

INTERNATIONAL GUARANTEES

– a question of compensation

Doing business with companies abroad is not the same as doing business with Danish companies. Distance alone can make a difference. Both parties may experience unpleasant surprises, which can make it difficult for them to meet their contractual obligations. Therefore, the parties will often require some kind of security, such as an international guarantee.

What is an international guarantee?

An international guarantee is a simple and practical way of ensuring that a business or its trading partner receives compensation in the event of breach of contract. There are several types of guarantee, and a contract can include more than one type. An overview of the various types of guarantee is provided on the next page.

Important aspects

- **The conditions in the home country of your trading partner**

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

Practice in Denmark does not necessarily match practice abroad. For instance, in some countries, it is quite normal not to respect the expiry date of a guarantee. Local law may also require the guarantee to be issued by a local bank against Danske Bank's counter indemnity. Danske Bank issues a counter indemnity when the Bank has requested the correspondent bank to issue a guarantee and the correspondent bank requires security in the form of a guarantee (a counter indemnity) from Danske Bank.

- **Order is very important**

The order of individual banking transactions is very important in connection with projects abroad. For instance, exporters often require documentary credits as security for payment of goods, and importers 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?

In few cases, an importer abroad has made a claim under an issued guarantee before the Danish exporter in question has even seen the documentary credit (to make a claim under a guarantee means that the importer requires payment under the guarantee because of breach of contract). This can be avoided by including the guarantee as one of the documents required under the documentary credit, 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 terms for meeting claims under the guarantee. Should payment take place against a simple declaration of breach (guarantee payable on first demand) or should the bank wait for a settlement between the parties – or, alternatively, a court decision (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. We know from experience that the latter type of guarantee is not accepted in some countries.

We recommend you to ask us for advice with respect to the text of the guarantee.

The parties to a guarantee

1. The guarantee applicant – the party requesting the guarantee
2. The guarantor – the bank that guarantees that the agreed compensation amount will be paid if the guarantee applicant fails to meet its contractual obligations
3. The guarantee beneficiary – the party in favour of whom the guarantee is issued

The most frequently used types of guarantee

Bid bond

A bid bond ensures that the party inviting a tender (the importer) receives an agreed compensation if a tenderer (the exporter) defaults on its obligations under an international tender. A tender will often not even be considered without a bid bond.

Performance bond

A performance bond ensures that the importer receives an agreed compensation if the exporter fails to meet its obligations towards the importer.

For instance, such failure of performance may relate to delivery, function or quality. A performance bond typically covers 10-20% of the amount of the agreement.

Advance payment bond

Advance payment bonds are used primarily in connection with contracts for substantial capital goods under which it has been agreed that the importer will pay part of the purchase amount in advance (often 10-30% of the amount). An advance payment bond ensures that the exporter will pay back the advance payment if it fails to meet its contractual obligations.

Retention bond

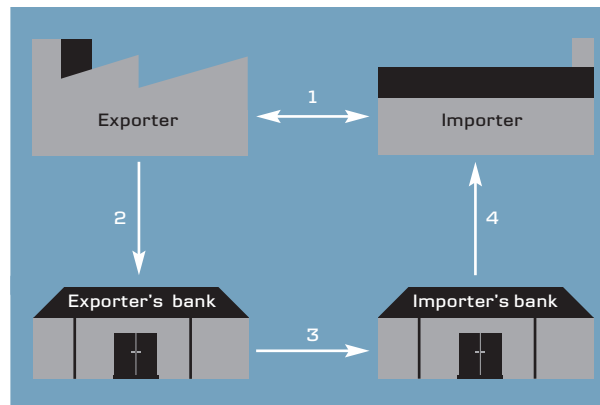
Retention bonds are used when it has been agreed that the importer will pay the remaining part of a purchase amount – which the importer would normally have retained during the guarantee period – to the exporter before the amount falls due. A retention bond ensures that the exporter will pay back this amount if it fails to meet its contractual obligations.

Payment guarantee

A payment guarantee ensures that the importer meets its payment obligations towards the exporter. A payment guarantee can be issued as an endorsement on a bill of exchange, which is known as a per aval endorsement. A per 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 figure above 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 Online

Danske Bank's Business Online system enables you to handle international guarantees easily and efficiently. Read more in our Trade Finance - Business Online factsheet.

Contact us

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

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

If you require advisory services on international guarantees, please contact us.

Our contact information is available at www.danskebank.com/tradefinance.