journals.unizik.edu.ng/index-php/jcpl ISSN: 2736-0342
NNAMDI AZIKIWE UNIVERSITY, AWKA
JOURNAL OF COMMERCIAL AND PROPERTY LAW

Guarantee as a Security under Nigerian Legal System

Onyinye OC-Chukwuocha*

Abstract
Security is very important in any business endeavour requiring credit. Sometimes a borrower may not have the necessary collateral to use as security. A lender in such a situation could fallback to personal security, such as a guarantee. Personal security could be in the form of guarantee or indemnity, but this paper focused on guarantee as a security. A Guarantee gives the creditor a claim against a particular person who assumes liability as surety for the principal debtor, rather than a claim upon any specific asset. The aim of this paper is to examine Guarantee as a security and to understand its effectiveness as a security. This paper explored the creation of guarantee, the legal nature of guarantee contract, the differences between a guarantee and an indemnity, credit guarantee companies and the challenges of guarantee as a security. The research methodology adopted in this paper is the doctrinal. This paper observed that Guarantee is not merely routine procedure in loan transaction; rather, it is actually a form of security just like a mortgage, even though a personal security. The paper also found that Guarantee as a security has some advantages over real or tangible security, as it is not affected by problems associated with tangible security, such as obsolescence, depreciation, verification, perfection and foreclosure. The paper recommends that Guarantors should be screened or investigated to ascertain their suitability to play the role of a Guarantor, in order to enhance its effectiveness as a security.

Keywords: Guarantee, Security, Personal Security, Secured Credit, Indemnity

1. Introduction

Many people often do not recognize a guarantee as a form of security. This is because the debtor's obligation doesn't actually create an interest in a specific property. But the truth is that Guarantee is a form of security and it is definitely better to have guarantee as a security than not having any security at all. However, it is important to maximize the effectiveness of a guarantee because many people still sign a contract of guarantee for people as a routine or mere procedure, without understanding its implication or going through the terms of the contract of guarantee. Many times, because the debtors (having primary liability) have always met with their obligation, the guarantors do not realize the gravity or relevance of what they are entering into, when they sign a contract of guarantee, until they encounter a debtor who fails to meet his obligation of paying and they discover they are in a big trouble.

Many times the process of creation of a contract of guarantee is faulty. We have guarantors who are not deserving, who lack the capacity and basic criteria of a guarantor or persons without the wherewithal to payback, acting as guarantors. We have persons who do not understand what they signed or the implication of accepting to serve as guarantors, until they are called upon to pay in the face of the default of the borrower and they are surprised.

2. Definition of Concepts

2.1. Credit

Credit is a contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some later date in the future, generally with interest.[1] Credit is also the ability of a customer to obtain goods or services before payment, based on the trust that payment will be made in the future.

***Onyinye OC-Chukwuocha,** An Associate of Business Recovery and Insolvency Practitioners Association of Nigerian and a Lecturer at Federal Polytechnic, Nekede, Owerri, Imo State, 08038735341. Email: maranatha233@yahoo.com
[1]Investopedia, <http://www.investopedia.com/terms/c/credit.asp>, accessed 23 May, 2018.

2.2 Secured Credit

Secured Credit are loans involving an agreement for the lender to take particular assets from the borrower if they cannot pay the money back.[2] Secured Credit are also loans where the lender has the right to claim some of the borrower's assets if they do not repay it.[3]

2.3. Security

According to Goode, Security is defined as a right given to one party in the property of another party to secure payment or performance by the other party or by a third party.[4]

According to Smith, Security involves a transaction whereby a person to whom an obligation is owed by another person is afforded in addition to the personal promise of the obligor to discharge the obligation, rights exercisable against some property of the obligor or a third party in order to enforce the discharge of the obligation.[5] Security can therefore be defined as "anything that makes money more assured in its payment or more readily recoverable".[6]

Security is also that additional right, which tends to render more certain or probable the discharge of a debt or claim, than, if, satisfaction were dependent only on the person primarily liable.[7]

2.4. Types of Security

There are two types of security namely: Real Security and Personal Security.

2.4.1. Real Security

Real security is a right in another's asset to secure performance of an obligation. The creditor acquires real rights over one or more of the debtor's assets in order to secure payment of the debt.[8] Real security confers an estate or interest in the property of the debtor or of a third party on the creditor by way of security. [9]This creates a right in *rem* over specific property to the satisfaction of a particular debt so that debt is a primary charge on the property. The lender whose right is secured by a real security is entitled to take that security for the borrower's assets available to the general creditors.[10]

There are various classifications of security, but under English Law, four types of Real security are recognized namely: mortgage, charge, pledge and lien.

i. Mortgage

A Mortgage is a legal or equitable conveyance of title as a security for the payment, of which it is given, subject to a condition that the title shall be reconveyed if the mortgage debt is liquidated.[11]

A mortgage involves the transfer of ownership in an asset to a creditor by way of security for borrowing, upon the condition that on the full discharge of the debtor's obligation, there would be a re-transfer of the mortgaged asset to the mortgagor. A mortgage does not at law require the delivery of possession for it to be valid.

[2]*Cambridge Business English Dictionary*, Cambridge University Press, <http://dictionary.cambridge.org/business-english /secured-credit>, accessed 24 May, 2018.
[3]*Longman Business English Dictionary*, <http://lexicon.ft.com/term?fenn=secured-credit>, accessed 25 May, 2018.
[4] R M Goode, *Legal Problems of Credit and Security* (2nd edn, Sweet & Maxwell, 1988) 1.
[5] I O Smith, *Secured Credit in a Global Economy-Challenges and Prospects* (Department of Private and Property Law, Faculty of Law, University of Lagos, 2003)230.
[6]Ibid, p 2.
[7] Per Mayo, JSC, Supreme Court of the South Australia, in *Maddeford v De Vantee* (1951) SASR 259, 267.
[8] R Goode, *Commercial Law* (3rd edn, LexisNexis UK and Penguin Books, 2004) 583-584.
[9]J O Enyia and U Okon, 'Classification of Credit Security in Nigeria: Resolving the Perceived Dichotomy', *Journal of Economics and Business* [2018] 1(2), 192.
[10] I O Smith, *Nigerian Law of Secured Credit* (Ecowatch Publications Limited, 2006) 8 – 9.
[11]*Santleyv Wilde* (1899) 2 Ch. 477.

ii. Charge

Unlike a Mortgage a Charge does not involve a conveyance of asset to the creditor. A Charge merely require appropriation of asset/property to a contract of loan with an assurance that upon default by the debtor, the property or asset may be attached for the purpose of liquidating the indebtedness.[12] The chargee has no interest whatsoever in the asset but merely has a right to payment out of the asset. A charge is a security by which the creditor obtains neither possessions nor ownership of asset/property, but a simple appropriation of a specific property to satisfaction of his debt. There are two types of a charge, the fixed charge and the floating charge.

iii. **Lien**

A lien is a right to retain property until an indebtedness is discharged.[13] Such a right could arise by operation of law and not based on the agreement of the parties as is applicable under mortgage. A lien may also be by agreement, whereby the parties contract to give the creditor right by contract to detain goods of the debtor to secure payment or performance of some other obligation, the good having been delivered to the creditor for some purpose other than security, such as storage or repair. An example is a vendor's lien on land conveyed to the purchaser for the unpaid balance of the purchase price.[14]

iv. The Pledge

The earliest form of security is the Pledge, in which the creditor takes possession of the debtor's asset as security until payment of the debt. A pledge involves transfer of possession to the creditor, unlike a mortgage where only proprietary interest or title is transferred. [15]

2.4.2. Personal Security

This is a contract by a third party wherein the third party undertakes to perform the obligation of the debtor. A personal security is a personal guarantee given by a third party called the guarantor or surety that he will discharge the obligation. Usually, the third party is not a party to the principal agreement. Hence, the contract embodying the Personal security is distinct and different from the principal loan agreement. [16]

There are doubts about categorizing personal security as a form of security, this is because the debtor's obligation doesn't actually create an interest in a specific property. Personal Security gives the creditor a primary or secondary contractual action against the surety should the principal debtor defaults. It gives the creditor no claim upon any particular thing but a claim against a particular person who assumes liability as surety for the principal debtor. A personal security is further classified into two major classes: Guaranty and Indemnity.

3. What is a guarantee?

A guarantee is a promise to answer for the payment of debt or performance of an obligation if the person liable in the first instance fails to make the payment or perform the obligation.[17] It is a written undertaking made by one person to a second person to be responsible if a third person fails to perform a certain duty.[18]

A Guarantee is an undertaking or promise that is collateral to the primary or principal obligation and that binds the guarantor to performance in the event of non-performance by the principal obligor.[19] A promise to answer for the debt, default, or miscarriage of another person.[20]

---

[12] R A, Onuoha, *The Law of Land and Company Securities in Nigeria: Reformation and Development of Viable Alternative* (1st edn, Anon Publishers, 2008) 58.

[13] Ibid

[14] Ibid.

[15] R A, Onuoha (n12).

[16] G Andrews and R Millett, *Law of Guarantees*, (6th edn, Sweet & Maxwell, 2011) 7.

[17] C Ofoha, 'An Introduction to the Contract of Guarantee and the extent of the liability of a Guarantor', <https://www.patrelipartners.com/wp-content/uploads/2021/01/Contract-of-Guarantee.pdf> accessed 25 August, 2024.

[18] The Encyclopedia of forms and precedent - fifth edition, 17(3) Guarantee and Indemnities

[19] C Ofoha, (n 17).

A guarantee is a legally binding promise by one party to another to perform the obligations of a third party if the third party defaults in performance of those obligations. [21]

A guarantee is a contract in which the guarantor promises to answer to the person in whose favour the guarantee is given ("the creditor") for a debt or obligation of a principal debtor if the debtor defaults.[22]

3.1. Distinction between a Guarantee and an Indemnity

Many times the terms 'Guarantee' and indemnity are used interchangeably, but the two terms, even though, both, are forms of Personal Security, have different meanings and implications. The major distinction between them is that whereas a 'guarantee' is a collateral obligation while an 'indemnity' is a principal obligation.

An indemnity is in form of a contract where a person or a surety agrees to save another person (the assured), from loss. Unlike a Guarantee which is a secondary and contingent liability, in an Indemnity, the Promisor undertakes a primary obligation to indemnify the promisee.[23] This means that in the eventual inability of the principal obligator to pay, the surety shall ensure the promisee is paid and the due obligation can be demanded from the surety without further claims from the principal Obligee.

A guarantor's promise to answer for the "debt, default or miscarriage" of another involves an obligation that is secondary or ancillary to the obligation of that other, who is primarily liable to the person to whom the guarantee is given. A promisor under an indemnity agrees, in terms that create a primary liability in the promisor to keep the other party to the contract harmless against loss as a result of that party's entry into a transaction with a third party.[24]

A contract of indemnity in contrast to a contract of guarantee, is one in which the indemnitor agrees with the creditor to make good all or an agreed measure of any loss the creditor may suffer consequent upon the debtor's default in meeting his financial obligations to the creditor. In such cases, there are usually two parties to the contract, that is, the creditor and the indemnitor and the person giving the indemnity assumes primary liability for the debt. A typical situation of an indemnity contract is illustrated by the case *of Apugo &Sons Co. Ltd. v African Continental Bank Ltd*[25], where the court in determining whether the undertaking was a guarantee or an indemnity held that the Ministry of Agriculture did not assume the secondary liability to answer for the debt default or miscarriage of the appellant (which is tantamount to a guarantee) but rather, gave to the bank the immediate right to look for satisfaction of the total overdraft sum by the Ministry of Agriculture in the event of Appellant's default, an arrangement tantamount to an indemnity.

Unlike a guarantee, a contract of indemnity need not be in writing, although it may be dangerous for a creditor to be content with an oral agreement for an indemnity. Again, liability under a contract of guarantee generally depends on the validity of the principal contract between the lender and borrower, an indemnitor remains liable under the contract of indemnity. The liability of the guarantor is normally co-extensive with the liability of the principal debtor, so that if the debtor is discharged, the surety will also be discharged. A guarantor is not liable in a situation of lack of capacity of the debtor or other invalidating causes under the main contract.[26] But in the case of an indemnity, an indemnitor remains liable under a contract of indemnity notwithstanding that the debtor is discharged under the main contract.[27]

[20]*Commercial Credit Corp. v Chisholm Bros Farm Equipment* Co. 96 Idaho 194525 p, 2d 976, 978.

[21]O Ayokunle,'The Nature and Enforcement of Contract of Guarantee'being a Seminar Presentation in Partial Fulfilment of the requirements for the award of LLM Degree, University of Lagos.

[22]Ibid.

[23]G Andrews and R Millett, *Law of Guarantees*, (6th edn, Sweet & Maxwell, 2011) 5.

[24]*Sunbird Plaza Pty Ltd v Maloney* (1988) 166 CLR 245 at 254.

[25] 9(1989)1CLQR p.87

[26]*Yeoman Credit Ltd v Latter* (1961) 1 WLR 838

[27]*Goulston Discount Co. Ltd v Clark* (1967) 2 QB 93

It is therefore apparent that an indemnity provides an important additional protection to a creditor that even if the principal debtor's liability may have for some reason been extinguished, the right to be indemnified for such loss may survive. Thus, unless there is clear agreement to the contrary, a creditor may require both a guarantee and an indemnity.

3.2. Importance of Security

Sykes and Walker define security as a transaction whereby a person to whom an obligation is owed by another person called the debtor is afforded, in addition to personal promise of the debtor to discharge the obligation, rights exercisable against some property of the debtor in order to discharge the obligation.[28]In definition only defined security in terms of real or tangible security.

Many of the failures witnessed in the Nigerian banking industry in the early 1990s were as a result of reckless lending practices and unethical conducts, ultimately leading to the creation of bad loans. The banking crisis witnessed in the early 1990s demonstrates the consequences of unsecured credit. During that period, banks and other financial institutions issued substantial amounts of credit with insufficient or, in some cases, no security at all. [29]This practice contributed to the banking industry's collapse, prompting the enactment of the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Decree No. 18 of 1994 (as amended), requiring institutions to obtain security when extending credit.[30]

Adequate protection for creditors is crucial for ensuring the availability of finance for businesses. In July 2010, the Asset Management Corporation of Nigeria (AMCON) was established to address non-performing loans, which posed a significant threat to the economy before AMCON's intervention. A robust legal framework should address various aspects, including fortifying the lender's position in lending transactions.

The value of security in secured credit transactions lies in its enforceability in the event of a debtor's failure or refusal to repay the loan. Without enforceable security, the lender faces uncertainty regarding loan repayment, hindering the advancement of credit for business purposes.

Lenders often hesitate to provide unsecured credit because of the associated risks, relying solely on the borrower's promise to pay or reputation. In secured transactions, promises are backed by collateral that the lender can seize and sell in case of non-compliance with the agreed-upon loan terms or through a third-party contract.

Smith emphasizes that security becomes necessary due to the unpredictability of borrowers, who may initially promise to repayment but later prove uncooperative[31] or may even suffer a genuine unforeseen setback. Therefore, whereas, the borrower's capacity to fulfill the repayment promise is a critical factor in assessing the safety of a credit. Yet, providing security minimizes risks by offering an alternative recourse for the creditor in case of default.

Taking security increases the creditor's chances of recovery in the event of the debtor's insolvency. In insolvency, the availability and sufficiency of the debtor's assets determine loan repayment possibilities, because in insolvency there is insufficient money for everybody[32]. Secured credit becomes imperative as it ensures the lender has a fallback option when the borrower fails to fulfill his financial obligations.

Because of the associated risk of unsecured credit the lender in most cases will refuse to accept the empty promise of the borrower, but would rather insist that certain property or additional third party assurance

---

[28] E I Sykes and S Walker, *Law of Securities* (5th edn, Law Book Company, 1993) 11

[29] Ibid.

[30] *Section*20 (1)(b) and *Section*20 (2)(a)& (b) Failed BanksRecoveryofDebts Decree.ThisDecreequalifiesasanAct oftheNationalAssemblybyvirtueofs. 315(1)(a) of the1999ConstitutionoftheFederalRepublicofNigeria.

[31] I.O, Smith, *Nigerian Law of Secured Credit* (Ecowatch Publishers 2001) 2

[32] Sykes &Walker, *The Law of Securities* (5th edn, Law Book Company Limited) 4.

be made available to secure the debt, so that when the borrower reneges, the lender can have something to fall back on.

Secured credit not only safeguards the interests of the creditor but also instills discipline in the borrower. The security provided compels the borrower to remain vigilant and committed to meeting his obligations.Security serves as an alternative means for the creditor to recover the loan if the borrower refuses or cannot repay.[33]

3.3. Nature of Guarantee

A Guarantee is a form of a contract, otherwise known as a contract of guarantee. A contract of guarantee can be described as an assurance to a creditor that if the principal debtor fails to pay, the guarantor or surety would repay the debt. [34]

It involves endorsement of a three-party agreement. In a contract of guarantee, the individual providing the guarantee is referred to as the "Guarantor". The recipient of the guarantee is known as the "creditor/lender", while the person primarily liable for the obligation is referred to as "the principal debtor". A guarantor is a person or a firm that endorses a three-party agreement to guarantee that promises made by the first party (the principal) to the second party (client or lender) will be fulfilled and assumes liability if the principal fails to fulfill them.[35]Guarantees may be used to support a variety of obligations other than the payment of a debt. However, this paper is concerned only with guarantees in the context of loans. [36]

A contract of guarantee is one by which one person called the 'guarantor' agrees to be answerable for the liability of the debtor either personally, or by way of a charge on the guarantor's property or both.[37]A guarantor is one who makes a guarantee or gives security for a debt. [38] It also invariably means that a guarantor technically is a debtor because where the principal debtor fails to pay a debt or fulfill a certain obligation, the guarantor will be called upon to pay the debt so guaranteed or fulfill the obligation so promised.

Guarantors are also sometimes referred to as "third party guarantors". This is because the guarantor is not a party to the loan contract between the borrower and the lender. Guarantors usually do not benefit from the loan. They may, however, provide a mortgage or charge over property as security for the guarantee.[39] A contract of guarantee presupposes the existence of another prior contract, a loan contract, under which the principal debtor is primarily liable. The liability of the guarantor under a contract of guarantee is secondary, because he is only to discharge the principal debtor's obligation if the debtor fails to do so.

Hence, the essential distinguishing feature of a contract of guarantee is the secondary, or ancillary, nature of the obligation that the guarantor assumes.The guarantor's liability is secondary in the sense that its dependant on the principal debtor's continuing liability and, ultimately, the debtor's default.The guarantor is not liable unless and until the principal debtor has failed to perform his or her obligations. Under Contract of Guarantee the promisor undertakes to be answerable for the debt, default or miscarriage of another person whose primary liability to the promise must exist or be contemplated.[40]Thus, without a principal obligation, there can be no accessory of guarantee.[41]

---

[33]J Omotola, *'The Law of Secured Credit' (*Evans Brothers, 2006) 1.
[34]*Gold Link Insurance Company Ltd v Petroleum (Special) Trust Fund* (2008) LPELR-4211(CA).
[35]<http://www.businessdictionary.com/definition/guarantor.html.>accessed on 25 December 2023
[36]O Ayokunle,'The Nature and Enforcement of Contract of Guarantee'being a Seminar Presentation in Partial Fulfilment of the requirements for the award of LLM Degree, University of Lagos.
[37]Ibid
[38]*Senator (Mrs.) EmeUfotEkaete v Union Bank of Nigeria Plc* (2014) LPELR-23111(CA).
[39]O Ayokunle, (n 36).
[40]The Court of Appeal in *Wema Bank Plc. & anor v Alaran Frozen Foods Agency Nigeria Limited & anor* (2015) LPELR-25980 (CA) relying on Halsbury's Laws of England, 4th edn Vol. 2, at paragraph 101.
[41]The Encyclopedia of forms and precedent – fifteen edition, Vol 17(3) Guarantee and Indemnities.

The liability of a guarantor only arise upon the failure of the principal debtor to fulfill or perform his part of the contract or obligation he owes the creditor. The Supreme Court have also held that the liability of a guarantor becomes due and mature immediately the debtor/borrower becomes unable to pay its/his outstanding debt. The guarantor's liability is then said to have crystallized.[42]

In a situation where the principal contract becomes void or unenforceable, the guarantor is released from his liability. This is because the guarantor's responsibility reflects that of the principal debtor; if the principal debtor isn't accountable, neither is the guarantor.[43]

4. Guarantee as a Secured Credit

The conventional notion of security primarily revolves around the presence of tangible assets that the lender can utilize to settle a debt in the event of a borrower's default. However, a contract of guarantee usually becomes crucial when a lender is faced with a borrower who has no assets or whose assets are encumbered. The lender rather than granting the borrower an unsecured advance, the common recourse is to involve a third party, preferably a person of substance who acts as guarantor to the borrower and back the borrower by assuming responsibility for their indebtedness to the lender.

The failure to fulfill a contractual obligation is an anticipated occurrence in any contractual arrangement, emphasizing the need for security to mitigate the risk of default. Consequently, a guarantee should not be taken as a mere formality, because, it represents a commitment from the guarantor to the obligee. Where the guarantor undertakes to fulfill the guaranteed obligation should the obligor fail to meet his contractual responsibilities to the obligee by the stipulated due date.

Real / tangible security could sometimes be used to compliment Guarantee as a security. In instances where the contract of guarantee involves a claim on the guarantor's property in addition to the borrower's personal commitment to pay, it provides the lender with a fallback option.[44]

In a situation where the borrower undertakes to indemnify the guarantor for losses resulting from the borrower's default. This motivates the borrower to endeavor to meet his financial obligation.

At other times personal security like a Guarantee helps to complement, enhance or reinforce real security. Guarantee provides an additional security, even in situations where real security are available. Many instances of corporate failures can be attributed to the actions of fraudulent directors. In such cases, only the company's assets are utilized in the liquidation process. When these assets fall short of covering the company's financial obligations, creditors find themselves unable to pursue legal action against the individuals responsible for the company's misfortune. Consequently, in contemporary times, creditors are reluctant to extend credit facilities to companies unless the directors provide a personal guarantee and/or indemnity.[45]

A guarantee, functioning as a form of security, possesses appealing characteristics such as safety, liquidity, and freedom from the problems associated with using tangible assets as security, such as obsolescence, depreciation, verification, perfection, and foreclosure.

Also, in situations real security involves assets that are either depreciating or subject to market price fluctuations, creditors are wise to seek a personal guarantee from the borrower as an additional protective measure.[46] However, in modern times, external guarantors like banks and national export credit agencies play an increasingly vital role in corporate financing.The emergence of commercial instruments such as letters of credit and letters of comfort as forms of assurances in meeting financial obligations represents a significant development in the realm of guarantees, which have helped businesses significantly.

---

[42]*Nwankwo & Anor v Ecumenical Development Co-Operative Society (Edcs) U.A*(2007) LPELR-2108(SC).
[43]G Andrews and R Millett, *Law of Guarantees*, (6th edn, Sweet & Maxwell, 2011) 5.
[44]I.O Smith, *Nigerian Law of Secured Credit* (Ecowatch Publishers 2001) 351
[45]OluwasanmiAyokunle,'The Nature and Enforcement of Contract of Guarantee'being a Seminar Presentation in Partial Fulfilment of the requirements for the award of LLM Degree, University of Lagos.
[46]*ibid*

5. Significance/Advantages of Guarantee as a Personal Security

The conventional notion on the concept of Security in Nigeria revolves primarily around the presence of tangible assets that can be employed by the lender in satisfaction of a debt in the event of a borrower's default.

However, a guarantee contract becomes necessary when a lender encounters a borrower lacking assets or possessing encumbered assets, and the lender does not want to take the risk of extending an unsecured credit. In such situations, the lender could resort to, looking for a third party, preferably with substance, to act as a guarantor for the borrower, supporting the borrower by guaranteeing his indebtedness to the lender.

Guarantee mechanisms has been very beneficial to Micro, Small, and Medium Enterprises (MSMEs), who form a substantial part of our economy, enabling them to secure loans that might have been otherwise unattainable due to challenges in providing immovable property as collateral. Secured credit plays a critical role in enhancing access to credit, which invariably stimulates economic growth.

There is also this apprehension of dual liability, where the borrower undertakes to indemnify the guarantor for losses resulting from the borrower's default, which usually keeps the borrower on his toes to fulfill his financial obligation.

Guarantee could sometimes be used in conjunction with real/ tangible security. This provides the lender with something to fall back to, especially where the contract of guarantee involves a charge on the property of the guarantor in addition to the borrower's personal commitment to repay. [47]

At other times, personal security is used to complement, strengthen and fortify the efficacy of real security. In such cases, it becomes essential to have directors and managers of a registered company stand as sureties or guarantors for a debt being raised by a company. This precaution helps to ensure that these individuals, who oversee the company, do not misuse the corporate veil to commit financial misconduct that could lead to the company's liquidation. Many instances of company failures have been attributed to the actions of fraudulent directors, yet, in those instances, it was only the company's assets that were committed to settle debts during liquidation. And when the company’s assets proved insufficient to cover the company's financial obligations, the creditors could not pursue legal action against the directors and managers, who are the actual architects of the company's downfall.

Therefore, in recent times, creditors are reluctant to extend credit facilities to companies without securing personal guarantees and/or indemnities from the directors. Also, in a situation where the subject matter of real security is a depleting asset, or an asset susceptible to market price fluctuations, creditors find it prudent to obtain a personal guarantee from the borrower as an additional protection.

6. Credit Guarantee Companies

According to Section1.1 of the Central Bank of Nigeria Guidelines for Regulation and Supervision of Credit Guarantee Companies in Nigeria, issued by the Central Bank of Nigeria on 23 March, 2023, the Central Bank of Nigeria (CBN) issued guidelines for the regulation and supervision of credit Guarantee Companies pursuant the powers conferred on it by *Section* 2(d) of the CBN Act 2007 and Section 56(2) of the Banks and Other Financial Institutions Act (BOFIA) 2020. The guidelines was issued by CBN in recognition of the role of guarantee schemes in facilitating lending.

A Credit Guarantee Company is an institution licensed by the CBN with the primary objective of providing guarantees to banks and other lending financial institutions licensed by the CBN, hereinafter referred to as Participating Financial Institutions (PFIs), against the risk of default by obligors. The CBN, as part of its effort to stimulate lending to Micro, Small and Medium Enterprises (MSMEs) facilitated the development of guidelines for the establishment and operation of credit guarantee companies in Nigeria.Micro, Small and Medium Enterprises (MSMEs) face various difficulties accessing credit from

[47] I O Smith, *Nigerian law of secured credit* (Ecowatch Publishers, 2001) 351.

the formal sector in developing countries like Nigeria. Difficulties like lack of collateral among other factors have limited MSMEs' access to credit and where credit is granted, it is often on unfavorable terms.

Credit Guarantee Schemes (CGCs) have been widely considered as one of the means of addressing the challenge of limited access to credit by MSMEs. CGCs provide third-party credit risk mitigation to lenders through the absorption of a portion of the lender's losses on the loans in case of default. The CGCs are only available to Nigeria-based MSMEs. A guarantee issued by a CGC represents a legal commitment to discharge an agreed portion of the liability of a borrower in the case of default.

The parties to Credit Guarantee Schemes, just like the conventional guarantee are; the lender to whom the guarantee is given, the Credit Guarantee Company that provides the guarantee and the borrower on whose behalf the guarantee is given.[48] The MSMEs may apply and obtain a guarantee directly or through the lending PFI from a CGC licensed by the CBN. [49] The PFI can only do so with the MSMEs permission.The PFIs shall receive and appraise loan applications submitted by its customers, monitor the performance of all exposures to obligors guaranteed during the guarantee period, register all eligible moveable assets with the National Collateral Registry. The PFI take the lead in the recovery of guaranteed sums from defaulting obligors, realise all collaterals used to secure MSME loans and apply the proceeds as stipulated in the relevant contracts, render periodic returns as may be specified by the CBN from time to time.[50]

The Credit Guarantee Company shall pay the claims on default by obligors in line with the contract terms and the general provisions of the Guidelines and Collaborate with PFI to recover the guaranteed sum from defaulting borrowers post claims payment and Ensure that the PFIs adhere to the terms of disbursement of loans to MSME, especially with regards to loans with fixed business circles.[51]The Guarantee may cover up to a maximum of 75% of the default amount. After the crystallized guarantee has been settled, the PFI and the CGC shall be required to take all necessary steps to recover the outstanding sum, and the CGC shall be reimbursed to the extent of the recovered sum.[52]

7. Challenges of Using Guarantee as a Security

It is usually the case that that individuals presenting themselves as guarantors lack an understanding of the implications associated with signing a guarantee form or contract. Many perceive a guarantee as a mere formality associated with the finalization of a contractual agreement.[53]They do not see a guarantee as commitment from the guarantor to fulfill the guaranteed obligation should the obligor fail to meet his contractual responsibilities to the obligee by the stipulated due date.

Individuals who undertake the role of guarantors, whether in a loan agreement or to ensure the performance of obligations within a contract, often view it as a gesture of goodwill toward a friend or family member, without a full grasp of the potential repercussions and liabilities involved.[54]

Although there may be a few who possess actual knowledge about the implications of assuming the role of a guarantor, they often do so under the assumption that their liability will never cystrallize.[55]They fail to recognize the possibility of failure by the principal obligor to perform the obligation, and that the guarantee is taken as an effort to mitigate the risk of default.

[48]CBNGuidelines for Regulation and Supervision of Credit Guarantee Companies in Nigeria, s 1.1
[49]Ibid, s1.2
[50]Ibid, s 3.2. 1
[51]Ibid, s3.3.1
[52]Ibid, s9.0.
[53]F I Erihiakporeh, 'Nigeria: The Guarantor's Prayers- Why a Contract of Guarantee is not a mere formality', available at <https://www.mondaq.com/nigeria/litigation-contracts-and-force-majeure/947762/the-guarantors-prayers--why-a-contract-of-guarantee-is-not-a-mere-formality?login=true&debug-domain=.mondaq.com> accessed 24December, 2023.
[54]Ibid.
[55]*ibid*

Guarantors sometimes are not screened or investigated to ascertain their suitability to play the role of a Guarantor. If borrowers use their friends and relatives as Guarantors irrespective of their financial standing, the creditor or lender may soon discover the guarantee he has in his hands is worthless because the Guarantor lacks the wherewithal to make good the debt upon the default of the primary obligor.

8. Conclusion

Security is very important in any business endeavour requiring credit. But sometimes, a borrower may not have the necessary collateral to use as security. A lender in such a situation could fallback to personal security like guarantee as a security. Guarantee gives the creditor no claim upon any particular thing but a claim against a particular person who assumes liability as surety for the principal debtor. Guarantee is not affected by problems associated with tangible security, such as obsolescence, depreciation, verification, perfection and foreclosure. As good as an asset used as security may be, especially where the security is an immovable property there the title is defective it cannot be enforced.

Guarantee is not just a form of routine engaged in taking loan, it is actually a form of security like a mortgage, even though a personal security. At other times, personal security is used in conjunction with real security. Where instead of relying of just real security, personal security is used to complement, strengthen and fortify its efficacy.

Guarantee can also be provided by Guarantee Companies for Micro, Small and Medium Enterprises (MSMEs). The Central Bank of Nigeria (CBN) has issued guidelines for the regulation and supervision of credit Guarantee Companies in Nigeria. The guarantee schemes was issued by CBN in recognition of the role of guarantee schemes in facilitating lending. The guidelines is to stimulate lending to Micro, Small and Medium Enterprises (MSMEs), who due to of security/collateral among other factors find it difficult to access to credit.

9. Recommendations/ The Way Forward

Security used for secured credit transaction is of no value, if, the security cannot easily enforced in event of refusal, failure or inability on the part of the debtor to repay the loan or perform any other obligation, such a security is no security at all. Therefore, Guarantee must be entered into by guarantors with proper sensitizations, explanation and clarification given to them as to its implication, in other to enhance its effectiveness as a security. Guarantee must not be entered into as a routine or favour to friends and cronieswhen someone wants to access financial services or loan.

Guarantors should also be screened or investigated to ascertain their suitability to play the role of a Guarantor. If borrowers use their friends and relatives as Guarantors irrespective of their financial standing, the creditor or lender may soon discover the guarantee he has in his hands is worthless because the Guarantor lacks the wherewithal to make good the debt upon the default of the primary obligor. Creditors/Lender should ensure that guarantors are deserving and that possess the wherewithal to payback in a situation of default by the primary obligor.

Guarantee should be required as an additional security where a real/tangible security is suspect. It is important to have directors and managers of a registered company stand as sureties or guarantors for a debt being raised by a company, in such instances. This precaution helps to ensure that these individuals, who oversee the company, do not misuse the corporate veil to commit financial misconduct that could lead to the company's liquidation.