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A Global Approach to Surety Bonding

STRATEGIC VIEWS, TAILORED SOLUTIONS

April 2018

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MARSH & McLENNAN COMPANIES

A Global Approach to Surety Bonding
What are Surety Bonds and Who Issues Them?

- Similar to a bank-issued bank guarantee or letter of credit, but issued by an insurance company known as the **Surety**
- A Surety Bond is a three party agreement between:
  - our Client (contractor / manufacturer / other) who is the **Principal**
  - the **Obligee** (the customer of our client or government agency)
  - the **Surety** (the insurance company who issues the surety bond)
- A Surety Bond guarantees to the Obligee that our Client will fulfil the terms of the Contract, or comply with the permit, law or statute that requires the bond
- A Surety Bond backs up our Client's obligations, but there's no risk transfer
- Surety bonds compete with LOCs / Bank Guarantees (U.S. and globally)
- Surety markets include large multiline players like AIG, Chubb, Euler Hermes, Liberty Mutual, Swiss Re, Travelers, Zurich and specialty regional and specialty markets.

A Global Approach to Surety Bonding
Common Bond Types

- **Bid bonds** – provides financial assurance that the bid has been submitted in good faith and the contractor, if hired, will enter into a contract at the price and conditions proposed and will provide any final bonds required
- **Performance bonds** – protects the Obligee from financial loss if the contractor defaults in accordance with contract terms and conditions
- **Other types of Contract bonds** – payment, advance payment, warranty, quality assurance, payment of wage and benefits
- **Litigation bonds –** financial assurance to the opposing party to carry on with legal proceedings following an adverse judgment (appeal bonds) or a fine
- **Customs bonds –** guarantees duties and taxes are paid on imported goods and that the goods are in compliance with customs regulation
- **Reclamation bonds** – guarantee restoration of disturbed lands, required by mining / natural resource companies
- **Breyne- GFA -** provide financial assurance to the buyer for the accomplishment or reimbursement of the project

A Global Approach to Surety Bonding
Themes Driving Opportunities = Client Benefits

Theme 1: Surety is largely a global product and competes well with banks

- Sureties have invested heavily and many can now write throughout North America, LATAM, Europe, and parts of Asia
- For strong credits, Sureties can often issue instruments that read and react like bank guarantee / LOCs
- The credit ratings of many sureties exceed those of the banks, making them attractive to beneficiaries

Theme 2: Challenged banking environment means Surety is even more competitive

- Higher capital requirements are impacting banks' risk appetite and their capital allocation models
- Rising interest rates will likely translate into higher pricing
- Consolidation and branch closures mean fewer choices with corresponding banks in other countries
- Bank guarantees and letters of credit are being affected - less capacity and/or higher pricing

What this means for Clients:

- Potential cost savings
- Increased availability under bank facilities

A Global Approach to Surety Bonding
Potential Client Benefits

Creating optionality – diversify issuers of security

Reporting is simplified and more easily aggregated, compared with local surety or bank guarantee placements.

Surety bonds are often a lower cost option than banks.

Many international markets require local issuance, and (many) Sureties have local office “in country” with bonds are often issued under a parental guarantee.

Under most accounting standards, surety bonds are often classified as contingent liabilities and therefore sit off-balance sheet.

Increased capital requirements are making bank guarantees are less attractive from the banks’ view, which is changing pricing and availability.

A Global Approach to Surety Bonding
International Surety Markets by Region

United States

- Largest surety market in the world, with over 100 sureties.
- Regulations (the Miller Act of 1935) require 100% insured value for performance bonds on public works, as well as payment protection bonds.
- Bonds are utilized to guarantee customs, judicial proceedings, payment of taxes and utilities required by statute, legal proceedings or contract.
- The major surety companies can offer single or aggregate capacity to individual credits in excess of $1 billion.

Canada

- Surety bonds widely accepted for construction projects and are normally 50% or 100% of contract value.
- Legislation does not mandate their usage like in U.S. but nonetheless common on projects involving public entities.
- Market is served by local carriers and large international sureties, especially U.S. based sureties.
- The major surety companies can offer single or aggregate capacity to individual credits in excess of $1 billion.

Western Europe

- Varies by country, but a very large, developed surety market with local and large players.
- The market generally dominated by banks, but surety is used for contracts with public entities..
- New players entering Western Europe and investing
- New applications are being developed, such as UK Pension bonds and bonds protecting employee benefits.
- Thin staffing discourages high volume facilities in some countries.

A Global Approach to Surety Bonding
International Surety Markets by Region

Latin America

- Varies by country, but a very large, robust surety market with local carriers and large international sureties present.
- Surety is widely used, more than bank guarantees and acceptance in public and private contracts.
- Contract bonds ,as well as court and customs bonds used, mostly conditional bonds .
- In Brazil capacities can exceed $2 billion USD and are largely for tax litigation obligations. Colombia, Argentina, Venezuela, Mexico, Panama, Puerto Rico are developed with Chile, Uruguay, Peru and Ecuador developing,
- Bond amounts vary based on obligation, but for contracts, performance bonds often between 10% to 30% but can be as high as 50% or even 100%.

Rest of World – Asia, Africa, Middle East

- Markets are developing, bank guarantees are the preferred instrument. Can differ by sub-region.
- China: No surety business within mainland China but sureties exploring ways to support Chinese firms with bond needs in other countries.
- Rest of Asia: Confirm by country.
- Australia: Largely a bank market but there have been significant recent breakthrough and an ability to marry surety and bank capacity. Surety bonds unconditional, pay on demand and irrevocable.
- Africa: Developed substantially in the past 5 years; bonds are written largely by local markets.
- India: Not a surety market
- Middle East: Minimal ability to use surety.

A Global Approach to Surety Bonding
Virtually Infinite uses for Surety Bonds

- There are virtually endless applications for surety (some restrictions on financial guarantees)
- Surety cuts across all industries (construction and natural resources are consistently large users)
- Marsh brings a global view and can take advantage of both global surety capacity and local capacity
- Marsh is leading the charge in using surety bonds to our clients' benefit, including bank syndication

United States

Largest surety market - regulations lead to large surety needs

Many European clients unfamiliar with bonding (banks dominate)

Opportunity to educate clients and add value

Brazil Tax Litigation

All multinationals have tax disputes, which often last several years

Security is required during appeal (5-10 years in most cases)

Change in law in 2014 made bonds equal to bank guarantees

EU Fines

Large fines issued by EU: anti-competitive trade practices

Fines can exceed 2 Billion Euro and security required during appeal (5 years +)

EU restrictions (banks & sureties) creating issues

GDPR Fines

General Data Protection Regulation (May 2018)

Firms who fail to protect customer data can face fines up to 4% of annual turnover

Firms will need to provide security during appeal

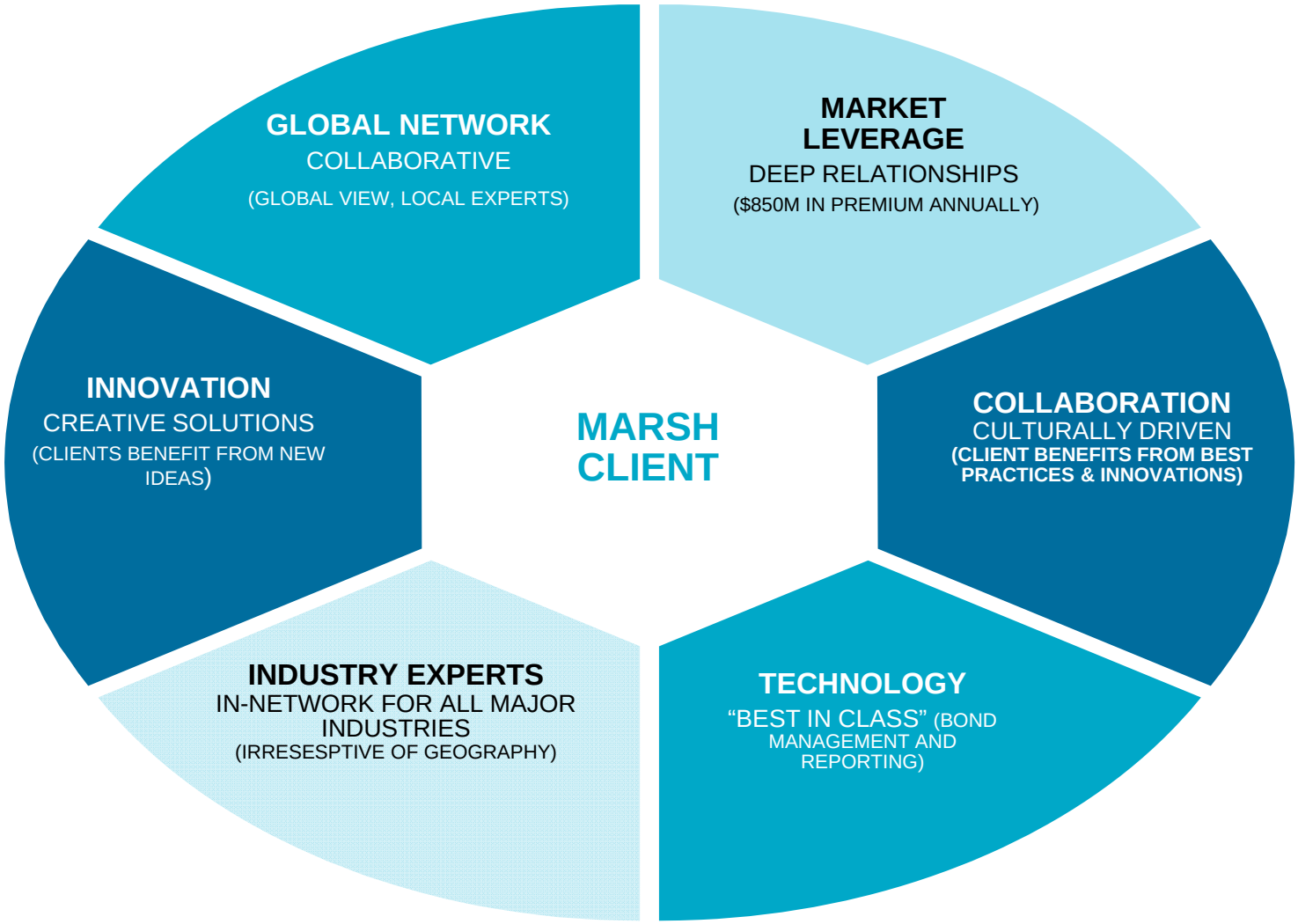
A Global Approach to Surety Bonding
Bank Syndication Approach - Disclosed

- This is risk transfer structure under which surety markets are introduced to the client's bank or banks.
- Sureties participate on selected risks, or on a portfolio basis, to the benefit of the client .
- This can be an ideal approach for countries where business where acceptance of surety bonds is limited : India, China and Middle East, and/or for customers or counterparties who do not accept surety bonds.
- This structure allows the surety to utilize readily available surety capacity to their benefit.
- There may not be a need for separate indemnity agreements ,as banking documentations may be valid.

BENEFITS TO CLIENT

- ✓ Can result in increased availability under bank facility / bank relationship, as the bank's appetite and ability to support the client is enhanced.
- ✓ Utilizing surety capacity available in the market, including geographies and customers who do not typically accept surety bonds.
- ✓ It may be possible to leverage aggressive surety pricing to negotiate better pricing from the banks.
- ✓ There is no additional costs to the client, as the surety underwriters are typically compensated by the bank fees which the corporate normally pays.

Marsh Value Proposition
Global Surety Team



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