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Major export contracts require the implementation of insurance bonds (performance bonds, down payment bonds, etc.) whose cost is not insignificant. A strategy must, therefore, be devised in order to diversify issuers.

Export insurance bond issuers

Bank or insurer: why choose?

France Arnaud de Taddéo

Sol Mondo, broker specialized in international risk

Depending on the country, insurance bonds can represent 10, 20 or even 40% or more of the value of the contract, when it is well negotiated with significant down payments, and up to 100% in countries where insurance bonds include extended guarantees like in the USA or certain Latin American countries (Colombia for example). As the cost of issuing insurance bonds does not represent a significant cost item, certain companies tend not to spend enough time preparing a strategy for issuers.

Yet insurance bonds are a necessary port of call that can have an impact on the effective date of the contract when the contractual lead-times allowed to issue them are very short (sometimes just a few days). It is important to anticipate your needs to prevent a bank or group of banks from raising their rates at the moment of issuing. The recent arrival of insurers on the export insurance bond market provides a great opportunity to diversify issuing sources and facilitate access to certain geographical zones – America in particular -, guarantee capacity and reduce rates.

A FIELD STILL QUITE UNTOUCHED BY GLOBALISATION

The issuing of insurance bonds for export markets is a field that has not yet been affected by globalisation. The harmonisation work carried out by the International Chamber of Commerce (ICC) concerned the texts of bonds, but their use is still often governed by local law, which reduces its benefit and maintains a diversity that is detrimental to exporters.

There is no harmonisation, however, on the choice of the type of issuer, between banks and insurers: the buyer (the beneficiary of the bond) must take the regulations into account before deciding to accept or refuse the sureties offered by the seller.

EVERY CONTINENT HAS ITS OWN SPECIFICITY

Practices in terms of issuing insurance bonds are specific to every region of the world, and the interference of local laws further increases this diversity.

In North America continent, insurers are the preferred issuers

In North America (USA and Canada), bonds on public contracts are only issued by insurers and the commitments made are obligations to do (rather than to pay): the insurance companies, therefore, underwrite a sum equivalent to the initial value of the contract since, in the event of a default, they are obliged to have the work carried out by another professional.

As a result, the prices - which are regulated - allow for the cost of the bond issued to vary depending on the difficulty of the works concerned.

These specialized companies, called *Sureties,* therefore have a special – often exclusive – relationship with their customer, and they carry out the due diligence on its activity and its resulting financial situation.

In Latin America (Mexico, Colombia, Venezuela, etc.), insurers issue bonds within an often highly regulated legal framework. In Colombia, for example, public buyers require a single bond to be issued, including different aspects (performance, but also civil liability), but for which the amount can reach 100% of the value of the contract.

To export to this continent, companies can go through their usual bank(s): some banks are able to identify a local insurer to whom they issue a *standby letter of credit.* There are several disadvantages to this solution: firstly, the company pays twice; the "standby" is a very "liquid" instrument, a disadvantage that is exacerbated by the legal risk, in some countries, of using certain local companies that may be tempted to pay too quickly if it is called. That's why it is safer to go through a specialized insurance broker, who will put the company in touch with an insurer based in Europe to issue the necessary bonds with a better level of legal protection at minimal cost.

In the Middle East and the Maghreb, it is forbidden to use an insurer as a direct bond issuer. Insurers can only be in the pool led by the issuing bank.

In Europe, an open legal framework

In Europe, the legal framework allows the use of banks and insurers indifferently to issue any legal bonds. The use of insurers for domestic purposes has been common practice for several decades in most countries (Germany, Belgium, Spain, France, the Netherlands, etc.). Some insurers have even developed on-site issuing systems for bond documents - on the principal's premises -, which significantly lightens the administrative side when the company must supply a large number of bonds. However, for export markets, the contracts generally mention "bank guarantees", which

implies that the exporter will go through a bank to issue the bonds it needs. Indeed, for a long time, insurers hesitated to work on export markets for lack of an adequate international network for issuing and during the life of the bond.

In Asia, the use of banks as issuers is still the dominant practice in many countries; the use of insurers to issue insurance bonds requires upstream buyers to be informed during the contract negotiations.

EXPORTERS' STRATEGIES

In this context, a well-informed company should implement capacities with both categories of issuers to export on different continents without any handicap and in order to have free access to all global markets.

For the exporter, going through an insurer limits the number of banks on a given project, which means fewer banking products and transactions. This total capacity can, therefore, be used depending on the country, in pools led alternatively by a bank or an insurer, according to the geographical zone. This optimises both the cost and the level of legal protection.

FOR A BALANCED BANK-INSURANCE COLLABORATION

The relationship between banks and insurers is more like an agreed collaboration than a competitive process. Even if the prudential supervision of banks is not quite neutral, the "Basel II" agreements represent a significant improvement because they have made the use of "non banking" partners possible in terms of solvency ratios. However, certain medium-sized banking institutions may still have difficulty with the high risk monitoring ratios until the regulator's reforms are implemented. Certain banks, depending on their financial make-up, can still be persuaded against syndicating an operation with insurers rather than other banks. In reality, however, there are operational advantages for them, since they are no longer obliged to share the other banking products.

For the banker, an insurance partner provides capacity where he needs it. It does not ask for anything in return in terms of the management of transactions or sharing banking products, like the confirmation of payment methods. Some banks have fully understood the leverage effect that collaboration with an insurer gives them.

Paris has only recently become a real marketplace for export insurance bonds where, for a good signature, through insurers we can mobilise an issuing capacity of 150 to 200 million euros for a single operation. Although the use of insurers is not a panacea with respect to banks' issuing potential, it increases the exporter's overall capacity. This helps to avoid tension the day after a contract is signed, gives access the highly regulated American markets and reduces the legal risk while applying a little pressure to reduce issuing costs.