

Loan Guarantor? Know your rights & liabilities

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Lending a helping hand to a friend is indeed extolled. But the pitfalls of doing so — particularly when it involves money — are often overlooked. This is particularly relevant while lending money or standing surety to a loan taken by a friend or a relative. In the latter, the guarantor will be under an obligation to make good the loan amount if the original debtor defaults.

Liabilities of the borrower

For the lending institution, the purpose of asking the borrower to bring in a guarantor is to secure itself in the event of default by the borrower. Therefore, in such a case, the lending institution can move against the guarantor to recover the dues. Moreover, the guarantor cannot insist that the bank exhaust other alternatives before serving the notice. "To an extent, the liability of a guarantor depends on the agreement he has signed.

Depending on the contractual arrangement, the lender can initiate proceedings against the guarantor — independently or simultaneously with the borrower — even without exhausting all the other remedies available," explains Vyapak Desai, head, litigation and dispute resolution practice group, Nishith Desai Associates. This means that a bank need not wait till the process of staking a claim to the debtor's estate — if liable to be attached — is completed.

Not just banks

It is not just in the case of home loans that most people seek guarantees from friends. There are also cases where employees seek guarantees from colleagues to avail of loans from employee co-operative credit societies. In such loans, the society obtains authorisation to debit the salary of the guarantor if the borrower defaults.

There have also been cases where guarantors for loans from such co-operative credit societies have found it difficult to encash their savings and quit the society upon retirement only because loans for which they have provided guarantees are outstanding.

Limited scope for recourse

There is precious little a guarantor can do if the lending institution has followed the process mentioned in the agreement before initiating the proceedings. "Persuading the borrower to repay the dues is the only remedy. Otherwise, the guarantor will have to bear the loan amount," says VN Kulkarni, chief counsellor, Abhay Credit Counselling Centre. You could also try to get someone else to be the surety, but accepting or rejecting the proposal would be entirely up to the lending institution.

Exercise caution

Since there is little scope for recourse once the debtor fails to repay the loan, one should be extremely careful while giving consent to the terms and conditions of the agreement. "First and foremost, a prospective guarantor needs to determine the repayment capacity of the borrower. Second, a guarantor should be careful when an enhancement in credit limit is being granted. If the guarantor does not give his consent, his liability will be to the extent of initial loan amount," advises Mr Kulkarni.

It is equally important to read the fine print of the agreement the lending institution wants you to sign. "The guarantors should ensure that the agreement does not bind them to an unlimited liability. They should be clear about the extent of their liability — for instance, if it will hold even in the event of a wilful default," suggests Mr Desai.

One should also insist on clarity in the procedure that will be followed, including the notice period to be served, that the creditor has to follow while invoking the guarantee. "In the agreement, the guarantor should insert a clause absolving himself/herself of the surety if the original debtor agreement is altered later, without guarantor's consent," he adds.