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COLLATERAL TRANSFER

The Definition Guide

Part Three

What exactly is a Bank Guarantee and a Standby Letter of Credit and the difference between them?

PART 3 OF 12 EDITIONS


What is a Standby Letter of Credit ?
What is a Bank Guarantee (BG)?
URDG 758 in relation to Bank Guarantees?
What is a Demand Guarantee?

Foreword: Collateral Transfer is the 'Leasing' of Bank Guarantees'

GlobalFund Limited, Hong Kong, have compiled this Guide to help you understand the meaning of 'leasing' bank guarantees, standby letters of credit and other bank instruments.

- Traditional Hong Kong Banking Methodologies
- Obtain a 'Leased' Bank Guarantee (or Standby Letter of Credit)
- Bolt-on Credit and Loan Facilities
- Competitive Rates & No Advance Fees or Charges
- Informative, Simple Procedures
- Professional Advice and Guidance
- Over 150 Years' Experience

This is the third of 12 tutoring papers that combine into a full and informative Guide on Collateral Transfer Facilities –The Definitive Guide To 'Leasing' Bank Guarantees And Standby Letter's Of Credit.

By signing up to receive our bulletins by email, you will receive all 12 editions totally FREE. All tutorial papers that make up the full Guide will be delivered to your email address provided.

If you can't wait to receive the Guides and require immediate help, guidance or assistance, please have no hesitation in contacting us.

THIS ISSUE

- What exactly is a Bank Guarantee and how does it work?
- What exactly is a Standby Letter of Credit and what is the di;erence between a Bank Guarantee?
- What is a Demand Guarantee and URDG 758?

NEXT ISSUE

- Collateral Transfer – The Definitive

COMING UP

- Advantages and Disadvantages of Collateral Transfer
- Typical Rates, Costs and Fees
- What is a Collateral Transfer Medium?
- Extension and Renewal Options
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- Bank to Bank Platforms
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- Who are Providers and How do I get an Introduction?

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What exactly is a Bank Guarantee and a Standby Letter of Credit?

What is a Bank Guarantee (BG)?

A Banker's Letter of Guarantee issued by a bank is often referred to as a 'Bank Guarantee'. In essence, a Bank Guarantee is an undertaking made on behalf of an Applicant to make payment to the Beneficiary in the happening of a specified event.

There are many different types of Guarantees, but those used in these types of facilities relate to guarantees to secure the repayment of credit. These types of Guarantees are worded to allow the Recipient (the Beneficiary) to utilise them as security for loans, obligations and other credit facilities.

Any Guarantee issued by a bank will be secured or underpinned by liquid assets of the applicant, typically cash, stocks or gold bullion or other form of instantly liquidable securities charged or otherwise 'blocked' by the issuing bank.

There is a common misunderstanding that some Guarantees are underpinned with illiquid assets and that unless a Guarantee is seen to be 'cash-backed' it is of less value or credence than a Guarantee issued by the same bank that is underpinned and secured by cash. This is totally wrong. Whether a Bank Guarantee is underpinned by cash, gold, stocks or another asset, the strength and credence of a Guarantee is that of the issuing bank, nothing else.

There are also Direct Guarantees and Indirect Guarantees. A Direct Guarantee is issued from by the Issuing Bank direct to the Receiving Bank. In contrary to an Indirect Guarantee where the Applicant asks a Counter-Guarantor who's credit worthiness is more acceptable to the Issuing Bank, opens the Guarantee in favour of the Issuing Bank and the Issuing Bank issues the Guarantee to the Beneficiary.

In Collateral Transfer only Direct Guarantees are used. It should be noted that Bank Guarantees are not confirmed by other banks unlike Standby Letters of Credit which, under certain circumstances and conditions, can be confirmed.

We enclose in Appendix A of this Guide, example wording of such a Direct Guarantee, used in Collateral Transfer facilities.

What is a Standby Letter of Credit?

Also called a Standby L/C or simply 'SBLC'. As with a Bank Guarantee, it serves as a guarantee to secure a payment or performance obligation. It is used more commonly in the United States and Far East Asia, whereas Europe tends to favour Bank Guarantees.

Unlike a Bank Guarantee, a Standby Letter of Credit can (under certain circumstances) be confirmed by the advising bank.

Whilst the structure of a Standby L/C is different to that of a Bank Guarantee, the results are the same and that it is a form of Demand Guarantee.

What is a Demand Guarantee?

A Demand Guarantee, sometimes referred to as an autonomous or an independent Guarantee, is an irrevocable undertaking issued by a Guarantor (commonly a Bank) upon receipt of instructions of an Applicant, to pay a Beneficiary a certain sum of money that may be demanded by the Beneficiary up to a maximum amount as will be stated in the Guarantee itself, upon submission of a formal demand to the Guarantor that complies with the terms of the Guarantee, as it is written.

There are many different forms of Demand Guarantees and the use of each shall depend on the circumstances and purpose of the Guarantee.

In Collateral Transfer facilities, it is typically a Bank Guarantee worded to secure credit and loans or a Standby L/C.

URDG 758 in relation to Bank Guarantees?

The phrases 'Lease' or 'Leasing' of Bank Guarantees stem from the way a Collateral Transfer transaction is structured (as we shall discuss in detail later in this guide).

The word 'leasing' in direct respect to a Bank Guarantee, Standby Letter of Credit or other form of 'demand guarantee' is a total misnomer and should really be avoided; although we all accept that people use this layman terminology when referring to finance facilities involving the implementation of bank instruments such as these bespoke funding contracts.

As we have discussed, Leasing Bank Guarantees or Leasing Standby Letters of Credit (or other types of Demand Guarantees for that matter) are common mis-phrases associated with Collateral Transfer facilities.

Therefore, words such as 'Lease', 'Leasing' or 'Rent' are not really the correct terms to use as it is not possible to actually lease a Bank Guarantee in the exact meaning of the word 'lease'. Equally, it is not possible to lease a Standby Letter of Credit, Documentary Letter of Credit (DLC) or any other form of demand guarantee (as defined by the Uniform Rules for Demand Guarantees Publication No. 758 – 'URDG758").

It is also not possible to buy or purchase Bank Guarantees, Standby Letter of Credit or other forms of demand guarantees (as defined by URDG 758). Likewise, it is not possible to sell them, as we explain later in this guide.

Hence, the phrase to 'lease a bank guarantee' is a misnomer. As we have over 150+ years of experience within this industry, we see inexperienced brokers, intermediaries and suspicious entities claiming to be 'providers' of these facilities, using this wrong terminology in formal documents. We assume that inexperienced middle-men have grasped these incorrect terms as the Collateral Transfer process mirrors almost exactly that of the process of commercial leasing. In effect, the Provider offers temporary ownership of his assets to the Recipient in return for a fee and at the end of the term the assets revert back to the ownership of the Provider. The assets are used to raise specific and non-transferable bank indemnities which the Recipient may utilise.

It is therefore a misnomer as in effect no leasing takes place. Through a Collateral Transfer Contract (the underlying agreement to a Collateral Transfer facility), a Provider will agree to place his assets with a facilitating bank. That bank will be the bank the Provider nominates to issue the Collateral and is referred to as the 'Issuing Bank'. Typically, that asset being pledged to the Issuing Bank as the underlying substance of the Collateral, will be physical cash or a form of instantly liquidable stock or commodity such as listed shares or gold bullion or an asset the bank can immediately liquidate.

Where to get further help and assistance

Whether applying for your own company or project (or as a professional financial intermediary on behalf of your client), GlobalFund Limited can assist you acquire the bespoke facility tailored and designed to meet exact objectives.
Located within one of the world's premier banking communities, partnered with some of the largest financial institutions and professional service providers, GlobalFund Limited are at the cutting edge of prevailing financial environments.

- The utmost professional service at all times
- Operating a strict Swiss code of conduct
- Dedication Broker Team Support
- Very competitive rates
- No upfront or advance fees

We will always ensure that our clients are given the correct advice in which to base their decisions and strategies.

We will present all options and facilities that are available to our clients and ensure they have full and comprehensive information to help plan ahead. We advise and implement all necessary actions needed to achieve our clients’ funding objectives.

Full terms and conditions can be found on our website at:
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