borrower has provided to you, and, if applicable, to prior servicers, in connection with a loss mitigation application

See *ii Release No. B075*, particularly the CFPB Mortgage Servicing Rule Small Entity Compliance Guide in Appendix A, for more information.

UCC ARTICLE 9: SALE OF COLLATERAL

(Wis. Stats. Ch. 409)

See *ii Release No. B045 - Disposition of Collateral Upon Default Under § 409.504(3)*, *Wis. Stat.* regarding the Uniform Commercial Code (UCC) requirement for every aspect of the sale or disposition of collateral, including the method, manner, time, place and terms, to be commercially reasonable.

In explanation, the UCC states:

The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner in any recognized market therefor or at the price current in such market at the time of the sale or if the secured party has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold, the secured party has sold in a commercially reasonable manner.

Furthermore, the UCC requires that the credit union act in good faith in the performance and enforcement of all agreements or duties. Thus, for example, the credit union must conduct the sale under conditions reasonably calculated to bring a fair market price.- the current market value of the collateral – and not methods just designed to just repay the delinquent loan.

Credit unions should avoid inappropriately:

- Failing to select a proper time and place for a sale,
- Failing to sell the goods within a reasonable time,
- Failing to give sufficiently broad public notice of the sale,
- Failing to target notice to specialized dealers and buyers of the collateral,
- Failing to correctly state the planned date, time and location of the sale in a notice of public sale,
- Failing to provide sufficient lead time for buyers to bid or attend a sale,
- Failing to clean, paint, repair or otherwise prepare the goods for sale, and
- Failing to protect the collateral upon foreclosure.

See *ii Release No. B060 - Overview of Revised Uniform Commercial Code Article 9* for updated guidance and sample notices on such matters as:

- Notice before disposition of collateral,
- Explanation of calculation of surplus or deficiency, and
- Responding to debtor requests for an accounting, list of collateral, or statement of account.

SERVICEMEMBERS' CIVIL RELIEF ACT

(50 USC §§ 501-591; Wis. Stats. Ch. 321)

The Servicemembers' Civil Relief Act (SCRA) and Wisconsin's "Service members civil relief; state active duty" law apply in time of peace as well as war. See *ii Release No. 0072, "Servicemembers' Civil Relief Act,"* for important details.

Under the SCRA, courts will not grant a default judgment (i.e., judgment against a defendant who does not respond when he/she is sued) unless the plaintiff files an affidavit stating whether the defendant is in military service, or stating that the plaintiff is unable to determine whether the defendant is in military service. If the defendant is in military service, then the court can stay the case.

Any time during a court action, before judgment is entered, a court must stay (postpone) the proceedings for at least 90 days if the servicemember requests it.

The SCRA says that a creditor must obtain a court order before foreclosing or repossessing on an active duty servicemember's loan that is secured by a mortgage or similar security agreement on real or personal property. This would include car loans, for example. Thus, the credit union cannot use the Notice of Right to Cure Default / Take Possession or any other self-help remedy when a servicemember is protected by this law.

The six-year statute of limitations for legal action on contracts (which varies from state to state) is suspended while a party is in military service, even if the claim arose prior to or during service. So, if a borrower defaults on a loan, then enters the military, the length of time in military service will not be included in computing the six years.

MILITARY LENDING ACT (MLA)

(32 CFR § 232)

The Department of Defense (DoD) has issued regulations that implement the federal Military Lending Act (MLA), limiting the costs and terms allowed for consumer loans made to people in active military service or to their dependents, including some terms relating to collections.

The MLA rules generally apply to “consumer credit” that a “creditor” makes to a “covered borrower.” “Covered borrower” means a consumer who, at the time he/she is obligated on a credit transaction, is either a “covered member” (that is, a member of the military on active duty) or a dependent of such a person. The rules do not apply once a consumer ceases to be a covered borrower.

ii Release No. B067 - Lending to Servicemembers provides detailed guidance on identifying covered borrowers, exemptions from the rule, the 36% cap on the “Military Annual Percentage Rate” (MAPR), and required disclosures.

The MLA rules contain a number of other important limits on any covered loan.

The credit union cannot require a covered borrower to waive any right to legal recourse under any state or federal law, including the Servicemembers Civil Relief Act. The Arbitration Agreement in form #83005 *Your Account Agreement, with Arbitration Agreement* has an exclusion for any consumer credit transaction secured by a dwelling, including a mortgage or a home equity line of credit secured by your principal dwelling. The MLA rules do not define the term “right to legal recourse” or provide examples. It is unclear whether, or how, this rule might affect clauses in loan forms in which a borrower waives or restricts certain rights, such as the right to receive certain notices. For information on the Servicemembers Civil Relief Act, see The League’s *ii Release No. 0072*.

The credit union cannot require a covered borrower to submit to arbitration or impose “other onerous legal notice provisions in the case of a dispute.” Also, the creditor cannot “demand unreasonable notice from the covered borrower as a condition for legal action.” The League’s (“WCUL”) loan forms do not include language requiring arbitration. Credit unions using forms from other vendors should check with those vendors. The MLA rules do not define the terms “onerous legal notice” or “unreasonable notice” or offer examples of what they mean. The DoD has said that their meaning would be “determined on a case-by-case basis.”

The credit union cannot require, as a condition of the credit, that a covered borrower establish “an allotment to repay” it. The MLA rules do not define “allotment,” though it appears to refer to allotments of military pay. Note that an exception (described earlier in this release) allows the credit union to require “direct deposit of the consumer’s salary as a condition of eligibility” for covered credit. It is not clear how these two provisions interact or how they may impact payroll deduction. For general information on using payroll deduction for loan payments, see The League’s *ii Release No. 0066*.

The credit union cannot prohibit a covered borrower from prepaying a covered loan or charge a prepayment penalty. A number of different state and federal laws bar prepayment penalties, including the Wisconsin Consumer Act. The League’s consumer loan forms guaranty the right to prepay, saying that a “borrower may repay this loan, in whole or in part, at any time, without penalty for prepayment.”

In its 2016 guidance, the DoD says that a creditor may include these prohibited terms in its standard written credit agreement forms, *as long as the “the agreement includes a contractual “savings” clause limiting the application of the proscribed term to only non-covered borrowers.”* Some vendors take that approach to MLA compliance with their forms. The League’s WCUL forms do not include such clauses. Instead, we offer special forms to be used for loans that are subject to the MLA rules. See the section titled “WCUL MLA Forms” earlier in this release.

HUD: HOMEOWNERSHIP DELINQUENCY COUNSELING NOTICES

The Department of Housing and Urban Development (HUD) requires credit unions to send two notices to certain mortgagors who are delinquent or in default on their loans. One advises delinquent borrowers of the availability of homeownership counseling. The other advises homeowners in default about the foreclosure rights of servicemembers and their dependents under the Servicemembers’ Civil Relief Act. Both notices may be needed regardless of whether the homeowners are in military service. See The League’s *ii Release No. B058* for details and sample notices.

HUD/NCUA: FAIR HOUSING ACT

HUD and the NCUA enforce the Fair Housing Act (FHA) for state-chartered and federal credit unions, respectively.

The FHA is part of the Civil Rights Act of 1968. It regulates many practices, but perhaps most critically relevant to credit unions, the FHA makes it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, familial status, handicap, color, religion, national origin, or sex.

Imposing more onerous interest rates or other terms, conditions, or requirements on minority loan applicants is explicitly prohibited under section 805 of the FHA. The phrase "terms and conditions," as used in the Act, covers many types of discriminatory practices. Most important for debt collectors, the application of the non-discrimination rules to the "terms or conditions" of real estate financing has been determined to prohibit the application of different standards or procedures in administering foreclosures, late charges, penalties, reinstatements, or other collection procedures. (*Harper v. Union Savings Association*, P-H ¶ 15,203 (N.D. Ohio, 1977)).

See *ii Release No. B021 - Fair Housing Act* for more guidance on compliance with that law.

FAIR CREDIT REPORTING ACT (FCRA)

The Fair Credit Reporting Act imposes extensive requirements on credit unions relating to consumer reporting agencies (CRAs) such as credit bureaus. It governs when a credit union is permitted to obtain various types of credit reports on consumers. It also imposes requirements on credit unions when they report information to the bureau or to other parties about consumers. *ii Release No. 0126 - Fair Credit Reporting Act* provides guidance on many of the requirements. Many of the requirements are important to collections, such as the topics listed below. See *ii Release No. 0126* for necessary details.

- *Permitted purposes of consumer reports.* The FCRA limits the use of consumer reports to protect consumers' privacy. Therefore, credit unions and others that use consumer reports must have a "permissible purpose" to obtain them under the FCRA.
- *Duty to furnish accurate information.* As a general matter, a credit union may not knowingly supply inaccurate information to a CRA. If the credit union learns that information it provided to a CRA is not complete or accurate, it must promptly notify the CRA and provide the information which is complete and accurate. Thereafter, only the complete and accurate information may be reported. Requirements are set forth addressing the credit unions duties when notified by the consumer of a dispute. Other duties apply when notified by a consumer reporting agency of a consumer's dispute.
- *Duty to report dates of delinquencies.* If the credit union reports to a CRA that a delinquent account has been placed for collection, charged off, or subject to similar action, the credit union must also provide the date of delinquency on the account, which is the "month and year of the commencement of the delinquency on the account that immediately preceded the action." The credit union must provide the date of the delinquency within 90 days after first reporting to the credit bureau the placement for collection or charge-off. Credit union compliance with this requirement enables the CRA to determine how long it may keep the information in the consumer's file.

Notice of negative information

(Regulation V - 12 CFR 1022, App. B)

The Fair Credit Reporting Act requires that financial institutions give a clear and conspicuous written notice to consumers when negative information is provided to a consumer reporting agency. Financial institutions must provide this notice *before* OR no later than 30 days *after* furnishing negative information to a consumer reporting agency. The Federal Reserve Board has issued two versions of model notice language.

Here is the model notice language that credit unions may use if they give the notice *before* furnishing the negative information to a consumer reporting agency:

We may report information about your account to credit bureaus. Late payments, missed payments, or other defaults on your account may be reflected in your credit report.

Here is the model notice language that credit unions may use if they give the notice *after* they have already furnished negative information to a consumer reporting agency:

We have told a credit bureau about a late payment, missed payment or other default on your account. This information may be reflected in your credit report.

For details on this requirement, and answers to frequently asked questions, see The League's "Guide to the FACT Act," attached as an exhibit to *ii Release No. 0126*.

BANKRUPTCY

Upon learning that a member (or co-borrower or guarantor) has filed for bankruptcy, the credit union must immediately cease all efforts to collect on a loan. Otherwise, the credit union would violate the federal "automatic stay," which bars creditors from any attempts to collect on debts once the debtor has filed for bankruptcy. The credit union should not initiate contact with the debtor without the consent of his/her attorney, meaning that billing statements (with some exceptions for mortgage periodic statements), collection letters or notices of right to cure generally should not be sent. Credit unions should work with their own bankruptcy attorneys for guidance whether/how they can communicate with debtors in specific situations.

America's Credit Unions' book "Bankruptcy Basics" explains:

From the time the case is filed with the bankruptcy court, debtors are protected by the automatic stay and creditors must cease all collection efforts and may not contact the debtor to collect, recover, or assess a debt. Failure to heed the automatic stay can result in severe penalties being assessed against the credit union by the bankruptcy judge.

Once the credit union has received notice of the case, all efforts to contact the debtor should cease including: phone calls, collection letters, attempted repossessions, foreclosures, garnishments, and account statements sent in the normal course of business.

Once the credit union has been notified of a bankruptcy filing, it must stop any and all communications with the debtor. Notification that a debtor has filed for bankruptcy may be made in various ways. It may come in the form of a notice from the bankruptcy court, a letter, a fax from the debtor(s) or their attorney, or from the debtor during a collection call. ...

Once that information is received, the credit union must have an internal system to flag the account so any employee coming in contact with the account will know the member has filed bankruptcy. This should include a bankruptcy flag for the appropriate chapter the debtor filed and a no-mail flag. If the credit union has a third-party processor for credit cards or other services, it should make sure the vendor is also contacted to stop mail or statements from being sent. It is a violation of the automatic stay to send statements that contain loan or credit card balances to the member. Each employee of the credit union should have an understanding of these flags to avoid unintentional violations of the stay. For example, a member attempts to make a withdrawal from or a deposit into their account after the credit union has received a bankruptcy petition. The teller notices the member is past due on a loan with the credit union and tells the member they must make a payment before they can complete their transaction. This violates the automatic stay and should be avoided at all costs.

Lastly, DO NOT FREEZE FUNDS ON DEPOSIT without receiving advice from your attorney.

Mortgage statements and bankruptcy

Unless a mortgage loan servicer is exempt from sending a periodic statement or coupon book due to a borrower's bankruptcy, it must provide periodic statements or coupon books when a borrower is in bankruptcy. The periodic statements or coupon books must be modified for bankruptcy. Certain modifications apply for chapter 7 or chapter 11 bankruptcy, and additional modifications apply for chapters 12 or 13.

For details, please see The League's *ii Release No. B075 – "Reg. X & Reg. Z: Mortgage Servicing Rule."* Attached as an exhibit to that release is a copy of the CFPB's current "Small Entity Compliance Guide" on Real Estate Settlement Procedures Act (Regulation X) and Truth in Lending Act (Regulation Z) Mortgage Servicing Rules. The guide effectively summarizes the Mortgage Servicing Rule, including material on periodic statement requirements in section 5.10. You should also review the *CFPB's Frequently Asked Questions* about mortgage servicing and bankruptcy-related topics.

CHARGE-OFFS

Loans must be charged off, in whole or in part, in the period in which they are determined to be a high probability of loss, i.e., uncollectible. Charge-off of a loan is not necessarily a reason to cease collection efforts.

The NCUA states in Letter to Credit Unions No. 03-CU-01 (January 2003) that the board of directors should appropriately tailor a charge-off policy to the size and complexity of the credit union's operation. The charge-off policy should reflect current judgments about the credit quality of the loan portfolio.

The board of directors may adopt a policy that delegates to the manager the authority to charge off loans. The board should approve the extent of the 2 delegation (i.e., the dollar amount and loan type), reflect the approval in board minutes, and note the parameters in the written loan charge-off policy. The policy should address any areas where the manager is specifically prohibited from charging off loans, e.g., when the charge off may constitute a conflict of interest, such as loans to family members.

Management should report loans charged off under the delegated authority to the board at the next regularly scheduled board of directors meeting. NCUA recommends the board ratify all delegated charge offs. The manager should refer loans not meeting the established criteria in the charge-off policy to the board for their consideration. The board should periodically review management and staff compliance with the charge-off policy.

When the board deems the loan a loss, they must charge off the loan to the ALLL account in compliance with full and fair disclosure requirements of Part 702 of NCUA Rules and Regulations.

The NCUA states in Letter to Credit Unions No. 03-CU-01 that any loan should be referred to the board of directors for possible charge-off when:

- A nonperforming loan more than six months past due without a payment of at least 75 percent of a regular monthly installment within the last 90 days. In cases of nonperforming loans, transfers from shares and proceeds from the sale of collateral will not constitute "payments."
- A delinquent loan in the hands of an attorney or collection agency, unless there are extenuating circumstances to indicate the credit union will collect the loan.
- A "skip" where the credit union has had no contact for 90 days.
- An estimated loan loss, where the credit union has repossessed, but not yet sold, collateral on hand. The loan balance may be transferred by the credit union into the Collateral In Process of Liquidation account. Any outstanding loan balance in excess of the value to the property, less the cost to sell, may be charged off.
- An estimated loan loss, on which the credit union has foreclosed on, but has not yet sold, the property securing the real estate at the fair value of the property. The credit union will transfer the loan balance into the Other Real Estate Owned (OREO) account and will charge off any loan balance in excess of the value of the property, less the cost to sell.
- A loan in bankruptcy, within 60 days of receipt of notification of filing from the bankruptcy court, unless it can be clearly demonstrated and documented that repayment is likely to occur. Loans with collateral may be written down to the value of the collateral, less cost to sell. However, in Chapters 11 and 13 bankruptcy proceedings, if the court lowers the amount that the borrower must pay, the credit union will immediately charge off that portion of the debt discharged by the court.
- A fraudulent loan, no later than 90 days of discovery or when the loss is determined, whichever is sooner.
- A loan of a deceased person when the loss is determined.
- A loan, where a deficiency balance remains after the sale of repossessed collateral and where no payment has been received and no other course of action is perceived.
- A loan deemed uncollectible, where additional collection efforts are deemed to be nonproductive regardless of the number of months the loan has been delinquent.

RIGHT TO SETOFF IS NOT ALWAYS AVAILABLE

Collectors should be sure they have the right to setoff before seizing member funds at the credit union. The analysis can be complicated and risks high, so don't take chances if unsure.

Credit unions must take care in any exercise of setoff (seizing a borrower's funds) to collect on a debt. Whether a credit union will actually have the right to setoff will depend on a combination of factors, and they will often not line up in a way to give the right to setoff. Those factors may include:

- Language in the loan note that applies in the particular situation,

- Who signed the loan note,
- Who is/are the owner(s) of the account (suffix) with the funds sought by setoff,
- Whether there is a statutory lien,
- Whether appropriate disclosures of the right to setoff or liens on shares have been made, per the Wisconsin Consumer Act and Regulation Z,
- Whether setoff or liens on the account are restricted by state or federal law in the particular circumstances (WCA credit sale, bankruptcy, Military Lending Act, credit card, etc.),
- Whether there is default on the note,
- Whether any required notice of right to cure default has expired,
- Whether the funds sought are general funds of the borrower, or are special funds (such as protected by Social Security, held for a special purpose, or held in a representative capacity),
- Whether there is a prior claim to the funds sought, such as garnishment, levy, pledge to a third party, etc.,
- Agreement by joint owners of an account that the funds are subject to setoff against the debts of any owner of the account.

Please see *ii Release No. B013* for more on the right of setoff.

IRS: INFORMATION RETURNS REPORTING

Credit unions can face stiff penalties for failing to properly file appropriate IRS information returns each year. These are two forms for which the debt collector should take an active role in seeing that they are properly filed:

- *1099-C - Cancellation of Debt*
- *1099-A - Acquisition or Abandonment of Secured Property*

Please see *ii Release No. 0130 - Tax Reporting Requirements* and the current *IRS Instructions for Forms 1099-A and 1099-C* for full details on reporting information for either or both forms. The following is an introduction to the topic.

1099-C Cancellation of Debt

The credit union must file *Form 1099-C, Cancellation of Debt*, for each debtor for whom you canceled a debt of \$600 or more if an identifiable event has occurred. It does not matter whether the actual cancellation is on or before the date of the identifiable event.

The League developed the WCUL 1099-C Determination Chart to help credit unions determine whether a debt of \$600 or more has been discharged and is reportable under IRS regulations. You can review the chart in Exhibit B of *ii Release No. 0130*.

Please do not overreport.

- Do not report a debt unless required to report it per the chart. The 1099-C filing is not a collection tool. You may risk IRS penalties for false reporting.
- Do not file Form 1099-C when fraudulent debt is cancelled due to identity theft and the debtor is not liable for the debt. Form 1099-C is to be used only for cancellations of debts for which the debtor may be personally liable.
- Do not attempt to collect on a debt once it has been reported as discharged on a 1099-C without consulting your attorney. In most cases the 1099-C is filed because a legal bar to collecting exists. But some court decisions have also come down against creditors collecting on other debts that had been reported as required by IRS rules even though the debt was otherwise still collectible.

1099-A Acquisition or Abandonment of Secured Property

Many credit unions will need to file *1099-A Acquisition or Abandonment of Secured Property* due to:

- Real estate foreclosures,
- Deeds in lieu of foreclosure, or

- Repossessions or abandonments of personal property *if* held for business or investment use.

The IRS rules say to file Form 1099-A for each borrower if you lend money and, in full or partial satisfaction of the debt, you:

- Acquire an interest in property that is security for the debt, or
- Have reason to know that the property has been abandoned.

However, no reporting is required for tangible personal property (such as a car) held only for *personal use*. You must file Form 1099-A if the property is totally or partly held for use in a trade or business or for investment.

Coordination of Form 1099-A with Form 1099-C

If, in the same calendar year, you cancel a debt of \$600 or more in connection with a foreclosure or abandonment of secured property, it is not necessary to file both Form 1099-A and Form 1099-C for the same debtor. You may file Form 1099-C only. You will meet your Form 1099-A filing requirement for the debtor by completing boxes 4, 5, and 7 on Form 1099-C. However, if you file both Forms 1099-A and 1099-C, do not complete boxes 4, 5, or 7 on Form 1099-C. See the IRS *Instructions for Forms 1099-A and 1099-C* for details.

INTEREST ON JUDGMENTS

(Wis. Stats. § 815.05)

Civil money judgments entered in Wisconsin state courts used to accrue interest at 12% annually, but interest on judgments entered after Dec. 2, 2011, is tied to the prime rate.

Section 815.05(8) of the Wisconsin Statutes says:

Every...judgment for the recovery of money shall direct the collection of interest at an annual rate equal to 1 percent plus the prime rate in effect on the day judgment is entered, as reported by the federal reserve board in federal reserve statistical release H.15.

The rate formula applies to judgments entered on or after December 2, 2011 (regardless when the underlying suit was filed). Older judgments will continue to accrue interest at 12%.

The prime rate in effect on January 1 (plus 1%) applies to judgments entered on or before June 30 of that year. The prime rate on July 1 (plus 1%) applies to judgments entered after June 30 of that year. For example, if the prime rate is 3.25% on July 1, then judgments entered on or after July 1 through Dec. 31 of that year accrue interest at 4.25%.

That rate will not change, even if the prime rate goes up or down in the future, until the judgment is satisfied, discharged or expires.

The Wisconsin court system provides a historical table tracking the appropriate interest rate in effect under this law for judgments granted at different points in time, at this website: <https://www.wicourts.gov/services/public/selfhelp/docs/interestrate.pdf>

TOOLS FOR COLLECTING ON A MONEY JUDGMENT IN WISCONSIN

Among the tools that may be available to collect on a money judgement in Wisconsin are:

- Voluntary repayment by the debtor;
- Statutory collection mechanisms including:
 - Delivery by the clerk of court of a writ of execution to the sheriff, directing the sheriff to satisfy the judgment out of the debtor's personal property (if any exempt property can be located) (*Wis. Stats. § 815.05*);
 - Garnishment of the debtor's non-exempt property (earnings or non-earnings) held by third parties (*Wis. Stats. Ch. 812*), and
 - Court-ordered turnover of property to a court commissioner or a supplemental receiver (*Wis. Stats. Ch. 816*).

Certain property is exempt from execution, as provided in *Wis. Stats. § 815.18*.

In addition, *Wis. Stats. § 806.15(1)* provides judgment creditors have a discovery tool available to identify property that could be used to satisfy their judgment. It is a supplemental examination, sometimes referred to as a "debtor's examination," that

allows a judgment creditor the right to require judgment debtors to answer, under oath, questions about the nature and extent of their assets.

The credit union's collection attorney will have a working knowledge of how to use these tools.

DENIAL OF SERVICES

ii Release No. 0183 describes compliance issues involved in denying services to members who cause losses or other problems.

Credit unions often want to deny various services to members who have caused the credit union a loss or who engage in other objectionable behavior. The release addresses four main topics:

1. General compliance issues that a denial of services policy raises.
2. The issues involved with denying specific types of services, such as accounts or new loans.
3. The process for expelling members from the credit union altogether.
4. Special issues that arise when the credit union wants to deny services to or expel a member who is in (or has gone through) bankruptcy.

However, there are many obstacles to deal with when seeking to limit services in whole or in part. They may operate to hinder, complicate, or prevent some types of denial of services in some cases. Obstacles may include any of the following:

- Credit union bylaws
- Restrictions on unfair or deceptive practices
- Change of terms notice rules
- Adverse action notice requirements
- Contract law
- Nondiscrimination rules
- Bankruptcy considerations
- Federal benefits regulations

Please review *ii Release No. 0183* on these issues.

League publications are designed to provide accurate information with regard to the subject matter covered, with the understanding that The League does not render legal services. If you have general questions regarding this release, please call The League at (608) 640-4050 if local or (800) 242-0833. For specific legal advice, please consult your credit union's attorney.

Legal Affairs Department

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