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BUSINESS LAW INSIGHT | OCTOBER 2026

PERSONAL GUARANTEES
WHAT BUSINESS OWNERS SHOULD KNOW BEFORE SIGNING

OCTOBER 29, 2026

READING TIME **8 MINUTE READ**

You have incorporated your business, and it is time to grow. You apply for a business loan to purchase equipment, hire employees or cover operating expenses.
The lender approves the financing, but there is a condition: you must sign a personal guarantee.

You may wonder why this is necessary. After all, the company is borrowing the money, not you personally. Isn't one of the reasons for incorporating to keep the company's debts separate from your own?

Generally, a corporation is a separate legal entity, and its debts are its own. A personal guarantee, however, creates a separate obligation. By signing one, you may agree to pay some or all of the company's debt if the company does not meet its obligations.

Understanding how a guarantee fits into the lending process can help you assess the risk before you sign and respond if the business later experiences financial difficulty.

Why would a lender ask for a personal guarantee?

When a lender provides credit to a corporation, it takes on the risk that the company may not be able to repay.

That risk may be particularly significant if the business is new, has limited assets or depends heavily on its owners. A lender may therefore ask an owner, director or another individual to guarantee the company's obligations.

Consider this example:

A corporation obtains a $200,000 loan from a bank. The bank asks the company's owner, Sarah, to sign a personal guarantee. The company remains responsible for repaying the loan, but Sarah also makes a separate personal commitment under the guarantee.

If the company makes its payments, Sarah may never be asked to pay personally. If the company defaults, however, the lender may be able to make a claim against her, depending on the terms of the guarantee and the circumstances.

Signing for the company and signing personally are different

A business owner may sign several documents as part of a financing transaction. It is important to understand **the capacity in which you are signing each one.**

For example, Sarah may sign a loan agreement on behalf of the corporation in her capacity as a director or officer. She may also sign a guarantee in her personal capacity.

Those signatures have different consequences. Signing on behalf of the corporation does not, by itself, necessarily mean that Sarah has personally guaranteed its debt. A separate personal commitment may be contained in a guarantee or elsewhere in the financing documents.

Being a director or shareholder also does not, by itself, mean that an individual has personally guaranteed every debt of the corporation. The guarantee is an obligation the individual undertakes personally.

What does a personal guarantee cover?

Not all guarantees are the same. The scope depends on the wording of the document.

A guarantee may relate to a specific loan, or it may cover a broader range of obligations the business owes to the lender. It may also be limited to a stated amount or be drafted more broadly.

Before signing, consider questions such as:

- Does the guarantee cover one loan or other existing and future debts?
- Is there a limit on the amount the lender can claim?
- Does that limit include interest, legal fees and other enforcement costs?
- Is the guarantee continuing, and if so, how can it be terminated?
- What happens if the loan is renewed, amended or increased?

A figure written in a guarantee does not necessarily answer every question about the guarantor's total exposure. The full document should be read carefully to determine how any limit operates.

What does a personal guarantee cover?

No. This distinction is central to understanding a business loan.

A **personal guarantee** is a personal promise to pay an obligation covered by the guarantee.

Security gives the lender rights in specified property as collateral for an obligation. The lender may ask for security from the company, from the guarantor, or from both. The property covered and the lender's rights depend on the documents.

A lender may therefore ask for a personal guarantee without taking a mortgage over the guarantor's home. In another transaction, it may ask for both a guarantee and a mortgage or other security over personal property.

Security over business assets

The lender may require the corporation to sign a **general security agreement**, often called a *GSA*. Depending on its terms, a GSA may give the lender a security interest in business assets such as equipment, inventory and accounts receivable.

In Ontario, a lender may register a notice of its security interest in the Personal Property Security Registration system under the ***Personal Property Security Act***, commonly referred to as the PPSA.

This registration is relevant to the lender's rights in relation to other parties who may claim an interest in the same property. It does not, by itself, mean that the lender owns the business assets or has registered a mortgage against the business owner's home.

Security over personal property or a home

A lender may also ask a guarantor to provide specific personal security. For example, the lender might require a mortgage or charge against the guarantor's real estate. If granted, that charge may be registered against title to the property.

This is different from a PPSA registration relating to the corporation's business assets. It is also different from an unsecured personal guarantee.

Even where a guarantee is unsecured, however, it can still create personal liability. If the guarantor does not pay an enforceable obligation, the lender may bring a legal claim and, if it obtains judgment, pursue available enforcement remedies.

What happens if the business cannot repay?

Suppose Sarah's company begins to experience financial difficulty and misses loan payments.

What happens next will depend on the loan agreement, the guarantee, any security documents and the applicable legal requirements. The following are some of the steps that may arise.

The lender may make a demand

A missed payment may constitute a default under the loan agreement. Other circumstances may also amount to default, depending on the contract.

The lender may issue a demand for payment and any notices required by the documents or applicable law.

The amount demanded may include more than the missed payment, depending on the terms of the facility and the circumstances.

The lender may enforce security against the business

If the company granted security over its assets, the lender may take steps to enforce that security. The available process depends on the type of collateral, the financing documents and applicable notice and enforcement requirements.

The value of the business assets may not be enough to pay the debt in full. Other creditors may also claim an interest in those assets, raising questions about priority.

The lender may also pursue the guarantor

If Sarah signed a personal guarantee, the lender may demand that she pay the amount covered by it.

Some business owners assume that the lender must first sell all the company's assets and pursue every possible remedy against the company before asking the guarantor to pay. **That is not necessarily the case.**

In *Toronto-Dominion Bank v. Konga*, 2016 ONCA 976, the Ontario Court of Appeal considered a case in which a bank demanded repayment from both a corporation and its personal guarantor at the same time.

The court confirmed that a debtor is entitled to a reasonable time to pay following a demand. What is reasonable depends on the circumstances. In that case, the court found that the corporation had been given a reasonable time because the bank waited several months before taking steps to enforce the demand.

The court also upheld the interpretation of the guarantee that allowed the bank to demand payment from the guarantor without first exhausting its remedies against the corporation or its other security.

The lender may start a legal proceeding

If a demand is not resolved, the lender may sue the company, the guarantor, or both, depending on the circumstances.

If the lender obtains a judgment against the guarantor, it may seek to enforce that judgment using available legal processes. Those processes are subject to applicable rules, including exemptions and procedural requirements.

Where the guarantor has separately granted security, such as a mortgage against real estate, the lender may also have rights under that security, subject to the applicable enforcement process.

A personal guarantee does **not** automatically transfer ownership of a guarantor's home to the lender. But it can create a personal obligation with serious financial consequences.

What if you sell your shares or leave the business?

This is an issue that business owners often overlook.

Imagine Sarah sells her shares and resigns as a director. She may no longer have any involvement in the company, but that does not necessarily mean the lender has released her from the guarantee.

A sale agreement between Sarah and the purchaser may address who should be responsible for the debt as between them.

But it is also necessary to consider the lender's rights and whether the lender has agreed to release Sarah.

Before leaving a business, review any guarantees and security you have provided. If a release is intended, make sure it is addressed with the lender and properly documented.

Questions to ask before you sign

A personal guarantee may be an important part of obtaining financing. But before signing, take the time to understand the risk you are accepting.

Ask:

1. Who is borrowing the money, and who is guaranteeing it?
2. Am I signing only on behalf of the company, or also in my personal capacity?
3. Which debts does the guarantee cover, and is my liability limited?
4. What security is the company providing?
5. Am I being asked to grant security over any personal assets, including real estate?
6. When can the lender make a demand, and does it have to pursue anyone else first?
7. What happens if I sell my interest, leave the company or the loan is refinanced?
8. What must happen for the guarantee and any registered security to be released?

The answers may be found across several documents, including the credit agreement, the guarantee, the GSA and any mortgage or other security agreement. Reading them together matters.

A decision worth understanding before you sign

A personal guarantee does not mean your business will fail or that you will inevitably be asked to pay. Many businesses obtain financing with guarantees and repay their loans as agreed.

But a guarantee can extend the financial consequences of a business debt beyond the corporation. Understanding its scope, and whether you are also granting security, allows you to make an informed decision before the financing is finalized.

If you have been asked to sign a personal guarantee or have received a demand under one you previously signed, reviewing the full set of documents is an important first step.

This article provides general information about Ontario law and is not legal advice. The effect of a guarantee or security agreement depends on its wording and the circumstances.