Atradius Reinsurance at Aman Union
Dubai training session
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Introduction to Bond Insurance

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Bond Insurance and Contract Parties

- **Bond Insurance is an accessory contract to the master agreement. It is one of the types of guarantees available to cover different kinds of obligations (alternative to the bank guarantee). It can be conditional or unconditional.**

- **Bond Insurance is composed by 3 parties:**

  - **Policyholder or Contractor/Debtor →Who has to guarantee its obligation.**

  - **Beneficiary → Who demands to the debtor to guarantee its obligation.**

  - **Insurer → Who guarantees the Beneficiary in case of non performance of the Policyholder or Contractor/Debtor.**

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Policyholder or Contractor / Debtor: Insight

- It represents the risk for the Insurance Company and generates obligations towards:
  - the Beneficiary:
    - Policyholder main duty is to perform within the terms agreed and obliged to;
  - the Insurance Company:
    - Policyholder main duties are:
      - Information;
      - Commitments – Proposal Forms;
      - Premium payment;
      - Policy restitution.

Beneficiary and Insurance Company: Insight

- **Beneficiary:**
  - **It can be a private or public entity;**
  - **It is usually the sponsor of a construction project or the market regulator;**
- **Insurance Company:**
  - **Monoliner or Multiliners (*multiliners offer polices as services to significant Credit Insurance policyholders*);**
  - **Domestic oriented as the risk operates mainly locally;**
  - **Facing problems to issue policy abroad and support the policyholder due to lack of license (*to be noted potential solution is the fronting agreement).***

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Credit Insurance vs. Bond Insurance: Main differences

CREDIT INSURANCE

1) The purpose is to cover only risks generated by trade transactions (e.g. political risk, insolvency or protracted default of the buyer);

2) The buyer should not know that its supplier has covered the transaction with a policy;

3)The product is standardized worldwide;

4) The insured participates in the loss (i.e. 85%);

5) The risk duration is based on the invoice payment terms;

6) Global market concentrated (80% in 4 companies).

BOND INSURANCE

1) It covers obligations of: to do or not to do - *The Insurer pays damages caused to the beneficiary if the contractor breaches the contract*;

2) All the parties involved have knowledge of the cover;

3) Different types of bonds / policies are available depending on local legislation;

4) The insured is not involved in the loss;

5) The risk duration goes from several months to years (regulated by contract or law);

6) Not concentrated market, differences by country as several companies operate only locally .

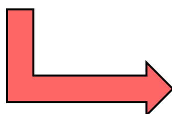
Global Bond Insurance Market 2010

- **Global Bond premiums are estimated at around EUR 7.5 billion;**
- **Main markets are the USA-Canada, Italy, Korea, Latin America and Japan:**

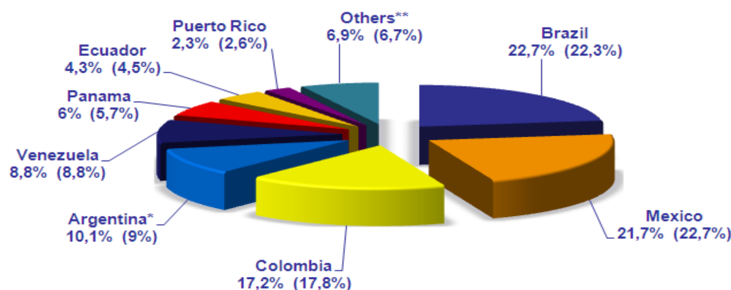
Premium Generated * :		
USA-Canada	USD	5.000.000.000
Italy	EUR	500.000.000
Korea	USD	450.000.000
Mexico	USD	375.000.000
Brazil	USD	375.000.000
Japan	USD	300.000.000

*Based on market estimation

Snapshot on Latin America:



Latin America - Surety: Premiums Market Share by country 1.994,5 US$ MM 2011 (2010)



Figures as of June 2011 12 months except for, Dominican Rep. (December 2010), Paraguay (June 2011), Puerto Rico (December 2010), Venezuela (projected figures to June 2011 12 months)

Does not include Fidelity

Argentina, Paraguay: Fiscal year June

Puerto Rico: Includes figures of non resident companies

** Includes: Bolivia, Dominican Rep., Chile, Guatemala, Honduras, Nicaragua, Peru, Paraguay, Uruguay, Salvador

Contract Bonds

- **Covering obligations generated by a contract to deliver the object (e.g. goods have to be customised such as buildings or equipment and machinery) that is not immediately available for delivery;**
- **Different bonds are used to cover different aspects of the contract process:**
  - **Bid Bond**
  - **Performance Bond**
  - **Maintenance Bond**
  - **Advance Payment Bond**

Contract Bonds - Cont'd

- **Bid Bond:**
  - **Guarantee against the *non signing* of the contract from the winner of a Public Tender and/or against the *absence*, from the latest, of all the technical/economical and financial requirements.**
  - **Duration: 180 days (at least).**
  - **Sum Insured: between 1% and 2% of the works *(it varies country by country).***

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Contract Bonds - Cont'd

- **Performance Bond :**
  - **Guarantee against all the obligations undertaken by signing the contract. It covers:**
    - **Non-performance of the works;**
    - **Any additional cost that the administrative body (Beneficiary of the Bond) can suffer for finishing the works with another contractor.**
  - **The duration of the obligation is related to the project and agreed by contract.**
  - **Sum Insured: 10% of the Winning Offer (*it varies country by country*).**

Contract Bonds - Cont'd

- **Performance Bond release process (*exposure at risk*) – an example:**
  - **Automatic release (pro rata) up to 75% of the Bond value based on the official working progress document attesting the percentage value of work performed;**
  - **Remaining 25% is released only after the issuance of:**
    - **A certificate of *provisional acceptance* or**
    - **A certificate attesting the *fulfilment of the obligation* or**
    - **After 12 months from the date of the final certificate of *completion of the works.***

The release process varies between countries (e.g. in few countries of Latin America the entire bond is released at the end of the works and prior receiving the certificate of completion issued by the beneficiary or independent bureau).

Contract Bonds - Cont'd

- **Maintenance Bond :**
  - **Guarantee against the maintenance of the object of the contract (e.g. roads).**
  - **The duration is fixed and usually between 1 or 2 years from the conclusion of the project.**
  - **Sum Insured: 2%-10% of the maintenance value (*it varies country by country*).**

Contract Bonds - Cont'd

- **Advance Payment Bond :**
  - **Guarantee against the non correct utilization of the funds given by the Beneficiary to the Debtor in order to fulfil the object contract obligation (common in the industrial sector i.e. shipyard).**
  - **The duration of the obligation is related to the project and agreed by contract (usually it has fixed expiry date and the extension is made against payment of penalties).**
  - **Sum Insured: 100% of the advance payment.**

Worldwide contract value bonds (%)

Countries	Bid bond	Performance bond	Maintenance bond
USA	2-20%	100%	100%
Japan	3-5%	10%	10%
Austria	-	5-20%	3-5%
Belgium	5%	10%	5-10%
Denmark	-	10%	10%
Finland	-	10%	2-5%
France	-	5%	5%
Germany	5%	5-10%	2-5%
Ireland	5-10%	25%	5-10%
Italy	1%-2%	5-10%	2%-15%
Netherlands	5-10%	5-20%	5%
Norway	2%	10%	2-5%
Portugal	2,5%	5-10%	5%
Spain	2%	4-10%	4-10%
Switzerland	-	10-20%	5-10%
UK	-	10%	-
Korea	5%	10%	5%

Introduction to Underwriting Approach

- **Besides the risk of the bond (legal aspect), the technical and economic-financial risk of the client has to be assessed.**

- **First question - whether the client is able to meet the obligations referred to the bond (e.g. can the Contractor build the bridge? can the Contractor produce the equipment in time and carry out the process agreed?) - *This is the technical risk.***

- **Second question - whether the client does not meet the obligations (e.g. will the Contractor be able to bear the financial consequences without going bankrupt?) - *This is the financial risk*:**

  - **Solvency/ liquidity/ profitability assessment required.**

  - **Cash-flow project assessment required.**

Introduction to Underwriting Approach- cont'd

- **Additional assessments:**
  - **Policy Holder history and behaviour (e.g. details of finished and in force works, reputation, etc.);**
  - **Commercial and banking references, line of credit granted from recognized banks;**
  - **Collaterals.**
- **Underwriting philosophy → Zero-loss assumption: a risk is only acceptable if the underwriter sincerely believes that there will not be a loss.**

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Thank you

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See you at 11:15 for the business case…

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