Definition of Guarantee

A Guarantee is an agreement by which the Guarantor accepts the responsibility for a debt owed by someone (the borrower) to someone else (the lender) if the borrower fails to do so. The Guarantor can then claim the money back from the borrower.

Difference between a Guarantee and an Indemnity

Guarantees and indemnities are very similar in nature. In both cases the person providing the guarantee or indemnity will ultimately become liable for the debt if the original borrower does not satisfy it.

In the case of a guarantee the guarantor only becomes liable if the borrower refuses to pay.

With an indemnity the "guarantor" becomes liable if the original borrower has not satisfied the debt **regardless of whether any demand has been made directly upon the original borrower or not**. Under a guarantee the liability only arises when the rights against the original borrower have been exhausted. Most documents are called guarantees but in actual fact also contain indemnity provisions and thus it is not safe just to consider the title of the document. The content of the document contains the obligations and **must be perused and considered carefully**.

Therefore in short, the major difference between a Guarantee and an Indemnity is as follows:

For a **Guarantee** the Bank must first exhaust its rights of recovery from the **Borrower**. Under an **Indemnity**, the Bank has a direct right of recovery against the **Guarantor** with no need to pursue or exhaust any rights that it may have against the **Borrower**.

It is common for documents to refer to a person as being a "guarantor" whether they are in fact a guarantor or whether they are indemnifying the lender for the borrower’s liability. For the purpose of this document we also will use the phrases interchangeably however we will add the warning that each document will depend upon its construction and the particular words and phrases used. It is recommended at all times that you seek the assistance of your legal adviser to interpret the effects of any document.

Guarantor's Obligation

Under this agreement the Guarantors obligation is to pay the amount specified as owing plus interest on that amount and all bank fees and taxes. This agreement distinguishes between your "basic liability" and "additional liability". The Guarantor is liable to pay both of these, so it is necessary to examine what is involved in each of them.

Basic Liability

The Guarantors guarantee that they shall pay to the lender the basic loan. This amount will only become due and payable in the event of a default of any description by the original borrower. Should any default be made then the guarantor is liable for the full amount regardless of whether the term of the loan has yet expired.

Additional Liability

If the borrower defaults under the original agreement the lender may incur further costs in attempting to obtain repayment of the debt. These costs will include the lenders administrative costs, legal fees, bank fees and charges and of course interest on those charges and fees. Charging interest on these additional fees of course has a snowball effect and can increase the actual liability very quickly.

All Lending Institutions have formulae whereby they calculate the amount of money that they will lend to the borrower. These formulae will depend upon the assets and the income of the borrower. Sometimes if the borrower does not have enough assets or sufficient income to meet the lender's requirements the lender will ask for a guarantee to "boost" the income or asset level of the borrower.

The Effect of Signing the Agreement

The effect of signing a guarantee is that the lender will be relying upon the guarantors ability to repay the loan either from the assets or the income of the guarantor. It is therefore not unusual for this liability to be absolute and as we have stated before to be expressed in the form of a complete indemnity rather than a "mere" guarantee. You should always be aware that the lender has recourse to your assets and make provision for this in all your financial dealings.

Guarantor's Securities

The Guarantee provided to the lender is done by way of additional "security". Sometimes however should the lender's margins not be sufficient the lender may require a specific charge of security to be taken over an asset belonging to the guarantor. This is commonly referred to as a Third Party Charge or Mortgage. The effect of granting a specific charge or security is that the lender or lenders will attach that security first. You should be aware however that your liability does not cease on the sale of that asset and that should the debt be larger than the value of your assets then the lender will seek recourse against you for any balance outstanding.

Subrogation

Subrogation is a principle of law that directly applies to guarantees and indemnities. The purpose of this principle of law is to give the guarantor the same rights against the borrower as the lender has. The guarantor is required to pay off all or part of the loan he is then capable of seeking recovery of that amount (together with any interest and costs incurred) against the borrower. It is as if the guarantor was "placed in the shoes of the lender".

The problem with this of course is that whilst it sounds wonderful as a concept you can usually rely on the fact that if the original lender has been unable to obtain the money from the borrower you also will be unable to obtain money from the borrower. It is usually because the borrower has none in the first place. For this reason you should be extremely cautious about entering into any guarantee arrangements.

General

The Guarantee is a continuing security for all the money that the borrower owes i.e. the Guarantee continues as a security until all the money that the borrower owes to the lender is paid off.

Usually until the borrower has paid off all that he owes to the lender the Guarantor cannot claim any payment of money from the borrower.

If the Guarantor has an account with the lender then the lender can often attach the money in that account to pay off any liability that the borrower may have incurred under this Guarantee.

It is fair to say that the lender would not require a guarantee if the original borrower has sufficient assets or income which the lender could have recourse to. The lender therefore relies strongly upon guarantees in order to make the advance. It is not uncommon in guarantees to have a provision that the guarantor will be liable for the full amount of the loan not withstanding the fact that due to some legal interpretation or factual circumstance the original borrower may not be liable to or may be able to escape from his liabilities.

As you can see from the comments above guarantees should not be entered into lightly and should only be considered when you have full knowledge of the borrower and even then only upon legal advice as to the specific terms and obligations you are entering into. There is no "standard" guarantee document and all lending institutions whilst requiring basically the same things will have their own specific requirements. These requirements can also vary depending upon the type of loan and transactions being entered into.

This brochure is intended as a general guide only and should not be used as an "instruction manual" in running a case or dealing with a dispute. If you find yourself in the position contemplating or of being involved in any form of litigation you should seek legal advice to clarify your position. Your legal adviser can at that time also advise you of relevant costs and fees which are applicable to your matter.

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