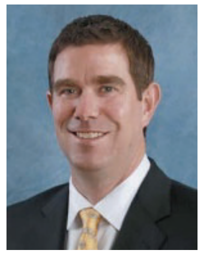
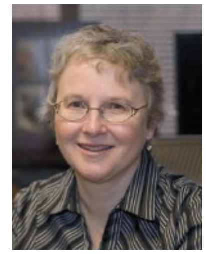
Feature

FACILITATING INTERNATIONAL Commercial Surety







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AS THE GLOBAL economy changes, the need to provide bonds in another country for U.S.-domiciled companies will increase. What do you do when your biggest U.S. client needs a bond in another country? This article outlines some of the issues that should be considered when arranging for a bond to be written outside of the United States.

Where are the majority of international bonds written?

Latin America is one of the largest and most well-established surety bond markets outside of the U.S. Some of the largest markets include Mexico ($603 million in 2013), Brazil ($508 million), and Colombia ($473 million), according to a Swiss Re 2014 report, “Trade credit insurance & surety: taking stock after the financial crisis.”

Surety bonds are also used throughout Europe although bank guarantees are used extensively. Asia is primarily a bank guarantee market although there are sizeable surety markets in South Korea and Japan. Africa and the Middle East are almost exclusively bank guarantee markets.

What are the most common types of international commercial bonds? Are international bonds typically regulated by underlying contracts or government regulations?

Performance bonds are the most common but, depending on the country, advance payment, customs, concession, tax payment, tax appeals, and other types of court bonds are used. Warranty bonds are also common in Latin America and issued along with performance guarantees.

Mexico uses a wide range of surety bonds that comes close to what we see in the U.S. In the Mexican surety market, as well as most of Latin America, bond forms are tightly controlled and written on prescribed forms. Many of these bonds are required by statute, and there is little or no deviation from the underwriting requirements and bond forms.

In most European countries, surety is a rather well-defined but narrow market where only a handful of statutory bonds, such as customs bonds, are written. Private contracts typically require letters of credit as opposed to a bond, and, if a bond is an option, it must be negotiated into the contract. These substitute bonds often look like a conditional letter of credit and typically are tailored to the contract.

What do producers need to know to support their clients' venture out of the U.S.?

Obtaining information up front before attempting a placement outside the U.S. is key to setting realistic expectations for what can be done and for satisfying your client. Some of the most important information needed includes:

a) Country the bond is to be filed in.
b) Time frame in which the bond is needed (5-10 days is a minimum turn-around, depending on country).
c) What is the obligation being guaranteed? Can this be guaranteed by another form of security, such as a letter of credit?
d) Are the underlying documents (bond form/contract) in English or is a translation needed?
e) Who is the bond beneficiary/obligee? Does the obligee routinely accept surety bonds or is this a new instrument?
f) The usual financial information, as would be required for a domestic case.
g) Previous experience with foreign bonds and management expertise outside of the U.S.

This information is critical to your ability to set proper expectations with your clients regarding their ability to get a bond in a particular country, the time needed to do so, and what additional information may be needed.

What does a producer need to know about indemnity required to support a foreign bond?

Many standard indemnity agreements now have language that covers bonds issued in foreign locales, whether through fronting companies or through the surety's own foreign subsidiaries. In some cases, however, riders or amendments to the indemnity agreement may be necessary. Further, indemnity from the foreign subsidiary of the customer, as bond principal, may be required, depending on the surety's standard practices or as a result of that foreign country's regulatory or legal environment.

There is an advantage to the surety in having "local indemnity" in order to manage disputes and mitigate losses, as the concepts and precedents in U.S. surety law may not be applicable in foreign jurisdictions. The options available to the surety in a foreign claim may be limited significantly without "local indemnity."

What are common practices for mitigating risk associated with the jurisdictional law?

Many underwriting companies have established country-specific indemnity agreements as a starting point in indemnity negotiations. That said, the involvement of experts, whether internal resources of the underwriting company or external counsel, is critical to a surety's efforts to mitigate risk. Who will bear these added costs should be part of any discussion relating to foreign indemnity.

Are bond amounts set at 100 percent of the contract or are they percentage bonds?

Percentage bonds are more common than 100% bonds; however, this does vary significantly. In Latin America 20% to 50% of the contract is fairly common, but typical supply contract and advance payment bonds are set at 100%. In Europe the percentages are lower (15–20%), but these bonds tend to be more like letters of credit and subject to unconditional demands by the obligee.

Will the U.S. surety market support clients that need only international bonds?

Most carriers prefer to write international obligations for principals where they have domestic business to offset the international risk. However, carriers will consider doing a one-off international bond, depending on the size and scope of the obligation, the country in which the bond is needed and the principal's financial metrics.

Correspondingly, the qualification requirements will vary depending on the nature of the obligation and country in which the bond is required. Carriers typically look for a working capital position of $30 million to $50 million before they consider international obligations.

Do international bonds have cancellation provisions in the bond form? Are bonds closed out at completion or are certificates of completion or other forms of releases required?

A lot depends on the type of bond, but, as a general rule, many foreign bonds require a release from the obligee. Cancellation provisions are more common in private contracts, but often, there are forfeiture requirements in the event the principal is unable to replace the bond. In countries such as Mexico, there are statutory requirements that a surety obtain a release and evidence that substantiates completion of the principal's obligation before a bond can be closed.

What triggers a bond claim in an international bond?

It is common to see "on demand" language in bonds issued outside of the U.S.—sometimes requiring the surety to pay within three business days. These clauses tend to be most common in bonds that require the surety to pay unconditionally in the event of a claim made against the bond. While there isn't a standard period of time that sureties will deem acceptable, it is rare to accept payment terms shorter than ten business days.

In summary, the international surety bond marketplace is both complex and growing; entrance into it should not to be undertaken lightly or quickly. The NASBP Commercial Surety and International Committees, composed of members and affiliates who are working in the international marketplace, can be a resource to help answer additional questions. ●

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