GUARDING AGAINST FRAUD AND LOSS–WHAT YOU NEED TO KNOW WHEN TAKING SECURITY BY WAY OF A BANK GUARANTEE

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Bank guarantees (BGs) are a very old invention yet remain one of the most common forms of security that are provided in respect of leasing and other property transactions.

Despite their prevalence, there are a number of risks in accepting BGs as a form of security.

For example, there is no digital or electronic means to immediately verify the authenticity of a BG as they do not contain security features such as those found in Reserve Bank of Australia banknotes.

Further, it can be very difficult to distinguish between an original BG and a high quality colour photocopy.

These pitfalls give rise to an increased risk of fraud. There is also the possibility of loss arising as a result of an accidental substitution of the original with a copy or the chance of loss or destruction of the original.

In this alert, we set out some of the key tips for owners, buyers, sellers and managing agents to mitigate the risks which exist when accepting security by way of BG.

HOW MIGHT A FRAUD OCCUR?

If the benefited party receives a copy of the BG instead of the original BG then two things could happen:

- The customer who arranged the BG could return the original to their bank and have it cancelled, with any security or cash deposit provided to the bank being released back to the customer without the benefited party's knowledge (this can occur even if the BG is made out in favour of the benefited party); and
- The benefited party, unaware of the fact that they are in possession of a copy, incorrectly believe they have received the security that they are entitled to.

IS YOUR TEAM EDUCATED ON THE STRICT REQUIREMENTS OF AN ORIGINAL BG?

A copy of a BG is not an enforceable BG. While an original BG can be used for its intended purpose, a copy cannot. In the absence of the original BG, the holder of a copy of the BG will be unsecured and unable to call on the BG. Although outside the scope of this alert you need to be aware of the necessary terms and conditions of the BG document for it to be enforceable.

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DID YOU COLLECT THE BG YOURSELF FROM THE BANK?

Ideally, the benefited party should arrange with the customer for the bank to hand the BG directly to the benefited party at the bank, instead of the customer being permitted to collect the BG and then provide the BG to the benefited party or its agent at some later time. This hand over may or may not be in the presence of the customer.

It is also possible for the customer to direct their bank to mail the BG directly to the benefited party. But extra care needs to be taken if doing this.

IS THERE A RECORD OF COLLECTION?

It is recommended that you make a contemporaneous written record of the fact the original BG was collected from the bank, who collected it and where the original BG was securely stored.

DOES THE BG CLAUSE ADDRESS THE ABOVE?

The document which gives rise to the BG requirement (such as an AFL or Lease) should include an obligation for the customer to arrange for their bank to hand the BG directly to the benefited party.

For example:

The tenant must arrange for the tenant's bank to provide the bank guarantee directly to the owner at the tenant's bank.

The clause might also say:

If at any time requested by the owner, the tenant must provide the owner with all assistance required to verify the authenticity and enforceability of the bank guarantee.

DO YOU HAVE THE ORIGINAL?

In a digital age the importance of "wet ink" original documents can be misunderstood or overlooked. An original BG will have a wet ink signature, usually in blue ink. A BG will not be signed by a bank using "Docusign" or an equivalent product.

Include in your settlement checklist the requirement to check that the BG handed over at settlement is the original.

CAN YOU VERIFY THAT A BG IS THE ORIGINAL?

In some relatively limited circumstances, where material doubts exist as to the authenticity of a BG, it may be possible for the issuing bank to confirm that it is the original. However, this is not an immediate or guaranteed process.

HAVE YOU MADE A COPY OF THE BG?

You should make a copy of the BG which could be stored electronically or available to be conveniently accessed (so that the original BG can remain securely stored without needing to be accessed frequently thereby increasing

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the risk of it being misplaced, damaged or inadvertently destroyed). However, it is critical that the copy and the original are not confused. A practical way to avoid confusion is to mark the copy as "copy" when it is made.

HAS THE BG BEEN STORED SECURELY?

BGs should be stored in a secure fire and weatherproof location. Copying, handling and filing of original BGs should be limited and recorded.

WHAT CAN BE DONE IN RELATION TO BGS IN A DUE DILIGENCE PROCESS?

In advance of a due diligence process, it is prudent for a seller to undertake an audit of each BG held to verify that it is the original, before getting the sale process underway.

The buyer should verify (or have the seller verify) that each BG held is the original.

WHAT CAN BE INCLUDED IN SALE AND PURCHASE AGREEMENTS?

From a buyer's perspective, seek warranties and representations in relation to the authenticity of each BG and an opportunity to inspect the BGs before settlement.

Sale and purchase agreements should also address, where possible, the process to issue replacement BGs in favour of the new owner.

WHAT ELSE SHOULD MANAGING AGENTS KEEP IN MIND?

When assuming the management of a new asset, verify that each BG is the original and ensure that all BGs are stored securely. The managing agent should also maintain proper records in relation to all BGs, including by recording and diarising any relevant expiry dates.

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