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Maximizing the Effectiveness of Personal Guarantees in Distressed Private Credit

Personal guarantees can be a powerful tool in distressed private credit, particularly in non-sponsor and founder-led transactions where corporate collateral may prove insufficient. But their effectiveness in default scenarios depends on a well-designed enforcement plan, emphasizing early asset mapping and cross-border strategies to improve the risk-adjusted recovery outlook.

As the private credit market continues to expand, personal guarantees remain an effective tool for lenders, especially in non-sponsor and founder-led transactions. While deal structuring typically focuses on company assets, cash flows, and security packages, personal guarantees can provide a critical backstop when corporate collateral is insufficient. The effectiveness of a personal guarantee depends not only on careful drafting but also on early enforcement planning and a clear understanding of where the guarantor's assets are held and how they can be reached.

Defaults often reveal the limits of corporate balance sheets, especially in closely held businesses with thin, encumbered, or hard-to-monetize assets. Personal guarantees allow lenders to look beyond the operating entity and pursue the individuals behind the borrower. Recent cross-border enforcement successes underscore that effective recoveries increasingly depend on whether guarantees were structured with enforcement in mind and whether lenders prepared in advance to pursue guarantors across jurisdictions.

#1: Prepare for Enforcement Ahead of Default. The value of a personal guarantee depends on preparation well in advance of default. Beyond drafting enforceable terms, lenders should map guarantor assets during the diligence process and assess enforceability across relevant jurisdictions. This includes identifying where assets are held, how they are owned, whether they are subject to competing claims, and which courts offer practical enforcement pathways.

Early asset mapping and jurisdictional analysis allow lenders to structure guarantees, governing law provisions, and dispute resolution mechanisms to maximize recoveries. Waiting until distress often means confronting asset dissipation, jurisdictional hurdles, or enforcement obstacles that planning could have avoided.

#2: Align Guarantees with the Ownership and Control Structure. Guarantees are most effective when they reflect the realities of ownership and control. In founder-led or family-controlled businesses, personal guarantees should be aligned with those individuals who have decision-making authority and access to assets, rather than relying on nominal or thinly capitalized guarantors. This alignment is especially important in cross-border structures, where operating companies, holding entities, and individual owners may be spread across multiple jurisdictions. Ensuring guarantees track control, and not just title—for example, by insisting that certain of the principal’s family members be co-guarantors—can materially improve enforcement prospects.

#3: Incentivize Cooperation Beyond Strict Liability. Personal guarantees should be structured not only as enforcement tools, but also as mechanisms to encourage early engagement and cooperation. Provisions that reward transparency, asset disclosure, and good faith restructuring efforts can increase the likelihood of negotiated outcomes while preserving enforcement options. Guarantees that go beyond misconduct-based triggers to include affirmative incentives for cooperation often provide lenders with greater flexibility and more effective leverage than guarantees focused solely on post-default litigation.

#4: Employ “Bad Boy” Structures to Enhance Leverage. So called “bad boy,” or full-recourse, guarantees—where personal liability for the entire debt amount is triggered by specified misconduct such as fraud, asset stripping, covenant breaches, or improper transfers—are a powerful way to align guarantor behavior with lender interests. These structures can preserve limited personal liability under ordinary circumstances while creating meaningful exposure if a guarantor takes actions that undermine recoveries in distress.

When properly drafted, bad-boy provisions do more than create theoretical liability. They can provide lenders with practical leverage in negotiations by increasing personal exposure precisely when incentives to misbehave are highest.

As private credit portfolios grow and maturity risk intensifies, personal guarantees remain a critical risk-mitigation tool—but they should be thoughtfully structured. Lenders who combine smart drafting with early asset mapping and enforceability analysis are far better positioned to preserve leverage and recover value in a downturn.

About Kobre & Kim

Kobre & Kim is a global law firm focusing on cross-border disputes and investigations, often involving fraud and misconduct. Our capabilities include:

- Assisting with enforcement risk underwriting and planning at the pre-deal diligence phase and the design of efficiently monetizable security packages.
- Acting on behalf of creditors, monetize defaulted bonds, loans, and high-value judgments and arbitration awards, with many of our matters involving face values of US\$100 million to billions of U.S. dollars.
- Focusing on helping clients recover misappropriated assets in challenging cross-border scenarios, realize value from claims in a host of legal and jurisdictional contexts (including in distressed and bankruptcy settings), and develop investigative, enforcement, and asset tracing/recovery plans in the pre-deal, pre-dispute stage to maximize future monetization.
- Supporting our onshore and offshore lawyers, the firm’s specialist asset tracing teams conduct in-depth research and provide valuable insights into complex asset structures.
- Maintaining our independence as advocates, ready to litigate against virtually any institution by avoiding repeat client relationships and the conflicts of interest that come with them.