The Importance of Credit Applications and Personal Guarantees

What's the main purpose of a credit application and why do they exist? "The key goal of a credit application is to assist the seller in learning as much as possible about the applicant before making a decision to extend credit," according to NACM's *Principles of Business Credit.*

Another reason for having a credit application is to "create a contract between the seller and the buyer." Within this contract are important details about the applicant, which include: the applicant's legal name, address, contact information and Federal Tax Identification Number (FEIN) among other items.

Making sure the correct name is on the credit application is the first step to a successful document, said Matthew Jameson, Esq. of Dallas-based Jameson & Dunagan, P.C. It is important to note that having an assumed or trade name could hold up the application process initially and cause issues down the line. This falls under the umbrella of "Know Your Customer (KYC)."

The credit application is designed to help credit professionals make the best, informed "decisions about a customers' ability and willingness to meet obligations within credit terms," according to NACM's publication. Two other goals for a credit application are to limit credit risk and to get a better understanding of a customer's business. "The credit application is the credit professional's first, and sometimes only, opportunity to protect their company from risk of loss through credit sales and/or fraud."

Another way to assure payment is with the personal guarantee. Having a personal guarantee could wind up being the difference between getting paid and not getting paid, advised Jameson. "Often, the personal guarantee is the most important piece of the credit application," said Jameson in *Business Credit* magazine's January 2017 issue. This clause in the application ensures that guarantors cannot escape the debt.

The personal guarantee could come into play later on if litigation occurs. Creditors with a personal guarantee have someone to go after if an entity such as an LLC loses assets. The underlying obligor is someone to pursue for payment should the life of a credit application go this far. The two types of guarantees, guaranteed collection and guaranteed payment, differ in that a creditor can sue the underlying obligor and the personal guarantor at the same time with a guaranteed payment, according to Jameson.

When putting together credit applications, Jameson said, he makes sure the language is clear and that the personal guarantee statement is not ambiguous. He added that it should be an open and continuous guarantee and not limited in time, so it will remain in force until the guarantee is terminated with a written notice. If the guarantor decides to remove their personal guarantee to personally back all debts, then the creditor has to make the decision whether to continue doing business or end ties.

-Michael Miller, editorial associate