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Indirect guarantee

Parties and how it works

Indirect bank guarantees serve to secure payment and performance obligations.

They're often used in cross-border transactions – especially if foreign government offices or state-owned enterprises are involved. Also, some countries do not accept foreign banks as guarantors due to statutory provisions.

The guarantee is based on a contract between two business partners.

Parties

Four parties are always involved in indirect guarantees:

Principal

Upon the contractual partner's request, it instructs its bank to issue an indirect bank guarantee. This guarantees the performance or payment promise.

Beneficiary

It can call on the guarantee if the principal does not effect the performance or make the payment – in this case the guaranteeing bank has to pay.

Principal's bank

It instructs another bank to issue the guarantee to the beneficiary. By way of counter-liability, it issues a counter-guarantee in favor of the guaranteeing bank.

Guaranteeing bank

In most cases it's at the beneficiary's domicile and issues the guarantee in its favor.

How it works
Let's have a look at how an indirect guarantee works, by taking the example of securing performance.

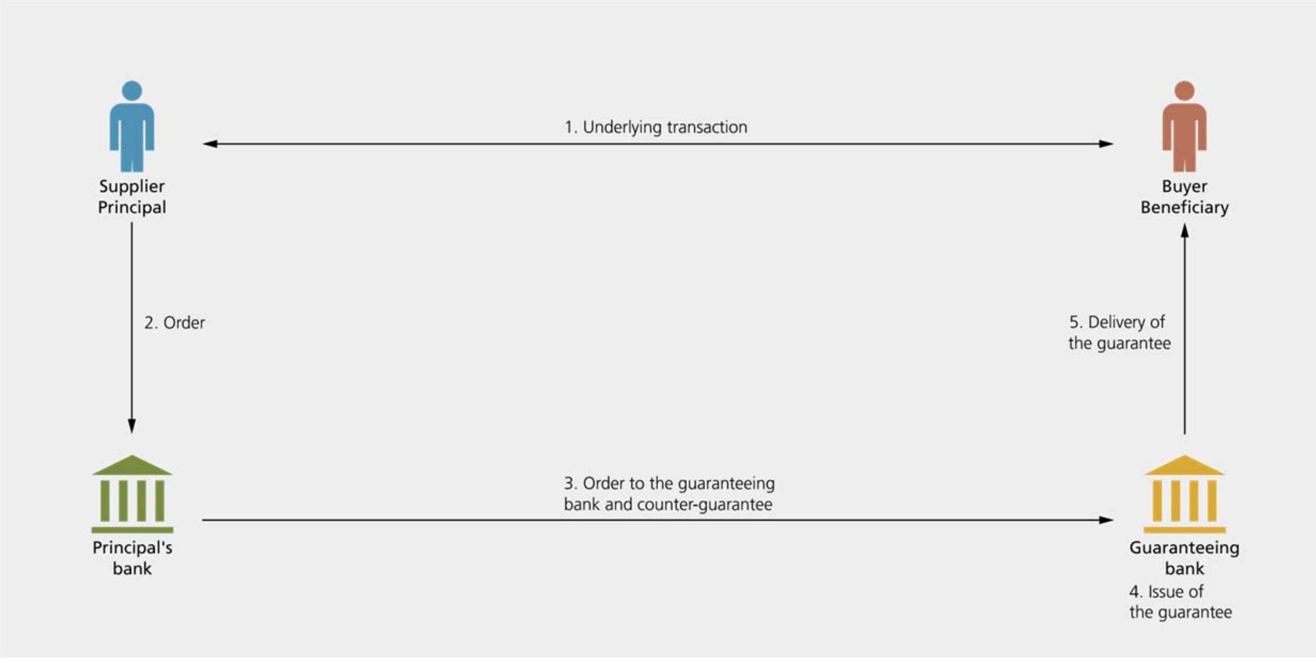
1. Underlying transaction
A Swiss supplier and an international buyer conclude a contract over an underlying transaction – for example, the purchase of a machine tool. The buyer requests a guarantee to secure any claims it may have on the supplier if it fails to effect the contractual performance.

2. Order
The supplier instructs its bank to issue an indirect guarantee in the buyer's favor.

3. Order to the guaranteeing bank and counter-guarantee
The supplier's bank instructs a bank at the beneficiary's domicile to issue a guarantee in the favor of the buyer. It takes on counter-liability by issuing a counter-guarantee to the guaranteeing bank.

4. Issue of the guarantee
The guaranteeing bank issues the guarantee in favor of the buyer and passes it on to the buyer. The buyer is the beneficiary of the guarantee, the supplier is the principal.

The underlying transaction is settled.



UBS Switzerland AG
Trade & Export Finance
P.O. Box, 8098 Zurich

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