The request for bank guarantees in support of contractual obligations has become common practice in the market and different forms of guarantees have evolved to cater for the diverse types of commercial and financial transactions.

**Guarantees**

A guarantee is a written undertaking issued by a bank in favour of the receiver of the goods or services, whereby it pledges to make certain payments on behalf of its client, if the latter fails to make a payment or to carry out specific functions in terms of the commercial contract. The bank’s commitment is legally independent of the underlying commercial contract.

A guarantee (bond or suretyship, as it is sometimes called) supports commercial contracts by providing trading partners with the flexibility to reduce credit and performance risk. It is a supplementary agreement or form of collateral or security relating to a specific transaction, for example:

- A seller may not be able to assess a buyer’s ability to pay for goods or a service rendered and wants protection against non-payment.

- The buyer questions the seller’s financial capability, resources and ability to perform under the commercial contract and needs protection against non-performance.

**Parties to a guarantee**

Guarantees usually involve a minimum of three parties:

- **The beneficiary** – the person in whose favour the guarantee has been issued, who requires security against the risk of the principal’s non-performance or default under the primary contractual obligation.

- **The applicant** – applies for the issue of a guarantee which covers a particular performance by him. The applicant can expect to be informed in writing why and how he is in breach of contract.

- **The guarantor** – the bank or party that issues the guarantee on behalf of the applicant. The guarantor is usually the applicant’s bank which is situated in the same country as the applicant.

**Direct guarantees**

A guarantee issued by the bank and handed to the beneficiary is known as a direct guarantee.

1. **Primary contractual obligation**
   The applicant agrees to provide a product/service to the beneficiary who, in turn wants security, usually in the form of a guarantee, that the underlying transaction will be completed.

2. **Application for a guarantee**
   The principal furnishes the information required and signs an agreement with Standard Bank, which describes the terms and conditions under which offshore guarantees are issued. The bank conducts a credit assessment of the principal and verifies compliance with the exchange control regulations.

3. **Issuance of the guarantee**
   In terms of the applicant’s instructions, the offshore guarantee is issued in favour of and sent directly to the beneficiary. Usually it is done through the intermediary of a bank in the beneficiary’s country, who can verify the authenticity of the instrument.
Indirect guarantees

Indirect or multiple guarantees come into play when the beneficiary wants a guarantee issued by a local bank in his own country. This comes about when the beneficiary is concerned about the standing of the issuing bank and/or the standing of the applicant’s country. The applicant’s bank arranges the issue of the guarantee to the bank nominated by the beneficiary who, in turn, will issue a counter guarantee to the beneficiary. This also happens when the beneficiary requires the guarantee to be governed by the laws of his country. The applicant must make sure of his legal position prior to issuing the guarantee.

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Types of guarantees

The more common types of guarantees in international trade are:

Bid bonds
A bid bond or tender guarantee is a safety mechanism that discourages companies from submitting a tender only to:

- Withdraw from the tender before its expiry
- Attempt to amend the tender
- Refuse to sign the contract when awarded to them
- Fail to furnish the required performance bond or other guarantees.

These guarantees are also called penalty bonds because the successful tenderer foregoes the amount of the guarantee should he default.

Bid bonds are also used as surety that the tendering company has the finances and the capabilities to undertake the contract.

The validity of the bond extends from date of issue to the signing of the contract or issuance of the performance guarantee.

Once the tender has been awarded, the bonds of the unsuccessful bidders are returned for cancellation.

Performance bonds
When a contract has been awarded, a performance bond is usually required, which guarantees the performance under the contract from commencement to completion. The bank issuing the performance bond undertakes
to pay a specified sum of money to the beneficiary if the applicant does not fulfil the contractual obligations.

Depending on the nature of the contract, it may be to the applicant's advantage to have separate performance bonds for each stage of the contract. The validity period extends to the completion of the contract.

**Advance payment guarantees**
These guarantees protect a beneficiary who makes an advance or progress payment to the applicant. A refund of progress payment is guaranteed if the applicant does not fulfil the terms of the contract.

**Retention guarantees**
Under the primary contract the beneficiary is permitted to retain a certain percentage of the payment due to the principal as a safeguard against latent defects. In order to secure the release of these retention monies, the applicant will apply for a retention guarantee.

Nevertheless, it does assure reimbursement to the beneficiary in the event of the applicant's non-performance after completion of the contract. Retention bonds aid applicants experiencing cash flow problems.

**Warranty bonds/maintenance bonds**
This type of guarantee is designed to protect the beneficiary by covering the cost of any defect or malfunction which might manifest itself after the completion of the project. The guarantee remains in force for the duration of the maintenance and warranty period as specified in the contract between the beneficiary and the applicant.

**Overdraft guarantees/banking facilities**
An overdraft guarantee is issued to secure banking facilities granted by a foreign bank to an offshore subsidiary of a South African company requiring working capital or general banking facilities.

**Lending-related guarantees**
A lending-related guarantee is an undertaking by the bank to fulfil a specified monetary obligation in the event of default by the offshore subsidiary of a South African company on whose behalf the guarantee is made. For example, it could guarantee the repayment of a foreign loan taken out by an overseas office of a South African concern.

**Shipping guarantees**
This is undertaken by a bank to indemnify the shipping company against any liability that arises as a result of releasing imported goods to the consignee without the documents of the title (bill of lading). The indemnity could incorporate the cost of the goods, freight charges, legal costs and more.

A shipping guarantee enables the consignee to obtain release of the goods from the shippers, so as to avoid inconvenience and financial loss such as demurrage charges, where goods arrive before the documentation. A shipping guarantee remains in force until the original bill of lading is produced.

**Airways releases**
A customer requires an airway release so that the cargo or parcel superintendent at the airport can release airfreighted goods consigned to the importer. The same conditions apply as for a shipping guarantee, except that it can be cancelled upon proof of payment of the import.

**Standby letter of credit**
This has wording similar to that of other documentary credits but has the qualities of a demand guarantee as it provides the beneficiary with security of payment.

**Negotiating guarantees**
When negotiating contracts involving guarantees, you are urged to liaise with the nearest International Trade Services office, which can advise you on the type of guarantee to meet your specific needs and to assist you with the wording of the guarantee.

Bear in mind that guarantees are subject to credit assessment and in a number of cases, exchange control regulations. In order to avoid unnecessary delays, contact your branch manager, commercial manager or account executive timeously.
Apart from offshore guarantees, the bank also issues a variety of local guarantees such as property guarantees, surety bonds and letters of undertaking.

**Risks**

**Legal consequences**
The laws of some countries allow claims to be submitted after the expiry date of the guarantee in which case you are liable until it is formally cancelled.

**Alterations**
Guarantees are subject to amendment and cancellation but in both cases, agreement from all parties is required.

**Payments under guarantees**
Payment under guarantees is called for at the sole discretion of the beneficiary, who submits a written claim stating that the applicant has failed to meet the obligations under the contract. The claim, together with supporting documents, if applicable, is presented to the guarantor (bank). Upon receipt of a claim that meets the requirements of the guarantee, the bank will pay the beneficiary immediately.

**Amendments/cancellations**
A guarantee is irrevocable and can only be cancelled or amended when all parties are in agreement.

**Costs of a guarantee**
The charges imposed by the bank are risk related and include an establishment fee, a telegraphic or postage fee and a risk related charge payable quarterly in advance until the guarantee is cancelled.

The overseas bank generally levies charges if it is to advise, negotiate or issue the guarantee in its own name. The applicant and beneficiary need to decide who will be liable for the payment of the charges. The applicant is responsible for all charges if the beneficiary refuses to accept some or all of the charges.

**Conclusion**
For further information on any of our products and services, please contact your nearest International Trade Services office, visit our website at www.standardbank.co.za (select Corporate and Investment, click on Banking/Finance solutions and go to International Trade Service), or call 0860iTrade/0860 487 233.

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