

# PROVIDING PERSONAL GUARANTEE – THE “OUGHT-TO-KNOW”



*Consider this scenario - You are a director of a company which is facing financial issues. The company is applying for a bank loan but the bank requires that you give a personal guarantee before the loan is approved. What should you consider before you sign on the dotted line?*

In today's ever-evolving marketplace and increasingly stringent banking & finance industry, there are times where a business' performance and positive, albeit uncertain, future prospects can no longer convince the banks to grant a loan or expand a line of credit. There are times, especially for small-medium enterprises, where the company director has to offer his/her personal guarantee in order for the funds to be released by the banks. Such personal guarantees are becoming commonplace as the banks and/or financial institutions require additional recourse for recovery in the event that the company or borrower becomes insolvent.

*What does it mean to give a personal guarantee?*

A personal guarantee empowers the lender to go after the guarantor and make the guarantor pay, on demand, all or part of the borrower's debts owing to the lender, however and whenever they arise. Once signed, a personal guarantee can generally only be revoked or cancelled with the concurrence of the lender.

From the perspective of a director or businessman, the provision of a personal guarantee may seem a worthy course if the financial assistance so obtained would eventually enhance the company's business. However, in a situation where the company is, unfortunately, no longer able to service such debts or is approaching a position of serious financial distress, the issues of a personal guarantee can become a cause of considerable concern.

In default situation, the lenders have various options to call upon the personal guarantee of the guarantor. An option could be through legal proceedings where a Court Order is obtained against the guarantor and his/her assets. Sometimes a garnishee order is granted, where the Court may order the company (or other employer) to pay the guarantor's earnings directly to the lender. A more drastic scenario could be an order for the borrowers and/or the guarantors' assets to be seized and sold for proceeds, which shall thereon be applied to the amount owed to the lenders. In this scenario, the family home and other substantial personal assets may be at risk. Hence, in times of financial distress, it is important to navigate one's exposure with the lenders and to negotiate for instalment schemes and other feasible refinancing arrangements before the lenders exercise their rights on the personal guarantee.

There is a variety of scenarios where a lender requires a personal guarantee for credit facilities or financing arrangements extended to a company or borrower. Common forms of such financing arrangements include:

1. Overdraft facilities
2. Trade financing and factoring arrangements
3. Mortgage loans
4. Unsecured loans
5. Bankers' guarantees

*What and how much to guarantee?*

Before providing a personal guarantee to a bank, it is important for a guarantor to be mindful of capping his/her own liabilities. Although reaching a common agreement with the lenders on this issue, is more often than not, rare, it is important to set a scope to limit your financial responsibilities. It also makes sense to establish contractual clarity on this subject. Before extending any guarantee, a guarantor should seek to establish clarity, whenever possible, on all the elements of an agreement. By doing so, the guarantor will better understand the consequences he/she would have to face in the event of the borrower's default. Occurrence of disagreements and disputes, if any, in future, can thus be minimised. Even issues that might initially seem insignificant and unlikely to be of any real consequence are worth the effort of clarifying because these can become of vital importance once the borrower becomes insolvent.

There are cases where a lender may agree to cap the guarantor's liability to a fixed amount plus interest and any other costs incurred in enforcing the lender's rights. Prior to entering into a personal guarantee, the would-be guarantor ought to discuss with the potential lender the limit to be placed on the guarantor's liabilities. It is worth bearing in mind during such negotiations that in reality, the total amount of liability covered by a personal guarantee could be much more than the capped amount after adding interest and other related costs.

Provisions in a personal guarantee typically provide that:

- a. The lender does not need to demand payment from the borrower first;
- b. The personal guarantee is separate from and not limited by any other mortgage or guarantee which may already have been given to the lender or which may be given in the future;
- c. The personal guarantee covers all types of current and future liabilities. This will include liabilities under overdrafts, loans and other facilities. It can also cover liabilities incurred by the borrower without the consent or knowledge of the guarantor.
- d. Where there are two or more people giving the guarantee, the obligations would be *joint and several*. This means that the lender may require either one or all of the guarantors to meet the demand for repayment. When a guarantor pays more than his/her share of the debt under the guarantee, he/she has an equitable right to demand for contribution from the co-guarantor(s) and from the borrower. However, in practical terms, this can be difficult to enforce. The lender's consent is also normally required before a guarantor can enforce his/her equitable right of contribution.

Upon extending a personal guarantee, if the guarantor changes his/her mind at a later date, he/she is typically unable to revoke or cancel it. In addition, a personal guarantee generally remains in existence even though there is no amount outstanding or owing to the lender at a particular point in time.

A termination on notice (usually 3 months) in respect of any new liabilities will normally be allowed for a personal guaranteed. However, the personal guarantee will remain binding in respect of any liabilities which have already been incurred by the borrower prior to the expiry of the notice to terminate. The only definite way to bring a guarantor's liability to an end is to obtain a letter of release from the lender.

Supposed you have extended a personal guarantee in connection with financing granted to a company for which you are a director and/or a shareholder. You decided to leave the company as its director and/or shareholder. It will be necessary to work with the existing director(s) and/or shareholder(s) to procure a replacement guarantor. Application to the bank/lender is necessary and any replacement thereof will be subject to the sole discretion of the lender. This step is often overlooked which could lead to the horrendous scenario where a person finds his/herself personally liable for all the debts of a company that he/she had left ages ago.

Hence, before extending any personal guarantee, it will be prudent to seek independent professional advice to understand the implications of providing such guarantee as there can be far-reaching terms and specific conditions contained in the guarantee that will have to be considered cautiously.

If you wish to understand more on the implications of providing personal guarantees,  
please feel free to approach:

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