

# A brand new coverage

How personal guarantee insurance can help business owners manage risk without losing control of their assets

**B**usiness failure has historically been a risk insurance carriers have assiduously avoided. Other than trade-credit insurance and limited credit-enhancement policies, the risk of default of a business is typically borne by the business owner.

In today's lending environment, as banks look to mitigate their own exposures to risk, nearly all small and mid-size business owners must sign a personal guarantee to secure financing. The result is that, if the business fails, the business owner's personal assets are used to cover the loss.

This is obviously an extremely angst-inducing, emotionally charged decision, which, if it ends badly, can cause significant hardship — including loss of the owner's home.

But with the introduction of personal guarantee insurance, a new category of coverage is now available to help business owners manage personal risks — and sleep better at night.

*Smart Business* spoke with Sergio Bechara, president and CEO of Millennium Corporate Solutions about how personal guarantee insurance works, how it can help business owners, and what features to look for in this coverage.

## What is a personal guarantee?

A personal guarantee is essentially a signed blank check without an expiration date. But with the introduction of personal guarantee insurance, business owners can manage their personal risks — and enjoy the peace of mind that comes with knowing their personal assets will not be used to cover the loss if their business fails.

## Why is personal guarantee insurance important?

Insurance practitioners are the guardians of their clients' assets, both personal and professional. They manage, mitigate, isolate, insure and have contingency plans if bad things happen.

As part of that task, they work with lawyers to create barriers to limit liability through corporations, LLPs, LLCs and trusts. For remaining liability exposures, there is general liability, auto liability, professional liability and a host



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of other coverage types, all of which are used in the name of protecting assets. For property exposures, the insurance practitioners negotiate special forms coverage for their clients.

Despite the great efforts of the insurance carriers, underwriters and brokers, bankers can destroy much of their good work with one stroke of the pen. In their efforts to mitigate their own risk exposure, banks have penned personal guarantee requirements that tie the business owner's assets to the business itself. These requirements, which most small and midsize business owners must meet in order to receive financing, have the effect of taking down the walls your insurers have so diligently erected, allowing for the unthinkable.

Since a personal guarantee gives the banker access to a business owner's personal assets (often including a spouse's) if a business loan is in default, bankers have traditionally had the upper hand in these situations — until now.

## How does personal guarantee insurance help business owners?

Personal guarantee insurance (PGI) helps neutralize the impact of the required guarantee. It puts back the wall

between the business and personal assets by covering a substantial portion of the liability of the personal guarantor in the event the loan guarantee is ever called.

With this policy, everyone can be satisfied: the bank receives the personal guarantee to complete the loan, while the client's personal assets are protected by the insurance policy.

As a benefit to bankers, one provision of the PGI policy is that the proceeds can be assigned to the lender, thereby improving the collateral position of the bank. Now, the bank has an even better position — it has the business as collateral and a signed personal guarantee, which is backed by an insurance policy to which it is a beneficiary.

## What features should business owners expect as part of this coverage?

Some features of the new insurance are:

- PGI is typically issued within six months of a loan origination or material modification.
- It can be designed to pay up to 70 percent of a deficiency judgment in the event of a loan default.
- It can typically be underwritten based on the same information the bank uses when making the business loan.
- While it adds cost to the overall loan transaction, it provides a tremendous backstop in the event personal assets are ever called into play.
- Since the bank is likely in a better position if the proceeds are assigned to the lender, it may be able to offer a more attractive interest rate on the loan once the coverage is put into place to help offset the cost of the insurance.

## How can insurance brokers and risk managers ensure the personal guarantee insurance is working as it should?

As we undertake the managing of risks for our clients, a review of the personal guarantee should be included in exposure-review checklists, just like we review employment practices, environmental or cyber-liability exposures. <<

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