Director’s Personal Guarantees
**Preliminary**

Directors of private companies are frequently asked to give personal guarantees to support the borrowings taken by their companies from a Bank.

The types of guarantee and the consequence and effect of each is often not understood. This Fact Sheet highlights key issues to be noted and considered by Directors in relation to such guarantees.

**The Alternatives**

The alternatives which may be very different in their legal effect are these:-

**Stand Alone Personal Guarantee**

Here the Director is asked to support the Company’s borrowings without giving any security.

The Bank’s standard form guarantee will be drawn to give the Bank maximum protection. So technically it will be both a guarantee and an indemnity. By framing it as an indemnity the Bank makes the Director liable even if there is a problem with the underlying loan.

In practice the Bank is very unlikely to look to the Director to pay unless the Company has defaulted on the loan and enforcement has been unsuccessful. Strictly, though, it could make a claim at any time.

The key things to watch out for with stand alone personal guarantees are these:-

(a) **Has a cap been agreed?**

It will be prudent to ensure that there is a cap. That way you will need to sign a new personal guarantee if a new company loan is to be taken. Without a cap you could find yourself personally liable for increased borrowings without appreciating that you are increasing your personal liability. Worse still you could be liable for new borrowings taken by the Company after you have ceased to be a Director.

(b) **Is the guarantee linked to a specific loan?**

Ideally you should try to link the guarantee to a specific loan not to all borrowings from time to time. That way you and the Bank will need specifically to review your position each time a new facility or loan is agreed. This is a good discipline to avoid ever increasing personal liability as company borrowings increase.

(c) **Is the loan is to be secured by a legal charge over your home or another property?**

You will want to avoid this if at all possible. If you do agree to give such security your spouse or partner who co-owns the property will also need to agree to give the security and will need to take independent legal advice before doing so. See the section below on this aspect. By you and your spouse/partner giving such security you are putting your house at risk and the equity portion held by you both.

Remember, though that even if you give an unsupported guarantee (i.e. one without security) which is called by the Bank and not paid, the Bank can enforce over your assets which could include them registering a judgment debt as a charge against your home. So the Bank may, through the courts, take security at a future date if you are in default.

(d) **Can you give notice to terminate your liability under the guarantee?**

Most standard form Bank guarantees will allow the Director/guarantor to give three months’ notice of termination. If such a notice is given the sum owed by the company to the Bank at the end of the three month period will fix the amount of the liability under the guarantee (subject to any other agreed cap).

A Director minded to give such a three months’ notice should be aware, though, that such action may cause the Bank to freeze any overdraft facility. This will be so as to avoid the need for the Bank to monitor fluctuations in the overdraft over the three month period.

**Secured Personal Guarantee**

In this situation the Director will be giving a charge over his home or other property to secure the promise in the personal guarantee that he will also give.

If there is a prior charge in favour of a mortgage lender the consent of that lender may be needed and this may complicate matters. It may also make it difficult for you to move house.

The Bank will be concerned to avoid a spouse or partner defending any future claim (e.g. for possession or to sell the property) by asserting undue influence by the Director. For this reason the Bank’s procedures will require that the spouse or partner takes independent legal advice.

**Third Party Charge**

Instead of a personal guarantee supported by a legal charge the Bank may ask for the Director and his spouse/partner to give what is called a Third Party Charge. This effectively combines a personal guarantee and a legal charge in one document.

On the face of it this is a mere technical difference compared with the more usual secured personal guarantee (see paragraph 2 above).

However, the following points should be noted:-

(a) There will not be a right of termination as there is no separate guarantee. So your property may be locked in to support a company’s borrowings indefinitely (and even after you have ceased to be a Director).

(b) The standard form documentation of the Bank is likely to provide that a Third Party Charge secures all money that the third party may owe the Bank from time to time. Most standard form guarantees will come complete with a clause anticipating a cap or limit of liability, to be completed in manuscript. Whilst a side letter imposing such a cap can be requested to achieve the same effect this is not as satisfactory. The side letter may be overtaken by events (e.g. if
a new loan is taken out) and any new borrowings may thereby cease to be capped. In addition it will not be necessary for your spouse/partner to take advice (as in the case of the supported personal guarantee) any new guarantee with its new cap is put in place. The need for such advice may be a good brake on excessive risk taking through personal liability.

(c) The standard documentation will also include a promise by the Director to pay all the money owed to the Bank by the Company: effectively an uncapped personal guarantee. Again this may be covered by a side letter but the same difficulty as noted in paragraph 3(a) may arise.

**Non-Recourse Third Party Charge**

With this type of security the maximum liability of the Director will be limited to the value of the property that has been charged. The words “non-recourse” mean there will be “no recourse” to the Director beyond the value of his property.

So if a Director has agreed to give security a non-recourse arrangement of this type may be preferable.

That way the Director is not vulnerable to a falling property market and/or a poorly executed sale (e.g. an auction sale with an inadequate reserve placed on the property by the Bank).

**Taking Good Professional Advice**

It is all too easy to assume that the documentation put forward by a Bank is standard and not negotiable. This may be the case but there may also be scope to negotiate and limit liability. There is also the potential (particularly for a spouse or partner) to say no!

For further information please speak to your usual Everyman Legal contact.

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**We would like to thank each and every one of you for your professional help and close attention to this matter. We couldn’t have done it without you!**

Simon and Margery Walshaw  
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