Global Surety

Anthony Sangchurl Hong

PhD Candidate at SKKU

Agenda

Introduction to Global Surety

- Suretyship
- Indemnity
- Surety Worldwide
- Surety Bond vs Bank Guarantee
- Structured Solutions
- Surety Underwriting
- Surety Performance

About Speaker

- **PhD Candidate (2020) in International Trade at SKKU**
  Master of International Business at University of South Carolina, USA

- **Research Interest**
  Trade Finance from National and Corporate Culture Perspectives

- **Professional Experience:**
  Aon Korea(Current) – Global Surety Manager
  AIG Korea – Head of Export Credit and Global Surety
  SEOUL GUARANTEE INSURANCE COMPANY– Surety Underwriter

- **Certification**
  Certificate in International Trade and Finance(CITF)

Suretyship

Facility

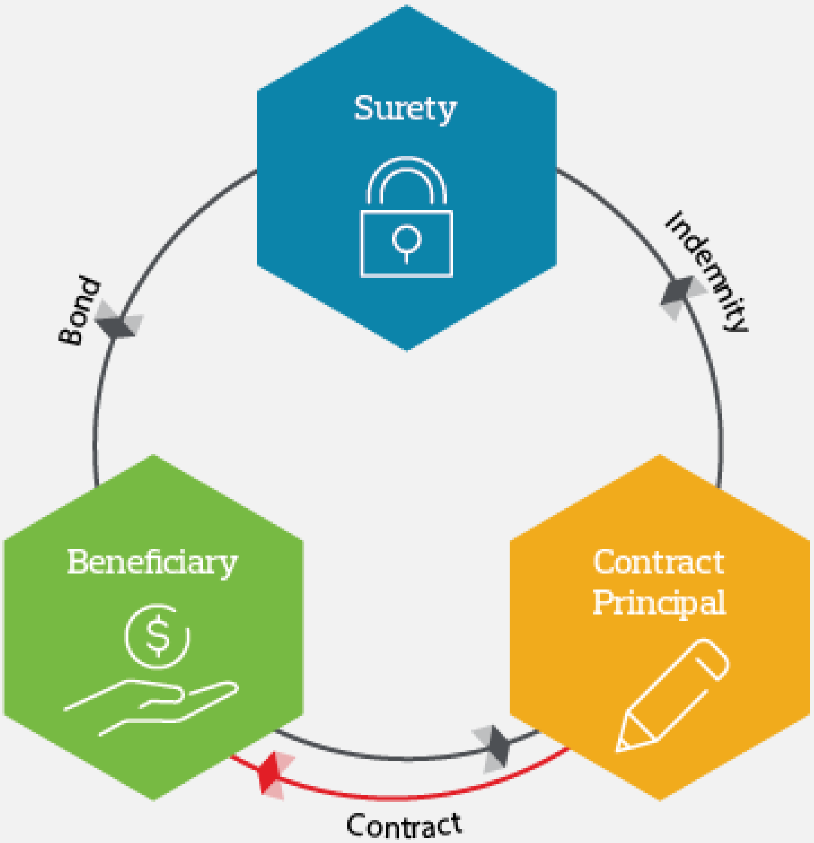
- Based on the financial strength of the Applicant and / or the Parent Group
- Surety may offer the Applicant an unsecured Surety facility

Indemnity Agreement

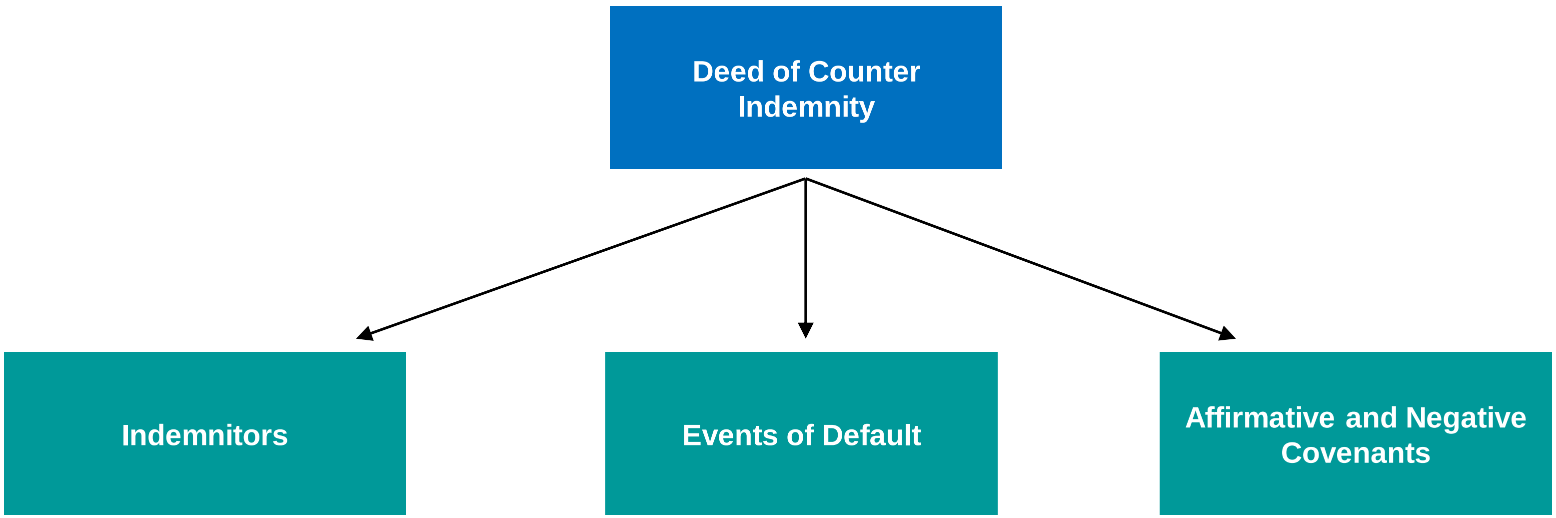
- Applicant (and/or Parent) will enter an Indemnity Agreement with the Surety
- Indemnity Agreement
  - is in simplified laymen's terms similar to a ‘Parent Company Guarantee’
  - is a legal undertaking from the Applicant that it will reimburse the Surety in the event that there is a call on the bond
  - is similar to the counter indemnity agreement between the bank and Applicant for bank guarantee facilities

Bond Issue

- Subject to satisfactory review of the bonding obligation and draft bond wording
- Premium is paid then the bond is issued by the Surety to the Beneficiary



Parental Indemnity Structure



INDEMNITORS:
- Parent Company
- any subsidiary which has a direct or indirect ownership of the Principal

KEY PROVISIONS
- Joint and Several Liability among all Indemnitors
- Obligation to keep the Deed pari pasu with all unsecured creditors
- Payment Due on First Demand the event of a claim

STANDARD EVENTS OF DEFAULT (EOD)
- Breach of a bonded contract
- Failure to pay amounts due
- Insolvency event
- Ratings trigger or Material Adverse Condition trigger
- Breach of financial covenant
- Cross default of any financing agreements
- Change in Control of Principal or Indemnitor

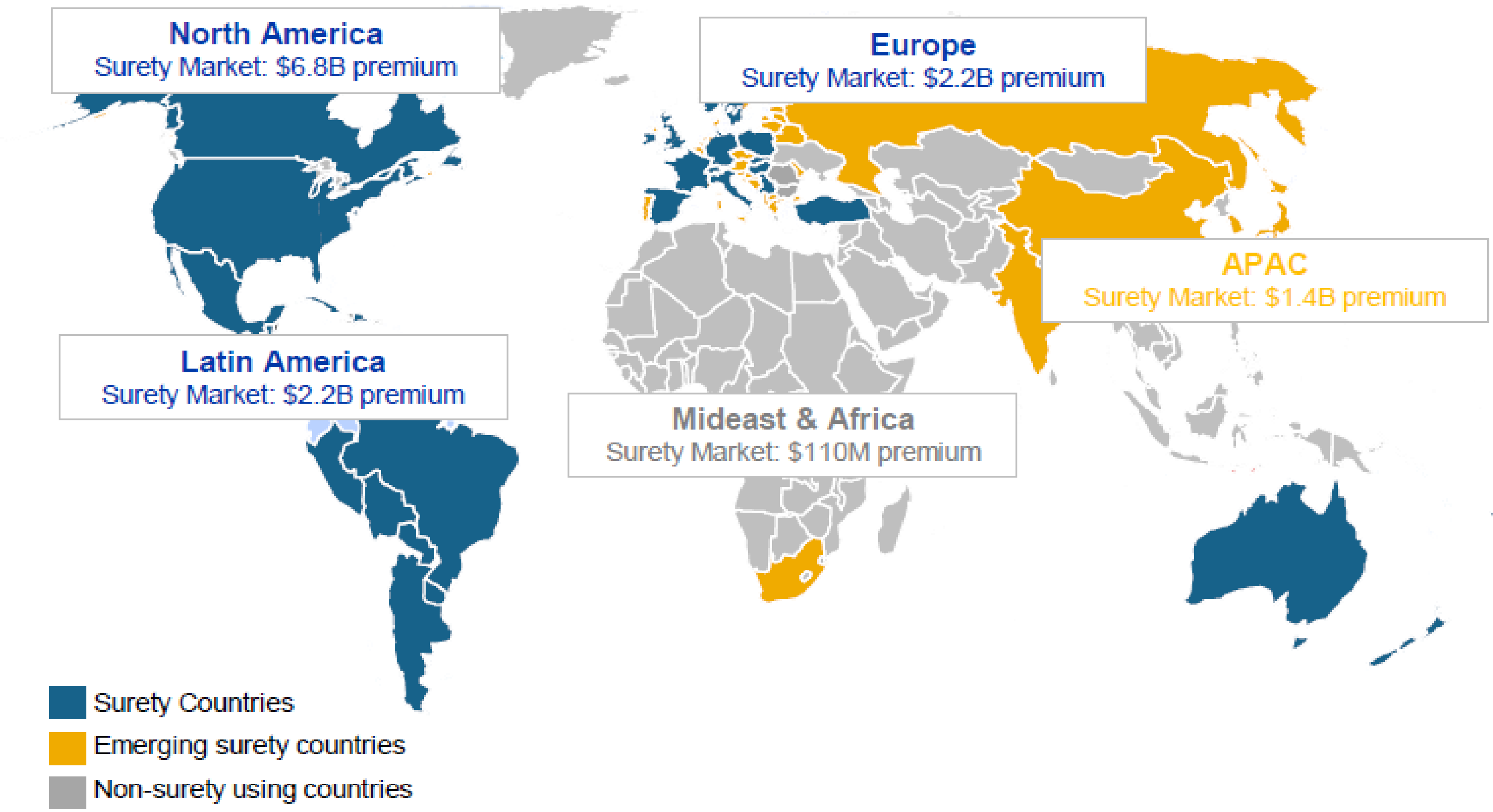
AFFIRMATIVE/NEGATIVE COVENANTS:
- Restriction on creating encumbrances/security over assets to secure financial indebtedness
- Restriction on the sale of assets over a certain threshold without consent
- Restrictions on mergers and acquisitions without consent
- Assignment to the Surety of Bonded receivables, inventory equipment, materials and subcontracts on Bonded projects

SURETY REMEDY IN AN EOD OR BREACH OF A COVENANT
- Surety may demand a cash deposit in the full amount of the outstanding bonds subject to an aggregate maximum amount specified within a pre determined number of days
- Indemnitors typically agree that any demand by the Surety shall be conclusive evidence of the amount due and shall waive the ability to raise any defense
- Surety takes over the bonded Contract and seeks to enforce its assignment of Bonded Contract receivables, equipment, inventory, materials and subcontracts

Sources: Aon insights and various web

Surety Worldwide

Where Surety is available



Sources: Aon insight and various web

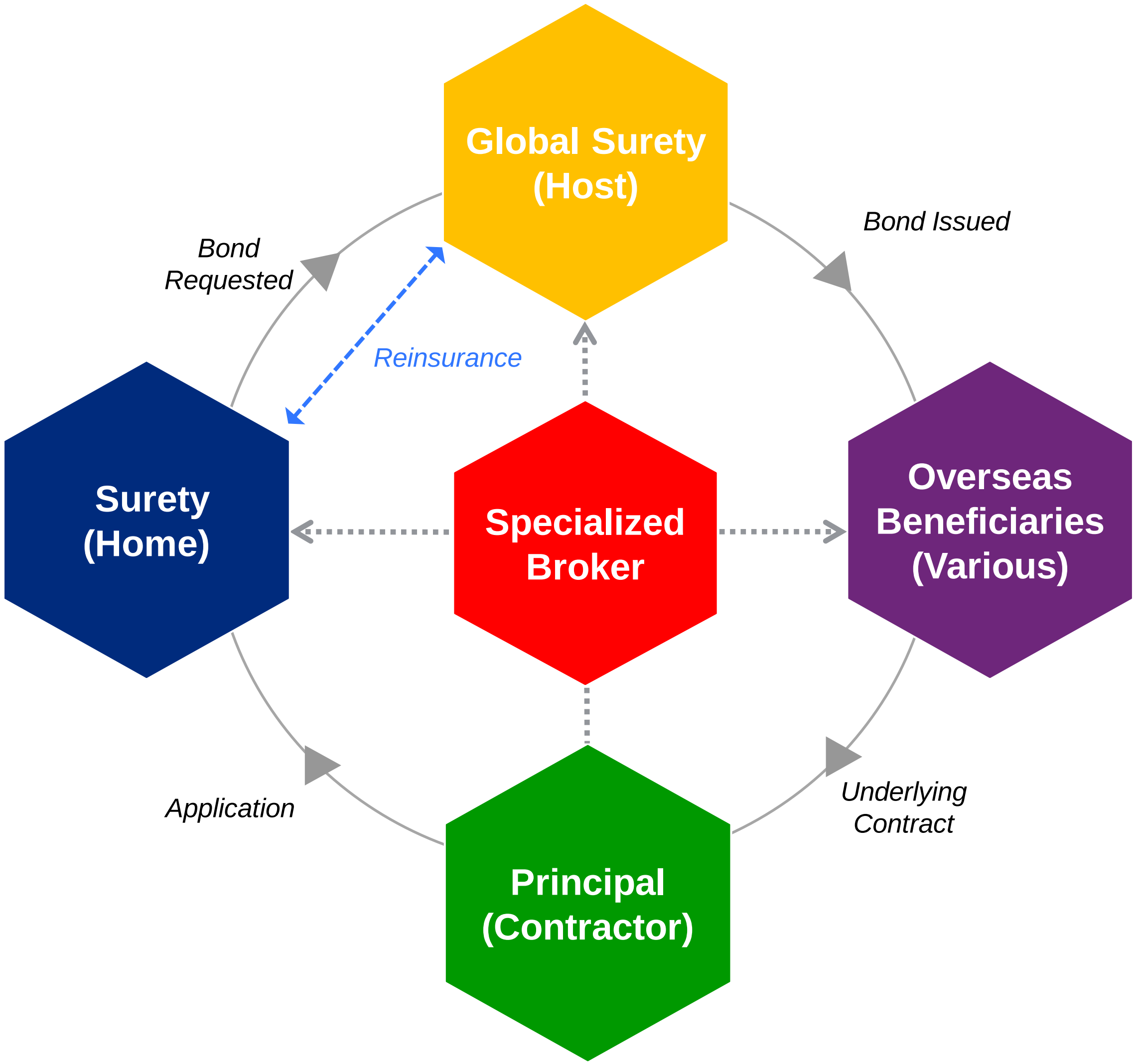
Surety Bond vs Bank Guarantee

Terms and Conditions	Conditional/Traditional US Surety Bond	Percentage “on Demand” Bond ROW	Letter of Credit or Bank Guarantee
Terms and Conditions for Default	Fully conditional bonds which require a default of the underlying construction contract. Surety will conduct a good faith investigation and act according to its sole option and discretion subject to the terms and conditions set forth in the bond.	On-demand/ forfeiture bonds require the surety to pay the obligee (beneficiary) upon demand per language in the bond form which is similar to a LOC or bank guarantee. A default dispute under the underlying construction contract is NOT a defense to payment under the bond.	Liquid Instrument triggered by notification to the bank by obligee (beneficiary). The bank will pay on a letter of credit upon demand of the holder. Payment by the bank is automatic and a dispute under the underlying construction contract does NOT prevent in any way the bank from making payment.
Remedy of Default by Surety or Bank	The Surety takes ACTION to remedy the default and complete the project. Surety completion options include: 1. Using the Principal to complete the work 2. Hiring a replacement contractor to complete the work 3. Making direct payment to the Obligee who completes the work	Surety pays damages up to the Bond Penalty upon notice of default.	The bank will pay the full amount of the LOC upon draw down of the LOC by the Beneficiary.
Response Time for Default	The Surety is required to act within a reasonable period of time after investigation and decision as to completion option which may take 3 to 6 months from initial notice of demand/claim. Some bond forms require definitive action within a specified period of time (20 to 30 days)	It will be defined in the bond form. Generally, the response time is 5 to 15 days from notice of default.	The Bank is required to act immediately” and a standard UCP 600 LOC allows a period of 5 days for payment.
Liability	Joint & Several	Joint & Several unless otherwise agreed	Several, but not joint
Duration	Varies. For contract bonds, the bond duration would be equal to the project duration & warranty. (Up to 10yrs)	Varies. For contract bonds, the bond duration would be equal to the project duration & warranty.	Annual (Not exceed to 5yrs in commercial space)
Amount	Bond Amount typically 100% of the contract price. Certain projects may allow lesser amounts typically 50% of the contract value.	Bond Amount varies per country and obligee. It can be 10% to 100% of the contract value.	The required amount for a letter of credit or bank guarantee varies per country and obligee. It can be 5% to 100% of the contract value.

Sources: Aon insights and various web

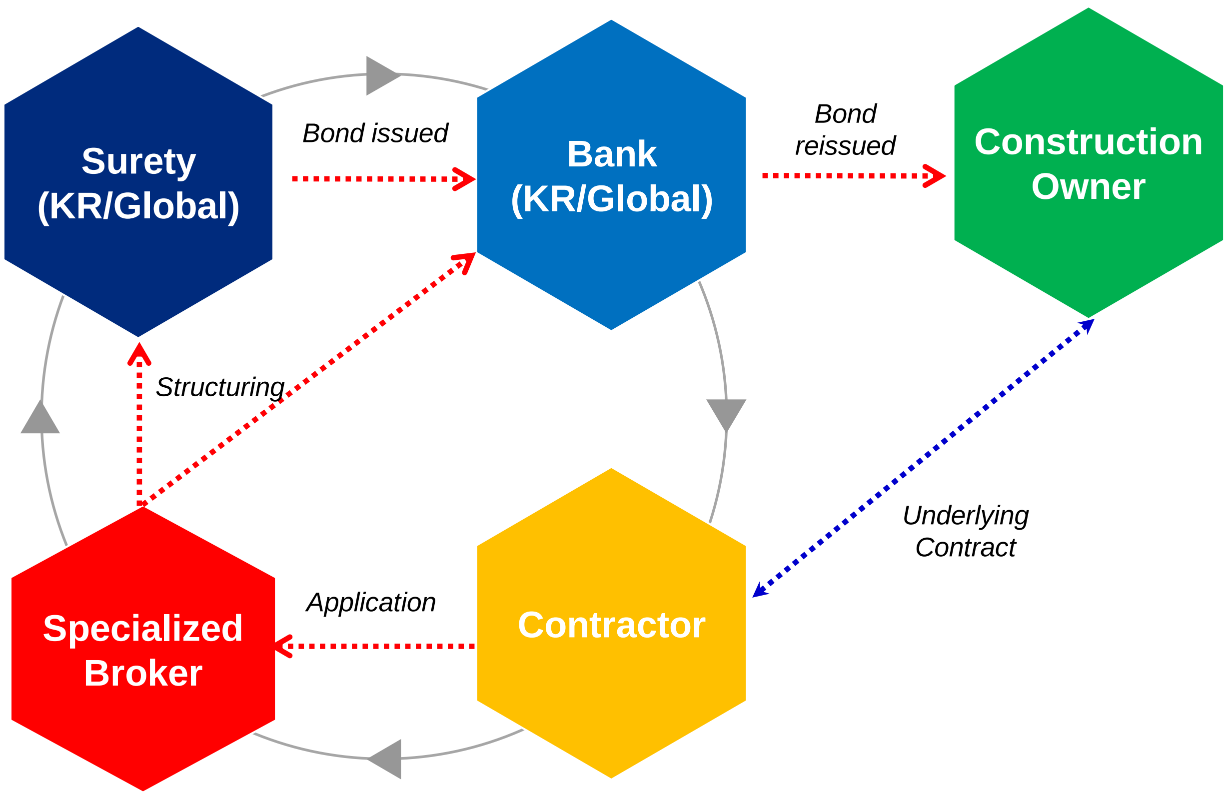
Structured Solution – Surety Fronting

- Local Regulation and Practices (Acceptability by Beneficiaries)



Structured Solution - Bank Fronting / Counter Guarantee

- Lack of Surety System, Credit Enhancement, Regulation, or Practices



- MENA and Some APAC countries prefers Bank Guarantee
- Collaboration between Banks and Surety to meet the market demand
- Capital Relief and additional commission income from Bank Perspectives

Structured Solution – Shared/Co Sureties (US & EU)

Sole Surety

A single surety supports the entire aggregate surety program- one surety issues all bonds

- This program structure can be difficult when large single project and aggregate capacity is required as a result of high PML and no risk sharing

Shared Surety

More than one surety supports the overall surety program with each surety providing bonds on a stand alone basis

- The participating surety is selected on a bond by bond basis
- This transactional approach is resisted by the contract surety market on the basis of adverse risk selection
- Single project bond limitations impact available capacity

Co Surety

Several sureties provide an equal amount of aggregate capacity and each surety participates on every bond in a amount which is a predefined percentage

- The co sureties are jointly and severally liable to the Obligee and have counter party risk to each other
- Preferred method of program structure by the markets
- Allows for larger aggregate capacity as well as larger single project bond limits

Sources: Aon insights and various web

Major Global Surety Market

Surety	Capacity/Appetite
Travelers	▪ Limited surety footprint ROW ▪ Very limited participation on reverse flow opportunities ▪ High TNW and WC requirements for US operation ▪ Not active in Counter Guarantee Structure ▪ Collateral typically required
Chubb/Ace	▪ Significant Surety footprint ROW ▪ Limited participation on reverse flow opportunities ▪ High TNW and WC requirements for US operation ▪ Collateral typically required
Liberty	▪ Significant Surety footprint ROW ▪ Very high participation on reverse flow opportunity ▪ Increasing international UW coordination ▪ Moderate TNW and WC requirements for US operation ▪ Collateral typically required
Zurich	▪ Significant Surety footprint ROW ▪ Very high participation on reverse flow opportunities ▪ Increasing international UW coordination ▪ Moderate TNW and WC requirements for US operation ▪ Collateral typically required ▪ Some trending decrease in capacity/credit

Surety	Capacity/Appetite
AIG	▪ Exit from Surety Business
Berkshire Hathaway	▪ Limited surety footprint ROW ▪ Increasing participation on reverse flow opportunities ▪ Moderate TNW and WC requirements for US operation ▪ Collateral typically required
C.N.A	▪ No surety footprint ROW ▪ More limited participation on reverse flow opportunities ▪ US only UW operation ▪ Conservative TNW and WC requirements for US operation ▪ Collateral typically required
Euler Hermes	▪ Limited surety footprint ROW ▪ Moderately high participation on reverse flow opportunities ▪ Active in APAC including Counter Guarantee
Swiss Re Corporate Solution	▪ Limited surety footprint ROW ▪ Moderately high participation on reverse flow opportunities ▪ Active in APAC including Counter Guarantee ▪ Higher Pricing due to change in methodology

Sources: Aon insights and various web

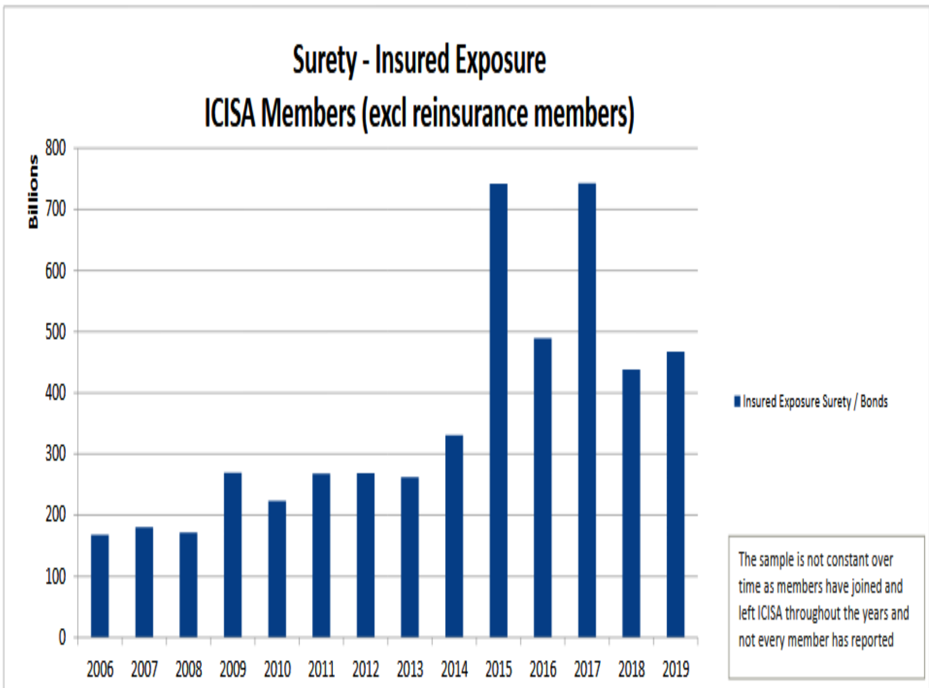
Credit Underwriting Criteria

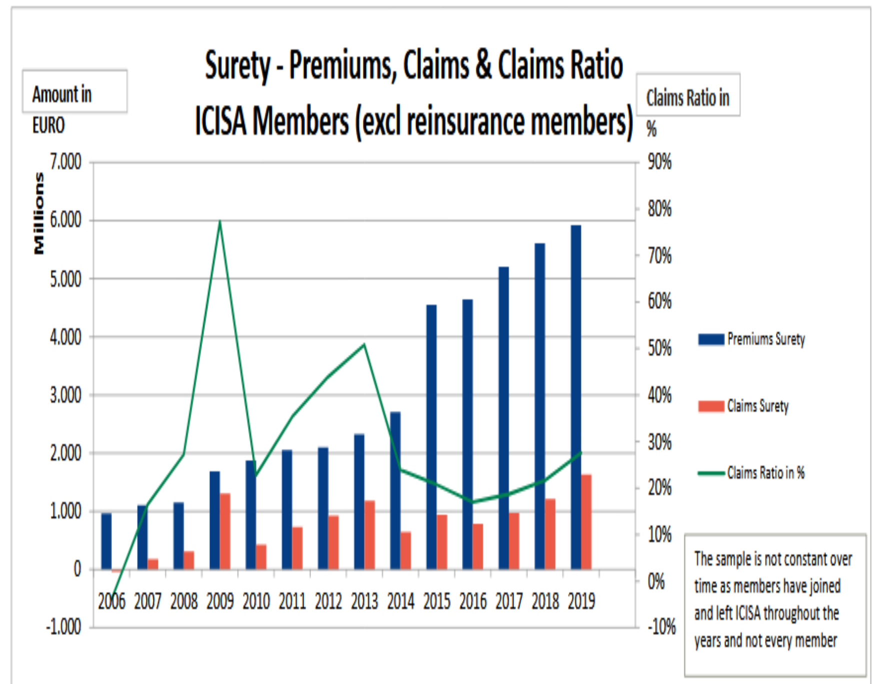
Key Criteria	Benchmarks
1. Financial Profile	▪ Credit rating ▪ Rated debt ▪ Credit default rating
2. Capital Structure	▪ Strength of the assets supporting the capital structure ▪ Relationship between assets and liabilities ▪ Headroom on banking/external facilities
3. Liquidity	▪ Cash and cash equivalents ▪ Restrictions, if any, on cash ▪ Cash requirements for equity investments and/or capex ▪ Cash required for the performance of the backlog of work
4. Debt Structure	▪ Recourse vs. non recourse debt—understanding which entities, and/or assets may guarantee debt ▪ The maturity schedule of debt—ability to refinance ▪ Financial and commercial covenants (restrictions on activities or triggers for default) ▪ Security package
5. Profitability	▪ Cash flow from operations ▪ Review of project profitability ▪ Evaluation of ERM system and process in place to mange profitability and performance
6. Equity	▪ Trend of Equity YOY ▪ Commercial understanding of targeted dividend/distribution
7.Cost Control and Financial Reporting	▪ Yearly audited FS and and semi annual internal FS including balance sheet and income statement for the parent company and construction operating subsidiaries including project level WIP reporting profit and loss on the full portfolio of construction work (bonded and unbonded)

Qualitative Underwriting Criteria

Integral part of Underwriting!

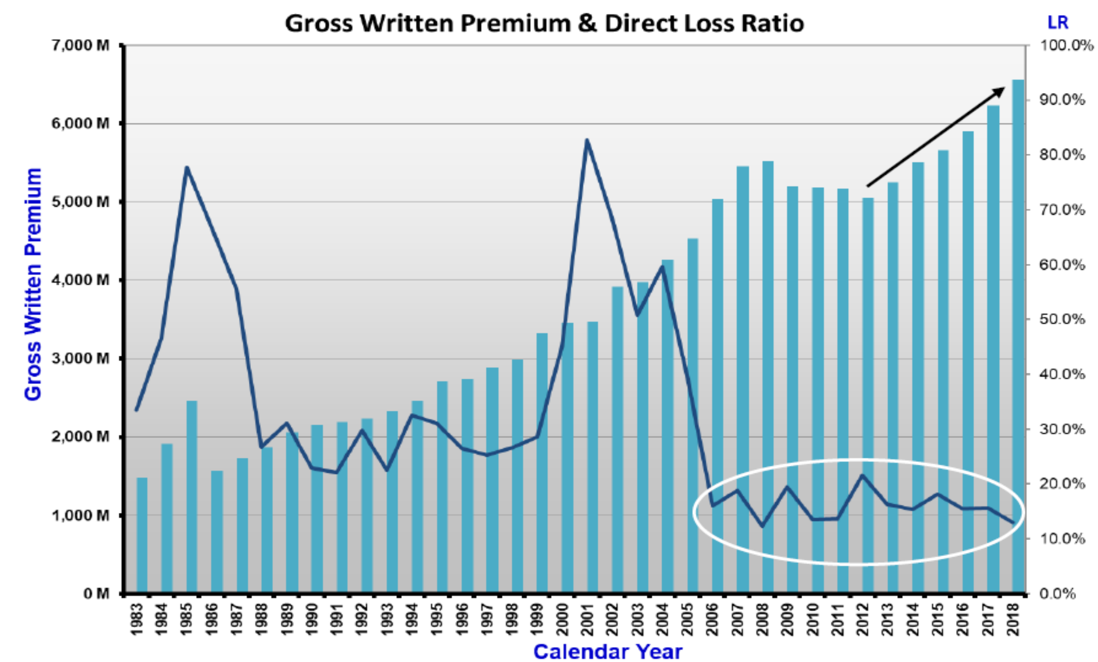
Surety Performance (ICISA)





Sources: ICISA

Surety Performance (US)



Data from Surety & Fidelity Association of America (SFAA)

	Direct Premium			Combined Ratio (CY 2014 - 2018)						CY 2018	
Company Name	**2018 DPW ($M)**	**Market Share**	**5 Yr DPW CAGR**	**Direct Loss & DCC Ratio**	**Net Loss & DCC Ratio**	**Direct Expense Ratio**	**Net Expense Ratio**	**Direct Combined Ratio**	**Net Combined Ratio**	**Direct Combined Ratio**	**Net Combined Ratio**
Top 5 Writers	**3,165**	**48%**	**3%**	**12%**	**13%**	**47%**	**51%**	**59%**	**63%**	**60%**	**65%**
Top 6 - 20 Writers	**1,828**	**28%**	**7%**	**23%**	**18%**	**56%**	**61%**	**79%**	**79%**	**76%**	**76%**
Industry ex. Top 20	1,590	24%	6%	24%	20%	57%	59%	81%	79%	74%	74%
Industry	**6,582**	**100%**	**5%**	**18%**	**16%**	**52%**	**55%**	**69%**	**71%**	**68%**	**71%**

Source: GC Risk Benchmarks Research, US Statutory Data

Q&A and Closing

Please feel free to ask any question or send me an e-mail at anthony.hong@aon.com.

Thank you.