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# Surety for Banks

## Another field of cooperation between Insurance and Banks

# Agenda

- Credit Risk – a brief summary
- Surety - Introduction
- How to underwrite Surety
- Surety for Banks
- Surety for Banks at Swiss Re: BTI
- The Surety Market: some statistics

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# Credit Risk

A brief summary

# Credit and Credit Risk
## Definition

- **Credit**
  Agreement between counterparties (typically creditor and debtor) by which something of value - good, services or money - is given in exchange for the promise to (re)pay at a later date

- **Credit Risk**
  Risk of an economic loss due to deterioration of the credit quality or a default of an obligor on its financial obligations vis-à-vis third parties and/or the Insurance.

➡ Very different risk approach to typical insurance such as life or property insurance with an evaluation of frequency and severity of risk events and no recovery in case of a claim.

# Credit Risk:
# How to manage?

- Keep it
  → do nothing
  → set up reserves

- Insure it

- Sell it
  → sell the credit (partially or completely)
  → sell the credit risk (--> swap it)

# Credit Insurance Products

Insurance Market Solutions

| | Surety | Trade Credit Insurance | Financial Guaranty | Bank Trade Finance | Political Risk Insurance |
|---|---|---|---|---|---|
| ***Typical Products*** | Construction, Supply, Customs Performance, Bonds | Domestic Credit Insurance<br>Export Credit Insurance | Consumer Loan Insurance, Mortgage Indemnity, "Credit Enhancement" | Documentary Trade Finance<br>Commodity Trade Finance | Confiscation, Currency Inconvertibility, Contract Frustration, Political Violence |
| ***Typical Providers*** | Specialized Surety Companies and Multiline Insurers | Credit Insurance Companies (Mono- and Multiliners) | Specialized Insurers, Export Credit Agencies | Banks, Insurers | Multiline insurers, Export Credit Agencies, Lloyd's Syndicates |
| ***Typical Clients*** | Large Construction Companies | Small / medium sized Corporates | Banks, Lenders, Investors | Large Corporates, Commodity Traders | Banks, larger Corporates |

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# Surety - Introduction

# Surety
## Definition of Suretyship

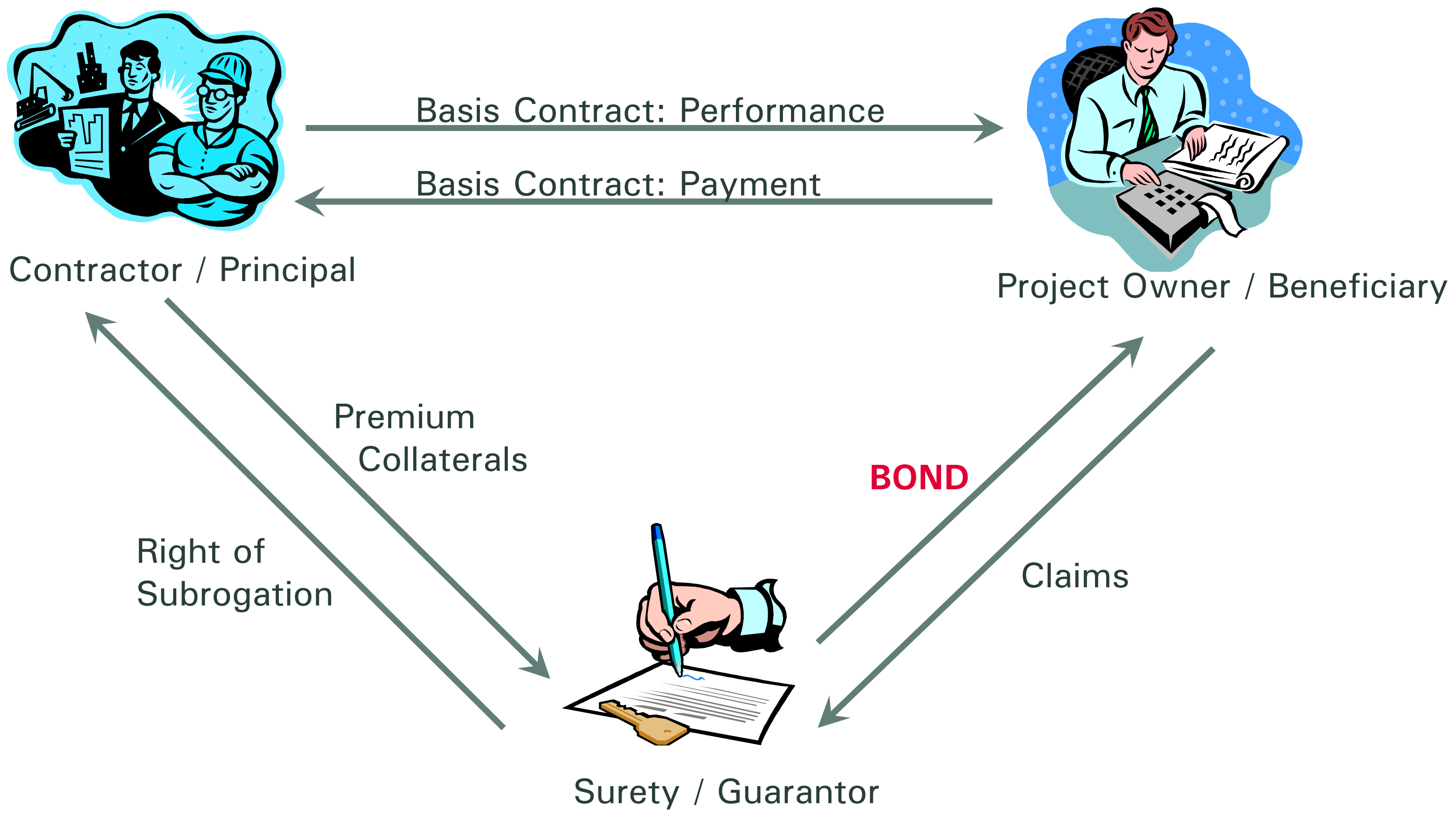
ICISA Definition:

*"A surety bond is an agreement, issued by an insurance company, which (in most cases) provides for monetary compensation in case the principal fails to perform. Although many types of surety bonds exist, the two main categories are contract and commercial surety ."*

- The earliest known surety contract was written on a Mesopotamian tablet in 2750 BC guaranteeing the performance of a farmer.

- Global Surety Market estimated to USD 11 bn written Premium in 2013.

# Surety
## Structure of Suretyship :




Suretyship = obligation in which one party undertakes to another party to guarantee the debts, obligations or conduct of a third party.

# Surety
## Description

| | |
|---|---|
| **Description** | Surety bond provided by a third party (= surety) guaranteeing performance of contractual or legal obligations entered into by two other parties (contractor/principal and beneficiary) |
| **Example** | The construction company Bauhaus enters into a contract with the State of Florida to build a new highway. Swiss Insurers guarantees that Bauhaus completes the project on time and in accordance with terms and conditions of the underlying contract. |
| **Rationale for Buying** | ■ Signals to the beneficiary that the surety is confident about the financial capacity and technical ability of the contractor to complete the project<br>■ Compensates beneficiary for losses incurred due to default or non-performance of contractor<br>■ Mandatory requirement for public construction projects or in connection with payments of tax or customs duties |
| **Product Characteristics** | Both the surety and the contractor/principal are liable under the surety bond, i.e. in case of loss the surety is entitled to fully recover the amount paid from the contractor/principal |

# Surety
## Obligations of the Principal / Contractor

- **Performance** in accordance with the terms and conditions of the *underlying Contract*
- **Payment of the premium** *for the Bond*
- **Indemnify the Surety** for any *payments* made under the bond or other costs incurred as a surety of the relevant project
- **Provide all relevant information** to the *Surety*

# Surety
## Obligations of the Project Owner / Beneficiary

- **Performance** in accordance with the terms and conditions of the *underlying contract,* including payment to contractor.

- **Inform the Surety** of all major *changes* agreed upon in respect of the underlying agreement, *progress* of work as well as arising *problems*

- **Discharge the Surety** from its liabilities after *completion* of the contract

# Surety
## Obligations of the Surety / Guarantor

- **Abstain from making any payments** under the bond if the *Contractor / Principal* has a **valid defence**
- **Professional claims handling** with prompt payments if *Project Owner / Beneficiary* has sustained a **loss**

# Surety
## Key Elements

- **Accessory Instrument**
  The need for an underlying obligation (⇨ Contract)
- **Joint & Several Liability**
  Both the Surety and Principal are liable
- **Limited Liability**
  Surety's liability is limited to the bond amount
- **Right of Indemnification**
  Surety is entitled by law to be refunded for any payments made under the bond by the defaulting Principal/contractor for any payments
- **Non-Cancellable**
  Contrary to other insurance products a bond can not be cancelled until the underlying obligations have been fulfilled, even for non-payment of premium
- **Subrogation**
  As soon as the Surety steps in due to failure of the Contractor all obligations and right of the Contractor are automatically inherited by the Surety

# Surety
## Benefits

- A surety bond increases the likelihood of a project being completed as initially agreed. By reducing the uncertainty of performance, a surety bond benefits the project owner.
- The surety company's expertise in prequalifying the principal assures the project owner that the contractor it hires has the financial and technical capacity to successfully complete the project.
- Much like a bank line of credit, having sufficient surety capacity available enables the principal/contractor to bid for public projects.  The prequalification process eliminates unqualified competition.
- Subcontractors and suppliers benefit from payment bonds that guarantee their receivables on bonded jobs are collectable.

# Surety
## Contract Surety vs Commercial Surety

- **Contract Surety**
  - **Bonds that guarantee the performance of a specific contract**
  - **Generally written for construction and service/supply contracts**
  - **Bond types include:**
    - **Bid Bond** – guarantees contractor is pre-qualified to undertake contract and provide a performance bond.
    - **Advance Payment Bond** – guarantees to proper use of advance payments made to the contractor
    - **Performance / Completion Bond** – guarantees performance of the underlying contract
    - **Payment Bond**– guarantees the contractors' suppliers and subcontractors will be paid
    - **Supply Bond**– guarantees performance of supply contracts
    - **Warranty / Maintenance Bond** – guarantees workmanship and materials after project is completed.
    - **Subdivision Bond**– specialized bond for homebuilders, guarantees that civil infrastructure (streets, curbs, utilities) for housing tract is completed.

# Surety
## Contract Surety vs Commercial Surety

- **Commercial Surety (Noncontract Surety)**
  - **A broad spectrum of bonds written for a variety of industries, including:**
    - **License & Permit Bonds –** required to obtain licenses/permits from governmental bodies.
    - **Judicial Bonds –** bonds used in our court systems, such as appeal bonds
    - **Fiduciary Bond –** guarantees faithful performance of court-appointed trustees.
    - **Public Official Bond –** guarantees faithful performance of public officials.
    - **Customs & Tax Bonds –** guarantee compliance and payment of tax or custom duties
    - **Reclamation/Post Closure Bond –** guarantees mines and landfills will be properly closed and land restored at the end of the mine/landfill's useful life.
    - **Miscellaneous Bonds –** bonds of this type include Workers Comp Self Insurer Bonds, Lost Instrument Bonds, Utility Payment Bonds, etc.

# Surety
## Attention

- Bonds issued for principals who do not carry out the work itself
- Bonds covering risks beyond the control of the principal
- Bonds covering liquidated damages / penalties
- Bonds covering legacies triggered by change in law
- Bonds for private individuals
- Bonds guaranteeing financial obligations (financial guarantees)
- Bond guaranteeing residual value of an asset

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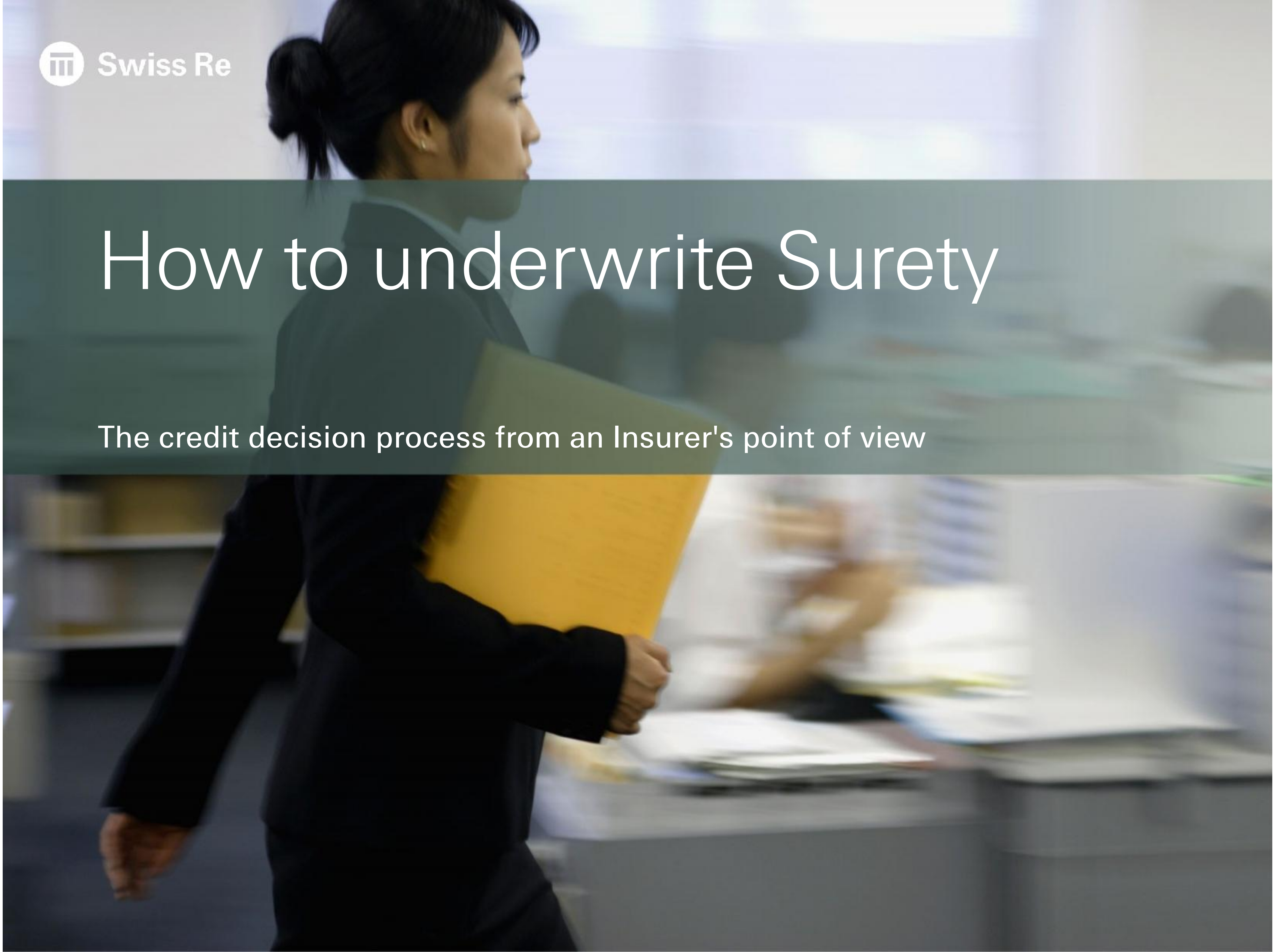
# How to underwrite Surety

The credit decision process from an Insurer's point of view



# General Underwriting Aspects

- Surety is a risk selection business, with a zero claims underwriting approach.
- Three major components of underwriting
  - Financial – what is the creditworthiness of your principal?
  - Transactional – does the project make sense for your principal to undertake?
  - Security – what indemnity/collateral is available to protect the surety?
- Know your principal, understand the underlying obligation
  - Financial transparency is critical
  - Review contracts for unfavourable terms and conditions
- Tenor risk – long term contracts (> 3 years) have more risk.
- Gut feeling matters. If you don't like it, don't write it.

# Underwriting Criteria 7Cs

- Capital
- Capacity
- Character
- Collateral
- Conditions
- Confidence
- Cedant

# Capital – The Credit Analysis

- Analysis of basic creditworthiness of principal
- CPA prepared financial statements
- Balance Sheet, Income and Cash Flow Statements
- Working Capital as analysed by surety
- Net Worth as analysed by surety
- Tax Returns
- Available Bank Facilities and Credit Lines
- Personal resources of owners

# Capacity – The Ability to Complete

- Amount & Profitability of Work in Progress
- Amount of Work on Hand
  (Order Book)
- Machinery / Equipment
- Human Resources
- Skilled Engineers
- Past Experience / Track Record

# Character – Worthy of Trust?

- Length of time in business
- Reputation of Company and Management
- Who owns the Company
- Form of Incorporation
- Philosophy & Strategy
- Contacts & Relationships

# Collateral – Security for the Surety

- Indemnity Agreement
- Counter Guarantees
- Personal Guarantees
- Cash / Assets
- Completion Guarantee from 3rd Party Contractor
- Bank Guarantee
- Back to Back Guarantee

# Conditions – The Transactional Analysis

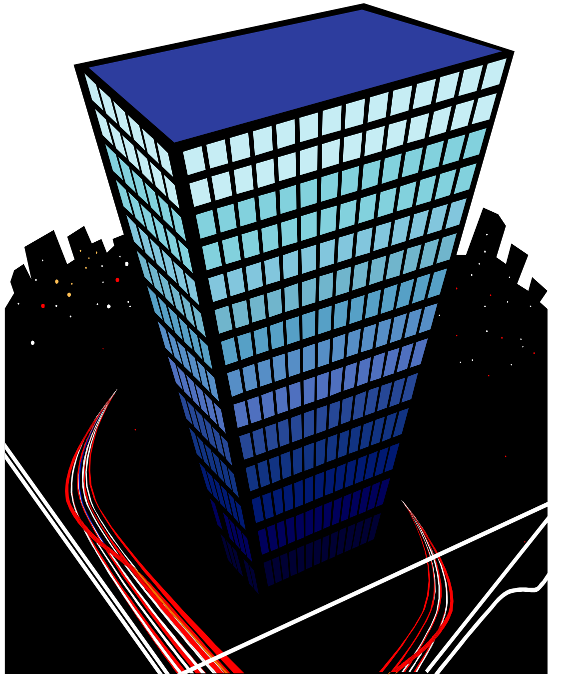
- Economic conditions
- Territory – has contractor worked here before?
- Basic Contract
- Acts of God (Force Majeure), Political Risks, Fixed Time & Price, Price Escalation, Arbitration Clause
- Bond Wording
- Indemnity Agreement/Counter Guarantees
- Funds Control/Escrow

# Confidence – The Gut Instinct

- Underwriting Experience
- No, in case of slightest doubts
- Careful with cases looking too good to be true
- Careful if only limited or verbal information is available
- Why are we approached at this point in time
- Who wants to give away what risk

# Cedant – Analysis of our partner

- Properly staffed with qualified personnel
- Experience
- Independence of surety operations
- Background of Underwriters
- Corporate Strategy
- Senior management support
- Reputation



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# Surety for Banks

Insurance – Banks: the perfect partners

# Surety for Banks:

Basel III / CRR: Changed regulatory requirements

Banks have to allocate more RWA at higher costs for each deal

Bank capacities decrease => bond/ guarantee facilities have to be reduced

Surety cover for banks is mostly CRR compliant

Saving you up to 80% of your capital usage...

# Which Bonds can be covered

- Advance payment bond
- Performance- / Completion bond
- Warranty- / Maintenance bond
- Combined Performance & Maintenance Bond
- Bid bond
- Import LC
- Tax bond
- Customs bond
- Restoration bond
- Waste shipment bond
- Payment bond
- Rental- / Lease bond (non-financial)
- Court bond

Above mentioned guarantees / bonds also include the issuance on respective SB-L/Cs.

# A WIN – WIN situation

For the bank:

- Banks resolve credit limit and capital constraints: capacities can be used for better priced business instead of blocking lines with low priced guarantee / bond facilities.
- Banks get access to positions as key banker or lead arranger – Insurer enables banks to achieve their customer's capacity requirements and improve their relationship with their customers. Banks can thus win market share, improve strategic positioning or even get access to new customer segments / markets.
- Risk mitigation is strictly confidential – silent: Insurer is not your competitor, but your partner.
- Allows the bank to diversify distribution channels for a more cost-efficient portfolio management. Insurer 's credit capacity is not as correlated to those of a bank as this is the case for other secondary market players.
- Improves KPIs of the bank's retained share thanks to commission on covered part.

For the Insurance:

- Insurer gets access to a markets and products otherwise out of reach for an insurer
- Insurer can rely on the product know how and market access of its excellent bank partners
- Insurer can leverage on its existing product know how and credit capacities

# Documentation

**Framework Agreement between the Bank and Swiss Re:**
**Master Guarantee and Risk Participation Agreement (MRPA)**

- At the beginning of the business relationship a bilateral framework agreement is signed between the Bank and the Insurer.
- The MRPA defines the general terms and conditions which apply to all single transactions which will be concluded between the 2 parties e.g. process of issuing guarantees, conditions for claiming, representations & warranties, applicable law in case of dispute etc
- The MRPA complies with the requirements of a security as defined in Article 194 (*Principles governing the eligibility of credit risk mitigation techniques*) and as set out in Chapters 3 and 4 Title II of Part 3 of Regulation No 575/2013 of the European Parliament and of the Council of 26.6.2013 on prudential requirements for credit institutions and investment firms (the Capital Requirements Regulations "CRR")

**For each single transaction: Guarantee and Risk Participation Agreement (GRPA)**

- The GRPA is the document specifying the details of each individual transaction
- The GRPA contains transaction-specific information, such as the amounts, tenors, pricing etc.
- This is a short document of max 2 pages.

**Between the bank and the Principal / Applicant**

- Bilateral agreements and guarantee application forms
- Bond Facility Agreement

⇨ Insurer will not be signatory to this documentation, but will need to be able to review the documents

⇨ **Insurer will normally participate in the Banks share in a Syndicated Bond Facility (existing or new) as well as in Bilateral Bond Agreements or one-off transactions.**

# Typical Case

A guarantee Facility of EUR 1 bn is granted to a construction company to issue bonds for their general business needs to various beneficiaries. The Details of the transaction are:

| | |
|---|---|
| – Principal (Applicant): | Construction Company Bauhaus |
| – Rating : | BB+ |
| – Total Facility Amount: | EUR 1 bn |
| – Type of bonds: | 40% Performance bonds, 30% Bid bonds, 30 % others |
| – Average Utilization: | 85% (i.e. approximately EUR 1,7 bn) |
| – Bank's Part: | EUR 200 m |
| – Max Tenor | 30.6.2019 |
| – Margin: | 250 bps |
| – Commitment Fee: | 40 bps |
| – Bank's Commission: | 20% |

The bank has only credit lines available for EUR 100 m but in order to obtain a lead arranger position will obtain a 50 % risk cover from Insurer in order to bid for a EUR 200 m part in the syndication. Bank's revenues p.a.:

| | |
|---|---|
| Bank's Part: | EUR 85m x 250 bps + EUR 15 m x 40 bps = 935 TEUR |
| Swiss Re's covered Part: | EUR 85m x 250 bps x 20% + EUR 15 m x 40 bps x 20% = 187 TEUR |
| Total revenue = | 1,122 TEUR |

RWA : EUR 100m on BB+ 250 bps and EUR 100m on AA- at 50 bps

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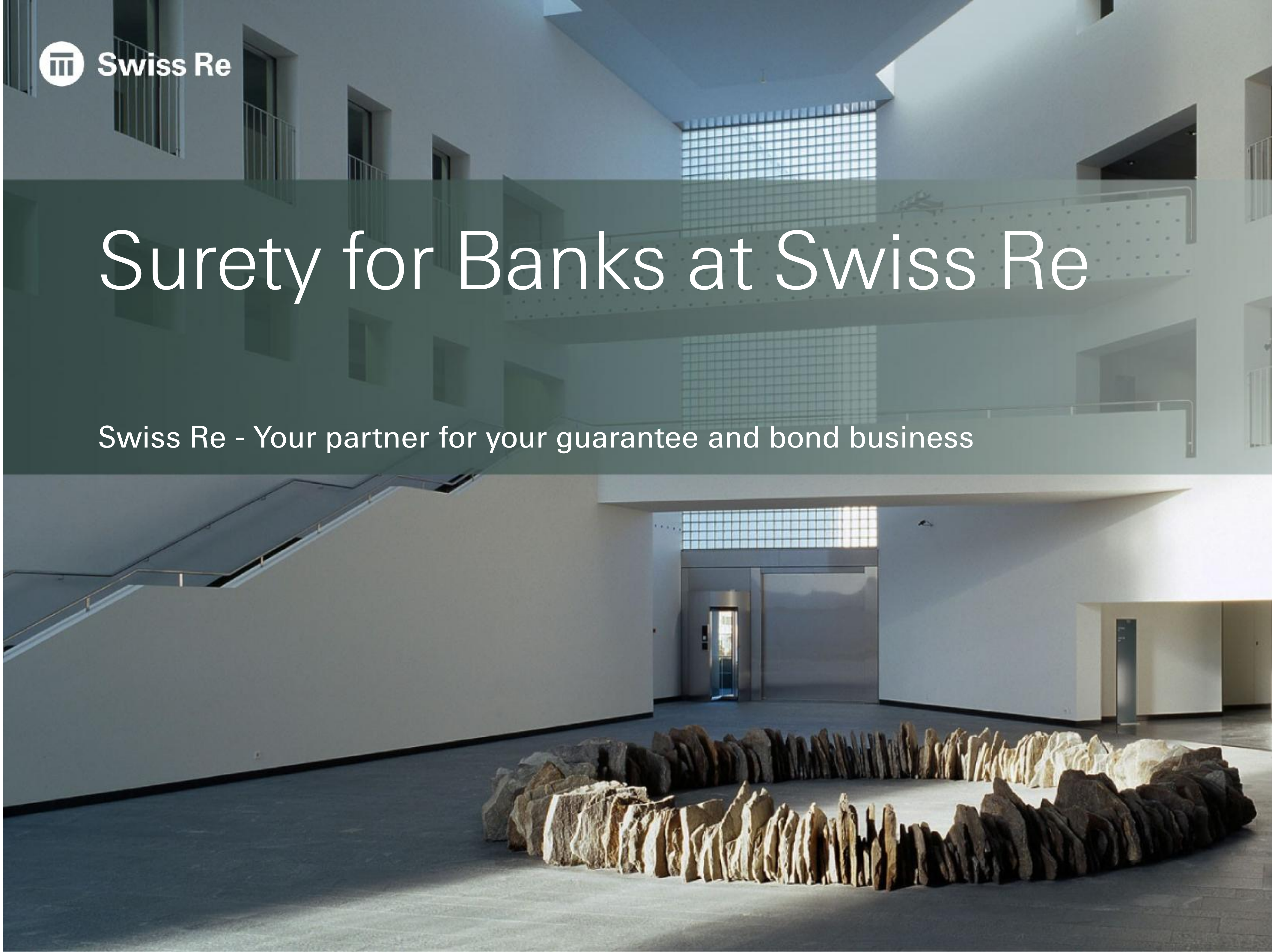
# Surety for Banks at Swiss Re

Swiss Re - Your partner for your guarantee and bond business



# BTI – Bank Trade and Infrastructure Finance

- Swiss Re's BTI team has been a leading provider of capacity to commercial banks for almost 20 years.
- Portfolio of USD 10+ billion.
- Over 30 experienced professionals combining banking, surety and reinsurance know-how.
- Global footprint with offices located mainly in Zurich, Munich, Frankfurt, Milan, Sao Paulo, New York and Singapore...

# The four product offerings of BTI

| Structured Trade Finance | Documentary Trade and Supply Chain Finance | Project and Infrastructure Finance | Surety |
|---|---|---|---|
| Pre-Export Finance, Borrowing Base Finance, Trader Finance, Reserved Based Lending ...<br><br>For Hard and Soft Commodities sectors across the globe | LC, SBLC, Post shipment, trade related bank-to-bank finance, Oil payment guarantees, Receivables Finance, ECA Financing... | Sectors:<br>- Transport<br>- Social Infrastructure<br>- Natural Resources<br>- Telecom | - Contract Bonds<br><br>- Commercial Bonds |
| USD 10-100m | USD 1-50 m | Depends on Transaction | USD 10-100m |
| Tenor: Market practice | Tenor: Market practice | Tenor: Market practice | Tenor: Market practice |

# How it Works

- Swiss Re participates in bank transactions on a **silent & unfunded** basis (credit risk in respect of the participation is fully transferred to Swiss Re).

- **Follow the Fortune**: economics of the participation are shared between the parties. In the event of a default, Swiss Re funds its share of amounts due and payable.

- Risk participation meets **Basel III requirements** (CRR) for capital relief.

- **Alignment of Interest**: Swiss Re asks that the bank maintains at least an equal amount of net exposure to the transaction as Swiss Re.

- **Transparency of Information**: As Swiss Re is a non-competitor, we seek the benefit of the banks internal transaction credit memorandum

# Key Benefits & Features

## Alternative Distribution Channel

Sell down on a private basis, alongside traditional loan syndication.

Sell down of club or bi-lateral transactions.

## Capacity/Limit Management

Provides relief on borrower and country limits.

## Capital Management

Joint default probability – you are exposed to a loss only in the event of a simultaneous default of Swiss Re and the borrower.

***whereby...***

- Swiss Re is not a competitor in the banking market.
- You retain full control over the origination, administration and monitoring of a transaction.

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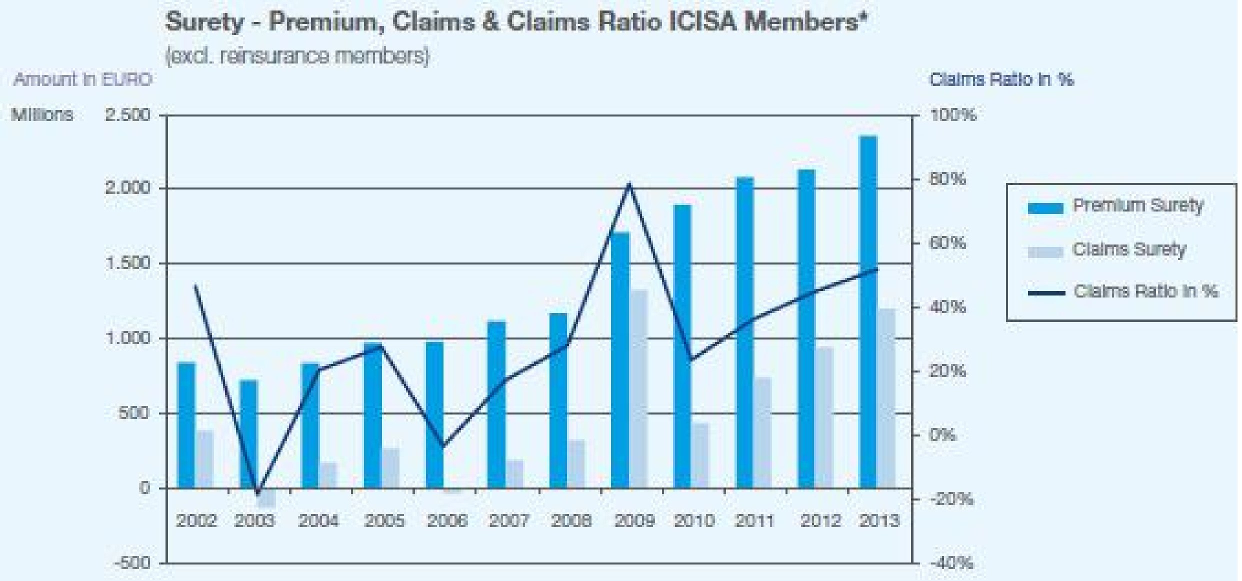
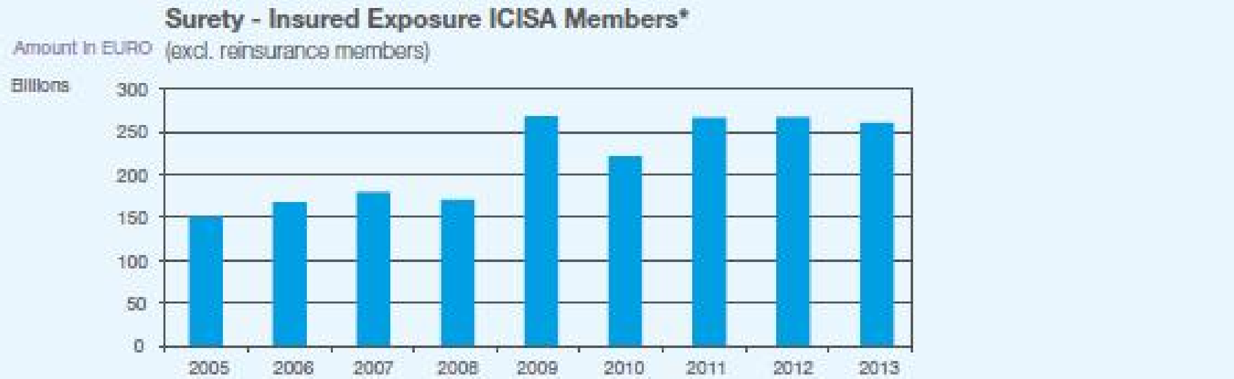
# The Surety Market

Some statistics...

# Overview Surety Market

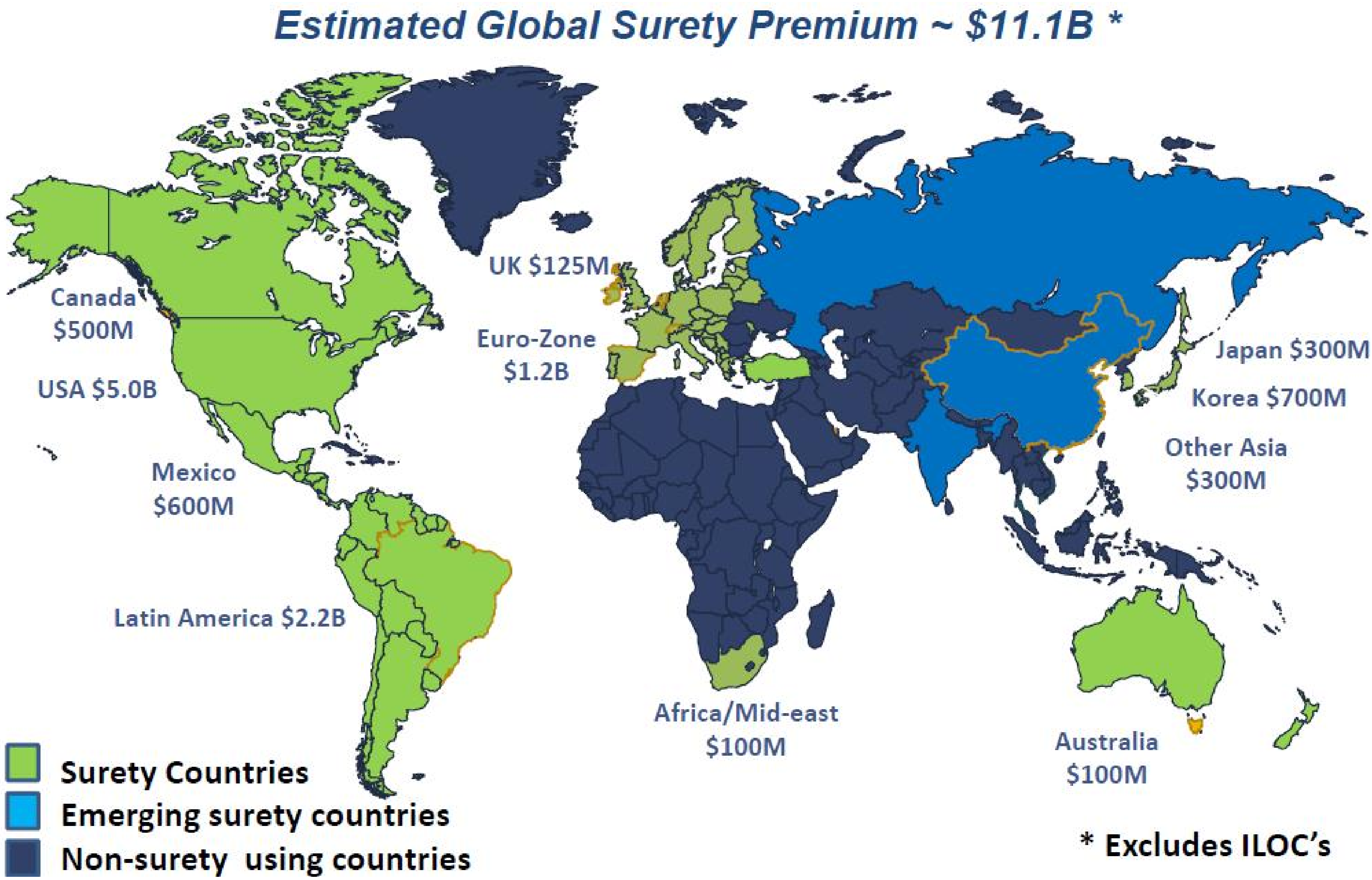



- Premium in 2013: 2.33 bn EURO (+11% compared to 2012, and more than doubled compared to 2007)
- Claims figures for 2013 are 1.18 bn EURO (30% higher than 2012) and are driven by some very large claims. However, this increase is not seen across the board and should not be seen as a trend for the industry.
- -Claims ratio for 2013 is 50.8% compared to 43.9% in 2012.
- -The insured exposure has decreased by about 2% compared to 2012, but grew by more than 45% compared to 2007.

Reinsurance members are not included
Note: The surety results differ per market / country and overall conclusions are not necessarily a reflection of a particular country or market's results.

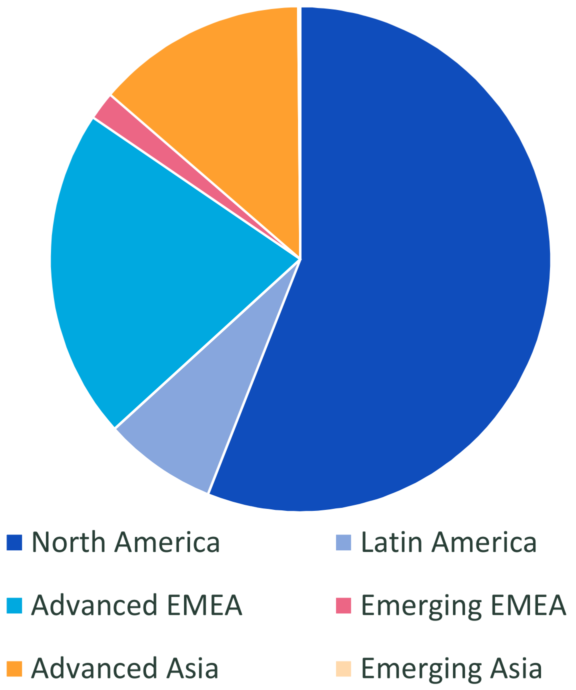
# Global Surety Market



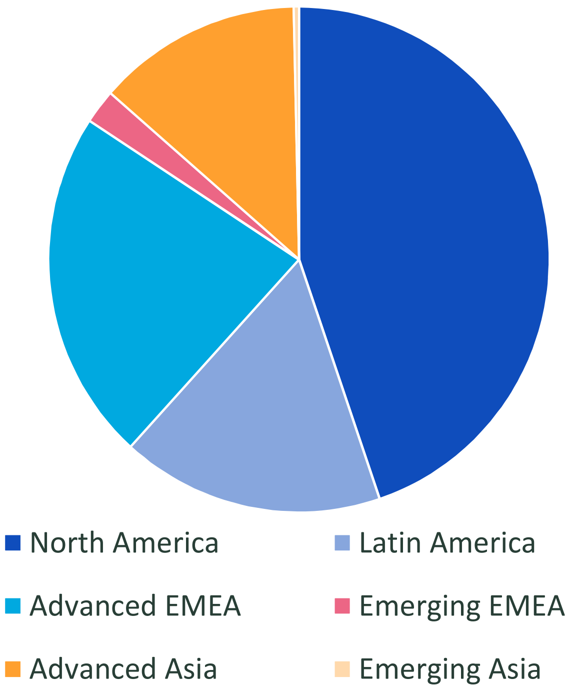

Source: Surety & Fidelity Association of America

# Geographic Distribution of Surety
## 2003 and 2013

World surety premiums in 2003:
USD 7.4 billion




World surety premiums in 2013:
USD 13.0 billion




Source: Surety & Fidelity Association of America

# Any Questions

Thanks !

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