

For the students of
B. Com. (Hons.) Sem. II
Banking Operations Management

Bank Guarantee

During business, banks are often required to provide guarantees on the behalf of their customers in lieu of their obligations or other requirement. The Indian contract act 1872, section 126 says that guarantee means a contract to perform the promise or discharge the liability of a third person in case of his default.

These guarantees can be of two types; one is where bank gives financial guarantees while another types of guarantees for the performance of the contract.

A bank guarantee is a kind of guarantee from a lending institution. The bank guarantee means a lending institution ensures that the liabilities of a debtor will be met. In other words, if the debtor fails to settle a debt, the bank will cover it. A bank guarantee enables the customer, or debtor, to acquire goods, buy equipment or draw down a loan.

Deferment of payment guarantee

This is a guarantee the bank undertakes to make payment of instalments payable by the buyer of capital goods such as machinery or industrial goods, on long term credit, given by the supplier or seller.

Usually advance payment of 10-20% of the price of the capital goods is made by the borrowers or purchaser. The balance amount, along with the interest, is payable in instalments spread over a period of payment, which is secured by the deferred payment guarantee.

Expiry of guarantee

On expiry of the validity period of guarantee, a registered acknowledge due notice is to be sent to the beneficiary indicating that the liability of the bank under the guarantee stand discharged as no claim on the basis of the guarantee has been received by the bank. If no reply is received form the beneficiary within a reasonable period like one month form the date of such notice, the entry is reverved by the banks.

Invocation

The amount claimed under the guarantee should be immediately paid to the beneficiary if invocation is in accordance with the terms and condition of the guarantee. Withholding payment at the instance of the customer should not be done as non-payment will affect the image of the bank. If the amount is not paid by the customer within a reasonable period, the recovery process will be initiated by the bank.

Limitation Clause

In a bank guarantee, the extent of monetary liability and the period of validity should be specific. As per the Indian contract Act 1872 section 28, even when the period of liability is specified in the guarantee, the beneficiary can enforce his remedies till the limitation period is alive. In case if beneficiary is government, limitation period is 630 years while in case of others this period is 3 years.

RBI INSTRUCTIONS ON BANK GUARANTEES

1. **Tenure-** No bank guarantee should normally have a maturity of more than 10years.
2. **Unsecured guarantees:** The restriction of 20% on unsecured guarantees has been withdrawn (w.e.f.17.6.2004) by RBI and banks' boards have been given the freedom to fix their own policies on their unsecured exposures.
3. **precautions for averting frauds:** Banks should refrain from issuing guarantees on behalf of customers who do not enjoy credit facilities with them. Ghosh committee recommendations: Banks should implement the following recommendations:
 - i. In order to prevent unaccounted issue of guarantees, as well as fake guarantees, as suggested by IBA, bank guarantees should be issued in serially numbered security forms. .
 - ii. Banks should, while forwarding guarantees, caution the beneficiaries that they should, verify the genuineness of the guarantee with the issuing bank. Internal control systems: Bank guarantees Issued for Rs.50,000/- and above should be signed by two officials jointly.
4. **Guaranteeon behalf of share and stockbrokers/ commodity brokers:** Banks may issue guarantees in favour of stock exchanges in lieu of security deposit andin

lieu of margin requirements. Banks to obtain a minimum margin of 50% (including 25% cash margin) while Issuing such guarantees. This margin condition also applies to guarantees issued by banks on behalf of commodity brokers in favour of the national level commodity exchanges, viz., National Commodity Derivatives Exchange (NCDEX), Multi Commodity Exchange Of India Limited (MCX) and National Mull Commodity Exchange Of India Limited (NMCEIL), in lieu of margin requirements

5. **Restrictions on guarantees of inter-company deposits/loans:** Banks should not execute guarantee covering inter company deposits/ loans thereby guaranteeing refund of deposit/loans accepted by NBFC/firms form other NBFC/Firms.
6. **Restriction on guarantees for placement of funds with NBFCs:** Guarantees should not be Issuedforthe purpose of Indirectly enabling the placement of deposits with NBFCs.
7. **Inter-institutional guarantees:** Banks may issueguarantees favouring other banks/ Fls/ other lending agencies for the loans extended by the latter, subject condition that the guaranteeing bank should assume a funded exposure of at least 10% of the exposure guaranteed.
8. **Payment of invoked guarantee:** where guarantees are invoked, payment should be made to the beneficiaries without delay and demur.

Types of Bank Guarantee

A bank guarantee is when a lending institution promises to cover a loss if a borrower defaults on a loan. The guarantee lets a company buy what it otherwise could not, helping business growth and promoting entrepreneurial activity.

There are different kinds of bank guarantees, including direct and indirect guarantees.

Banks typically use direct guarantees in foreign or domestic business, issued directly to the beneficiary. Direct guarantees apply when the bank's security does not rely on the existence, validity and enforceability of the main obligation.

Individuals often choose direct guarantees for international and cross-border transactions, which can be more easily adapted to foreign legal systems and practices since they don't have form requirements.

Indirect guarantees occur most often in the export business, especially when government agencies or public entities are the beneficiaries of the guarantee. Many

countries do not accept foreign banks and guarantors because of legal issues or other form requirements.

With an indirect guarantee, one uses a second bank, typically a foreign bank with a head office in the beneficiary's country of domicile. For example, Company A is a new restaurant that wants to buy \$3 million in kitchen equipment. The equipment vendor requires Company A to provide a bank guarantee to cover payments before they ship the equipment to Company A. Company A requests a guarantee from the lending institution of the vendor's country. The bank essentially consigns the purchase contract with the vendor.

Other main types of bank guarantees are as following:

- 1. Guarantee of payment.** This type of guarantee is a guarantee of payment obligations of Buyer to Seller.
- 2. Guarantees of advance payment return.** This guarantee signifies an obligation of the bank to return advance payment if, after receiving an advance, the Seller does not perform its contractual commitments.
- 3. Contract execution guarantee.** This guarantee is assurance of timely delivery of goods or performance of services according to a contract.
- 4. Tender guarantees.** This guarantee plays a role of assurance in those cases when the Company fails to perform its obligations to tender organization or other party that is specified in the order received by winning the tender.
- 5. Guarantee in favour of the customs authorities.** This guarantee is a security of obligation of the company performing import and export operations to the Customs authorities for payment of customs taxes and duties.
- 6. Guarantees of warranty execution.** This guarantee plays a role of security of quality for delivery to the contract terms.
- 7. Guarantee of credit return.** This guarantee is a security for repayment of credit.

Bank Guarantee format of ICICI Bank

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To
The Branch Manager,
ICICI Bank Ltd
_____Branch

Date : DD/MM/YYYY

- (1) I/ We, _____ << name of the Borrower >> _____ ("**Borrower**"), hold current/ savings account number _____ with you (the "**Account**"). I / We request ICICI Bank Limited ("**ICICI Bank**") to issue a Bank Guarantee ("**BG**")/Letter of Credit ("**LC**") ("**the Facility**"), as per format enclosed and as per details given below against the security of the Fixed Deposit ("**FD(s)**") described below:

Particulars	Details
Type of Bank Guarantee	Performance/ Financial/ Others:
Beneficiary Name	
Beneficiary Address	
Currency & Amount	Currency Amount
Amount of Bank Guarantee/Letter of Credit (in words)	
Purpose	
BG Tenor	Years Months Days
LC Expiry	
Claim Period* (if any)	
Beneficiary Bank IFSC Code*	

*Applicable for BG only

Details of the FD(s) arranged as security:

Name of the Depositor(s) (the " Depositor ")	FD No. / FD Application No.	FD Date	Final Maturity Date of FD	Amount (in Rs.)

Open New FD(s)

I/we _____ (the "**Depositor**") authorize ICICI Bank to debit my / our current/ savings account no. _____ with ICICI Bank for Rs. _____ for opening a new FD(s) as per following details:

Name of the Depositor(s) (the " Depositor ")	Amount (in Rupees) of FD(s)	Period of FD(s)	Renewal Instructio n	Type of FD(s)
		---- year ---- month ____ days	<input type="checkbox"/> Auto- renewal mode	<input type="checkbox"/> Monthly interest payout <input type="checkbox"/> Quarterly interest payout <input type="checkbox"/> Interest payout on maturity

- (2) In relation to the FD(s), I/we agree and confirm that:

- (a) all terms and conditions, applicable to FD(s) with ICICI Bank and as uploaded on www.icicibank.com, not expressly over-riden herein, shall continue to apply in relation to the FD(s) and the same shall be binding on me / us including any alteration, changes, revision etc. as may be done by ICICI Bank, at its sole discretion, applicable from time to time.
- (b) ICICI Bank is authorised to renew the FD(s) during the subsistence of the Facility or for the tenor of any

or all of the BG/ LC so issued under the Facility(ies).

- (1) Interest Rates, Commission and Charges:** I/We agree and undertake to maintain cash margin and pay interest, charges, fees and commissions on the BG / LC facility at the following rates:

Cash Margin to be maintained	Upfront Commission	Upfront Processing Fee for the Facility	Interest payable on the non-payment of the BG / LC on due date	Other Charges/ Fees
___% of the BG / LC Facility amount	___% per annum on the amount of BG /LC		I-MCLR ¹ ___ + ___% Spread	

I/We authorize ICICI Bank Limited to debit the Account towards additional margin requirements in case of market movement in foreign currency resulting in the amounts of the cash / FD(s) not satisfying the cash margin requirement. I/We undertake to bring in additional cash/FD(s)/security to the satisfaction of ICICI Bank.

- (2)** I/ We hereby declare and confirm that: **(a)** I/ We, the Borrower and/ or the Depositor, confirm that I/ we have paid all taxes payable under applicable taxation laws and undertake to pay all taxes (without any demur, protest or delay) during the currency of the Facility; **(b)** the Facility(ies), the FD(s) or any part thereof is not in contravention or evasion of the provisions of all or any applicable laws; **(c)** I/We are not availing any fund based/non fund based facilities from any other bank(s); or as on date of this Application, following credit facility(ies) are being availed by me/us :

Name of the bank/financial institution & branch	Fund based (in millions)	Non Fund Based (in millions)
	Rs.	Rs.

(d) I/we are not in RBI defaulter list and the credit facilities availed by us are within our assessed bank finance limits and none of the other credit facilities with other banks/financial institutions are classified as non-performing assets.

- (3)** I/We shall, unless otherwise agreed to by you, repay to you forthwith on demand the Facilities / such of the amounts as may be outstanding in respect of the Facilities, together with all interest, costs, charges, expenses and monies whatsoever stipulated in, or payable in respect of the Facilities. I / we also authorize ICICI Bank to debit the above Account or liquidate the FD(s) mentioned above to make payments in case of invocation of the BG by the Beneficiary even though it may lead to pre-mature closer of the FD(s).
- (4)** The Borrower and/ or the Depositor, hereby give specific consent to ICICI Bank for submitting/ disclosing the: **(a.)** 'financial information'; and **(b.)** 'security interest' as defined under the Insolvency and Bankruptcy Code, 2016 (including all amendments made thereto) (the "IBC"), in respect of the Facility and the security interest created on the FD(s), from time to time, to 'Information Utilities' as defined therein, and directions issued by Reserve Bank of India to the banks from time to time and hereby specially agree to promptly authenticate and verify the financial information and information relating to 'security interest' submitted by ICICI Bank, as and when requested by Information Utilities.
- (5)** I/We have read and understood the "Terms and Conditions for OD/LC/BG/LUT/Inland bill discounting /Export finance (pre-shipment/post-shipment/both) facility against FD / RD", duly registered on June 17, 2014 with the sub-registrar assurance V, New Delhi vide registration no. 649 in book no.4, vol no. 4051 from pages 82 to 95 (the "Terms and Conditions"), a copy of which has been handed over to me. I/We agree to abide and ensure that the Depositors abide, by the same at all times.
- (6)** Until all amounts as may be outstanding in respect of the Facilities, together with all interest, costs, charges, expenses and monies whatsoever stipulated in, or payable in respect of the Facilities, actual or contingent, are fully paid to the satisfaction of ICICI Bank, I/We the Depositors, hereby: **(a)** create security interest and charge over the aforesaid FD(s) and all underlying amounts in favour of ICICI Bank to secure the Facilities; **(b)** expressly waive all rights possessed by me/ us in relation to the aforesaid FD(s) and the underlying amounts; **(c)** expressly discharge ICICI Bank of all its obligations in relation the aforesaid FD(s); **(d)** expressly authorize ICICI Bank to set off such monies due from me/ us/ the Borrower against any or all of the aforesaid FD(s); **(e)** confirm that there are no subsisting security interests / encumbrances on / assignments of the aforesaid FD(s) (other than in favour of ICICI Bank) and I/ We agree not to create security interest on / assign / dispose of / encumber such FD(s) to any

¹ "I-MCLR" means the percentage rate per annum decided by the ICICI Bank and announced / notified by ICICI Bank from time to time as its Marginal Cost of Funds Based Lending Rate ("MCLR") in terms of the guidelines of Reserve Bank of India. ICICI Bank publishes I-MCLR for five tenures namely overnight, one-month, three-month, six-month and one year.

person; **(f)** undertake to and shall ensure that the details of the security created in favour of ICICI Bank over the aforesaid FD(s) shall be expressly mentioned in each of my/ our financial statements at all points of time until the release of such security by ICICI Bank; **(g)** declare and confirm that ICICI Bank shall be entitled to hold the aforesaid FD receipt(s) and I/ we shall not be entitled to demand or receive the same; **(h)** declare and confirm that the security interest created in favour of ICICI Bank is valid and enforceable in all respects; **(i)** agree to comply with and abide by the Terms and Conditions, to the extent applicable to me/ us.

Nothing herein contained shall prejudice or adversely affect any general or special lien or right to set-off to which ICICI Bank is or may by law or otherwise be entitled or any rights or remedies of ICICI Bank including in respect of any present or future security, guarantee, obligations of the Borrower/ Depositor.

- (1)** In case the Borrower/ Depositors are a partnership firm, the partners of the Borrower/ Depositor hereby declare that the partners named in the signature clause are the only partners of the Borrower/ Depositor and they undertake to advise in writing of any changes in the partners or constitution of the partnership firm of the Borrower/ Depositor. The partners of the Borrower/ Depositor further declare that they are authorized to avail the Facility(ies) / provide the securities on the aforesaid FD(s) and execute all transaction documents in relation thereto and are jointly and severally liable to ICICI Bank for the performance of all obligations under the transaction documents.

<p>Name of the Borrower:</p> <p>Signed and delivered for and on behalf of M/s _____ (a proprietorship firm, partnership firm / public limited company / private limited company / HUF / limited liability partnership, by / through its proprietor / partners/ authorized signatory / Karta</p> <p>Mr. / Ms. _____</p> <p>Mr. / Ms. _____</p> <p>Mr. / Ms. _____</p> <p>Mr./ Ms. _____</p>	<p>Signature</p>
<p>Name of the Depositor:</p> <p>Signed and delivered for and on behalf of M/s _____ (a proprietorship firm, partnership firm / public limited company / private limited company / HUF / limited liability partnership, by/ through its proprietor / partners/ authorized signatory / Karta</p> <p>Mr. / Ms. _____</p> <p>Mr. / Ms. _____</p> <p>Mr. / Ms. _____</p>	<p>Signature</p>

