

Guaranteeing somebody else's debt

8 March 2016

Sometimes a bank will only provide credit to a customer if someone else provides a guarantee. If you agree to be a guarantor for a borrower, the bank can require you to pay the borrower's debts if they default on their repayments.

Guarantees can be complex. Please seek independent legal advice if you are considering becoming a guarantor. If you are already a guarantor and have any concerns, contact this office, the bank directly, or your lawyer, as soon as possible. The following is intended as a guide only.

I have been asked to guarantee someone's debts. What should I do?

You should take independent legal advice and think carefully before agreeing to be a guarantor. If a bank has asked for a guarantee it may indicate the borrower does not meet the bank's lending criteria or the bank thinks the borrower may default on the lending. You should ask yourself the following questions.

1. Do you know if the person asking you to guarantee their loan has the ability to service and repay the loan?
2. Do you know what their credit history is like?
3. Do you know if the borrower already has other obligations to the bank? Do you know the extent of their obligations?
4. Is the borrower likely to let you know if they start to find it difficult to keep up with their obligations? Are they likely to keep you informed if their obligations increase, eg if they take out further lending?
5. Could you afford to meet all of the borrower's obligations?
6. Can you assist the borrower in another way?

I have already guaranteed somebody else's loan – what does this mean?

If you have guaranteed a borrower's debts and the borrower defaults on their lending, the bank can require you to pay the borrower's debts.

Your situation as a guarantor will be determined largely by provisions in the guarantee.

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What is the extent of lending I am agreeing to guarantee?

Most guarantees are unlimited in amount and guarantee 'all obligations' of the borrower. This means the debt you guarantee may include lending that exists at the time the guarantee is provided, plus all of the borrower's obligations to the bank on an on-going basis. This could include further lending, credit card debts and overdrafts. You can ask for your guarantee to be limited to a specified amount, but the bank does not have to agree to the guarantee being limited.

Can I cancel the guarantee?

Generally speaking, you can cancel a guarantee at any time. However, this does not release you from the guarantee. The cancellation only freezes your liability at the amount of the guaranteed debt when you asked for it to be cancelled. Even after you do this, the bank can require you to pay the guaranteed debt that existed at the time you cancelled the guarantee (including any interest and costs). If you cancel a guarantee, the Bank may require the borrower to provide alternative security.

Will the bank tell me if the borrower is not meeting their obligations?

Being called on as a guarantor may be the first time a guarantor is made aware of the borrower's financial difficulties. This is not uncommon. Generally speaking, lenders are not obliged to notify guarantors of a borrower's financial difficulties. In fact, the bank could be in breach of its duty of confidentiality to the borrower if it did so. The only exception would be if the guarantee has specific provisions all parties agree to for the bank to notify the guarantor. However, you can ask the bank to advise you of the guaranteed debt amount at any time.

Could a bank require me to repay all the debt before asking the borrower or other guarantors to repay the debt?

The bank does not have to pursue the borrower for the debt. Once the borrower is in default the bank has the right to pursue you as guarantor. Generally speaking, if more than one guarantor has guaranteed the borrower's debts, the bank can choose who to pursue. The bank also has the right to require only one guarantor pay the full amount of the guaranteed debt. In some circumstances you may be able to pursue the other guarantors to obtain their contribution to the debt. This is not always straightforward and you should seek legal advice.

If the bank also has a mortgage as security for the debt, could it require me to pay when it could sell that property instead?

A bank does not have to realise any securities it holds before requiring you to repay the guaranteed debt. However, if you pay the guaranteed debt, you may be entitled to claim against securities held by the creditor in respect of the debt.

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What happens if I do not pay or cannot pay?

If you have an account with the same bank as the borrower, it may take funds from your account. Most guarantees provide that any security you have provided to the bank is security for your obligations as guarantor. This means if the bank has a mortgage over your home, it could take steps as mortgagee to sell the property to satisfy your obligations as guarantor. If you have not provided security to the bank, it could sue you through the courts for payment of the guaranteed debt.

Do I have any remedies against the borrower?

You may be able to encourage the borrower to pay the amount required to the bank. However, the borrower may not have the financial ability to do so. Once you have paid the guaranteed debt, you may be able to assume any rights the bank has against the borrower, including a claim to any security such as a mortgage.

When I agreed to be a guarantor I did not understand what I was signing and what my obligations would be. What can I do?

If you feel you were not properly advised about the guarantee or were pressured into agreeing to it, you should seek legal advice or contact this office.

Case note 1

Mr Q agreed to guarantee a loan taken out by a company for which he was a director. He later resigned as director. The company then got into difficulties and was unable to repay the loan. The bank sought repayment of the shortfall from Mr Q, who disputed his liability.

Mr Q asked the bank for information about the company's accounts and why certain bank charges had been incurred. The bank told Mr Q it could not do that because he was no longer a director. Mr Q was unhappy and complained to us that the bank had not given him debt information he was entitled to as guarantor.

We found the bank couldn't give him the information he sought because he was no longer associated with the company, other than as a guarantor of the residual debt.

However, the bank had not responded to Mr Q's questions about his guarantor obligations in a timely manner. The bank acknowledged this and offered to discharge the guarantee if he repaid less than half the residual debt. We concluded the bank's offer was reasonable and recommended Mr Q accept.

Case note 2

Mr A and a group of friends formed a company to purchase investment properties. The bank provided a loan to the company on condition the loan was secured by a mortgage over the properties and an unlimited deed of guarantee.

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The deed of guarantee listed the company and each of the shareholders as both customers and guarantors. This meant each of the guarantors was liable for each and any of the customers' debts to the bank.

In 2008, unknown to the other shareholders, two of the company's shareholders, Mr and Mrs C, took out a personal loan to buy a rental property. They subsequently got into difficulty with repayments on that loan and it went into arrears. The bank then wrote to all guarantors to warn them the bank could look to them to clear Mr and Mrs C's debt if it remained unpaid.

Mr A was unhappy with the situation and complained to us. He believed the bank could not rely on the guarantee because when he entered into it he was not told he could be liable for future lending of any of the customers.

He also said the bank could not rely on the guarantee because it failed to advise the guarantors about Mr and Mrs C's 2008 loan. He said he would never have agreed to the bank providing that loan to Mr and Mrs C had he been told about it.

On the face of it, Mr A was clearly liable under the guarantee, along with the other guarantors, for Mr and Mrs C's debts to the bank. The guarantee specified each guarantor could be liable for the future lending of any of the customers. Mr A executed the guarantee in the presence of a solicitor who had certified that proper disclosure about the contents of the guarantee had been made at the time the guarantee was signed.

However, we had to consider whether there was an obligation on the bank to advise the guarantors about Mr and Mrs C's loan. We found there was not. Under the Credit Contracts and Consumer Finance Act 2004, the bank was only required to provide information about that loan to the guarantors if it was a consumer credit contract as defined in the Act.

As Mr and Mrs C's loan was being used to buy a rental property it was not a consumer credit contract. We noted even if the bank did have an obligation to advise the guarantors about Mr and Mrs C's loan, they would not have had the right to veto that loan. We confirmed the bank could rely on the guarantee and did not uphold the complaint.

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