

# Risk Mitigation and Guarantees

Doing business in the Middle East

Date: 20<sup>th</sup> June 2011



# What is the Bank's Role in International Trade

- To provide Risk Mitigation
- To act as a Facilitator

# The Risks of International Trade

- Country Risk
- Importer Risk
- Exporter Risk
- Exchange Risk
- Industry Risk
- Transport Risk

# The Risks of International Trade

## Country Risk

- Political and economic instability
- Transfer risk/currency controls
- War and civil disturbances
- Import/export regulations

## Exporter Risk

- Problems in producing correct documentation
- Failure to supply goods in accordance with the sales contract

## Importer Risk

- Non-payment of invoices
- Delayed payment of invoices
- Insolvency of buyer

# The Risks of International Trade

## Exchange Risk

- Fluctuating exchange rates affect pricing and profit

## Industry Risk

- Demand for particular products
- Recession in particular industry
- Competitive products/pricing
- Seasonal goods

## Transport Risk

- Loss of or damage of goods
- Risks associated with the mode of transport e.g. marine risks
- Storage facilities in ports
- Delayed shipment

# How to Mitigate Risk

- Country Risk      Confirmed Documentary letter of Credit  
Export Credit Insurance
- Exporter Risk      Know your counterparty  
Credit/Confirmed Documentary Letter of Credit  
Check the Documentary Letter of Credit for workability  
Export Credit Insurance
- Exchange Risk      Foreign Exchange Contracts  
Foreign Currency Accounts  
Invoice in own currency
- Industry Risk      Research
- Transport Risk      Marine/Air Insurance

# How Do Banks Mitigate Risks?

- Payment methods
- Insurance
- Expertise

# Payment Methods

Four principal mechanisms for international trade settlement:

- Prepayment
- Open Account
- Collections
- **Documentary Letters of Credit and Guarantees**



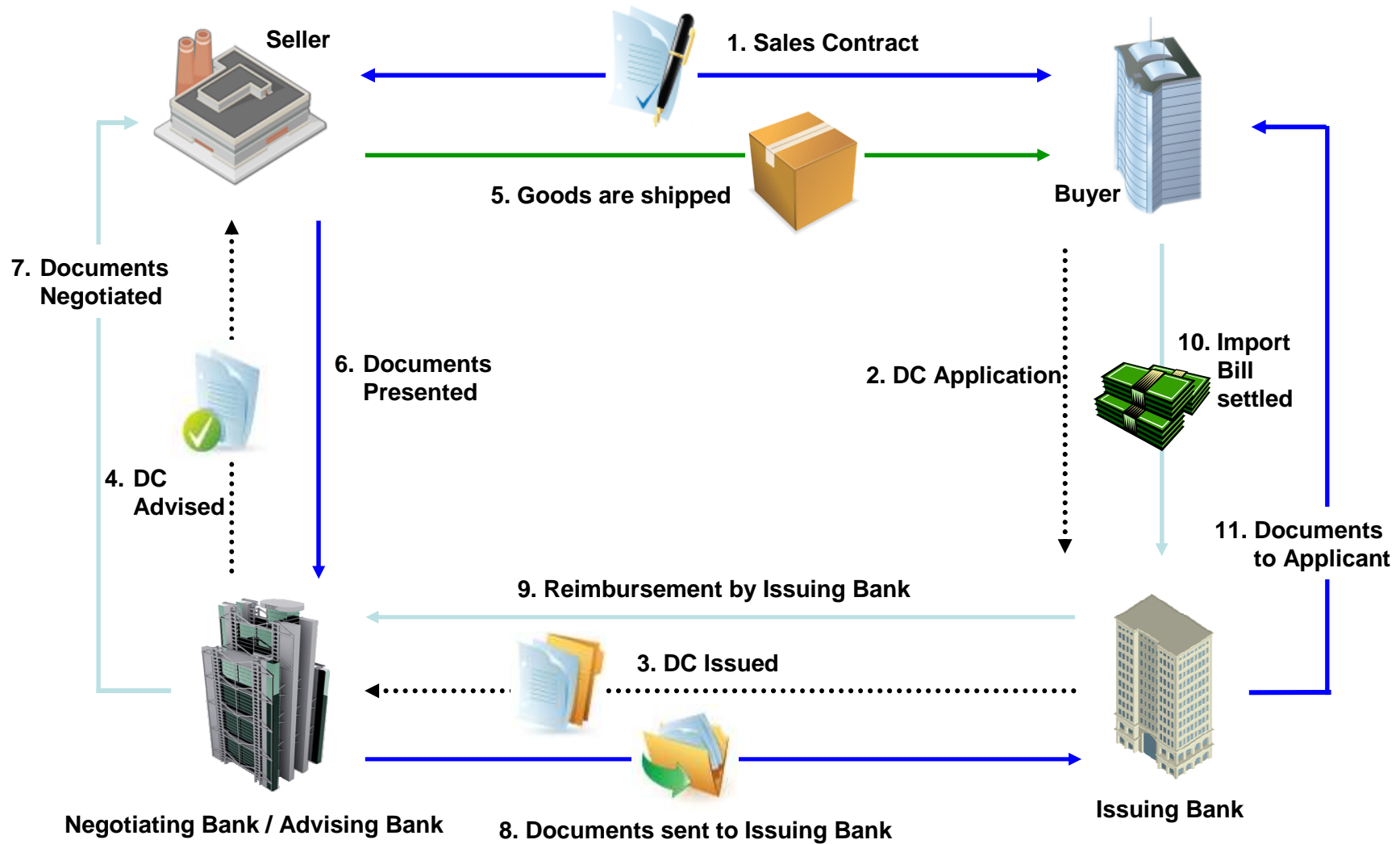
# Documentary Letter Credit

A written undertaking by a bank (issuing bank) given to the seller (beneficiary) at the request, and on the instructions, of the buyer (applicant) to pay at sight or at a determined future date up to a stated sum of money, within a prescribed time limit and against stipulated documents that comply with documentary letter of credit conditions.

## Irrevocable Confirmed Documentary Letter of Credit

- Advising bank may be requested (by Issuing Bank, or Beneficiary) to 'Confirm' the Letter of Credit, i.e. add its undertaking to that of the issuing bank
- Confirming bank assumes the credit risk of the issuing bank and the political risk associated with the importing country
- On an unconfirmed letter of credit, the advising bank does not make any commitment to honour the letter of credit; the exporter is relying primarily on the undertaking of the issuing bank to make payment

# Documentary Credit



# Guarantees and Standby Documentary Credit (DC)

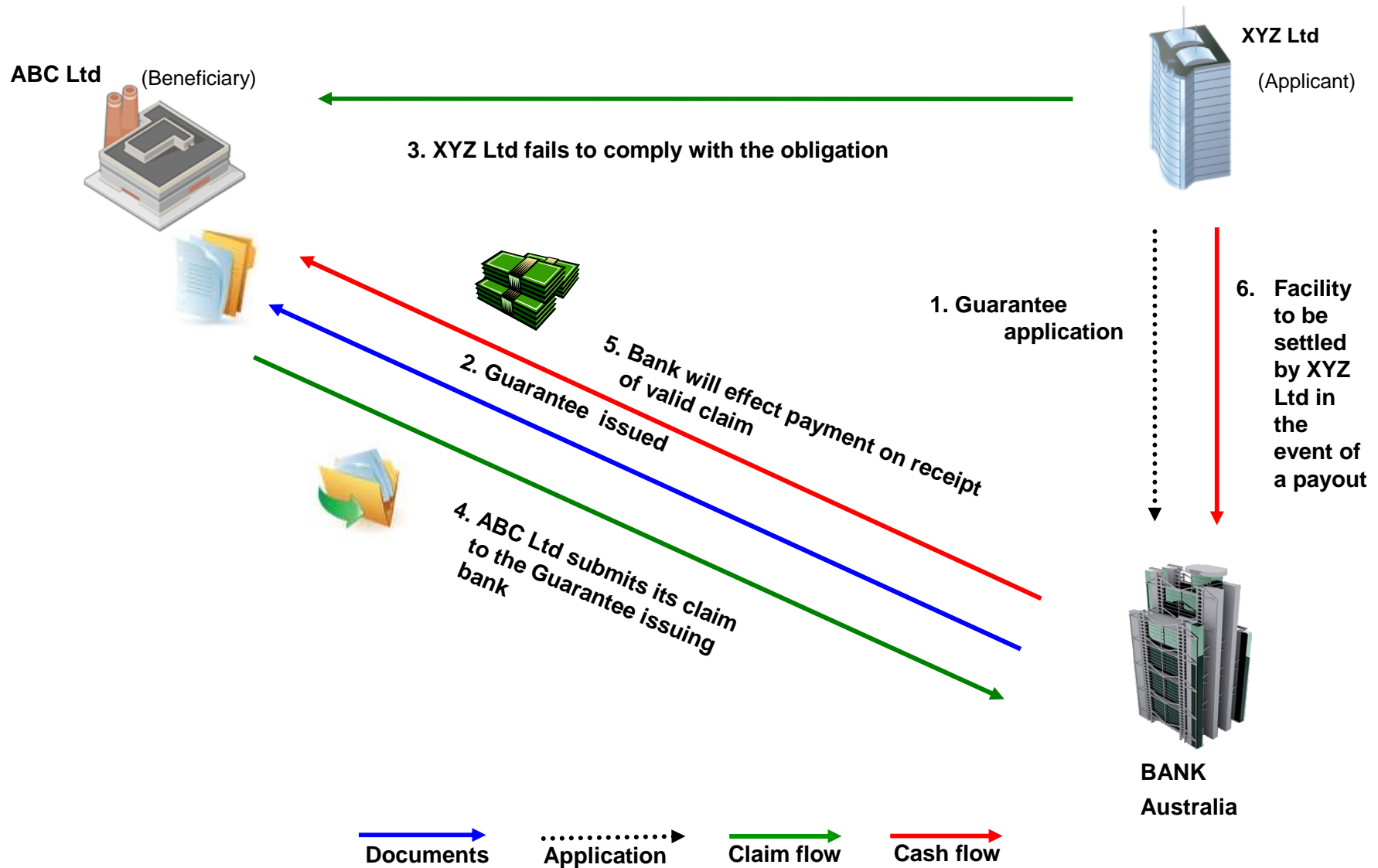
## Your Needs

- Want to expand your field of commercial activities
- Are looking to enter new geographical markets
- Aim to reduce the risks of your international operations
- Need to improve your cash flow management
- Want to continue to trade on open account terms

## Guarantees- What are they?

- A Guarantee is an unconditional undertaking in writing, issued by a bank (the Issuing Bank or Guarantor) on behalf of their client (the Applicant) in favor of another party (the Beneficiary), to pay on demand in the event of non-performance, non-delivery or otherwise, in compliance with the terms and conditions as outlined in the Guarantee.

# Guarantee – Flow diagram

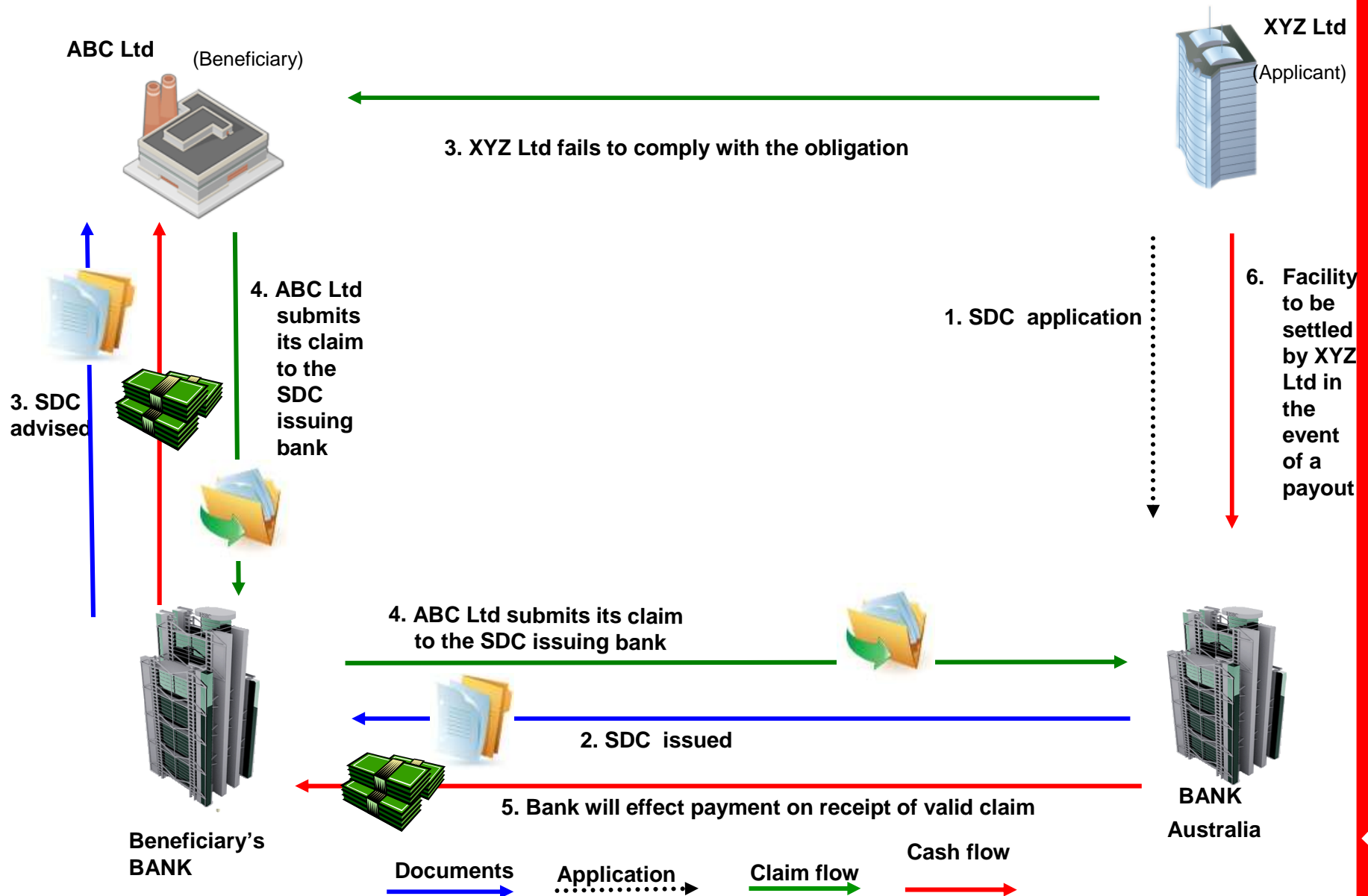


# Guarantees and Standby Documentary Credit (SDC)

## Standby Documentary Credit (SDC)- What are they?

- A Standby Documentary Credit is an unconditional undertaking when issued by a bank (the Issuing Bank) on behalf of their client (the Applicant) in favor of another party (the Beneficiary), to pay on demand in the event of non-performance, non-delivery or otherwise, in compliance with the terms and conditions as outlined in the Standby Documentary Credit.
- The Beneficiary can request another financial institution to ***advise*** or ***confirm*** the Standby Documentary Credit to strengthen its security.

# Standby DC – Flow diagram



## Comparison - Guarantee and Standby Documentary Credit

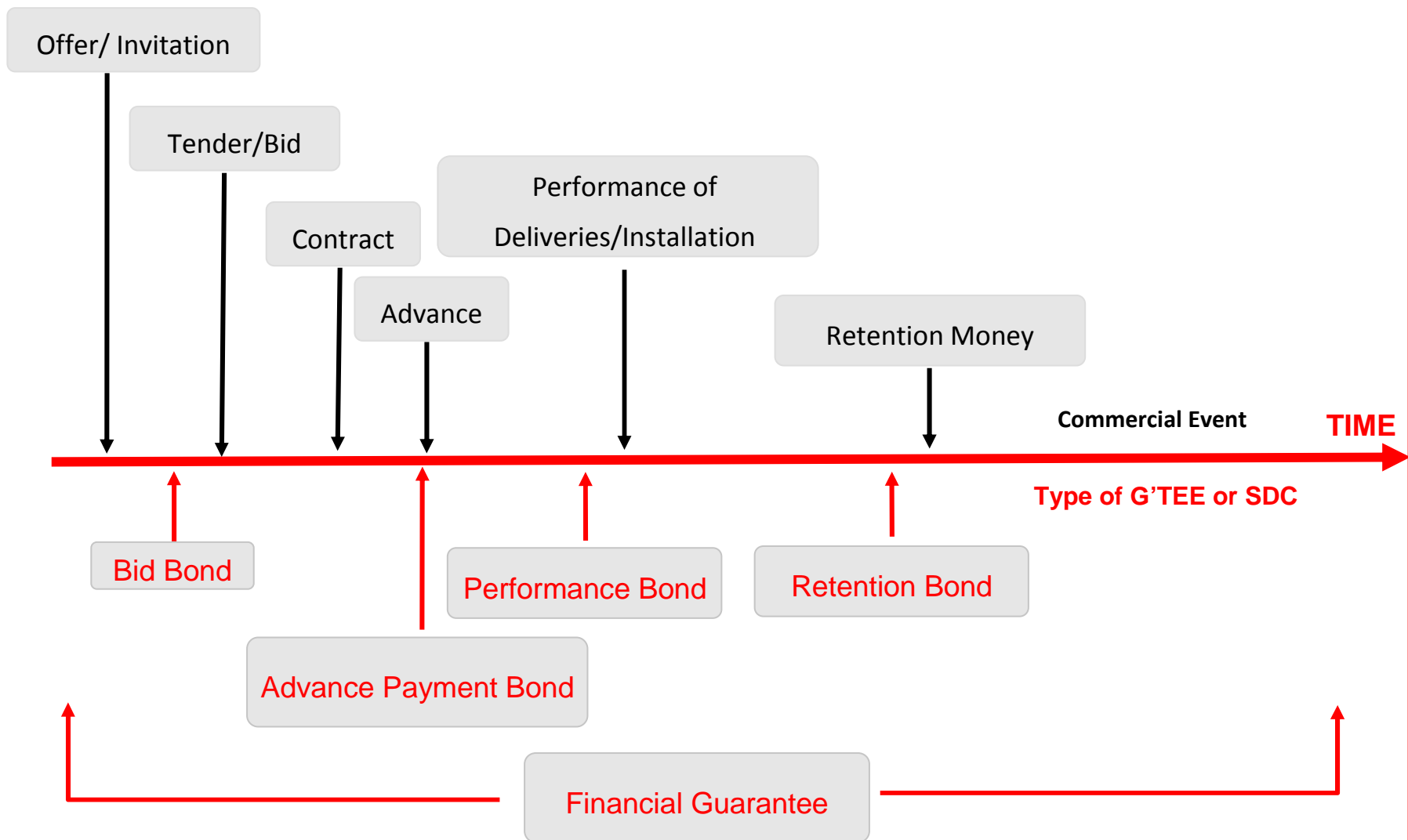
Product	Purpose	Governing Rule or Law	Structure and Terminology	Tenor	Documents to Claim
Guarantee	Independent instrument to secure obligations of a commercial or financial nature;	Subject to ICC's Uniform Rules for Demand Guarantees 758 or Laws of the Country in which the applicant or beneficiary is domiciled	Separate transaction from the contract and it should state that it is a Guarantee	Fixed expiry date, Open ended or Evergreen	On first demand, normally consist of a statement of default. Local regulation may require the original guarantee to be returned in addition to the demand for claim
Standby Documentary Credit	Independent instrument to secure obligations related of a commercial or financial nature;	Subject to ICC's International Standby Practices publication 98 or UCP 600	Separate transaction from the contract and it should state that it is a Standby DC	Fixed expiry date or Evergreen	Normally consisting of a draft and statement of default.

## Comparison between Documentary Credit & G'TEE/SDC

Product	Purpose	Tenor	Terms and Conditions	Documents Required
Documentary Credit (Commercial)	It relates to export (selling) and import (buying) of goods and services	Shorter tenor with an average of 6 months	Standardized payment method  Transferable for partial amounts and to multiple beneficiaries Applicable Rule UCP 600	Financial document in the form of a bill of exchange/drafts in addition to commercial documents such as; invoice, transport (B/L), certificates, etc.
G'TEE/SDC	It relates to securing commercial or financial obligations or any other form of legal obligations	Longer tenors except in case of trade-related SDC	Would vary and depend on the text and wording of the guarantee  Partial transfer not permissible, however can be transferred to multiple beneficiaries Applicable Rules: GTE: URDG 758, SDC:ISP98 / UCP 600	Normally consists of a statement of default



# Guarantees & SDC – Where they fit in a transaction cycle



# Guarantees – Performance & Financial

## Performance Guarantee (Trade Related Guarantee)

- A Performance Guarantee supports the applicant's obligation under the contract and can be claimed in the event of non-performance or non-delivery by the applicant.

## Financial Guarantee

- A Financial Guarantee supports various types of financial obligations of the applicant which allows the beneficiary to claim upon non-payment of monies.

# Types of Guarantees and Standby Documentary Credits

## Bid/Tender Bond

- This bond is usually a pre-requisite for a commercial or trade-related tender and is issued to support the applicant's bid for the tender. The Bond will be claimed by the beneficiary in case the applicant is awarded the bid but is unable to comply with its terms
- Usually issued for short tenor, for percentage not exceeding 5 % of contract value

### Common sectors requiring these bonds:

- Government, Infrastructure, Construction, Engineering, Mining, Privatization and Real Estate

## Advance Payment Bond

- This bond is issued on behalf of the applicant to evidence receipt of an advance payment for a commercial or trade-related contract and can be claimed if the applicant does not meet its obligations under the terms of the contract
- Usually issued for short or medium tenor, for percentage between 10 to 30 % of contract value

### Common sectors requiring these bonds:

- Government, Infrastructure, Construction, Engineering, Mining, Privatization, Real Estate, Export of Machinery and Equipment, Shipping and Aeronautical

# Types of Guarantees and Standby Documentary Credits

## Performance Bond

- A Performance Bond supports the applicant's obligation under the contract and can be claimed in the event of non-delivery or non-performance of the applicant
- Usually issued for short or medium tenor, for percentage not exceeding 10-15 % of contract value

### Common sectors requiring these bonds:

- Government, Infrastructure, Construction, Engineering, Mining, Privatization, Real Estate and project-type business

## Warranty/Maintenance/Retention Bond

- This bond is usually issued after completion of a contract to support the applicant's obligation to maintain the goods or services for a specified period of time
- Usually issued for short tenor, for percentage between 5 to 20 % of contract value

### Common sectors requiring these bonds:

- Government, Infrastructure, Construction, Engineering, Mining, Real Estate, Installation of Machinery and Equipment and Aeronautical

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