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EXPORT SURETY BONDS

The increasing appetite of bond insurers

Most export contracts require contract bonds (performance bond, advance payment bond…) whose amount might be substantial. By using both banks and insurers' capacities, exporters can optimize capacities, costs and legal safety thanks to the increasing appetite of bonds' insurers.

Depending on the country, contract bonds may reach 10%, 20%, or more than 40% of the amount of the contract when it has been well negotiated with significant advance payments, and even up to 100% in countries where bonds include extensive guarantees, as in the United States or in some Latin American countries (Colombia, Panama, for example).

As the costs for bonds issuance are not supposed to be a significant cost item, some companies tend not to devote the necessary time to develop an optimisation strategy between bankers and insurers. A market of about 12 insurers can be mobilized depending on the beneficiary's country.

However, bonds are a necessity which may challenge the entry into force of the contract if they have to be issued a few days after signature. The recent involvement of insurers in the contract bonds market for export contracts offers a real market where the broker has the opportunity to diversify the issuing sources, thus providing access to various geographic areas – especially the American continent - increasing capacities and reducing rates.

Globalization for Export Bonds

The issuance of bonds for the export market is an area which has not yet been affected by globalization. The International Chamber of Commerce (ICC) standardization efforts have focused on the bonds **texts**, but their use is subordinated to local laws, which creates a diversity that is detrimental to exporters.

There has been no harmonization on the type of issuer between bankers and insurers; the buyer (beneficiary of contract bonds) must take into account the regulations before deciding whether to accept or to reject the Guarantee offered by the seller.

Each continent has its own specificity.

Concerning the issuance of contract bonds, practices differ from one area of the world to another and local laws add to this diversity.

On the American continent, insurers are the “benchmark” issuers. In North America (United States, Canada), bonds requested by public buyers are only issued by insurers and their commitment is an obligation to fulfil the contract (rather than an obligation to pay a limited amount): insurance companies hence pledge on amounts equivalent to the original value of the contract because, in case of failure, they are bound to finish the work employing another professional. Accordingly, the regulated quotation of the issued bonds depend on the technical degree of the concerned work.

These specialized companies, called *Sureties*, thereby have a special relationship with their client, often exclusive, carrying out regular diligences on their activity and its resulting financial position.

In Latin America (Panama, Mexico, Colombia, Equator, Venezuela…), insurers are also the reference issuers of bonds in a legal framework often highly regulated. For example, in Colombia, public buyers require a guarantee which includes multiple aspects (performance, advance repayment but also civil liability) and for which the amount can reach 100% of the contract value.

To export to the American continent (North and South a specialized bond broker will manage to issue the required bonds with maximum legal comfort and minimal costs.

In the Middle East and North Africa, the tradition is with Bank bonds: this implied to structure insurers’ capacities behind an issuing bank. However, some countries are beginning to grant the first licenses to insurers in the UAE, Qatar and Saudi Arabia.

In Europe, an open legal framework. The use of bonds insurers for domestic needs has been well known for several decades in most countries (Germany, Belgium, Spain, France, Netherlands, Italy…). Some insurers have even developed a system to print the domestic bonds in the contractor’s offices – thus reducing paperwork.

However, export contracts usually mention "bank guarantees”, which implies that the exporter will use a bank to issue those bonds. Actually insurers have long been reluctant to intervene in the export market, especially to issue first demand Guarantees.

In Europe, the legal framework allows to use banks as well as insurers to issue any legal guarantee, even for export contracts and with efficient rate conditions.

In Asia, many countries (China, Korea, Hong-Kong, Singapore …) allow the use of insurers as issuers either by direct issuance from Europe (France, Germany, the UK …) or by local issuance.

The risk of bonds’ calling

International guarantees are “payment orders” destined to secure the use of the “Buyers’ funds” as well as the right execution of their project. International guarantees may be subject to threats of calling that are often intended to "reopen negotiations." Those payment orders are more or less easy to call: this is where the difference between “first demand guarantees” and “conditional bonds” is important.

Certain callings can be insured on the political risk market, composed of more than 50 insurers in Paris, London and Singapore consulted from Paris by specialised brokers. In the case of a public buyer, any calling is covered (except for proven technical litigation). With a private buyer, the coverage protects against all political events preventing the proper execution of the contract: embargo, withdrawal of licenses, war, political violence... and thus inducing the call.

Exporters' strategies: the use of a specialized broker

With a market of about 12 bonds-insurers and increasing capacities, a company should solicit a specialised broker in order to have access to capacities from insurers. That way it is ready to export to different continents and can safely access worldwide markets, even the most exotic ones.

The specialized broker can share with his client his experience on local practices and acceptable texts in a given country. He creates market competition between up to 12 insurers, coordinates capacities and contributes to the improvement of legal comfort, the increase of available capacities and the reduction of the bonds' cost.

For political risk, he consults more than 50 insurers to identify the one that will best protect issued bonds from unjustified calling or simply political calling.

For a balanced collaboration between banks and insurance companies

For the exporter, the use of insurers can reduce the number of banks required on a project, which simplifies the distribution of cash flows and other products (LC confirmation).

These overall capacities from banks and insurers for the issuance of bonds can thus be combined by the Bond Broker according to the Beneficiary's geographic area.

That way, both costs and legal certainty can be optimized.

The relationship between bankers and insurers is more of a mutually beneficial collaboration than a competition. Even if banks supervisory regulations are not entirely neutral, "Basel III" is a significant step forward because it trivializes the use of 'non banker' partners in their solvency ratios. On the other hand, some medium size banks can still be bothered by the monitoring ratio for large exposures. Some banks, depending on their own financial characteristics, can still be deterred to organise an operation with insurers rather than with other banks, but they actually get some operational advantages out of it, since they are no longer asked to share other banking products.

For the banker, having an insurer as partner provides capacity when he needs it. He does not ask for counterparts regarding flows management or sharing banking products – such as payment instruments confirmation. Certain bankers have understood the leverage effect that they can get from working with bond brokers.

Paris has become a vanguard marketplace for insurers' export bonds

It is possible to mobilize 2 billion euros from insurers for a single operation and on a good signature, when we could only reach 150 to 200 million 10 years ago. If the use of insurers is not a panacea with regard to banks capacities, it nevertheless increases the overall capacity for the exporter. This enables him to avoid tense situations after a new contract has been signed, allows him to access the high potential markets of the Americas and reduces his legal risk, while exerting a gentle downward pressure on issuance costs.

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