

## What You Should Know Before Signing That Letter of Guarantee\*

### I. INTRODUCTION

1. With COVID-19 hitting the economy hard, many smaller businesses and employees are struggling to stay afloat. Someone you know, such as your friends or relatives, could be looking for loans to tide them through this period. If so, they may ask you to sign a letter of guarantee.
2. What then, is a letter of guarantee? Simply put, it is a promise to pay another person's debt if he or she is unable to do so. However, being a guarantor can certainly be risky, especially when the debt is significant. So, the question is: should you sign the letter? How might your own finances be affected?
3. Therefore, before signing any letter of guarantee, it is important that you first understand what it is and what it does. This article addresses four common questions that you may have. First, when would you want to sign a letter of guarantee? Second, what are its legal effects? Third, what are the consequences if you are unwilling or unable to pay? Lastly, if you do decide to sign the letter, what should you do to protect yourself?

### II. DISCUSSION

#### (a) *When would you want to sign a letter of guarantee?*

4. A letter of guarantee is essentially a contract. You (acting as the *guarantor*) are promising to be responsible for the debt of another person (called a *debtor*) if the debtor fails to pay his debt to the lender.<sup>1</sup> Hence, you would want to sign a letter of guarantee if you intend to protect the debtor in case he or she cannot pay up.
5. What are some common situations where a letter of guarantee may be useful? One situation is where a friend or family member wants to obtain a loan from the bank in order to buy a home. Another common situation is where a student wants to obtain a

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<sup>1</sup> *Hong Leong Finance Bhd v Tamilcheleven s/o Palinesamy & Anor* [1996] 1 MLJ 351 at 360–361.

scholarship. A third situation is when you are obtaining financing from investors or banks for a business venture.

6. Therefore, in order to ensure that the debtor is effectively protected by your guarantee, you should ensure that the following requirements are fulfilled.
7. First, the letter of guarantee must be in writing and signed by the guarantor. This is a requirement under section 6(b) of the Civil Law Act.<sup>2</sup> Its purpose is simply to protect honest people from being liable for guarantees which they never gave.<sup>3</sup>
8. Second, the lender must have given valuable consideration.<sup>4</sup> This means that the lender must have conferred some advantage on the debtor or the guarantor.<sup>5</sup> One example is where the bank agrees not to sue the debtor.<sup>6</sup> Another example is where the guarantee is defined as a “continuing guarantee”. Since the guarantor benefits from the promise of future loans, this is sufficient consideration.<sup>7</sup>
9. Lastly, the guarantor must be at least 21 years of age before he or she can be a guarantor.<sup>8</sup>

**(b) What are the legal effects of signing a letter of guarantee?**

10. Before you sign the guarantee, it is very important that you have carefully read and understood all the terms. This is because *what* you are held liable for depends strictly on the terms in the letter.<sup>9</sup> For example, guarantees today often contain terms allowing the debtor to change the limit of the loan, or to adjust the interest rate.<sup>10</sup> In *Development Bank of Singapore v Yeap Teik Leong*,<sup>11</sup> a term allowed the bank to

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<sup>2</sup> Civil Law Act (Cap 43, 1999 Ed) s 6(b).

<sup>3</sup> Low Kee Yang, *The Law of Guarantees in Singapore and Malaysia* (LexisNexis Butterworths, 2013) (“*Law of Guarantees*”) at p 88–89.

<sup>4</sup> *Halsbury’s Laws of Singapore* vol 12 (LexisNexis, 2017) (“*Halsbury*”) at [140.819]; Low, *Law of Guarantees*, *supra* n 3, at pp 69–70.

<sup>5</sup> *Ibid.*

<sup>6</sup> *Imperial Steel Drum Manufactures Sdn Bhd v Wong Kin Heng* [1997] 1 SLR(R) 297 at [31].

<sup>7</sup> *Overseas Union Bank v Lew Keh Lam* [1998] 3 SLR(R) 219 at [28].

<sup>8</sup> *Bank of India v Rai Bahadur Singh* [1994] 1 SLR(R) 89 at [8]–[9].

<sup>9</sup> *Quah Poh Hoe Peter v Probo Pacific Leasing Pte Ltd* [1992] 3 SLR(R) 400 at [20];

<sup>10</sup> *Halsbury*, *supra* n 4, at [140.826].

<sup>11</sup> *Development Bank of Singapore v Yeap Teik Leong* [1988] 2 SLR(R) 201.

“enlarge or vary any credit to the company”.<sup>12</sup> The court considered that this term allowed the bank to increase the loan.<sup>13</sup> If so, you should first check whether you can afford to pay the debt if it increases.

11. Another important issue is *when* the guarantor is liable to pay. Generally, the guarantor’s liability arises when the debtor fails to pay his debt to the lender.<sup>14</sup> However, this may also depend on the terms of the guarantee. It is possible that a term states that the guarantor’s liability arises upon the occurrence of some condition.<sup>15</sup> If so, that condition must be fulfilled first.<sup>16</sup> For example, most guarantees today require the guarantor to pay only when the lender has made a demand for payment.<sup>17</sup>
12. Finally, when does the guarantor’s liability end? Generally, it will end if the debt is fully paid off.<sup>18</sup> It may also end if there is a significant change to the guarantee without the guarantor’s consent.<sup>19</sup> For example, in *Burnes v Trade Credits*,<sup>20</sup> the debtor and lender had changed the interest rate from 9% to 16% without the guarantor’s consent. The court considered that this change was sufficiently large for the guarantor’s liability to end.<sup>21</sup> However, if the letter contains a term permitting the change, the court would allow it because the guarantor is taken to have consented to it.<sup>22</sup> This further emphasises the importance of reading the terms.

**(c) What are the consequences if the guarantor is unwilling or unable to pay?**

13. Assuming that the debtor fails to pay his debt, you will become liable to pay. The lender may send a letter of demand to you to demand repayment. If you are unable to

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<sup>12</sup> *Id.*, at [25].

<sup>13</sup> *Id.*, at [26].

<sup>14</sup> Low, *Law of Guarantees*, *supra* n 3, at p 52.

<sup>15</sup> *Development Bank of Singapore Ltd v Eng Keong Realty Pte Ltd* [1990] 1 SLR(R) 265 at [14].

<sup>16</sup> *Associated Japanese Bank (International) Ltd v Crédit du Nord SA and another* [1988] 3 All ER 902 at 908.

<sup>17</sup> *Kim Eng Securities Pte Ltd v Tan Suan Khee* [2007] 3 SLR(R) 195 at [20]; *Halsbury*, *supra* n 4, at [140.830].

<sup>18</sup> *Halsbury*, *supra* n 4, at [140.836].

<sup>19</sup> *Halsbury*, *supra* n 4, at [140.844].

<sup>20</sup> [1981] 1 WLR 805.

<sup>21</sup> *Id.*, at 807.

<sup>22</sup> *Halsbury*, *supra* n 4, at [140.826]; *Development Bank of Singapore Ltd v Yeap Teik Leong* [1988] 2 SLR(R) 201 at [27].

pay within the specified deadline, you could approach the lender to arrange instalment plans to repay the debt, or to ask for an extension of the deadline.<sup>23</sup>

14. However, it is also possible that the lender may sue you for breach of the guarantee. If the debt owed is less than \$15,000, the lender may apply under Order 47 of the Rules of Court to seize and sell your assets.<sup>24</sup> Alternatively, the lender may also apply for a garnishee order, which allows the lender to automatically deduct the debt from your income.<sup>25</sup> In the worst-case scenario, if you are unable to pay the debt of more than \$15,000, the lender may apply for bankruptcy proceedings against you.<sup>26</sup>
15. Lastly, you should also be prepared that your relationship with the debtor may become strained. This may occur particularly if the guarantee was given on the basis of a close relationship, such as to friends or family.

**(d) *What should you do to safeguard yourself?***

16. As a practical matter, you should sign the letter of guarantee only after you have diligently determined and accepted the risks. It is a good idea to put your relationship with the debtor aside and objectively consider whether the debtor is capable of paying off his debt. You can ask the debtor for documentary proof of his loans, income statements, and credit reports. This will assist you in determining the debtor's financial standing. If it appears that the debtor is unlikely to be able to pay the debt, you should consider whether you are still willing to take on the high risk of repayment.
17. You should also check whether the debtor has any assets that can be used as security for the loan. This lowers your risk because the lender is required to first claim the security before the guarantor's liability arises.<sup>27</sup> It is advisable to negotiate with the parties to include this as a term of the guarantee. However, you should seek legal advice before doing this in order to avoid potential complications. For example, in order to incorporate such terms into the guarantee, the parties must have objectively

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<sup>23</sup> Credit Collection Association of Singapore website, Code of Conduct & Practice (2015) at section 2(b) <http://www.creditcollection.org.sg/files/CCASCodeofEthics.pdf> (accessed 10 October 2019).

<sup>24</sup> Rules of Court (Cap 322, 2014 Rev Ed), o. 47.

<sup>25</sup> Rules of Court (Cap 322, 2014 Rev Ed), o. 49, r. 1.

<sup>26</sup> Bankruptcy Act (Cap 20, 2009 Rev Ed) s 57.

<sup>27</sup> *Halsbury, supra* n 4, at [140.825]; *Byblos Bank SAL v Al-Khudairy* [1987] BCLC 232 at 243.

intended to do so.<sup>28</sup> Hence, it is important to put these in writing, and in clear and certain terms. It is also important to ensure that such terms do not contradict any other terms.

18. Lastly, if the terms of the letter of guarantee are unclear or you do not understand them, you should seek legal advice to clarify your doubts.

### **III. CONCLUSION**

19. Signing a letter of guarantee is risky. Before doing so, you should ensure that the debtor is effectively protected. You should also carefully read through the terms to determine exactly what you may be liable for and carefully consider the consequences of failing to pay the debt.
20. That said, if you must sign the letter of guarantee, do try to take measures to protect yourself by minimising the risks. It is prudent to either ensure that the debtor is realistically able to pay off his debt or ask the debtor to offer his assets as security. Finally, you should seek legal advice to clarify any doubts about the risks or your obligations.

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<sup>28</sup> *R1 International Pte Ltd v Lonstroff AG* [2014] SGCA 56 at [51].