

Sign your life away

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By Barbara Drury

A new code of practice gives greater protection to loan guarantors - in theory at least, reports Barbara Drury.

Most parents want to give their adult children a financial helping hand to get them started in **life**. Before guaranteeing a home or business loan, however, parents, relatives or family friends need to ask themselves if it is money they can afford to lose. In many cases, that is exactly what happens.

Brenda Turner of CCAS Financial Counselling says the loan guarantee cases counsellors see most often are elderly parents who have guaranteed business loans for their children using their home as security.

When the business fails, the guarantee is called in and the parents lose their house (see story, below).

Peter Jackson, a partner with Jackson Smith Solicitors, says the courts have accepted the principle that wives should be protected from their husband's debts because of the trust and confidence that exists between marriage partners. He believes the same protection should be extended to parents and other family members. The courts have been willing to stop banks pursuing a wife for debts if she received no financial benefit from her husband's loans and was under undue influence or pressure to **sign** a guarantee or had an inadequate understanding of what she was **signing**.

"The law doesn't seem to have caught up with the fact that we have an ageing population and many elderly people guarantee their children's loans. Older people are often willing to guarantee their children's debts out of affection and with no thought about the risks," Jackson says.

The Code of Banking Practice introduced last year and adopted by most banks gives greater protection to guarantors, but is yet to be tested in court.

Under the new code, banks have a duty to act fairly and reasonably, to advise guarantors to get independent financial and legal advice and to inform the guarantor if they received an adverse report on the debtor from a credit rating agency or if the debtor is in default on their loans.

Guarantors should also make sure the debtor is present when the guarantee is **signed** and that the bank allows one day for the guarantor to consider all the information given to them.

While the code is welcome, Turner says the requirement for financial institutions to advise potential guarantors to get independent advice means the banks

are covered when people come back and say they didn't know what they were getting into.

Turner believes people are increasingly being urged to be co-borrowers rather than guarantors, which is an even more binding financial obligation and works to the advantage of the banks.

If you decide you really want to act as guarantor for someone, there are a number of issues you should consider.

Most important is understanding the purpose of the loan and whether the guarantee is limited to a specific amount for a specific security or property.

Turner says guarantors should ask themselves if they are prepared to risk their homes, because that is the asset most often at stake. They should also get some external assessment of the venture the money is to be used for and explore other avenues of raising funds.

"If you are being asked to give a guarantee it is usually because the venture is a risky prospect in the first place," she says.

Once a guarantee is given and things go sour, the only way to get out of the contract is to pay the debt. However, Jackson says if the debtor has disappeared the guarantor should first ascertain whether the bank has made reasonable attempts to locate them.

In some cases, Jackson says, guarantors may be better off paying out the debt before it gets out of control.

Even better is to avoid mixing family, friends and business in the first place.

Jackson firmly advises parents not to guarantee their children's business debts, because they rarely have enough knowledge of what is happening in the business and are unlikely to see the warning **signs** if it is struggling.

THE LOAN THAT LOST A HOME

Five years ago Evelyn* lost her husband of 54 years to cancer. Recently she also lost the home they had shared their entire married **life** when the bank called in a loan to her son.

Shortly after her husband's death, Evelyn's son and his partner asked her to act as guarantor for a business loan. Despite reservations, she **signed** on the dotted line.

"[My son] was very domineering and demanding. He took me to his solicitor who didn't explain anything to me, he just said '**sign** here' and '**sign** there'," she says.

Evelyn later found out that her son and his partner were drug users. Understandably their business venture never materialised and they failed to make any loan repayments. Their bank finally pursued Evelyn for the \$400,000 outstanding on the loan.

Evelyn sought legal advice and the case dragged on for more than three years but, in the end, the bank won.

Evelyn hadn't told her two adult daughters about the loan arrangement and they were shocked when they found out she was going to lose her home and they were losing their inheritance.

Luckily, the story has a happy ending of sorts. The daughters clubbed together to buy their mother a villa, which they put in their names to prevent their brother claiming a share.

But family relationships are not so easily mended.

"I wouldn't recommend anyone go guarantor for their family - I don't speak to my son any more," says Evelyn.

*Not her real name