

INTERNATIONAL GUARANTEES

Managing compensation

Entering into business with companies abroad can, in many ways, be different to doing business with local companies. Distance alone can make a difference. Both parties may experience unforeseen difficulties, which can affect their ability to meet their contractual obligations. In these circumstances there may be a requirement for the bank to create some form of security, such as an international guarantee.

What is an international guarantee?

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.

An overview of the main types of guarantees is provided on the next page.

Important aspects

- **The conditions and current economic climate in your trading partner's country.**

It is important to be aware of the conditions and any cultural differences in the countries you trade with and that you make your own terms and conditions clear before you sign a contract.

- **Guarantees are sometimes issued subject to local rules and regulations.**

Local conditions and regulations influence whether it is Danske Bank that will issue the guarantee or a local bank, in the beneficiary's country, against Danske Bank's counter guarantee.

If a guarantee is issued by a local bank in the beneficiary's country, it will not be subject to Northern Ireland law. This would mean that although the expiry date has passed, the local laws in the beneficiary's country may fail to recognise 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.

- **The order and importance of sequence of events**

The order of individual banking transactions is very important in relation to projects abroad. For example if you are an exporter and require a documentary credit as security for payment of goods, your customer (the importer) may require a bank guarantee to ensure that work is carried out or goods are delivered.

Which should be issued first - the documentary credit or the guarantee?

To reduce the risk of an importer making a claim under a guarantee prior to issuance of a documentary credit, the documentary credit should be issued first. The documentary credit should include the guarantee as being one of the documents required, that is, by making the guarantee subject to the terms of the documentary credit.

- **Payment under international guarantees**

It is important that you and your trading partner agree on the conditions in the event of a claim being served under a guarantee.

A payment may be made under a guarantee against a simple declaration of breach of contract (i.e. guarantee payable on first demand) or the bank may wait for a settlement between the parties or alternatively, a court decision (i.e. guarantee payable by agreement between the parties or a judicial decision). This must be clearly stated in the text of the guarantee so that all parties know when a claim must be met. Some countries however will only accept first demand guarantees.

The parties to a guarantee

1. The guarantee applicant the party requesting the guarantee
2. The guarantor the bank that guarantees to repay an amount if the guarantee applicant fails to meet its contractual obligations
3. The guarantee beneficiary the party in whose favour the guarantee is issued.

The most frequently used types of guarantee

Bid bond

A bid bond is issued to ensure that the tenderer (exporter) submits realistic bids under the tender process and to protect the importer for any loss that might occur if the tenderer (exporter) fails to sign the contract. A bid bond also assures the importer that the tenderer (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 fulfil its contractual obligations.

Retention bond

Retention bonds are used when it has been agreed that the importer will pay the exporter the remaining balance of the contract amount which the importer would otherwise have upheld during the guarantee period. The exporter will request its bank to issue a retention bond in favour of the importer. Once the importer receives the retention bond he will transfer the amount of the bond value directly to the exporter by international money transfer. A retention bond is usually issued for 5%-10% of the contract amount.

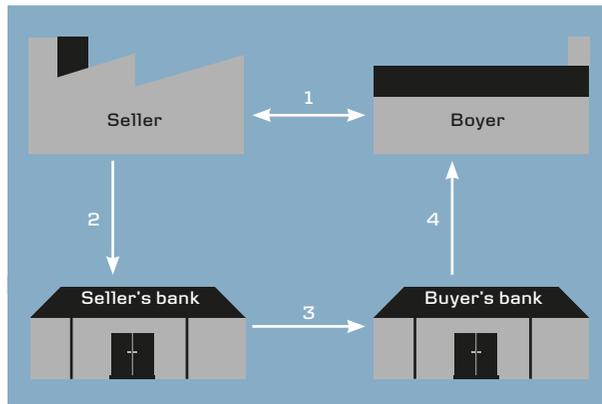
Payment guarantee

A payment guarantee ensures that the importer meets its payment obligations to the exporter. A payment guarantee can be issued as an endorsement on a bill of exchange, which is known as an aval endorsement. An aval endorsement means that a bank issues a guarantee in favour of the exporter and in that way ensures payment of the bill of exchange.

Counter indemnity

In some countries, it is a statutory requirement that a bank issuing a guarantee may issue the guarantee only if it receives a counter indemnity from the bank requesting it to issue the guarantee. A counter indemnity is always payable on first demand. This means that if the bank issuing the guarantee receives a claim fulfilling the terms of the guarantee, the bank must meet the claim immediately.

The diagram below shows an example of the use of a counter indemnity in export trade.



1. The exporter and the importer conclude a sales contract.
2. The exporter asks its bank to issue a guarantee.
3. The exporter's bank asks the importer's bank to issue the guarantee against its counter indemnity.
4. The importer's bank issues the guarantee in favour of the importer.

International guarantees in Business eBanking

Danske Bank Business eBanking enables you to handle international guarantees easily and efficiently. Read more in our Trade Finance in Business eBanking factsheet.

Contact us

Danske Bank has many years experience with international trade, including international guarantees.

We are in contact with banks all over the world on a daily basis and have considerable expertise in handling guarantees. Through our global network of correspondent banks, we can process guarantees in any country in the world.

If you require advisory services on international guarantees, or for more information, go to www.danskebank.co.uk/tradefinance for contact details.