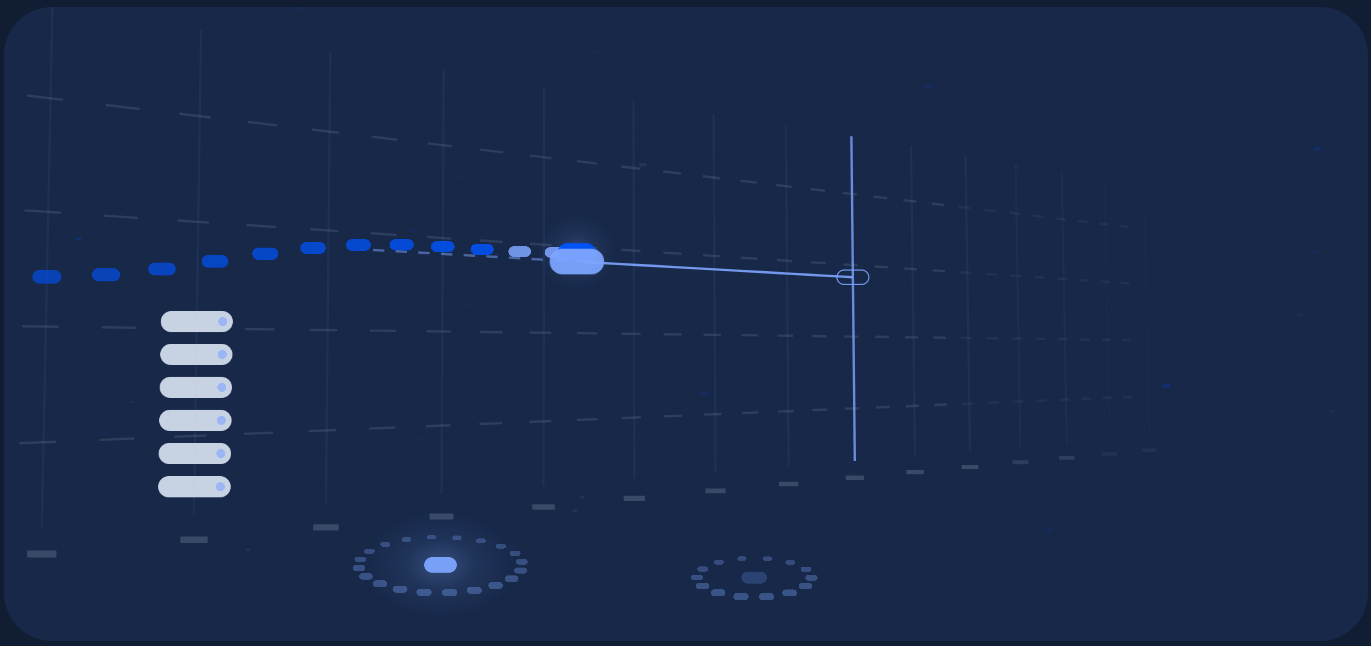
Rillor

EXPLAINER

Performance bonds, standby letters of credit and escrow compared

Performance bond vs standby letter of credit for an equipment purchase, with the buyer's escrowed deposit beside them: what triggers each payment and what can stop it.



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Summary

Three instruments secure an equipment purchase whose delivery sits months after signing: the seller's surety performance bond or standby letter of credit, and the buyer's deposit held in escrow.

- A standby letter of credit pays against documents. Article 5 of the Uniform Commercial Code (UCC) makes the issuer's duty independent of the sale contract, as do the International Chamber of Commerce rules for standbys (ISP98) and demand guarantees (URDG 758) [2, 19, 20].
- A surety performance bond pays after a default. A 2020 law-firm comparison calls the surety's obligation secondary, maturing only when the seller defaults, with a claim process in which the surety investigates and can deny it [28].
- Deadlines to pay or refuse a demand under a standby or demand guarantee run in business days: at most seven under the UCC, five under URDG 758, while ISP98 deems three not unreasonable and over seven unreasonable [5, 19, 20].
- A standby uses the seller's bank credit. It counts as an extension of credit under U.S. lending limits, and to calculate exposure amounts, bank capital rules apply a 50% credit conversion factor to a performance standby (paid when the seller fails a non-financial obligation) and 100% to a financial standby (backing a loan or debt) [14, 15, 24].
- One public credit agreement, dated 27 March 2026, prices standby letters of credit at 1.125% to 1.625% a year plus 0.125% a year to the issuing bank, within a $50 million cap inside the borrower's revolving credit [33].
- The buyer's deposit is a separate exposure. An escrow agent releases it only on the parties' agreed instructions, and deposit insurance treats funds an agent holds as if deposited in the name of the principal, up to the $250,000 standard maximum [16, 17, 26].
- Stopping a standby demand is hard by design. Under UCC 5-109 a court may enjoin payment for forgery or material fraud only if, among other findings, the party asking is more likely than not to succeed, and the Supreme Court of Ohio held that material fraud means fraud that "has so vitiated the entire transaction" that the purposes of the issuer's independence can no longer be served [6, 31].

Background

Security for a purchase that delivers later

When equipment is ordered months before delivery, each side carries a risk the other controls. The buyer pays before it receives anything, and the seller commits supply to a buyer that could fail to pay the balance. Two instruments posted by the seller protect the buyer: a performance bond issued by a surety and a standby letter of credit issued by a bank. The third protects the buyer's prepayment: a deposit held by an escrow agent until agreed conditions are met [26]. The United Nations Convention on Independent Guarantees and Stand-by Letters of Credit lists securing "construction, supply and commercial payment obligations" among the uses of such undertakings [22].

Three bodies of rules

In the United States, letters of credit sit under Article 5 of the Uniform Commercial Code (UCC), which defines a letter of credit as a definite undertaking by an issuer to a beneficiary, at the request or for the account of an applicant, to honor a documentary presentation by payment or delivery of an item of value [1].

Rules of practice published by the International Chamber of Commerce (ICC) apply when an instrument adopts them. The International Standby Practices (ISP98), ICC Publication No. 590, became effective on 1 January 1999 [19]. They are intended for standby letters of credit, "including performance, financial, and direct pay standby letters of credit", and any similar undertaking can adopt them by express reference [19]. The Uniform Rules for Demand Guarantees (URDG 758), in their 2010 revision, define a demand guarantee as "any signed undertaking, however named or described, providing for payment on presentation of a complying demand", and apply when the guarantee expressly says so [20]. The Uniform Rules for Contract Bonds (URCB 524) define a bond whose liability is "accessory to the liability of the Principal", and count a written agreement for "the supply or provision of any goods" as a contract a bond can secure [21].

The UN Convention covers guarantees and standbys under one neutral term, "undertaking" [22]. It entered into force on 1 January 2000, the UN Commission on International Trade Law (UNCITRAL) lists eight parties, and the United States signed it on 11 December 1997 with no ratification shown [23].

A national bank may issue letters of credit and other independent undertakings within applicable laws or rules of practice. The regulation's footnote lists UCC Article 5, the Uniform Customs and Practice for Documentary Credits (ICC Publication No. 600), its supplements for electronic presentation (eUCP), ISP98, the UN Convention and the Uniform Rules for Bank-to-Bank Reimbursements Under Documentary Credits (ICC Publication No. 725) [12]. The footnote calls these examples, and URDG 758 is not among them [12].

Words that differ by country

U.S. lending-limit rules count as a standby any letter of credit that obliges the issuer to repay money advanced, to pay a debt, or "to make payment on account of any default by the account party in the performance of an obligation" [14]. Call Report instructions separate a performance standby, paid when a

customer "fails to perform some contractual non-financial obligation", from a financial standby, which covers a failure to repay a loan or debt instrument [24].

"Bond" and "guarantee" change meaning across jurisdictions. Norton Rose Fulbright, writing in August 2020, describes surety bonds as forms of guarantees, with a surety, a principal and an obligee [28]. In English-law practice, the note says, instruments that create primary obligations are often called on-demand bonds or guarantees, first-demand guarantees or standby letters of credit, and those that create accessory obligations are called guarantees, default bonds or surety bonds [28]. It adds that standbys "were first developed in the United States because US banks were prohibited from issuing guarantees" [28]. Today a national bank may act as guarantor or surety where it has a substantial interest in the transaction or holds a segregated customer deposit sufficient to cover its total potential liability, and may also guarantee a customer's, subsidiary's or affiliate's obligations that are financial in character when the amount is reasonably ascertainable [13].

In Wuhan Guoyu v Emporiki Bank (2012), the English Court of Appeal applied a presumption from Paget's Law of Banking: a bank's undertaking to pay "on demand", relating to a transaction between parties in different jurisdictions and with no clauses limiting a guarantor's defenses, is almost always construed as a demand guarantee [32]. Alan Tyree, writing on Australian law in December 2023, treats performance bonds, demand guarantees and standby credits as alike "for the purposes of this article" [29]. That is his working choice. ISP98 and URDG 758 each state their own scope [19, 20].

This report is for buyers, sellers and finance teams arranging an equipment purchase with delivery months away. It is research, never legal or financial advice.

Method

What was examined. For the standby letter of credit, the surety performance bond, the demand guarantee and the escrowed deposit: the parties, the payment trigger, the deadline to pay or refuse, the payer's defenses, cost and collateral, expiry defaults and the grounds for stopping payment.

Sources. The UCC [1-11], federal bank and deposit insurance regulations [12-17], the Bankruptcy Code [18], the ICC rules and the UN Convention [19-23], Call Report instructions and an examination manual published by the Federal Deposit Insurance Corporation (FDIC) [24, 25], legal encyclopedia entries [26, 27], two commentaries [28, 29], the Circular 570 list [30], two court decisions [31, 32] and three SEC filings [33-35].

How. Each rule was read in its own text and is paraphrased, with short quotes where the wording matters. ICC rules are cited by rule or article number. Filings serve as dated examples, never as market data. Commentaries are labeled by date and jurisdiction, and arithmetic done for this report is labeled. Web pages were viewed on 8 November 2026.

Findings

1. Three instruments and their parties

Standby letter of credit. Article 5 names three parties: the issuer, a bank or other person, the applicant, at whose request it is issued, and the beneficiary, who may draw [1]. In an equipment sale secured this way, the seller is the applicant and the buyer the beneficiary. A confirmer "is directly obligated on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation", while an adviser that does not confirm is not obligated to honor [4].

Behind the standby stands the seller's promise to repay the bank. The FDIC, which abbreviates a standby letter of credit as SBLC, notes that standby documents generally include "a separate binding agreement wherein the account party agrees to reimburse the bank for any payments made under the SBLC" [25]. An issuer that honors is entitled to reimbursement from the applicant in immediately available funds no later than the date of its payment [5].

Surety performance bond. Wex describes a three-party agreement among the principal, who needs the bond, the obligee, who requires it, and the surety, which guarantees the principal's performance [27]. Its example is a company making a large purchase from a foreign supplier and requiring the supplier to post one [27]. Here the seller is the principal and the buyer the obligee. Norton Rose Fulbright notes that a surety, unlike a typical insurer, can seek repayment from the principal [28]. Under URCB 524, the guarantor undertakes, on default, to pay up to the bond amount or, at its option, to perform the contract [21].

Demand guarantee. The URDG 758 instrument provides for payment on presentation of a demand that complies with its terms, among a guarantor, an applicant and a beneficiary [20].

Escrowed deposit. "Escrow is an arrangement in which money, property, documents, or other assets are deposited with a neutral third party, known as the escrow agent, who holds them until specified conditions in an escrow agreement are satisfied" [26]. The agent releases them only when the parties' agreed instructions have been fulfilled [26].

The bond and the standby protect the buyer against the seller's failure to deliver, and the escrow protects the buyer's prepayment while it waits. That pairing is this report's reading of the definitions cited.

2. When each one pays: performance bond vs standby letter of credit

The standby pays on documents. The issuer's rights and obligations to a beneficiary "are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it" [2]. The issuer is not responsible for performance of the underlying contract [5]. ISP98 makes a standby "irrevocable, independent, documentary, and binding" when issued, whether or not it says so, and ties the issuer's obligations to an examination of documents on their face (Rules 1.06(a), (d)) [19]. URDG 758 says a guarantee "is by its nature independent of the underlying relationship", and that guarantors "deal with documents and not with goods, services or performance" (Articles 5(a), 6) [20].

What the beneficiary presents. Norton Rose Fulbright wrote in 2020 that the issuer must honor once it receives a statement, usually "a properly completed draw certificate", that the other party is in default or the draw conditions are met [28]. Under ISP98 Rule 4.17, a required statement of default with no specified content complies if it represents that payment is due because a drawing event described in the standby has occurred, with a date and the beneficiary's signature [19]. URDG 758 Article 15(a) requires a statement by the beneficiary "indicating in what respect the applicant is in breach", unless the guarantee expressly excludes it (15(c)) [20].

Rules	Deadline as stated	Source
UCC Article 5	A reasonable time, "but not beyond the end of the seventh business day" after receipt of documents, to honor or give notice of discrepancies	[5]
ISP98	Notice of dishonor "within three business days is deemed to be not unreasonable and beyond seven business days is deemed to be unreasonable"	[19]
URDG 758	Examine the demand "within five business days following the day of presentation", with any rejection notice by the close of the fifth business day	[20]
UN Convention	A reasonable time, "but not more than seven business days", to examine, decide and give notice of refusal	[22]
URCB 524	The guarantor "shall consider any claim expeditiously", with no day count	[21]

Table 1. Time to pay or refuse a demand or claim.

Missing the deadline costs the payer its objections in two texts. A UCC issuer that gives late notice of a discrepancy, or none, is precluded from relying on it, except for fraud, forgery and expiry [5]. A URDG 758 guarantor that misses the rejection deadline is precluded from claiming the demand does not comply (Article 24(f)) [20].

The surety pays after default. In Norton Rose Fulbright's 2020 comparison, a surety bond "attaches to the underlying contract", and the surety's obligation is secondary and does not mature until the principal defaults [28]. Bonds involve a "claim adjustment process" in which the surety investigates the default, which slows reimbursement, and sureties deny claims they believe lack merit [28]. "The obligation of an issuer in a letter-of-credit transaction is primary" [28].

URCB 524 sets out the steps. A claim must be in writing, served by the expiry date, and state the contract and the breach (Article 7(a), (f)). The guarantor must notify the principal before paying, may inspect the works, goods or services, and honors a claim only if a default has occurred (7(g) to (i)). Default is established

by a third party's certificate if the bond provides for one, otherwise by the guarantor's own certificate, or by a final judgment or award (7(j)) [21]. Every defense the principal has under the contract is open to the guarantor (Article 3(d)) [21].

A bond drafted to pay like a standby. Norton Rose Fulbright wrote in 2020 that an obligee can change the trigger to the due presentation of a proper notice of default and negotiate waivers of the surety's defenses, and that courts had generally enforced broad waivers [28].

Wrongful dishonor. A beneficiary whose complying presentation is wrongly dishonored may recover the amount from the issuer, with incidental damages and interest but not consequential damages, and has no duty to mitigate [7].

3. Cost, collateral and credit lines

Standby fees and credit. The FDIC describes a standby's payments as "guaranteed in exchange for an ongoing, periodic fee throughout the life of the letter", and says "an SBLC is a potential extension of credit and should be evaluated in a manner similar to direct loans" [25]. The lending-limit rule of the Office of the Comptroller of the Currency (OCC) counts an obligation to "advance funds under a standby letter of credit" as a commitment to advance funds, which is a loan or extension of credit (12 CFR 32.2(g)(1)(iv), (q)(1)(i)) [14].

One dated fee schedule. An industrial borrower's revolving credit agreement, dated 27 March 2026, shows how one bank group prices standbys [33]. The letter of credit fee equals the applicable rate times the daily amount available to be drawn. The rate runs from 1.125% to 1.625% a year across five pricing levels set by the borrower's debt-to-capitalization ratio, the same rate as its benchmark-rate loans [33]. A fronting fee of 0.125% a year goes to the issuing bank on each standby [33]. The sublimit is the lesser of the revolving commitments and $50,000,000, "part of, and not in addition to" them, and ISP98 applies unless agreed otherwise [33]. These are one borrower's terms at one date.

Bank capital and collateral. Under the Federal Reserve's capital rule, a bank calculates the exposure amount of an off-balance sheet exposure using credit conversion factors [15]. A performance standby, grouped with performance bonds, bid bonds and warranties as a transaction-related contingent item, takes a 50% credit conversion factor, and a financial standby 100% [15]. The OCC's safe and sound practices say a national bank's undertaking "should be limited in amount", limited in duration or terminable or backed by cash collateral on demand, and that the bank "either should be fully collateralized or have a post-honor right of reimbursement from the applicant" [12].

Standbys in GPU infrastructure filings. A GPU cloud company's quarterly report for the quarter ended 30 June 2026 describes a data-center lease signed in May 2026 that required "an irrevocable standby letter of credit" of about $12.96 million "as security for its payment and performance obligations under the lease" [34]. The amount "was determined based on six months of the initial annual base rent", the beneficiary may draw on certain events of default, and nothing had been drawn at 30 June 2026 [34]. A seven-year colocation lease at the same company required a $6.435 million standby, issued in the fourth quarter of 2025 [34]. Both secure

capacity leases. Another GPU cloud company's registration statement reports restricted cash supporting a letter of credit related to security deposits, with a fixed maximum of $3.7 million at 31 December 2024 and 31 March 2025 [35].

Surety bonds. Norton Rose Fulbright's 2020 note says bonds appeal to principals because they "do not appear on a corporation's balance sheet", do not diminish a line of credit, and "are generally cheaper to procure and maintain and may not require posting of collateral" [28].

Why buyers value an on-demand instrument. Tyree lists three functions of a demand guarantee: protection from the counterparty's insolvency, deciding who holds the funds during a dispute, and replacing a cash deposit [29]. He writes that it "relieves the account party of the need to make a cash deposit" and that it can serve its functions only if it is "as good as cash" [29].

4. The buyer's deposit and escrow

Release on instructions. The escrow agent holds the deposit until the conditions in the escrow agreement are satisfied and releases it only on the parties' agreed instructions [26]. Those instructions decide when the seller receives the money and when the buyer gets it back.

The UCC's deposit rule. If a seller justifiably withholds delivery because of the buyer's breach, the buyer may recover what it paid above the seller's liquidated damages or, where the contract fixes none, above "twenty per cent of the value of the total performance for which the buyer is obligated under the contract or $500, whichever is smaller", subject to offsets [9]. On any contract above $2,500, $500 is the smaller figure (computed here from [9]). Liquidated damages must be reasonable in light of the anticipated or actual harm, and an unreasonably large amount is void as a penalty [9].

If the seller fails. A buyer who has paid part or all of the price may recover identified goods only "if the seller becomes insolvent within ten days after receipt of the first installment on their price" [10]. The Bankruptcy Code's priority for deposits covers individuals' deposits for property or services "for the personal, family, or household use of such individuals", capped at $3,800 from 1 April 2025 [18]. A business buyer's equipment deposit falls outside it [18].

Deposit insurance. Funds of a principal deposited in an agent's or custodian's name are insured "to the same extent as if deposited in the name of the principal(s)", and funds held for two or more persons jointly are insured as a joint account [16]. The standard maximum deposit insurance amount is $250,000 [17]. For a hypothetical $10 million deposit held for one buyer at one bank, no more than $250,000, or 2.5%, is insured, and the rest is exposure to that bank (computed here from [16, 17]).

Asking for assurance. When reasonable grounds for insecurity arise, either party may demand adequate assurance in writing and suspend its own performance, and a failure to give it within a reasonable time "not exceeding thirty days" is a repudiation [11]. Between merchants, commercial standards decide what is adequate [11].

5. Strict compliance, independence and fraud

Strict compliance. An issuer shall honor a presentation that, under standard practice, "appears on its face strictly to comply" with the letter of credit's terms, and shall dishonor one that does not [5]. The standard practice of financial institutions that regularly issue letters of credit governs, and whether it was observed is a question for the court [5]. Under ISP98, where a standby requires a statement without precise wording, the wording presented must "convey the same meaning", and where it says "exact" or "identical", even typographical errors must be reproduced (Rule 4.09(a), (c)) [19].

Conditions without documents are disregarded. "An issuer shall disregard the nondocumentary conditions and treat them as if they were not stated" [5]. ISP98 Rule 4.11 says the same in its own terms [19]. URDG 758 Article 7 disregards a condition, other than a date or lapse of time, that no document shows, unless the guarantor can determine it from its own records or a specified index [20]. On these rules, a standby payable if the seller fails to deliver, naming no document, pays on the demand alone.

Room to vary. Rules of practice a credit is expressly subject to govern over Article 5 where they conflict, except for a few fixed provisions, the independence rule among them [2, 8].

Material fraud under the UCC. If a presentation appears to comply but a required document is forged or materially fraudulent, or honor would facilitate a material fraud by the beneficiary, the issuer must still pay protected parties, such as a confirmer who has honored, and otherwise may honor or dishonor in good faith [6]. A court may enjoin honor only if it finds, among other things, that affected parties are adequately protected and that the applicant "is more likely than not to succeed under its claim of forgery or material fraud" [6].

The Supreme Court of Ohio, applying Ohio's enactment of 5-109(b) in 2002, quoted the official comment: "Material fraud by the beneficiary occurs only when the beneficiary has no colorable right to expect honor and where there is no basis in fact to support such a right to honor" [31]. It held that material fraud means fraud that "has so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation can no longer be served", in either the credit transaction or the underlying one, and that the applicant must also show no adequate remedy at law [31]. The case concerned a letter of credit securing an import purchase of tires [31].

What the rules of practice leave to law. ISP98 Rule 1.05 leaves "defenses to honour based on fraud, abuse, or similar matters" to applicable law [19]. The URDG 758 articles on the ICC's page contain no fraud rule [20]. The UN Convention supplies one: acting in good faith, the guarantor or issuer may withhold payment if it is "manifest and clear" that a document is not genuine or is falsified, that no payment is due on the basis asserted, or that the demand has no conceivable basis (Article 19(1)) [22]. The United States is not a party [23].

English and Australian courts. Tyree writes that under the autonomy principle "it is almost impossible to prevent the bank from paying against a proper presentation", though courts have enjoined beneficiaries in cases of fraud, unconscionability, a contract barring the call, or illegality [29]. In Wuhan Guoyu, about a payment guarantee for a ship sale, the Court of Appeal quoted Lord Denning's 1978 description of

performance guarantees as "virtually promissory notes payable on demand", which banks must pay on an honest demand [32]. Longmore LJ added that such guarantees "are almost worthless if the Bank can resist payment on the basis that the foreign buyer is disputing whether a payment is due" [32].

6. Checking the issuer or surety, and expiry

Confirmers. A buyer can ask a bank it knows to confirm a standby. The confirmer is then directly obligated, with an issuer's rights and obligations to the extent of its confirmation [4].

Sureties. The Treasury's Department Circular 570 list of certified companies, whose original listing was published on 1 August 2026, gives each company's underwriting limitation in dollars and the states where it holds surety licenses [30]. It is one public check on a surety's standing.

Rules	With no expiry date stated	Source
UCC Article 5	Expires one year after issuance. One stated to be "perpetual" expires after five years	[3]
ISP98	Must contain an expiry date or permit the issuer to terminate on reasonable notice or payment	[19]
URDG 758	With no expiry date or expiry event, terminates three years after issue	[20]
URCB 524	Six months after the latest date for performance of the contract, unless the bond says otherwise	[21]

Table 2. Expiry defaults.

Under URDG 758, a beneficiary may demand, as an alternative, that the guarantee be extended, and the guarantor may then suspend payment for up to 30 calendar days (Article 23(a)) [20]. Read together, these defaults show why expiry matters when delivery runs in tranches: an instrument that ends before the latest delivery month leaves later tranches without security. That is this report's reading of the rules.

Governing law. With no choice of law, both the UCC and URDG 758 look to where the issuing bank or branch is located [8, 20].

Implications

For buyers. The trigger decides how quickly money moves when delivery fails. A standby or demand guarantee pays against documents within days counted in each text [5, 19, 20], and a surety bond pays after the surety has investigated and a default is established [21, 28]. Because conditions without documents are disregarded, the document a standby names is the buyer's whole proof [5, 19, 20]. Expiry defaults vary by rule set, so the date written in the instrument is what counts against the delivery calendar [3, 19, 20, 21]. On the deposit side, the escrow instructions set the release, and deposit insurance covers no more than $250,000 at one bank [16, 17, 26].

For sellers. A standby counts as an extension of credit [14, 25], banks expect collateral or a right of reimbursement [12], and in the one fee grid reviewed it costs a yearly percentage of the amount available plus a fronting fee [33]. A contract dispute alone does not stop a demand: an injunction needs a likely showing of forgery or material fraud [6], which Ohio's Supreme Court reads narrowly [31]. A surety bond keeps the seller's contract defenses in play [21], and the 2020 law-firm note describes it as off balance sheet and generally cheaper [28].

For finance teams. GPU infrastructure filings show standbys sized against lease rent [34] and a letter of credit backed by restricted cash [35].

Forward purchase agreements. In Rillor's forward purchase agreements for GPU systems, the buyer pays a deposit at signing to an independent escrow agent, which holds it and releases it as the agreement sets out, and the seller posts a performance bond.

Limits of this analysis

- This explainer reads published texts. It is research, never legal or financial advice, and recommends no instrument for any transaction.
- The UCC is enacted state by state, and the Ohio decision applies Ohio's own code section [31]. State variations were not reviewed.
- No primary source reviewed publishes surety premium rates or market-wide standby fees. The fee grid cited is one credit agreement's [33].
- No source reviewed gives claim, call or default rates for these instruments, or the days a surety takes to resolve a claim. URCB 524 says only "expeditiously" [21].
- The GPU filings cited show standbys securing leases and security deposits [34, 35]. No filing reviewed shows a standby, a bond or an escrow securing a GPU hardware purchase.
- Whether escrowed funds stay outside a seller's or an escrow agent's insolvency estate was not reviewed, nor escrow agent licensing.
- The Norton Rose Fulbright note dates from August 2020 [28] and Tyree's article from December 2023, on Australian law [29].
- ISP98 and URCB 524 were read as reproduced in UNCITRAL reports of April 2000 [19, 21], and URDG 758 on the ICC library's page [20].

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Cite as: Rillor. Performance bonds, standby letters of credit and escrow compared. 12 November 2026. https://rillor.com/insights/performance-bond-vs-standby-letter-of-credit

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