momentum

Contingent liability protection

A business often requires financing, whether it is to start a new venture, expand on existing business opportunities or to acquire new business assets. When negotiating with a financial institution for financing, it is often required that the business owner (referred to as the guarantor) provide personal surety for the loan. This can pose a potential risk to the personal estate of that guarantor.

The risk – upon the death or disability of the guarantor

The guarantor can be held personally liable for the debt during his/her life and upon death, if:

- The business has a liquidity problem and cannot service or settle the debt, resulting in the personal estate of the guarantor being targeted.
- There is no suitable candidate to replace the guarantor upon his/her death.
- Alternative security is not available.

If the estate of the guarantor is targeted after death, it can have the following effects:

- The winding up of the estate can be delayed unnecessarily.
- The estate can be depleted of all liquid funds available and be left insolvent.
- The lifestyle of the dependants will be affected.

Death of a guarantor can also have a detrimental impact on the business. Should the personal estate of the deceased guarantor settle the debt, the estate can claim it back from the business or its surviving owners. This may result in the unnecessary sale of business assets.

The solution

The business insures the life of the guarantor who has signed surety with a contingent liability insurance policy. The policy should ideally include a disability benefit and the amount of cover should be equal to the total outstanding debts (plus provisions for estate duty).

Policy premiums are paid by the business and an agreement is entered into whereby the business undertakes to utilise the proceeds to settle the outstanding liabilities, thereby relinquishing the guarantor's personal estate of any liability. An agreement between the business and the guarantor formalises this arrangement.

Benefits to the guarantor

- The personal estate of the guarantor is released from any liability.
- The winding up of the estate is not unnecessarily delayed.
- The lifestyle of the dependants will be unaffected.

Benefits to the business

- Liability is settled in full without impacting on the business's financial position.
- The proceeds will pay out tax free as the premiums are not tax deductible.