सत्यमेव जयते

GOVERNMENT GUARANTEE POLICY

MINISTRY OF FINANCE
DEPARTMENT OF ECONOMIC AFFAIRS
BUDGET DIVISION
NEW DELHI
SEPTEMBER, 2010
www.finmin.nic.in

GOVERNMENT GUARANTEE POLICY

MINISTRY OF FINANCE
DEPARTMENT OF ECONOMIC AFFAIRS
BUDGET DIVISION
NEW DELHI
SEPTEMBER, 2010
www.finmin.nic.in

F.No. 12(15)-B(SD)/2005
Government of India
Ministry of Finance
Department of Economic Affairs
(Budget Division)

New Delhi, the 22nd September, 2010

OFFICE MEMORANDUM

Subject :- **Policy Paper on Government Guarantees.**

The issue of streamlining and improving methodology for approval of Guarantee has been engaging the attention of Budget Division, Department of Economic Affairs, in the Ministry of Finance. A policy paper on Government Guarantees (copy enclosed) is issued herewith. This will serve as an overall guideline alongwith Chapter XI on Government Guarantees of General Financial Rules, 2005 for considering various guarantee proposals from Ministries/Departments.

2. This issues with the approval of Finance Minister.

Encl:- As above.

Sd/-
(Shaktikanta Das)
Joint Secretary to the Government of India

To,

1. All the Ministries/ Departments and Secretaries to the Government of India (with a spare copy to the Financial Adviser of all the Ministries/Departments);
2. Finance Secretary , Ministry of Finance;
3. Secretary (Expenditure), Ministry of Finance;
4. Secretary (Revenue), Ministry of Finance;
5. Secretary (Financial Services), Ministry of Finance;
6. Financial Commisioner(Railways), Ministry of Railways, Rail Bhawan, New Delhi;
7. Member (Finance), Department of Telecommunication, Sanchar Bhawan, New Delhi;
8. Secretary (Finance), Ministry of Defence, South Block, New Delhi.
9. Addl. Secretary (EA), Department of Economic Affairs;
10. The Comptroller & Auditor General of India, 10 - Bahadurshah Zafar Marg, New Delhi - 110002
11. The Controller General of Accounts, Ministry of Finance, Lok Nayak Bhawan, New Delhi;
12. All Joint Secretaries , Department of Economic Affairs;
13. All Joint Secretaries , Department of Expenditure;
14. All Joint Secretaries , Department of Revenue;
15. All Joint Secretaries, Department of Financial Services;
16. Joint Secretary and Financial Adviser, Ministry of Finance
17. CCA, Ministry of Finance;
18. All Officers in the Budget Division;
19. Policy File in the SD Section, Budget Division, DEA
20. Finance Library, North Block, New Delhi - 110 001(5 Copies)

GOVERNMENT GUARANTEE POLICY

Article 292 of the Constitution of India (Annex-I) extends the executive power of the Union to the giving of guarantees on the security of the Consolidated Fund of India, within such limits, if any, as may be fixed by Parliament. In terms of Article 299 of the Constitution, all contracts made in the exercise of the executive power of the Union shall be made expressly indicating that the contract has been made on behalf of the President.

2. The Fiscal Responsibility and Budget Management Act, 2003 and the Rules made there under (Annex-II) prescribe a limit of 0.5% of GDP for guarantees to be given in any financial year beginning with the financial year 2004-05. If this limit is exceeded owing to unforeseen circumstances, the Finance Minister is required to make a statement in both Houses of Parliament explaining the deviation including whether the deviation is substantial and relates to the actual or the potential budgetary outcomes and the remedial measures that the Central Government proposes to take in the matter.

General legal provisions relating to guarantees

3. In terms of the Indian Contract Act, 1872, "contract of guarantee" is a contract to perform the promise, or discharge the liability, of a third person in case of his default. Where only two parties are involved, i.e. where one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, such a contract is called a "contract of indemnity". Sections 124 to 147 of the Indian Contract Act (Annex-III) specify the common law provisions relating to the contracts of indemnity or guarantee.

4. Besides the common law provisions on contracts of guarantee, administrative instructions have also been issued by the Ministry of Finance, from time to time, in respect of issue of sovereign guarantees. The basic instructions date back to May 1969 wherein it was stipulated that the guarantee proposal must be justified by public interest.

5. Till 1988, there was also no uniform practice prescribed or being followed in respect of levy or collection of guarantee fee. In January 1989, the Finance Minister had desired that guarantee fee should be collected in respect of all guarantees. However, the guarantee fee was being allowed to be prescribed on a case-to-case basis. In April 1992, uniform rates of guarantee fee were prescribed by the Ministry of Finance in respect of internal borrowings, inter alia, @ 1% per annum on borrowing by Public Sector Enterprises including the Cooperative Sector, and @ 2.5% on borrowings by other sectors. However, in respect of external borrowings, guarantee fee continued to be determined on a case-to-case basis by the ECB Division, in consultation with the Budget Division. In June 1993, a uniform guarantee fee of 1.2% per annum on the outstanding amount of principal + interest was prescribed even in respect of external borrowings. To sum up, the prevailing rates are as follows:-

S.No.	Type of Borrowing	Rate of Fee (Per Annum)
1.	Borrowing under the market borrowing programme approved by the RBI	0.25%
2.	Borrowing under inter-corporate transfers envisaged in the Annual Plan	0.25%
3.	Other Domestic Borrowings:	
	(i) Public Sector including the cooperative sector	1.00%
	(ii) Other sectors	2.50%
4.	External borrowings	1.20%

6. Prior to December 1994, Administrative Ministries/Departments took on such contingent liabilities up to specified financial limits and conditions without reference to

Ministry of Finance or any centralized authority. Subsequently, the guarantee approving authority was centralized in the Ministry of Finance, Department of Economic Affairs (Budget Division). Once the guarantee is approved by Ministry of Finance, the guarantees are executed and monitored by the Administrative Ministries concerned, who are also required to report the status in this regard on an annual basis till they are invoked or are obliterated. From 2002, a decision has also been taken not to give guarantees in favour of private companies/ institutions.

7. Guarantees are contingent liabilities that come into play on the occurrence of an event covered by the guarantee. Since guarantees result in increase in contingent liability, they should be examined in the same manner as a proposal for a loan, taking into account, inter alia, the credit-worthiness of the borrower, the amount and risks sought to be covered by a sovereign guarantee, the terms of the borrowing, the justification and public purpose to be served, probabilities that various commitments will become due and possible costs of such liabilities, etc.

8. Chapter 11 of the General Financial Rules, 2005 details the current administrative guidelines for grant, review, accounting and monitoring of sovereign guarantees (Annex-IV). The existing guidelines indicate the conditions to be prescribed such as the period of guarantee, lien on assets, submission of periodical reports and returns, right to get accounts audited on behalf of Government, guarantee fee, etc.

9. **Objective of Guarantee:** The sovereign guarantee is normally extended for the purpose of achieving the following objectives:-

(i) To improve viability of projects or activities undertaken by government entities with significant social and economic benefits;

(ii) To enable public sector companies to raise resources at lower interest charges or on more favourable terms;

(iii) To fulfil the requirement in cases where sovereign guarantee is a precondition for concessional loans from bilateral/multilateral agencies to sub-sovereign borrowers.

10. **The extant guidelines on sovereign guarantees further stipulate that:**

(i) The guarantee cover shall be limited only to the payment of principal and normal interest in case of default. GOI shall not be liable to pay any penal interest/any other charges;

(ii) In view of the quasi-sovereign nature of the borrowings, the interest payable should compare with yield on G-securities of comparable maturity with a small spread;

(iii) The guarantee once given would not be transferable to any other agency;

(iv) In case of default, the lending agency shall invoke the Guarantee within a time limit not exceeding 45 to 90 days of the default. In case the guarantee is not invoked within the stipulated period, the guarantee would cease to exist for that portion of the tranche/loan/liability for which guarantee has not been invoked;

(v) The Administrative Ministry/Department should review proper utilisation of the guaranteed funds and will also review the guarantees annually to ensure that there is no risk of default in repayment of loans together with interest thereon as well as the guarantee fee payable to the Government of India;

Guarantee Redemption Fund

(vi) A Guarantee Redemption Fund (GRF) has been established in the Public Account of India from 1999-2000 for redemption of guarantees given to CPSEs, FIs, etc. by the Union Government whenever such guarantees are invoked. The fund is fed through budgetary appropriations with an annual provision in the Budget Estimates (BE), under the head 'Transfer to Guarantee Redemption Fund' (Grant No. 32 of Department of Economic Affairs).

Procedure for approval/execution of guarantees

11. In addition to the above extant guidelines and in order to bring about further improvements in the procedures for approval of guarantees and to reduce the time taken on unwarranted correspondence, it has been decided that:-

(i) In respect of bilateral and multilateral credit, Guarantees on standard format of the lending institutions may be signed by administrative Ministry/Department for issue of the guarantee. New conditions or covenants, if any, shall be referred to Budget

Division of the Department of Economic Affairs (DEA) while sending guarantee proposals.

(ii) In respect of other loans, Administrative Ministry should ensure that there are no inconsistencies between the guarantee approval given by the Ministry of Finance and the guarantee agreement signed by them; or between the guarantee approval given by the Ministry of Finance and the loan agreement signed by the borrower, as to the obligations agreed to be undertaken by the Government as guarantor.

(iii) The obligations of the borrower to service the loan and the guarantee, and the monitoring of the utilization of the guaranteed loans and adherence to the terms and conditions of the guarantee by the Borrower shall be ensured by the Administrative Ministry/Department through a back-to-back agreement with the borrower which may be drawn up and implemented to the satisfaction of the Administrative Ministry concerned. For this purpose, necessary records to monitor the guarantee, including servicing of guarantee fee shall be maintained by the Line Ministries/Departments concerned.

(iv) Deviations/modifications/amendments on the main conditions of the guarantee, particularly with reference to the rate of interest on the loan to be guaranteed and obligations to be covered, should not be referred in a routine manner for clarification/ change through the instrument of guarantee format once the conditions of the guarantee are approved by the Ministry of Finance. The Administrative Ministry concerned shall make out a separate case, fully justifying the need for considering any proposed modifications/amendments, after thorough scrutiny of the request of the borrower for the same, for placing these proposals before the Finance Minister for a final decision.

Risk profiling and Prioritization

Assumption of Guarantee under FRBM Rules, 2004

12. The volume of Sovereign guarantees undertaken during a financial year is limited under Rule 3(3) of the Fiscal Responsibility and Budget Management (FRBM) Rules, 2004, which stipulates that the Central Government shall not give guarantees aggregating to an amount exceeding 0.5% of the GDP in any financial year beginning with the financial year 2004-05.

13. In order to ensure greater transparency in its fiscal operations in the public interest, Rule 6 of the FRBM Rules, 2004 also requires government to publish a disclosure statement on guarantees given by government, at the time of presenting the annual financial statement and demands for grants. This statement covers, inter alia, details regarding the class and number of guarantees, amounts guaranteed, outstandings, invocations, guarantee fee payable and other material details. These statements are compiled by the Line Ministries/Departments and submitted to Controller General of Accounts Office, for onward submission to Ministry of Finance (Budget Division). Based upon the inputs, a statement of Guarantees given by the Central Government is depicted as an annexure in the Receipt Budget.

14. The best and often the only time to regulate fiscal risk effectively is before it is taken. With a view to achieving better management and control of fiscal risks, associated fiscal costs upon assumption of contingent liabilities, **the following principles are required to be followed for implementation by the concerned authorities, before new contingent liabilities in the form of sovereign guarantees are undertaken:-**

Assessment of Risk and quantum/ probability of future payout

(i) Risk associated with assumption of a new contingent liability/guarantee proposal, including the probability of future payouts is required to be thoroughly assessed by the concerned Administrative Ministry/Department recommending the proposal. Such assessment should ideally be entrusted to an independent unit and should be undertaken even when it has already been decided by a higher authority to provide guarantees. The assessment should reveal an accurate picture of the financial condition of the entity to be guaranteed; risks associated with implementation of the project/ scheme, etc. This information would be useful to estimate the funds needed to meet such liabilities if the need should arise, in current or future budgets.

Institutional limits on guarantees

(ii) In cash based budgeting, since losses are recognized only when payments are made and not when liabilities are incurred, it is considered expedient to specify limits not only for the volume of guarantees to be issued during the year for the budget as a whole but also limits on the volume of guarantees each Ministry/Department is authorized to issue in a year. The Ministries/Departments should send their prioritized list of proposals for guarantees before 30th April every year to the Budget Division of DEA. The list should prioritise the proposals and include only such proposals where the loan agreement can be signed during the financial year. Individual Ministries/Departments are also expected to closely review the outstanding stock of guarantees issued by them as a proportion of their annual budgetary provisions and examine the need, quantum and scope of the guarantee with the objective of further containing Government exposure.

(iii) All such lists received would be looked at for drawing up an overall prioritized list. This list would only imply that the proposals will be considered for guarantee during the year. Individual proposals will have to be sent to the Budget Division separately. A mid-course review in the month of December of each year shall be undertaken by the Budget Division of DEA based on actual and likely utilization of approved guarantees to re-prioritise the guarantee requirement.

Guarantees v. other forms of budgetary support

(iv) Guarantees may not be proposed for pursuing low priority objectives or programmes. Proposal for grant of guarantee as an off-budget support should also be examined comprehensively by the proposing Ministry/Department against other alternative forms of support which may be more appropriate and cost-effective. For example, in the case of provision of credit guarantees to enterprises that continually incur losses, while there may be good reasons to support such enterprises if their losses are a result of government's pricing policy, budgetary subsidies or direct government loans may be a more effective and less costly option.

(v) Approval of Government Guarantee would cast a bigger responsibility on the concerned administrative Ministries/Departments of the Public Sector Enterprises to be more diligent to ensure that there is no devolution. In other words there should be a thorough scrutiny of the loan proposal by both the lending and borrowing agencies. Existence of a government guarantee should not become a substitute for financial prudence.

Public Sector Enterprises with strong financial credentials

(vi) Guarantees may not also be proposed in respect of Public Sector Enterprises whose strong financial credentials and high credit rating would indicate inherent ability to directly raise the required resources without the support of government guarantee.

Progressive Measures

15. **Additional measures that may be considered to further streamline the process of assuming risk in the form of Sovereign Guarantee would include:**

(i) Charging risk-based premia or establishing deductibles for cash payouts in the event of a guarantee invocation. Risk-based premia would recognize that not all liabilities assumed may be equally risky. In other words, every proposal for guarantee will be assessed independently and the guarantee fee would be fixed, based on the assessment of risk. The more risky projects would have a guarantee fee greater than the base level prescribed in para 5. Government may also reduce its exposure by paying for the last rather than the first loss, by setting deductibles that must be satisfied before it makes payment. Under the 'deductible' arrangement, in case of default of guarantee, Government would pay 70% to 90% of the amount in default and the balance 10% to 30% would be paid by the borrowing institution. The borrowing institution would first have to pay 10% to 30% and then approach the Government for settling balance amount.This would require that the borrowing institution identifies resources from its own internal resources/assets to meet its obligation.

(ii) Before guarantee proposal is tendered, the sponsoring Ministry/Department must thoroughly analyse the project and demonstrate that it cannot be financed without government's assistance and that cash flows will be adequate to cover repayment of the debt as well as interest.

(iii) Government may also seek to safeguard its interest and mitigate moral hazard and loss by regulating the actions of the beneficiaries of sovereign guarantees and by monitoring the proper use of guaranteed funds. This has to be done to eliminate any perverse incentive for willful default.

(iv) Government may assume no more than 70% to 90% of the risk in certain cases, depending on the credit worthiness of the entity to be covered. This would incentivize other stakeholders to make proper analysis of the project, credit worthiness of the borrowers, and build in strategies for risk management.

(v) Bankers/lenders may be asked to share the risk by bearing a minimum of 10% to 30% of the net loss associated with any default. The arrangement would give lenders an incentive to undertake a more rigorous assessment of the risk exposure.

(vi) Interest rates on guaranteed loans should invariably be benchmarked at the government's cost of funds. Government's liability for meeting interest defaults may be restricted to the benchmark level, i.e., equivalent to G-Securities of comparable maturity with a suitable spread.

16. **Conclusion**

The extant guidelines on the procedure to be followed for approval of government guarantees would continue. Any deviation from the extant guidelines and the new policy would require the approval of the Finance Minister.

****

Annex-I

The Constitution of India

CHAPTER II-BORROWING

292. The executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by Parliament by law and to the giving of guarantees within such limits, if any, as may be so fixed.

293. (1) Subject to the provisions of this article, the executive power of a State extends to borrowing within the territory of India upon the security of the Consolidated Fund of the State within such limits, if any, as may from time to time be fixed by the Legislature of such State by law and to the giving of guarantees within such limits, if any, as may be so fixed.

(2) The Government of India may, subject to such conditions as may be laid down by or under any law made by Parliament, make loans to any State or, so long as any limits fixed under article 292 are not exceeded, give guarantees in respect of loans raised by any State, and any sums required for the purpose of making such loans shall be charged on the Consolidated Fund of India.

(3) A State may not without the consent of the Government of India raise any loan if there is still outstanding any part of a loan which has been made to the State by the Government of India or by its predecessor Government, or in respect of which a guarantee has been given by the Government of India or by its predecessor Government.

(4) A consent under clause (3) may be granted subject to such conditions, if any, as the Government of India may think fit to impose.

Annex-II

FRBM Act and Rules

Fiscal Responsibility and Budget Management Act, 2003

4. (1) The Central Government shall take appropriate measures to reduce the fiscal deficit and revenue deficit so as to eliminate revenue deficit by the 31 March, 2008 and thereafter build up adequate revenue surplus.

(2) The Central Government shall, by rules made by it, specify

(a) the annual targets for reduction of fiscal deficit and revenue deficit during the period beginning with the commencement of this Act and ending on the 31 March, 2008;

(b) the annual targets of assuming contingent liabilities in the form of guarantees and the total liabilities as a percentage of gross domestic product:

Provided that the revenue deficit and fiscal deficit may exceed such targets due to ground or grounds of national security or national calamity or such other exceptional grounds as the Central Government may specify: Provided further that the ground or grounds specified in the first proviso shall be placed before both Houses of Parliament, as soon as may be, after such deficit amount exceed the aforesaid targets.

....

7(3)(a) Except as provided under this Act, no deviation in meeting the obligations cast on the Central Government under this Act, shall be permissible without approval of Parliament.

(b) Where owing to unforeseen circumstances, any deviation is made in meeting the obligations cast on the Central Government under this Act, the Minister-in-charge of the Ministry of Finance shall make a statement in both Houses of Parliament explaining

(i) any deviation in meeting the obligations cast on the Central Government under this Act;

(ii) whether such deviation is substantial and relates to the actual or the potential budgetary outcomes; and

(iii) the remedial measures the Central Government proposes to take.

Fiscal Responsibility and Budget Management Rules, 2004

3. Annual targets

....

(3) The Central Government shall not give guarantees aggregating to an amount exceeding 0.5 per cent of the GDP in any financial year beginning with the financial year 2004-2005.

CHAPTER VIII
OF INDEMNITY AND GUARANTEE

"Contract of indemnity" defined.

124. A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a "contract of indemnity."

Illustration

A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of 200 rupees. This is a contract of indemnity.

Rights of indemnity-holder when sued.

125. The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor

(1) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies ;

(2) all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit;

(3) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit.

"Contract of guarantee ", "surety", "principal debtor " and "creditor".

126. A "contract of guarantee" is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the "surety"; the person in respect of whose default the guarantee is given is called the "principal debtor", and the person to whom the guarantee is given is called the "creditor". A guarantee may be either oral or written.

Consideration for guarantee.

127. Anything done, or any promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.

Illustrations

(a) B requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A’s promise to deliver the goods. This is a sufficient consideration for C's promise.

(b) A sells and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year, and promises that if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is a sufficient consideration for C's promise.

(c) A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

Surety's liability.

128. The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract.

Illustration

A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

Continuing guarantee.

129. A guarantee which extends to a series of transactions is called a "continuing guarantee".

Illustrations

(a) A, in consideration that B will employ C in collecting the rents of B's zamindari, promises B to be responsible, to the amount of 5,000 rupees, for due collection and payment by C of those rents. This is a continuing guarantee.

(b) A guarantees payment to B, a tea-dealer, to the amount of $100, for any tea he may from time to time supply to C. B supplies C with tea to above the value of $ 100, and C pays B for it. Afterwards B supplies C with tea to the value of $200. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of $100.

(c) A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C. C pays for them. Afterwards B delivers four sacks to C, which C does not pay for. The guarantee given by A was not a continuing guarantee, and accordingly he is not liable for the price of the four sacks.

Revocation of continuing guarantee.

130. A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.

Illustrations

(a) A, in consideration of B's discounting, at A's request, bills of exchange for C, guarantees to B, for twelve months, the due payment of all such bills to the extent of 5,000 rupees. B discounts bills for C to the extent of 2,000 rupees. Afterwards, at the end of three months, A revokes the guarantee. This revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for the 2,000 rupees, on default of C.

(b) A guarantees to B, to the extent of 10,000 rupees, that C shall pay all the bills that B shall draw upon him. B draws upon C. C accepts the bill. A gives notice of revocation. C dishonours the bill at maturity. A is liable upon his guarantee.

Revocation of continuing guarantee by surety's death.

131. The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions.

Liability of two persons, primarily liable, not affected by arrangement between them that one shall be surety on other ' s default.

132. Where two persons contract with a third person to undertake a certain liability, and also contract with each other that one of them shall be liable only on the default of the other, the third person not being a party to such contract, the liability of each of such two persons to the third person under the first contract is not affected by the existence of the second contract, although such third person may have been aware of its existence.

Illustration

A and B make a joint and several promissory note to C. A makes it, in fact, as surety for B, and C knows this at the time when the note is made. The fact that A, to the knowledge of C, made the note as surety for B, is no answer to a suit by C against A upon the note.

Discharge of surety by variance in terms of contract.

133. Any variance, made without surety's consent, in the terms of the contract between the principal (debtor) and the creditor, discharges the surety as to transactions subsequent to the variance.

Illustrations

(a) A becomes surety to C for B's conduct as a manager in C's bank. Afterwards, B and C contract, without A's consent, that B's salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss.

(b) A guarantees C against the misconduct of B in an office to which B is appointed by C, and of which the duties are defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, B misconducts himself. A is discharged by the change from future liability under his guarantee, though the misconduct of B is in respect of a duty not affected by the later Act.

(c) C agrees to appoint B as his clerk to sell goods at a yearly salary, upon A's becoming surety to C for B's duly accounting for moneys received by him as such clerk. Afterwards, without A's knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not by a fixed salary. A is not liable for subsequent misconduct of B.

(d) A gives to C a continuing guarantee to the extent of 3,000 rupees for any oil supplied by C to B on credit. Afterwards B becomes embarrassed, and, without the knowledge of A, B and C contract that C shall continue to supply B with oil for ready money, and that the payments shall be applied to the then existing debts between B and C. A is not liable on his guarantee for any goods supplied after this new arrangement.

(e) C contracts to lend B 5,000 rupees on the 1st March. A guarantees repayment. C pays the 5,000 rupees to B on the 1st January. A is discharged from his liability, as the contract has been varied, inasmuch as C might sue B for the money before the 1 st March.

Discharge of surety by release or discharge of principal debtor.

134. The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

Illustrations

.(a) A gives a guarantee to C for goods to be supplied by C to B.C supplies goods to B, and afterwards B becomes embarrassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C, and A is discharged from his suretyship.

(b) A contracts with B to grow a crop of indigo on A's land and to deliver it to B at a fixed rate, and C guarantees A's performance of this contract. B diverts a stream of water which is necessary for irrigation of A's land and thereby prevents him from raising the indigo. C is no longer liable on his guarantee.

(c) A contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber. C is discharged from his suretyship.

Discharge of surety when creditor compounds with , gives time to, or agrees not to sue, principal debtor.

135. A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal debtor, discharges the surety, unless the surety assents to such contract.

Surety not discharged when agreement made with third person to give time to principal debtor.

136. Where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged.

Illustration

C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with M to give time to B. A is not discharged.

Creditor' s forbearance to sue does not discharge surety.

137. Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not, in the absence of any provision in the guarantee to the contrary, discharge the surety.

Illustration

B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. A is not discharged from his suretyship.

Release of one co-surety does not discharge others.

138. Where there are co-sureties, a release by the creditor of one of them does not discharge the others; neither does it free the surety so released from his responsibility to the other sureties.

Discharge of surety by creditor's act or omission impairing surety's eventual remedy.

139. If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.

Illustrations

(a) B contracts to build a ship for C for a given sum, to be paid by instalments as the work reaches certain stages. A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays to B the last two instalments. A is discharged by this prepayment.

(b) C lends money to B on the security of a joint and several promissory note made in C's favour by B, and by A as surety for B, together with a bill of sale of B's furniture, which gives power to C to sell the furniture, and apply the proceeds in discharge of the note. Subsequently, C sells the furniture, but, owing to his misconduct and wilful negligence, only a small price is realised. A is discharged from liability on the note.

(c) A puts M as apprentice to B, and gives a guarantee to B for M's fidelity. B promises on his part that he will, at least once a month, see that M make up the cash. B omits to see this done as promised, and M embezzles. A is not liable to B on his guarantee.

Rights of surety on payment or performance.

140. Where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor.

Surety ' s right to benefit of creditor ' s securities.

141.A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

Illustrations

(a) C advances to B, his tenant, 2,000 rupees on the guarantee of A. C has also a further security for the 2,000 rupees by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.

(b) C, a creditor, whose advance to B is secured by a decree, receives also a guarantee for that advance from A. C afterwards takes B's goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged.

(c) A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives up the further security. A is not discharged.

Guarantee obtained by misrepresentation invalid.

142. Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.

Guarantee obtained by concealment invalid.

143. Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

Illustrations

(a) A engages B as a clerk to collect money for him, B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid.

(b) A guarantees to C payment for iron to be supplied by him to B to the amount of 2,000 tons. B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

Guarantee on contract that creditor shall not act on it until co-surety joins.

144. Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.

Implied promise to indemnify surety.

145. In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety; and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully.

Illustrations

(a) B is indebted to C, and A is surety for the debt. C demands payment from A, and on his refusal sues him for the amount. A defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt with costs. He can recover from B the amount paid by him for costs, as well as the principal debt.

(b) C lends B a sum of money, and A, at the request of B, accepts a bill of exchange drawn by B upon A to secure the amount. C, the holder of the bill, demands payment of it from A, and, on A's refusal to pay, sues him upon the bill. A, not having reasonable grounds for so doing, defends the suit, and has to pay the amount of the bill and costs. He can recover from B the amount of the bill, but not the sum paid for costs, as there was no real ground fordefending the action.

(c) A guarantees to C, to the extent of 2,000 rupees, payment for rice to be supplied by C to B. C supplies to B rice to a less amount than 2,000 rupees, but obtains from A payment of the sum of 2,000 rupees in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.

Co-sureties liable to contribute equally.

146. Where two or more persons are co-sureties for the same debt or duty, either jointly or severally, and whether under the same or different contracts, and whether with or without the knowledge of each other, the co-sureties, in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt or of that part of it which remains unpaid by the principal debtor.

Illustrations

(a) A, B and C are sureties to D for the sum of 3,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,000 rupees each.

(b) A, B and C are sureties to D for the sum of 1,000 rupees lent to E, and there is a contract between A, B and C that A is to be responsible to the extent of one-quarter, B to the extent of one-quarter, and C to the extent of one-half. E makes default in payment. As between the sureties, A is liable to pay 250 rupees, B 250 rupees, and C 500 rupees.

Liability of co-sureties bound in different sums.

147.Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

Illustrations

(a) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 30,000 rupees. A, B and C are each liable to pay 10,000 rupees.

(b) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 40,000 rupees; A is liable to pay 10,000 rupees, and B and C 15,000 rupees each.

(c) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 70,000 rupees. A, B and C have to pay each the full penalty of his bond.

CHAPTER - 11 of General Financial Rules, 2005

GOVERNMENT GUARANTEES

Rule 245. The power of the Union Government to give guarantees emanates from and is subject to such limits as may be fixed in terms of Article 292 of the Constitution of India, the Fiscal Responsibility and Budget Management Act, 2003 and Rules framed there under.

Rule 246.

(1) **Guidelines for grant of Government of India Guarantee :**Powers to grant Government of India Guarantee vest with the Ministry of Finance, Budget Division. The following guidelines should be followed by the Ministries or Departments of the Government of India for recommending guarantee or counter guarantee:-

(i) A proposal for guarantee by Government must be justified by public interest such as in the case of borrowings by public sector institutions for approved development purposes or borrowings by public sector undertakings from Banks for working capital and other purposes.

(ii) The concerned Ministry or Department shall examine the proposal in consultation with the Financial Adviser in the same manner as a proposal for loan. While examining the proposal the following considerations shall be kept in view :-

(a) Public interest which the guarantee is expected to serve.

(b) Credit worthiness of the borrower to ensure that no undue risk is involved.

(c) Terms of the borrowing take into account the yields as applicable on Government paper of similar maturity.

(d) The conditions prescribed in the guarantees in order to ensure continued credit worthiness of the borrower.

(iii) After examination in the concerned Ministry or Department, all proposals for extending guarantees shall be referred to Ministry of Finance (Budget Division) for approval. No guarantees shall be given without the approval of the Ministry of Finance (Budget Division).

(iv) Government guarantees shall not be provided to the private sector.

(v) Government guarantees should normally not be extended for external commercial borrowings.

(vi) Government guarantees may be given on all soft loan components of the bilateral aid. However guarantee should not be given for the commercial loan components of such aid. In case of power sector, extension of Government guarantee even in respect of commercial components may be considered on a case to case basis.

(vii) Government of India guarantee will not be given in cases of grants. However, if the donor or insists on ensuring performance, the same may be listed as a negotiating condition for getting the grant.

(viii) The conditions, if any which should be made by Government while giving the guarantee e.g. period of guarantee, levy of fee to cover risk representation for Government on the Board of Management, Mortgage or lien on the assets, submission to Government of periodical reports and accounts, right to get the accounts audited on behalf of Government etc. Even if fee, representation and mortgage are not considered necessary, the right to verify the continued credit–worthiness of the borrower should be ensured.

(2) The Department of Economic Affairs (DEA) shall act as the nodal agency for external borrowings. The credit divisions of DEA shall prescribe limits for external borrowings, sector wise or lender wise and play a role in negotiating external assistance and evolving monitoring systems. In the case of external borrowings where guarantees, are sought to be provided, credit divisions of

Department of Economic Affairs should obtain prior approval of Budget Division.

Rule 247. Borrowings from multilateral agencies by Central Public Sector Undertakings :

(a) All borrowings from the multilateral agencies by Central Public Sector Undertakings would be direct (without Government of India's intermediation) on the terms as agreed mutually between the borrower and the lender and approved by the Government of India. However, where such terms involve grant of Government of India Guarantee, prior approval of the Budget Division of the Ministry of Finance may be obtained.

(b) The borrowing should relate to approved Projects.

(c) Wherever guarantee is to be given by Government of India, the borrower shall enter into an agreement with the Government of India for the payment of guarantee fee on the principal amount of the loan drawn and loan outstanding from time to time.

(d) The borrower shall bear the exchange risk and get the funds directly on terms and conditions prescribed by the lending agency.

Rule 248. Levy of Guarantee Fees :

(1) The rates of fee on guarantees are laid down by the Budget Division in the Ministry of Finance, Department of Economic Affairs, from time to time. The rates of guarantee fee prevalent in July, 2004 are given in Appendix - 16. Ministries or Departments should levy the prescribed fee in respect of all cases. The fees are also to be levied in respect of non-fund based borrowings or credits (viz. letters of credit, Bank guarantees etc.). In case of any doubt with regard to the categorisation of any particular undertaking or organization or the nature of borrowing for the purpose of levy of fee, the matter may be referred to the Budget Division for clarification. The Ministries or Departments should also take adequate steps to ensure prompt recovery of the prescribed fees.

(2) The guarantee fee should be levied before the guarantee is given and thereafter on first April every year. The rate of guarantee fee is to be applied on the amount outstanding at the beginning of the guarantee year. Where the guarantee fee is not paid on the due date, fee should be charged at double the normal rates for the period of default.

Rule 249. Review of Guarantees

(1) All Ministries or Departments shall ensure that all guarantees are reviewed every quarter. The monitoring or review undertaken should examine whether the borrower is discharging repayment obligations or interest obligations as per terms of the loan agreement. The Financial Advisers of the Ministries or Departments should undertake these reviews.

(2) The Financial Adviser of the Ministries or Departments would be responsible for ensuring that the periodical reviews are carried out by the Ministries or Departments concerned. They shall also ensure that a register of guarantees in Form GFR 43 is maintained :-

(i) to keep a record of guarantees;

(ii) to retain information required from time to time in respect of guarantees;

(iii) to keep record of the periodical reviews to see that these are carried out regularly;

(iv) to keep record of levy and recovery of guarantee fee;

(v) to send data as contained in Form GFR 43, duly updated every quarter to the Budget Division in the Ministry of Finance, Department of Economic Affairs by tenth of the month following the quarter.

(3) In respect of guarantees issued by the Ministry of Finance for external loans, the respective credit divisions shall conduct a quarterly review. For this purpose the Financial Adviser (Finance) shall ensure the maintenance of the required registers, as well as ensure that the periodical reviews are carried out by the concerned credit divisions, and report forwarded to the Budget Division in the Form GFR 43. In cases, where the guarantees on external loans are issued by the concerned administrative Ministry, that Ministry would be responsible for conducting the review.

(4) Classification of guarantees : For the purpose of record keeping, guarantees shall be classified as under:-

(i) guarantees given to the RBI, other banks and industrial and financial institutions for repayment of principal and payment of interest, cash credit facility, financing seasonal agricultural operations and/or providing working capital to companies, corporations and cooperative societies and banks;

(ii) guarantees given for repayment of share capital, payment of minimum annual dividend and repayment of bonds or loans, debentures issued or raised by the statutory corporations and financial institutions;

(iii) guarantees given in pursuance of agreements entered into by the Government of India with international financial institutions, foreign lending agencies, foreign governments, contractors, suppliers, consultants etc., towards repayment of principal, of interest or commitment charges on loans etc., and /or for payment against supplies of material and equipment;

(iv) counter guarantees to banks in consideration of the banks having issued letters of credit or authority to foreign suppliers for supplies made or services rendered;

(v) guarantees given to Railways or State Electricity Boards and other entities for due and punctual Payment of dues by companies or Corporation;

(vi) performance guarantees given for fulfillment of contracts or projects awarded to Indian companies in foreign countries;

(vii) performance guarantees given for fulfillment of contracts or projects awarded to foreign companies in foreign countries.

(viii) Others.

Rule 250. Accounting for Guarantees : A statement showing the guarantees given by the Central Government is required to be annexed to the Detailed Demands for grants prepared by the Ministries or Departments. The statements should show the position upto thirty-first March of the second preceding year, to the year to which the Budget documents relate. For example, the Budget documents for 2004-05 will show the position of guarantees outstanding as at thirty-first March 2003. The form in which the statement of guarantees is to be shown would be as prescribed in the Budget circulars. Where interest payments are also guaranteed, the outstanding shown under the columns for sums guaranteed and outstanding should disclose the interest element outstanding, if any, separately. While furnishing the summary statement of guarantees to the Finance Ministry, the Ministries or Departments should ensure and certify that the amounts shown tally with the total figures in the statement to be included in the Detailed Demands for grants. While furnishing the summary statements, the Ministries or Departments should also certify that the information tallies with the material furnished to the Controller General of Accounts for the purpose of inclusion in the Finance Accounts of the relevant year.

Rule 251. Invocation of Guarantee : In the event of invocation of a guarantee, the obligation may be discharged by sanctioning loan equal to the amount of guarantee outstanding with the approval of Budget Division, Ministry of Finance. However, any payment on this account will finally be charged to the Guarantee Redemption Fund maintained in the Public Account.

Rule 252. Furnishing of data regarding Guarantees : With a view to enable the Ministry of Finance to examine cases of Government of India guarantees and extension thereto, all Ministries or Departments should furnish to that Ministry, data of certain operational parameters of the Public Sector Undertaking or Entity. In case the accounts of the Public Sector Undertaking have been audited by the Comptroller & Auditor General of India under Section 619 (4) of the Companies Act, the effect of the comments of the Comptroller & Auditor General of India on the Public Sector Undertaking's profitability should be brought out. Further, where BIFR targets have been assigned to the Company, the actuals vis-à-vis targets for the preceding three years should be indicated. The data should be furnished in the Form GFR 44 along with the proposal.