

Being a Guarantor: What does it mean and what are the risks?

Being a guarantor for another person can be a great benefit to another person since approval or refusal of a credit application may depend on it. However, there are many major risks involved in being a guarantor and it is important that people understand these risks and know if they can manage them before they agree to be a guarantor. This article describes the key features of guarantees and the risks a person takes on by signing a guarantee.

Some people think signing a guarantee is just a formality – a simple and riskless way to help a friend or colleague by giving him/her a reference. It is much more than that – you become responsible for their debt if they fail to meet their obligations.

A guarantor is a person who agrees to be responsible for the payment of another person's loan debt if the other person breaks the loan agreement.

What are the guarantor's obligations under this? This means that if the borrower does not make the loan payments on time or fails to keep any of the other terms and conditions of the loan agreement they have signed with a bank or micro-credit organization, you will be responsible to the bank or micro-credit organization for paying any of the funds that are still owing on the loan.

How does a person become a guarantor: a person can become a guarantor when, first, they are asked by someone who is borrowing money if they would help get the loan by agreeing to be a guarantor for them and, second, they sign a written and legally binding agreement, called a guarantee, with the bank or micro-credit organization. Nobody can become a guarantor without their agreement and without signing a legal document. However, people who sign a guarantee need to be sure that the guarantee they sign is not an unlimited one, which allows the banks to grant additional loans to the same borrower without seeking the further approval of the guarantor. Be sure you always know the maximum amount you are guaranteeing.

Responsibilities of a guarantor: Becoming a guarantor is a big responsibility and carries many risks. It can have serious financial and legal consequences for the guarantor. For example, it can put your own financial situation in danger and possibly ruin your credit rating thus making it difficult or impossible for you to borrow in the future. Therefore, it is very important that a person understands exactly what they are getting himself/ herself into if they agree to become a guarantor.

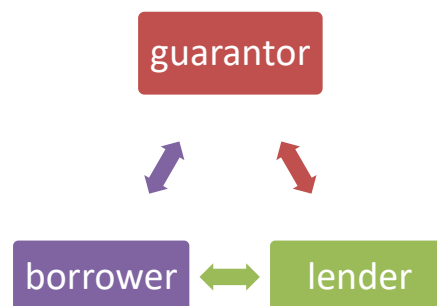
The benefit of acting as a guarantor: Being a guarantor can be a helpful and worthwhile thing to do, especially for a relative or a friend. It may help them get a loan that the financial institution would not otherwise give to them and thus help them get ahead. In Kosovo, there is sometimes strong social pressure on a person to help out their relative or friend in this way and people can feel they are being unreasonable if they refuse to help. You may be told by the person asking you to be a guarantor for him/her and possibly even by the lender that all you are doing is signing a piece of paper that they need to get the loan and you won't be asked to 'do anything'. Unfortunately, in some cases, that turns out to be very far from the truth. You are taking on a potential financial obligation (the repayment of the loan and all interest charges) and if the person who borrowed the money fails to meet the loan repayments, this will become a real financial obligation – you will have to repay the loan.

Why would a bank ask for a guarantee? One question you should ask yourself is why does the bank or micro-credit organization require the borrower to have a guarantor?

The lender may give you many reasons but, basically, there is only one main reason why they will request the borrower to provide one or more guarantors. That is that the lender is not prepared to take the risk of lending money to this person himself. They want someone else (the guarantor) to take that risk.

Do you know the person who wants to borrow money better than the bank?

Possibly you do. The bank may not be willing to lend to the person without the involvement of a guarantor because the person is young or wants to set up a new business and thus has not yet established a credit track record. Nevertheless, the bank may not be willing to lend without a guarantor for other reasons such as that they know the potential borrower has defaulted on loans in the past. Therefore, knowing and understanding the reasons a guarantee is being requested is important, as it should have a big impact on your decision whether or not to agree to be a guarantor.



When should you agree to be a guarantor? When you are considering guaranteeing someone else's loan you must ensure that you know the person well and that you are confident the person has the financial ability and the personal character to repay the loan. You must also understand what your potential financial obligations could be if the borrower defaults. You also need to feel confident that you could meet these financial obligations if you had to as you could end up having to pay off all of the debt plus interest and charges if the borrower does not.

People are often asked to sign guarantees for friends to help them get a loan. But doing so may put your financial position at risk if the friend defaults on the loan and the default may be due to events beyond the friend's control such as illness or unemployment. It could also put an impossible strain on the friendship if you and your family's standard of living is severely depressed because you have to service your friend's loans.

How can a default arise? Defaulting on a loan is not always a question of character. It can even arise if the borrower becomes ill, becomes unemployed or is unable to make the payments for some other unanticipated reason. In most instances, the lender will not be that interested in why the default happened. They will want to protect their money and will thus pass the loan obligations onto the guarantor. Even in the case of the death of the borrower, the loan will still be required to be repaid and the bank will turn to the guarantor.

What documentation should you look at before you sign a guarantee?

Look at both the guarantee document and the loan document the borrower will need to sign. The terms may not always be the same. Some examples of things you should look for are:

Are you guaranteeing a fixed amount or can the bank make future loans to the borrower that this guarantee would also cover? If the borrower is able to borrow further funds under the guarantee agreement, so the size of the potential financial obligation you have under the guarantee could increase without your knowledge. This type of guarantee is called an 'unlimited' guarantee and it is much more risky than a 'limited' guarantee which specifies the maximum amount of your potential obligation. So make sure you understand clearly what type of guarantee you are signing. You should avoid signing an 'unlimited' guarantee if possible.

Does the guarantee document give the lender (bank) the power (the right) to take money out of your bank deposits without having to get any further approval from you if the borrower misses payments?

Are any of your assets, such as property, being used as security for the loan and thus available to the bank to claim repayment in the event of default?

You need to know the borrower's past credit history. If the bank or the borrower claim this information is confidential and you can't see it, you should say you cannot sign the guarantee without seeing it. It is too risky for a person to sign a guarantee without this information.

When guaranteeing a loan, the CBK Regulations require the lender (bank) to give you a copy of the loan agreement. Make sure you get this. The lender must also inform you of any changes to

the loan contract. There have been some complaints made by guarantors to the CBK because the bank failed to do this. So make it clear to the bank that this is what you expect and demand.

You need to get expert advice on the guarantee document before you sign it to make sure you fully understand the potential obligations you would be taking on if you signed it. It is important that you do not rely on the advice offered to you either by the borrower or by the lending institution. Their interests are the opposite of yours. You need to get your own independent advice on the obligations you would be taking on if you sign the guarantee.

If you are feeling pressure to provide a guarantee, don't do it until you have taken independent advice, are sure you are aware of all the major relevant facts and issue and are comfortable with providing the guarantee. If you succumb to the pressure and sign the guarantee without being well-informed you are likely to regret it and could suffer serious consequences.

Make sure you understand the loan and the guarantee the loan is advanced. The document and you can't month or so later and say from the guarantee. To get obligation you have signed, pay off the loan, which they refinance it through a new guarantee supporting it, which the lender may be unwilling to do, or to have the bank's approval, which they are unlikely to give. So be very careful before you sign it. The guarantee, once given, continues to bind you until the borrower's obligations to the bank are completely repaid.

Do not be rushed into signing a guarantee!

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Involvement of the guarantor: if the borrower meets the obligations of the loan in full and on time, the guarantor will have little or no involvement in the loan servicing process at all. But, if something goes wrong and payments are missed, the guarantor will move to the center of the loan servicing process and will become responsible for servicing the loan.

As a guarantor, you have no direct control over the behavior of the borrower. You could ask for a written agreement with them that requires them to keep you informed of their financial position

and their schedule of loan repayments – after all, you will be responsible for making those payments if the borrower defaults. Therefore, you are a very interested party.

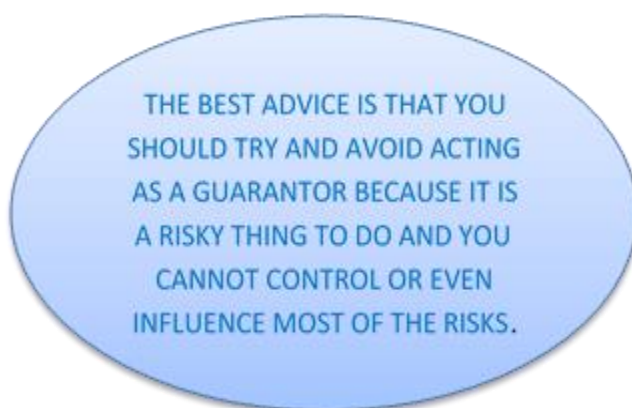
Will being a guarantor affect my credit rating? It could do. At the time a loan is granted, all the parties involved in the loan contract, including the guarantor, are recorded by the bank granting the loan in the Credit Registry of Kosovo that is administered by the Central Bank of Kosovo. Any problems in the servicing of the loan could therefore affect the credit rating of the guarantor as well as the credit rating of the borrower.

Being a guarantor may affect your own ability to borrow (get loan) as a bank may look at your potential obligations under guarantees you have signed in deciding if you have the financial capacity to service a new loan.

The guarantor was not informed about loan restructuring. In most cases, this was a legitimate complaint as the lender should have a legal obligation and certainly has a moral obligation to inform the guarantor about any changes to the loan conditions.

The guarantor's bank account was charged or blocked because the borrower missed payments on the loan. In most cases, the bank was within its legal rights under the guarantee to do this and the guarantor should have been aware when the guarantee was signed, that this was a risk they were taking. When the lenders were sometime at fault was in not informing the guarantor that they had taken this action against the guarantor's bank account;

The guarantor's status within the CBK's Credit Registry was changed. This is another risk that a guarantor needs to be aware of. Only if the guarantor's status was changed on the basis of incorrect information would the complaint be justified and the credit record within the CBK's Credit Registry should be corrected.



If you have been asked to give a guarantee, and you feel for personal or social reasons you cannot say no, you need to ensure that you are fully informed on the financial circumstances of the borrower at the time the loan is granted – and on an on-going basis. By keeping informed throughout the loan period, you will be alerted to issues or problems as they arise and may be able to help the borrower address cash-flow problems before they go too far and lead to default.

