Just what is an SBLC/BG?

A Bank Guarantee (more properly called a Banker's Guarantee) is a banking arrangement whereby a bank substitutes its creditworthiness for that of its customer.

Unlike an L/C which is intended to be paid, a BG is a contingent obligation. "Contingent" means "depending on the happening of an event, which may or may not occur" and 99% of the time it is not paid because the event does not happen.

Everyday, banks big and small issue BGs on behalf of their customers for a variety of mundane purposes. A BG is never issued for the bank's own account, always on behalf of its customers, and the final liability falls on the customers.

The most common type of BG is performance-related, in which a bank tells the beneficiary if the customer does not do this or that, the bank will pay. A common example is a BG issued to a shipping company for the release of goods without the Bills of Lading. The other type is to substitute for a cash payment, an example being a BG issued to a utilities company to guarantee an account in lieu of a cash deposit, or in lieu of a cash deposit to support a tender.

Less common are BGs issued for financial reasons. An example is, say, an MNC in one country wishes to borrow from a bank for its subsidiary in another country. The MNC can ask their bank to issue a BG to the subsidiary's bank guaranteeing the loan. Again the BG will only be paid in case of default by the borrower.

The term Standby Letter of Credit (SBLC or SLC) was invented by U.S. banks because under the Glass-Steagal Act banks in the U.S. were not allowed to issue Bank(er's) Guarantees so they got round the law by formatting their BGs like Letters of Credit and called them Standby L/Cs. The word "standby" means the same as "contingent" – available when called upon, like reserve footballers sitting on the bench waiting to be called if needed.

The terms SBLC and BG are interchangeable, both do the same work and both serve the same purpose. All the above examples can be issued either in the form of a BG or a SBLC. The difference between a BG and a SBLC is legal, a BG is a simple obligation subject to civil law whereas a SBLC is issued subject to UCP 500 and ISP 98, both well-accepted banking protocols.

Both SBLCs or BGs can be issued and sent by Swift, telex, courier, mail, messenger or pigeon. The mode of transmission does not matter.

It is therefore clear that both SBLCs and BGs are not tradeable securities nor are they negotiable instruments for the simple reason that they are issued for a specific purpose covering an underlying obligation and this purpose and underlying obligation cannot be transferred to anyone.