What Is a Bank Guarantee?
A bank guarantee is a type of financial backstop offered by a lending institution. The bank guarantee means that the lender will ensure 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.

KEY TAKEAWAYS

- A bank guarantee is when a lending institution promises to cover a loss if a borrower defaults on a loan.
- Parties to a loan choose direct guarantees for international and cross-border transactions.
- The guarantee provides additional risk to the lender, so loans with such a guarantee will come with greater costs or interest rates.

Understanding Bank Guarantees
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.

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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.

Examples of Bank Guarantees

Because of the general nature of a bank guarantee, there are many different kinds:

- A payment guarantee assures a seller the purchase price is paid on a set date.
- An advance payment guarantee acts as collateral for reimbursing advance payment from the buyer if the seller does not supply the specified goods per the contract.
- A credit security bond serves as collateral for repaying a loan.
- A rental guarantee serves as collateral for rental agreement payments.
- A confirmed payment order is an irrevocable obligation where the bank pays the beneficiary a set amount on a given date on the client's behalf.
- A performance bond serves as collateral for the buyer's costs incurred if services or goods are not provided as agreed in the contract.
- A warranty bond serves as collateral ensuring ordered goods are delivered as agreed.

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 keeping its cash accounts. The bank essentially cosigns the purchase contract with the vendor.

NOTE : This article is the basic knowledge of Bank Guarantee, Aura doesn't practice such business or mode of transaction.

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