Bank Guarantee

Introduction

A bank guarantee is a written contract given by a bank on the behalf of a customer. By issuing this guarantee, a bank takes responsibility for payment of a sum of money in case, if it is not paid by the customer on whose behalf the guarantee has been issued. In return, a bank gets some commission for issuing the guarantee.

Any one can apply for a bank guarantee, if his or her company has obligations towards a third party for which funds need to be blocked in order to guarantee that his or her company fulfils its obligations (for example carrying out certain works, payment of a debt, etc.).

In case of any changes or cancellation during the transaction process, a bank guarantee remains valid until the customer dully releases the bank from its liability.

In the situations, where a customer fails to pay the money, the bank must pay the amount
within three working days. This payment can also be refused by the bank, if the claim is found to be unlawful.

**Benefits of Bank Guarantees**

**For Governments**
1. Increases the rate of private financing for key sectors such as infrastructure.
2. Provides access to capital markets as well as commercial banks.
3. Reduces cost of private financing to affordable levels.
4. Facilitates privatizations and public private partnerships.
5. Reduces government risk exposure by passing commercial risk to the private sector.

**For Private Sector**
1. Reduces risk of private transactions in emerging countries.
2. Mitigates risks that the private sector does not control.
3. Opens new markets.
4. Improves project sustainability.

**Legal Requirements**

Bank guarantee is issued by the authorised dealers under their obligated authorities notified vide FEMA 8/ 2000 dt 3rd May 2000. Only in case of revocation of guarantee involving US $ 5000 or more need to be reported to Reserve Bank of India (RBI).

**Types of Bank Guarantees**

1. **Direct or Indirect Bank Guarantee**: A bank guarantee can be either direct or indirect.

   **Direct Bank Guarantee** It is issued by the applicant's bank (issuing bank) directly to the guarantee's beneficiary without concerning a correspondent bank. This type of guarantee is
less expensive and is also subject to the law of the country in which the guarantee is issued unless otherwise it is mentioned in the guarantee documents.

**Indirect Bank Guarantee** With an indirect guarantee, a second bank is involved, which is basically a representative of the issuing bank in the country to which beneficiary belongs. This involvement of a second bank is done on the demand of the beneficiary. This type of bank guarantee is more time consuming and expensive too.

2. **Confirmed Guarantee**
It is cross between direct and indirect types of bank guarantee. This type of bank guarantee is issued directly by a bank after which it is send to a foreign bank for confirmations. The foreign banks confirm the original documents and thereby assume the responsibility.

3. **Tender Bond**
This is also called bid bonds and is normally issued in support of a tender in international trade. It provides the beneficiary with a financial remedy, if the applicant fails to fulfill any of the tender conditions.

4. **Performance Bonds**
This is one of the most common types of bank guarantee which is used to secure the completion of the contractual responsibilities of delivery of goods and act as security of penalty payment by the Supplier in case of nondelivery of goods.

5. **Advance Payment Guarantees**
This mode of guarantee is used where the applicant calls for the provision of a sum of money at an early stage of the contract and can recover the amount paid in advance, or a part thereof, if the applicant fails to fulfill the agreement.

6. **Payment Guarantees**
This type of bank guarantee is used to secure the responsibilities to pay goods and services. If the beneficiary has fulfilled his contractual obligations after delivering the goods or
services but the debtor fails to make the payment, then after written declaration the beneficiary can easily obtain his money form the guaranteeing bank.

7. Loan Repayment Guarantees
This type of guarantee is given by a bank to the creditor to pay the amount of loan body and interests in case of nonfulfillment by the borrower.

8. B/L Letter of Indemnity
This is also called a letter of indemnity and is a type of guarantee from the bank making sure that any kind of loss of goods will not be suffered by the carrier.

9. Rental Guarantee
This type of bank guarantee is given under a rental contract. Rental guarantee is either limited to rental payments only or includes all payments due under the rental contract including cost of repair on termination of the rental contract.

10. Credit Card Guarantee
Credit card guarantee is issued by the credit card companies to its customer as a guarantee that the merchant will be paid on transactions regardless of whether the consumer pays their credit.

How to Apply for Bank Guarantee

Procedure for Bank Guarantees are very simple and are not governed by any particular legal regulations. However, to obtained the bank guarantee one need to have a current account in the bank. Guarantees can be issued by a bank through its authorised dealers as per notifications mentioned in the FEMA 8/2000 date 3rd May 2000. Only in case of revocation of guarantee involving US $ 5000/ or more to be reported to Reserve Bank of India along with the details of the claim received.

Bank Guarantees vs. Letters of Credit
A bank guarantee is frequently confused with letter of credit (LC), which is similar in many ways but not the same thing. The basic difference between the two is that of the parties involved. In a bank guarantee, three parties are involved; the bank, the person to whom the guarantee is given and the person on whose behalf the bank is giving guarantee. In case of a letter of credit, there are normally four parties involved; issuing bank, advising bank, the applicant (importer) and the beneficiary (exporter).

Also, as a bank guarantee only becomes active when the customer fails to pay the necessary amount whereas as in case of letters of credit, the issuing bank does not wait for the buyer to default, and for the seller to invoke the undertaking.

Recommended Read
- [Project Report on Real Estate for Bank Loan](#)
- [Significance of Bank Reconciliation Statement](#)
SAMIDURAI KALAIPANDIAN
It is very useful for me. Thank u verymuch

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