

Understanding Personal Guarantees: Key Questions Answered

The content provided in this briefing is not a replacement for independent legal advice, which we strongly recommend you obtain.

Personal guarantees are a long-standing feature of the commercial lending market and play a critical role in the provision of lending to SME businesses.

Providing a personal guarantee helps business owners to access finance, but they are legally binding agreements that can have significant implications for the individual providing a guarantee.

UK Finance, working with law firm Crowell & Moring U.K. LLP, has produced this briefing which explains in general terms what personal guarantees are and what the implications of agreeing to one can be.

This briefing also sets out:

- why lenders may require a personal guarantee and their role in enabling lending to businesses;
- relevant key terms and issues to consider;
- the importance of early engagement with lenders when issues arise; and,
- information on how to raise complaints about personal guarantees.

Please note that the content provided in this briefing **is not a replacement for independent legal advice**. It is **strongly recommended** to seek independent legal advice before signing any personal guarantee to ensure you fully understand your obligations and potential liability. Further, the information contained in this briefing is generic and each lender will have their own preferred form of personal guarantee, underlining the need for prospective guarantors to seek independent legal advice.

What is a personal guarantee?

A personal guarantee is a legally binding commitment between a lender and an individual (the "**guarantor**") whereby the guarantor agrees to be personally liable for repaying the debt of a business if for whatever reason the business does not meet the terms and conditions of the finance agreement, such as missing repayments.

A personal guarantor is often connected to the business; for example, an owner (e.g. shareholder) or a director or a family member or friend of an owner or director.

Personal guarantees can have significant implications for those who enter into them. If the lender makes demand on the guarantor, it may have a significant adverse impact on the guarantor's personal finances.

Why do lenders take personal guarantees?

Lenders may require personal guarantees in respect of finance (such as loans and overdrafts) provided to SME businesses, to mitigate the risk that the business does not repay its debt.

This can be common where a business is a limited company or a limited liability partnership, which means it has a separate legal identity to that of its owners. This means that business owners are generally not held personally liable for their business' debts and liabilities. As such, without a personal guarantee, the owner of a limited company could simply walk away from their company and the debts they had incurred, leaving lenders with a financial loss.

Personal guarantees are often used where businesses may not have a trading record, capital or assets to use as security and therefore represent a higher lending risk. In these circumstances, personal guarantees can help these businesses to access finance that they might otherwise not be able to obtain.

Personal guarantees give lenders greater confidence that they have recourse to recover the finance amount in the event a business breaches the terms and conditions of the finance agreement, thereby striking a balance between doing business and the need to manage risk effectively.

The personal guarantee also demonstrates to a lender that the business owner is supportive of their business and committed to repaying the finance they have obtained.

Providing a guarantee

Before providing a guarantee, you should ensure you fully understand its terms, including the extent of your potential liability. We set out below some information on the key provisions you will likely see referenced in any guarantee document. It is important that you understand the terms of the guarantee and the risks involved in providing it. You should obtain independent legal advice before signing the guarantee.

Changing circumstances: the importance of engagement with the lender and the business

It is also important for guarantors to remember that it is their responsibility to engage with the lender to discuss any relevant change in their circumstances and to notify the lender of any changes in their contact information.

Similarly, guarantors should engage directly with the business to ensure awareness of its financial performance and its ability to meet its obligations to the lender. This is because the

information lenders are able to share with guarantors about the business' performance may be limited due to confidentiality/privacy considerations.

Key terms of a guarantee

1. What does "Joint and Several" mean?

When more than one individual signs a guarantee, the term "*joint and several*" is often used in the guarantee. Simply put, "*joint and several*" liability means that the lender can demand the full amount of the debt from any or all of the guarantors. If one guarantor fails to pay, the lender can demand the shortfall from the other guarantors.

2. Is the amount that can be recovered under the guarantee capped?

Not necessarily. Personal guarantees may be "limited" or "unlimited".

Under an unlimited personal guarantee, the guarantor assumes liability for the whole of the liabilities of the borrower to the lender, plus interest and any associated costs and expenses. In contrast, a limited guarantee caps the guarantor's liability at a pre-determined monetary limit – although associated costs and expenses may also be included in addition to this limit amount. This gives the guarantor the reassurance of knowing the amount of debt that they could be liable for under the personal guarantee.

3. What does "All Monies" mean?

The guarantee may use the term "*all monies*". This means that the personal guarantee extends to all present and future debts owed by the business to the lender, not just the debt when the personal guarantee was signed. Even where a personal guarantee does not include the term 'all monies', it may include all of the business' debts (present, future, actual or contingent), depending on the wording of the guarantee agreement.

4. What does an increase to the amount borrowed by a business mean for the guarantor?

A lender may notify a guarantor should there be an increase in the amount borrowed or the term of an underlying finance agreement after a guarantee has been given, where that guarantee is unlimited or "all monies".

It is really important for guarantors to understand the terms of the guarantee and any provisions related to changes in the amount of finance borrowed. Guarantors should keep in regular contact with the business they are supporting and discuss such changes with the borrower directly to understand the reasons why additional finance may be required and the resulting impact on their own obligations.

Ending a Guarantee

5. *Does a guarantee remain in place if the guarantor ceases to be a director of the business or ceases to have any involvement or connection with the business?*

This is an area of common misunderstanding. Life and people move on, but personal guarantees generally remain in effect even when directors or other guarantors cease to have any involvement with a business, unless the terms of the guarantee expressly provide otherwise.

A guarantor may have given a personal guarantee because they were a director of the business at that time or simply to support a relative's business. The guarantee does not usually fall away when the director resigns or is removed or when the relative no longer has an interest in the business. It is essential that guarantors review the specific terms of the guarantee to understand their ongoing obligations and whether the guarantee can be terminated. For example, under the guarantee terms, the guarantor may be able to give notice to discontinue the guarantee which would limit their liability from a certain date. A guarantor should act quickly should they wish to limit their obligations.

6. *How can a guarantor bring a guarantee to an end?*

A personal guarantee does not generally end after a set period of time – it is in place until both parties agree to end it or it is ended in accordance with the guarantee agreement.

The terms of the guarantee will set out circumstances, if any, in which the guarantor can withdraw from the guarantee, so it is important the guarantor reviews and understand these terms. Otherwise, the lender will need to consent to their release and may as a condition of that release, require a replacement guarantee from another individual.

It should also be noted that in the scenario where a guarantor dies, the lender can still make a claim against the deceased guarantor's estate.

Enforcing a Guarantee

7. *For how long can a claim under a guarantee be made?*

The length of time in which a lender can bring a claim to recover a debt (in other words, to take enforcement action) in any given case is known as “the limitation period” and this depends on whether the guarantee was executed as a deed or a contract. This period also depends on the jurisdiction in question: in England & Wales and in Northern Ireland, a deed has a limitation period of 12 years, while a contract has a six-year limitation period; in Scotland, where there is not the same distinction between deeds and contracts, there is a five-year limitation period.

The point at which the limitation period starts to run will depend on the terms of the guarantee. If the guarantee agreement sets out that the guarantee is payable on demand, then the limitation period will start to run from the date the demand is issued. If not, it will start to run from the point at which the business is in breach of the terms and conditions of their finance agreement.

8. Does a lender need to claim against the business before the guarantor?

For a lender to make a claim under a personal guarantee, the business must be in breach of the terms and conditions of its finance agreement. Once the business breaches these terms and conditions, a lender may typically either (i) seek repayment from the guarantor without first claiming from the business, where the guarantee contains an indemnity provision (see section 11 below) or (ii) claim against both the guarantor and the business simultaneously. However, there may also be scenarios where the lender may initially pursue the business and then pursue the guarantor for any shortfall or projected shortfall, if any.

9. What happens when a personal guarantee is called in?

Lenders are mindful of the impact that calling in a personal guarantee can have and will only do so when all other options have been explored with the borrower prior to issuing a formal repayment demand.

When a repayment demand is issued to a guarantor, although lenders retain the right to seek the full guarantee amount, guarantors should be treated fairly at all times and lenders will wherever possible work with the guarantor(s) to agree an acceptable repayment plan or proposal. This will be based on their affordability and other relevant factors. The use of insolvency proceedings will typically be a last resort after having explored all reasonable options.

As noted above, all other options will be explored before this point is reached and due legal process needs to be undertaken to enable any property or goods to be repossessed. Indeed, repossessing a residential property to repay a personal guarantee liability is rare. A lender must first establish the debt and pursue legal action through the court system. The lender must demonstrate they have followed the required pre-action protocol, including contacting the guarantor and exploring alternative solutions.

10. If a guarantor has a complaint about how a guarantee was obtained or enforced – who should they speak to?

If you have any complaints about how a guarantee was obtained or enforced you should contact the lender in the first instance. If, having gone through the lender's complaints process you are unhappy with the lender's response, you may be able to complain to the Financial Ombudsman Service ("FOS"). The FOS website has helpful step-by-step guides on how to

raise a complaint and the types of matters the FOS can assist with (<https://www.financial-ombudsman.org.uk/>).

Indemnities

11. How does a guarantee differ from an indemnity?

Most guarantees will also include an indemnity clause. It is important to understand the difference between a guarantee and an indemnity.

A guarantee is a promise to pay the debt if the company breaches the terms and conditions of the finance agreement, while an indemnity is a commitment to compensate the lender for any loss or damage. Guarantees are secondary obligations, whereas indemnities are primary obligations, meaning the indemnifier can be called upon to pay directly without the lender needing to pursue the business first.

The focus of this briefing is on personal guarantees rather than indemnities. Should you require information or advice in this regard, you should discuss this with your independent legal adviser.

Conclusion

Remember, it is strongly recommended to seek independent legal advice before signing a personal guarantee and thoroughly review and understand the terms to ensure you are fully aware of your obligations and potential liability.