

INTERNATIONAL BUSINESS

PART 1: TRADE AND EXPORT FINANCE

SECTION 3: GUARANTEES

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GUARANTEES

An international guarantee is a written undertaking by a guarantor, usually a bank, to ensure that a supplier or contractor receives compensation in the event of a breach of contract.

There are several different types of guarantee, and more than one type can be included in a contract.

Demand guarantee

Requires payment on the first demand. As soon as the issuing bank receives a claim that fulfils the conditions of the guarantee, the issuing bank must pay. This means that the applicant has no right to object.

Conditional guarantee

Requires payment only upon the fulfillment of certain conditions. The issuing bank will not pay beneficiary's claim before it has been accepted by the applicant or a court decision stipulates payment. (But please note that a beneficiary will rarely accept a guarantee payable on agreement, and some banks are reluctant to provide such forms of guarantee.)

Guarantees are subject to local rules and regulations

Local conditions and regulations influence whether your bank will issue the guarantee or a local bank in the beneficiary's country, against your bank's counter guarantee.

If a guarantee is issued by a local bank in the beneficiary's country, it may not be subject to your country's law. This would mean that although the expiry date has passed, the local laws in the beneficiary's country may fail to recognize this and hold that the guarantee may be valid for claim beyond the expiry date. If a guarantee is issued by a local bank, you would be liable to pay its commission and fees.

Guarantees from abroad

If you are to receive a guarantee from abroad and you would prefer your bank to underwrite the guarantee, find out first if they are prepared to issue guarantees on behalf of banks worldwide.

INTERNATIONAL RULES

Demand guarantees are subject to a set of international rules: Uniform Rules for Demand Guarantees (URDG), ICC Publication No. 458, issued by the International Chamber of Commerce (ICC) in Paris.

The rules set forth the requirements of the parties under a guarantee. In some banks' experience, however, that these rules are not followed widely enough.

You can obtain a copy of the rules from the ICC.

FAQ: GUARANTEES

What is the difference between a guarantee payable on demand and a conditional guarantee?

Under a guarantee payable on demand, the bank will typically pay against a declaration of breach of contract or default, whereas under a conditional guarantee, the bank will wait for confirmation that the condition has been satisfied before paying. Some banks are reluctant to issue conditional guarantees.

What is a bid bond and what is a performance bond - and why must they be issued?

Bid or tender bonds are issued by the bank on behalf of an exporter to protect the importer in cases where the exporter's bid is accepted under a tender process but the exporter fails to sign the contract.

A performance bond is also issued by the exporter's bank and will reimburse the importer if the exporter fails to fulfill its obligations under the contract.

What is the difference between a direct guarantee and a counter-guarantee?

The direct guarantee is issued by the bank and sent direct to the beneficiary or sent via his bank. In contrast, if your bank asks a foreign bank to issue a guarantee on their behalf, your bank issues a counter-guarantee as security.

If your bank issues a counter-guarantee, it means as a rule that there are more expenses entailed in the issue of the guarantee than in an issue of a direct guarantee, as they are actually dealing with two guarantees. Furthermore, the guarantee will not be subject to the laws of some countries, which can mean that an expiry date might not be respected.

What is the difference between guarantees with and without an expiry date?

If a guarantee is issued with an expiry date, it means that the guarantee is no longer valid after this date provided the guarantee is subject to the laws of the particular country. If subject to foreign law, the beneficiary's country may fail to recognize this and hold the guarantee valid for claims after the expiry date.

If there is no expiry date in the guarantee, the guarantee can be cancelled only when either the original guarantee is returned to your bank or when your bank receives notice that they are released from their obligations.

TYPES OF GUARANTEES

Exporters seeking to win overseas contracts that are put out to tender may have to provide the importer with guarantees as part of the tendering process. Northern Bank offers a wide range of guarantees, and samples can be downloaded in Word files for your company's use.

BID OR TENDER BOND

A bid bond is issued to ensure that the exporter submits realistic bids under the tender process and to protect the importer for any loss that might occur if the exporter fails to sign the contract. A bid bond also assures the importer that the exporter will comply with the terms of the contract in the event that the tender is accepted. Bid bonds are usually issued for 2% to 5% of the tender amount.

PERFORMANCE BOND

A performance bond safeguards the importer should the exporter fail to meet its contractual obligations. Performance bonds are usually issued for 10% to 20% of the contract amount but may be fixed by the local law of the importer's country.

ADVANCE PAYMENT BOND

An advance payment bond ensures repayment to the importer of an agreed percentage of the contract amount (typically 10%-30%) if the exporter does not fulfill its contractual obligations.

RETENTION BOND

With the supply of factory plant, machinery and other capital goods, it is often agreed that the buyer may withhold 5%-10% of the contract amount for a period, for example 12 months after the plant or machine(s) are up and running.

The exporter may wish to receive the full contract amount before the end of the contract period (in the example given above, 12 months) by issuing a retention bond that covers the amount that would otherwise be withheld.

The exporter will request its bank to issue a retention bond in favor of the buyer. Once the buyer receives the retention bond he will transfer the amount of the bond value direct to the exporter by international money transfer. A retention bond is issued usually for 5%-10% of the contract amount.

PAYMENT GUARANTEE

A payment guarantee ensures payment to the exporter if the importer does not fulfill its payment obligations.

A payment guarantee can be issued in the form of an endorsement on a draft, also known as an "aval".

SAMPLE: BID BOND OR TENDER BOND—ON DEMAND

Name and address of beneficiary

Guarantee No. _____

Amount _____

Date of expiry _____

We are informed by _____ ('the Tenderer') that they are submitting an offer to you for the supply of * under Tender No. _____ ("the Tender") and in this connection they have requested us to issue our Guarantee.

In consideration of your permitting the Tenderer to participate in the aforesaid Tender, we, (Name of Bank), hereby irrevocably undertake to pay to you the sum of _____ despite any objection by the Tenderer upon receipt by us of your first demand in writing provided that such demand contains your certification that the Tenderer has failed to fulfil its obligations under the Tender and that the sum demanded is accordingly due and payable under this Guarantee. The signatures to such demand must be authenticated by your bankers. Such demand shall be accepted by us as conclusive evidence that the sum claimed is due under this Guarantee.

Always provided that:

- Our liability is limited to a maximum aggregate total amount not exceeding _____ inclusive of any costs, expenses and taxes.
- Our Guarantee will expire on (Date). Any claims hereunder must be lodged with us at our Registered Office at (Name of Bank) (marked for the attention of Trade & Export Finance, Guarantee No. _____ by (time and date) (state Time Zone), when our Guarantee will become of no effect whether returned to us or not.
- You are not entitled to rank in any insolvency of the Seller prior to any claim of (Name of Bank) for any payment made to you under this Guarantee.
- The rights and benefits arising hereunder are personal to you and may not be assigned or transferred to any third party.
- This Guarantee shall be governed by and construed in accordance with the laws of (State) and you agree to submit to the exclusive jurisdiction of the Courts of (Country).

When the guarantee expires, please return this document to us.

SAMPLE: Performance Bond On Demand

Name and address of beneficiary

Guarantee No. _____

Amount _____

Date of expiry _____

We are informed by _____ ('the Seller') that they have entered into Contract No. _____ ("the Contract") with you for the supply of

_____ and in this connection we have been requested to issue a Performance Guarantee.

In consideration, therefore, of the foregoing Contract we, (Name of Bank), hereby irrevocably undertake to pay to you an amount not exceeding _____ despite any objection by the Seller upon receipt by us of your first demand in writing provided that such demand contains your certification that the Seller has failed to fulfil their obligations under the Contract and that the sum demanded is accordingly due and payable under this Guarantee. The signatures to such demand must be authenticated by your bankers. Such demand shall be accepted by us as conclusive evidence that the sum claimed is due under this Guarantee.

Always provided that:

- Our liability is limited to a maximum aggregate total amount not exceeding _____ inclusive of any costs, expenses and taxes.
- Our Guarantee will expire on (Date). Any claims hereunder must be lodged with us at our Registered Office at (Name of Bank) (marked for the attention of Trade & Export Finance, Guarantee No. _____ by (time and date) (state Time Zone), when our Guarantee will become of no effect whether returned to us or not.
- You are not entitled to rank in any insolvency of the Sellers prior to any claim of (Name of Bank) for any payment made to you under this Guarantee.
- The rights and benefits arising hereunder are personal to you and may not be assigned or transferred to any third party.
- This Guarantee shall be governed by and construed in accordance with the laws of (State) and you agree to submit to the exclusive jurisdiction of the Courts of (Country).

When the guarantee expires, please return this document to us.

SAMPLE: ADVANCE PAYMENT BOND - ON DEMAND

Name of address of beneficiary _____

Guarantee No. _____

Amount _____

Date of expiry _____

We are informed by _____ ('the Seller') that they have entered into Contract No. _____ dated _____ ("the Contract") with you for the supply of _____.

In accordance with the terms thereof they are to receive an amount of _____ by way of an advance payment representing ____ % of the amount of the Contract and in this connection they are required to furnish a guarantee.

In consideration, therefore, of your paying to the Seller the amount of _____, we, (Name of Bank), hereby irrevocably undertake to repay up to the said sum to you despite any objection by the Seller upon receipt by us of your first demand in writing provided that such demand contains your certification that the Seller has failed to fulfil their obligations under the Contract and that the sum demanded is accordingly due and payable under this Guarantee. The signatures to such demand must be authenticated by your bankers. Such demand shall be accepted by us as conclusive evidence that the sum claimed is due under this Guarantee.

Always provided that:

- Our liability is limited to a maximum aggregate total amount not exceeding _____ inclusive of any costs, expenses and taxes.
- Our guarantee will come into force upon receipt of the amount of the advance payment in account number _____ held with (Name of Bank) in the name of the Seller and will expire on (Date). Any claims hereunder must be lodged with us at our Registered Office at (Name of Bank) (marked for the attention of Trade & Export Finance, Guarantee No. _____ by (time and date) (state Time Zone), when our Guarantee will become of no effect whether returned to us or not.
- You are not entitled to rank in any insolvency of the Sellers prior to any claim of (Name of Bank) for any payment made to you under this Guarantee.
- The rights and benefits arising hereunder are personal to you and may not be assigned or transferred to any third party.
- This Guarantee shall be governed by and construed in accordance with the law of (State) and you agree to submit to the exclusive jurisdiction of the Courts of (Country).

When the guarantee expires, please return this document to us.

SAMPLE: RETENTION BOND - ON DEMAND

Name and address of beneficiary

Guarantee No. _____

Amount _____

Date of expiry _____

We are informed by _____ ('the Seller') that they have entered into Contract No. _____ ("the Contract") with you for the supply of _____.

We understand that under the terms of the Contract _____ % of the value of the equipment was to be withheld until _____. However, as an alternative you have agreed to pay the full contract price provided that the Seller furnishes a bank guarantee for an amount equal to _____.

In consideration, therefore, of your paying to the Seller the full price, we, (Name of Bank), hereby irrevocably undertake to repay to you despite any objection by the Seller an amount not exceeding _____ upon receipt by us of your first demand in writing provided that such demand contains your certification that the Seller has failed to fulfil their obligations under the Contract and that the sum demanded is accordingly due and payable under this Guarantee. The signatures to such demand must be authenticated by your bankers. Such demand shall be accepted by us as conclusive evidence that the sum claimed is due under this Guarantee.

Always provided that:

- Our liability is limited to a maximum aggregate amount not exceeding _____ inclusive of any costs, expenses and taxes.
- Our guarantee will expire on (Date). Any claims hereunder must be lodged with us at our Registered Office at (Name of Bank) (marked for the attention of Trade & Export Finance, Guarantee No. _____ by (time and date) (state Time Zone), when our Guarantee will become of no effect whether returned to us or not.
- You are not entitled to rank in any insolvency of the Seller prior to any claim of (Name of Bank) for any payment made to you under this Guarantee.
- The rights and benefits arising hereunder are personal to you and may not be assigned or transferred to any third party.
- This Guarantee shall be governed by and construed in accordance with (State) Law and you agree to submit to the exclusive jurisdiction of the Courts of (Country).

When the guarantee expires, please return this document to us.

SAMPLE: PAYMENT GUARANTEE - ON DEMAND

Name and address of beneficiary

Guarantee No. _____

Amount _____

Date of expiry _____

At the request of (name and address of applicant), we hereby guarantee you irrevocably for the above maximum amount to secure that our clients pay you for (description of goods/project) in accordance with (order/contract/offer etc).

Your claim(s), if any, duly made and presented to us under the guarantee will be honoured on your first demand also stating that (name of applicant) have not fulfilled their above payment obligations towards you.

Where we have received no such claim by (expiry date) at the latest, we stand released from our liability under this guarantee.

We will reduce the guarantee maximum by any such amount as we have had to pay in order to meet your claim(s) duly made and presented under the Guarantee.

Always provided that:

- Our liability is limited to a maximum aggregate total amount not exceeding _____ inclusive of any costs, expenses and taxes.
- Our Guarantee will expire on (Date). Any claims hereunder must be lodged with us at our Registered Office at (Name of Bank) (marked for the attention of Trade & Export Finance, Guarantee No. _____ by (time and date) (state Time Zone), when our Guarantee will become of no effect whether returned to us or not.
- You are not entitled to rank in any insolvency of the Applicant prior to any claim of (Name of Bank) for any payment made to you under this Guarantee.
- The rights and benefits arising hereunder are personal to you and may not be assigned or transferred to any third party.
- This Guarantee shall be governed by and construed in accordance with the laws of (State) and you agree to submit to the exclusive jurisdiction of the Courts of (Country).

When the guarantee expires, please return this document to us.

GLOSSARY: GUARANTEES

Term	Explanation
Advance payment guarantee	See Types of guarantee
Advise	To give information about the guarantee to the beneficiary (person who receives the guarantee) of another bank, without responsibility
Applicant	Person requesting the guarantee
Avalise	To guarantee payment of a draft or bill of exchange; used in certain cases instead of a payment guarantee
Beneficiary	The person in whose favor the guarantee is issued
Bid Bond	See Types of guarantee
Conditional guarantee	The bank awaits agreement between the parties or a judicial decision before paying
Counter-guarantee	When exporter's bank asks a foreign bank to issue a guarantee, the foreign bank will demand a guarantee from exporter's bank as security - a counter-guarantee
Demand guarantee	Claims under the guarantee are paid against a simple declaration of default
Payment guarantee	See Types of guarantee
Performance bond or guarantee	See Types of guarantee
Retention bond or guarantee	See Types of guarantee
Statement	A simple declaration used in connection with claims under demand guarantees
Tender bond	See Types of guarantee
URDG 458	The international guarantee rules. Uniform Rules for Demand Guarantees, ICC Publication No. 458
Unconditional guarantee	See Demand guarantee above
Undertaking	Another word for guarantee