

Invoking Personal Guarantees – Insurance Protection

The Insolvency and Bankruptcy Board of India (IBBI) was established on 1st October, 2016 under the Insolvency and Bankruptcy Code, 2016 (IBC) primarily for the purpose of resolution of insolvencies of corporate persons, firms, and individuals in a time bound manner. With the notification no. S.O. 4126 (E) dated 15.11.2019, an amendment to the Insolvency & Bankruptcy Code of India, a creditor could exercise the option to initiate insolvency proceedings against the personal guarantor of a corporate debtor under Chapter III of the Insolvency & Bankruptcy Board of India. When lenders find that the recovery is not adequate to cover the recoverable amount, they invoke the personal guarantee clause. Till recently, lenders could not succeed in their attempts, as personal guarantors challenged the validity of some provisions of the law in the Supreme Court.

Honourable Supreme Court of India in a landmark judgment in Dilip B Jiwrajka ... Versus Union of India & Ors case has upheld various provisions of the Insolvency and Bankruptcy Code (IBC). Copy of the judgement can be accessed [here](#). This has cleared the way for lenders to initiate insolvency proceedings against personal guarantors of loans taken by defaulter companies. This judgement assumed significance in the context of the fact there are about 2289 applications before several tribunals claiming Rs 1.63 lakh crore from personal guarantors as of September 30, according to the Insolvency and Bankruptcy Board of India (IBBI).

Following this judgement, when lenders initiate steps to invoke personal guarantees, personal guarantors are perforce expected to start negotiating a settlement or face insolvency proceedings under the IBC with all its ramifications. Personal guarantors now have increased risk exposure of insolvency proceedings, leading to likely loss of personal assets.

The purpose of the article is not to get into details of IBC, but see if the Directors & Officers liability (D&O) insurance or any other insurance could be of some use to the guiltless and uninvolved, not unscrupulous, directors.

What is a personal guarantee?

A personal guarantee is a provision in a loan agreement that requires owners—mostly directors, to be personally responsible for their company's debt in the event of default. Lenders often insist on personal guarantees when they have concerns over the credit history, or financial stability of the company's business. A personal guarantee is considered to reduce the risk of default.

Due diligence is a must – Always

Given the heightened risk posed by the recent developments and also as a matter of good governance, directors need to ensure that the guarantee given is fair and equitable on the basis of sound legal advice followed by continuous monitoring of payments to effect timely payments. When there are delays in payments and red flags are raised, it is necessary to be proactive and personal guarantors should try to renegotiate terms or rework the payment plan. As regards directors retiring or

resigning or leaving the company, they need to work on releasing themselves from the personal guarantees extended before they exit.

Can D&O insurance come to rescue when lenders invoke personal guarantees?

Normal D&O insurance cannot come to the rescue of directors when personal guarantees are invoked for the following reasons.

- Is there a wrongful act - the act resulting in the claim? D&O policy offers indemnity in respect of wrongful acts committed in the official capacity for which they are appointed and compensated. Personal guarantees are not offered in the official capacity. Hence, it does not fit into official capacity validation.
- Is there a loss? Amount paid in discharge of personal guarantee is a contractual obligation. Repayment of a loan does not constitute loss. Contractual obligations are not in the realm of D&O insurance. (Primary wordings in some of the D&O policies do not exclude contractual obligations explicitly though.) Personal guarantee does not fit into the definition of loss as generally defined in a D&O policy.
- While D&O policy is primarily a personal asset protection insurance policy, it cannot extend to every act and loss.

That personal guarantees are not covered under D&O policies is clear from the available case law. Judgement in In Sauter v. Houston Cas. Co, case can be accessed [here](#).

Then, is there any other insurance available?

Yes. In some jurisdictions. Not in our country at present. There is **Personal Guarantee Insurance (PGI)** which is designed to protect owners/ directors who provide a personal guarantee to the lenders while raising a loan. The amount payable under this insurance would be the final dues the insured is required to pay not exceeding the limit of indemnity or a part thereof subject to the terms and conditions of the policy.

Policy Summary of Personal Insurance Guarantee Insurance from one of the providers can be accessed [here](#)

How does this policy help?

1. It protects the personal assets of the directors.
2. It offers peace of mind. Knowing that there is an option to fall back upon helps.
3. It is cost effective to buy a policy rather than facing the adverse consequences of defaults.
4. It helps business growth, as it provides confidence to personal guarantors to take the calculated risks that can help the business grow.
5. It reduces the threat of bankruptcy for the directors.

This being a speciality insurance product calls for elaborate underwriting. Insurance brokers will have a significant role in this area. This opportunity is worthy of attention and evaluation of insurers to meet the unaddressed needs of the market in India

P. Umesh
Consultant – Liability Insurance
p.umesh@liabilityinsurancepractice.com
www.liabilityinsurancepractice.com

Disclaimer: The information contained and ideas expressed in this article represent only a general overview of subjects covered. It is not intended to be taken as advice regarding any individual situation and should not be relied upon as such. Insurance buyers should consult their insurance and legal advisors regarding specific coverage and/or legal issues.

Bibliography:

1. <https://www.mondaq.com/india/insolvencybankruptcy/1326750/understanding-the-liability-of-personal-guarantors-under-the-insolvency-and-bankruptcy-code-2016>
2. <https://www.caclubindia.com/articles/liability-of-director-as-guarantor-for-debts-of-company-46056.asp>
3. <https://www.lexology.com/library/detail.aspx?g=6bfaa25b-be53-483d-9952-5f885c8bfa15>
4. <https://www.mondaq.com/india/insolvencybankruptcy/1394712/landmark-ruling-of-the-supreme-court-on-personal-guarantors-under-ibc-will-shape-the-future-of-lender-creditor-dynamics>
5. <https://www.lexology.com/library/detail.aspx?g=6bfaa25b-be53-483d-9952-5f885c8bfa15>
6. <https://www.wiley.law/newsletter-4282>
7. https://economictimes.indiatimes.com/industry/banking/finance/banking/sc-denial-of-ibc-relief-to-personal-guarantors-opens-new-recovery-window-for-lenders/articleshow/105172575.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst