THE SUNDAY TIMES (SINGAPORE) 16 NOVEMBER 2003

The Perils Of Being A Guarantor For Loans: If A Friend Or Family Member Asks You To Be A Guarantor For Loans, Think Twice Before Saying Yes

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BODY:

FOR years, you kept a steady head when it came to spending money.

Your friends could be forgiven for thinking you would be the last person to get into financial trouble. Unfortunately, that's exactly the situation you are facing now.

And all because a long-forgotten, seemingly innocuous favour you did many years ago has gone awry.

You had put your name on a loan taken by a close friend.

As the guarantor, you are the one the bank comes after when the borrower is unable to repay the loan.

Chances are the debt will be a drain on your savings but won't be bad enough to make you a bankrupt.

Not so, though, in the case of one in every 10 bankrupts who are currently undischarged, says assistant Official Assignee Karen Loh. They were overwhelmed by the debt they were a guarantor to.

She cites the case of a company director who acted as the guarantor for a company loan of $78,000.

When the company was wound up by another creditor, the bank called on the guarantee. As the guarantor could not pay up, he was made a bankrupt.

Lawyer Vijai Parwani of Parwani & Company cites another case of a 28-year-old man who stood as the guarantor for a loan his wife took to buy a used car.

She defaulted on the loan, and a writ of seizure and sale was initiated. Their household assets such as a refrigerator and a TV set were seized but were insufficient to settle the debt of around $13,000.

The husband was made a bankrupt recently, and the creditors are contemplating making his wife a bankrupt too.

The unfortunate part is that in many cases, guarantors probably don't have an inkling at the outset of the burden they have signed to take on.

Mr Parwani says: 'The frightening thing is some of them don't know what they are getting

themselves into. They think it's just for administrative purposes.'

They lend their names to loans for a car, house or business.

Or study loans and scholarships, and even loans for home renovation. All of the these do not have underlying assets which can be used as collateral.

In other cases where collateral is available, bankers say many loans do not require guarantors except when the borrowers' income is perceived to be unstable or weak.

So everything else being equal, a salesman and the sole proprietor of a small business would probably require a guarantor but not, say, a civil servant.

Financial planner Leong Sze Hian says that sometimes you are as good as a guarantor when you agree to be a joint owner of an asset.

'It appears to be no risk for a daughter to let herself be named as a joint owner of a property bought by her father. But when there's a loan default, she too can get sued even though she is not a guarantor,' says Mr Leong, who is a board member of the Society of Financial Services Professionals.

He cites another way a joint owner can find himself in the soup as a guarantor. Suppose your brother is in some difficulty servicing his home mortgage.

The bank is prepared to extend the tenure of the housing loan, which would lead to lower monthly repayments, if your brother can rope you in as a joint owner of the property.

It's all fine until and unless the unimaginable happens - your brother defaults on the loan. Then the bank comes after you.

If you are asked to be a guarantor by a friend or family member, one of the first questions to ask is: What is the size of the loan?

If the borrower defaults, can his debt overwhelm you?

Says Leong: 'If the debt is, say, $50,000 and that sum is small potatoes to you, then it's OK to be a guarantor.'

Another key question to ask: is the debt a fixed amount or one that can expand?

Laywer Hoh Chin Cha of Hoh & Partners gives an example of the latter: Let's say a businessman has taken out a loan of $1 million using his house which is worth $2 million as collateral.

He has a guarantor for the loan. Some time later, the businessman asks for a higher financing from the bank, using his home as collateral.

'The guarantee is usually drafted as a continuing guarantee,' he says. 'The initial documents cover a wide scope and include additional financing facility granted at a later date. This is frightening.'

More often that not, borrowers turn to family members for guarantors, and it's difficult to say no to such a request.

Parents, for example, are the most likely guarantors for a study loan or a scholarship of their children. If the students decide not to return home to serve their bond, or because they got married, their guarantors have to bear the consequences.

Says Mr Hoh: 'I know of a case where the parents are not rich enough and they got an auntie to come in as a guarantor - and she took a hit too.'

A spouse, in particular, will find it impossible to refuse to be the guarantor.

OCBC Bank wealth management expert Anne Tay suggests spreading the risks out among more than one guarantor.

The agreement can be crafted so that each guarantor will bear only a portion of the risk - even if the other guarantors are unable to fulfil their obligations.

There are long-term implications for you if you are unable to pay up.

You could be served with a writ of summons by the court.

Information on the writ is kept indefinitely at the Credit Bureau even after you have settled the loan or had gone into bankruptcy and have been discharged since.

In future, when you apply for a loan, your bank will check with the Credit Bureau and may hesitate to grant the loan if it is concerned about your financial history.

You can take steps to lessen the negative impact of the information, says Mr Parwani.

You should request the bank to file a 'Notice of Discontinuance' or 'Consent to Entry of Satisfaction', he says.

This basically informs any financial institution doing checks on your credit-worthiness that you have resolved the earlier matters.

Escaping obligations

IF YOU want to be freed of your obligations as a guarantor, you will need the consent of the lender.

The lender will need a replacement who has acceptable creditworthiness.

If you are already facing demands to pay up, you may have little room to escape.

Lawyer Vijai Parwani of Parwani & Company says that a few defences have been successfully pleaded in court.

The first is non est factum - the colourful Latin phrase which basically means that the

guarantor did not know what he was signing.

If the guarantor is an illiterate old person and had appended his thumbprint on the guarantee, then there is a possibility that the defence would succeed, says Mr Parwani. But that is only if the document was totally different from what was represented to him.

Other defences that could be raised are that the guarantee was signed under duress, undue influence or that it was procured by a misrepresentation.

Undue influence is relied upon as a defence where the guarantee was provided by someone with emotional ties to the borrower, usually the wife, parent or child of the borrower.

Do not think, however, that a divorce will dissolve a guarantee on a loan.

Mr Parwani says that a former spouse has to make good the debt of the other spouse. 'In an acrimonious divorce, you can imagine the anger and frustration of the guarantor,' he says.