The ITFA Muse

Wednesday, 27 January 2016

CHAIRMAN'S MESSAGE - Sean Edwards, ITFA Chairman / Head of Legal at SMBC

On behalf of the ITFA team, I would like to take this opportunity to wish you all a very Happy New Year and all the very best for 2016. May the year ahead bring good health, peace and prosperity.

My first start to the year as Chairman of ITFA brings with it enthusiasm for the year ahead whilst acknowledging the challenging twelve months gone by.

2015 was an unforgiving year for commodities and emerging markets. The major commodities across an array of sectors which pretty much are synonymous with global trade were heavily in the red for 2015, from the energy and mining sectors to the metals and grains sectors. And this all boils down to one of the fundamental theories of economics of demand and supply.

There have been sectors, such as the metals and grains sectors which were negatively impacted by the global economic glut (lack of demand), particularly within the Emerging Markets space. On the other hand, the price of oil for example has been adversely impacted by supply concerns as the leading oil-producing countries are pumping more oil than ever before, sending oil prices to multi-year lows, the consequence of which has driven some large energy companies into unchartered territory.

Equities, currencies, commodities, emerging markets, bonds are amongst the key asset classes which had their fair share of volatility in 2015, but few would have envisaged what the first trading sessions of 2016 would have in store for most investors.

Markets gave investors a crude awakening in the early trading sessions of 2016, with risky assets markedly off the table. From ongoing worries about weaker economic dynamics in China, and the possible implications this could have not only on emerging markets but also on the global economy, additional weakness in the price of oil and geopolitical tensions picking up in the Middle East; all these factors ensured that 2016 was a start to the year many investors are willing to forget. And possibly the above three themes could pretty well shape the rest of the year.

Surety has grown steadily over the last ten years. In this issue of the newsletter, Silja Calac explains that insurance has become a more and more important part of international trade finance. We will also introduce you to one of the newly elected ITFA Board members; Zeyno de Vries-Davutoglu whose role within the Board primarily entails ensuring that ITFA members are kept abreast with the educational aspect of the industry.

We are currently compiling a list of scheduled events for 2016. Shortly, this will be available on our ITFA website and will be updated on an ongoing basis. We will communicate with you on this matter accordingly.

We look forward to hearing from you with any feedback you may want to share with us by sending an email to myself, any of the Board Members or to our general email, info@itfa.org.

Posted by Alexia Vella at 00:01 No comments:

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Monday, 18 January 2016

GUARANTEEING PERFORMANCE: SURETY EXPLAINED - by Silja Calac - Senior Surety Underwriter, Corporate Solutions at Swiss Re International SE

Surety is a new area of cooperation for banks and insurance companies, says Silja Calac. Note this is an extract from TFR's A Guide To Receivables Finance, 2nd edition.

Insurance has become a more and more important part of international trade finance. There are many different insurance products which support banks in their task to forfait receivables, finance trade, or issue guarantees and letters of credit (LCs).

But bankers as well as brokers and insurers often complain that this cooperation is not always as smooth as it should be: lack of information, misconceptions, regulations, internal barriers etc. often hinder insurance companies from providing efficient protection for transaction banking.

One big issue is the variety of insurance products available (trade credit and political risk insurance being just two examples) and the terminology related to it with which bankers are often not familiar. Thus, it is not always known that besides the traditional credit or political risk insurance, there are other potential areas of cooperation between banks and insurers such as surety, for instance.

Cooperation of banks and insurers in this field has only recently started, when insurance companies active in this field for years discovered that there was a large business potential to which an insurance company has no direct access as certain markets/sectors are exclusively covered by banks.

What is surety?

The ICISA (International Credit Insurance & Surety Association) provides the following definition on its website:

"A surety bond is an agreement, issued by an insurance company, which (in most cases) provides for monetary compensation in case the principal fails to perform. Although many types of surety bonds exist, the two main categories are contract and commercial surety."1

Although guaranteeing performance of third parties has been done nearly for as long as human kind has existed - as a 5,000-year-old Mesopotamian tablet guaranteeing the performance of a farmer proves - and has even been praised in poems (such as Schiller's Bürgschaft), in its modern form, it has its origins in US regulation. In most US states, it is required that a contractor provides a bond issued by an insurance company guaranteeing to the project owner the completion of the construction as per the contractual obligations.

Surety has grown steadily over the last ten years to reach more than €2.5bn in premiums, according to the statistics of ICISA. Suretyship is therefore the obligation in which one party (the insurance company) undertakes to another party (the beneficiary) to guarantee the debts, obligations, or conduct of a third party (the contractor).

A typical transaction would therefore be the following. A construction company enters into a contract with a US state to build a new highway. The

insurance company would guarantee that the construction company will complete the project on time and in accordance with the terms and conditions of the underlying contract. The surety bond provided by the insurer (surety) guarantees the performance of contractual or legal obligations entered into by two other parties (contractor and beneficiary). By doing so, the insurance company signals to the benefciary that it is confident about the financial capacity and technical ability of the contractor to complete the project. In case of non-performance or default, it compensates the beneficiary for losses incurred. It is often a mandatory requirement for public construction projects or in connection with payments of tax or customs duties. Both the surety and the contractor/principal are liable under the surety bond; i.e., in case of loss, the surety is entitled to fully recover the amount paid from the contractor/principal.

In a suretyship, each party has specific obligations. The obligations of the principal are:

- performance in accordance with the terms and conditions of the underlying contract;
- payment of the premium for the bond;
- to indemnify the surety for any payments made under the bond or other costs incurred as a surety of the relevant project; and
- to provide all relevant information to the surety.

The owner/beneficiary is obliged to:

- perform in accordance with the terms and conditions of the underlying contract, including payment to contractor;
- inform the surety of all major changes agreed upon in respect of the underlying agreement, progress of work, as well as arising problems; and
- discharge the surety from its liabilities after completion of the contract.

Last but not least, the surety/guarantor has the following obligations:

- to abstain from making any payments under the bond if the contractor/principal has a valid defence; and
- professional claims handling with prompt payments if project owner/beneficiary has sustained a loss.

So, from what has been seen so far, the key elements of suretyship are:

- Accessory instrument - it is accessory to an underlying obligation; namely, the construction contract or the obligation to deliver under an advanced payment.
- Joint and several liability - in a traditional surety, both the surety and principal are liable.
- Limited liability - the surety's liability is limited to the bond amount.
- Right of indemnification - the surety is entitled by law to be refunded for any payments made under the bond by the defaulting principal/contractor for any payments.
- Non-cancellable - unlike other insurance products, a bond cannot be cancelled until the underlying obligations have been fulfilled, even for non-payment of premium.
- Subrogation - as soon as the surety steps in due to failure of the contractor, all obligations and rights of the contractor are automatically inherited by the surety.

Benefits of surety

By reducing the uncertainty of performance, a surety bond benefits the project owner. It also increases the likelihood of a project being completed as initially agreed, as the surety will step in, in case a contractor is not able to perform.

The surety company's expertise in prequalifying the principal assures the project owner that the contractor it hires has the financial and technical capacity to successfully complete the project. Much like a bank line of credit, having sufficient surety capacity available enables the principal/contractor to

bid for public projects. The prequalification process eliminates unqualified competition.

Different types of surety

Insurance companies distinguish between two types of surety: contract surety and commercial surety.

Contract surety are bonds that guarantee the performance of a specific contract. They are generally issued under construction and service/supply contracts. Bond types include:

- bid bond - guarantees the contractor is pre-qualified to undertake the contract and provide a performance bond;
- advance payment bond - guarantees proper use of advance payments made to the contractor;
- performance/completion bond - guarantees performance of the underlying contract;
- payment bond - guarantees the contractors' suppliers and subcontractors will be paid;
- supply bond - guarantees performance of supply contracts;
- warranty/maintenance bond - guarantees workmanship and materials after project is completed; and
- subdivision bond - specialised bond for home builders, which guarantees that civil infrastructure (streets, curbs, utilities) for housing tract is completed.

Commercial surety comprises a broad spectrum of bonds written for a variety of industries, including:

- permit bonds - required to obtain licences/permits from governmental bodies;
- judicial bonds - bonds used in court systems, such as appeal bonds;
- fiduciary bond - guarantees faithful performance of court-appointed trustees;
- official bond - guarantees faithful performance of public officials;
- customs and tax bonds - guarantee compliance and payment of tax or custom duties;
- reclamation/post-closure bond - guarantees mines and landfills will be properly closed and land restored at the end of the mine/landfill's useful life; and
- miscellaneous bonds - bonds of this type include workers self-insurer bonds, lost instrument bonds, utility payment bonds, etc.

Underwriting surety - analysis of credit risk

Unlike traditional insurance business, such as life or property insurance, where the insurance companies evaluate the probability, frequency, and severity of risk events, and where in case of a claim no recovery is possible, surety analyses a credit risk. So risk management here is very akin to what banks do when assessing risk.

When underwriting surety, insurance companies will proceed in a very similar way as banks do when assessing a credit. It is a risk selection process with a zero claims underwriting approach; insurance will not underwrite a surety where there is a true risk that the contractor will default. Thus the main aspects of risk analysis are:

- financial - what is the credit-worthiness of the principal;
- transactional - does the project make sense/is the tenor adapted; and
- security - what indemnity/collateral is available to protect the surety.

In particular situations, insurance companies will be very careful before signing a surety, such as if the bonds are issued for a principal which does not carry out the work itself or if they cover risks beyond the control of the principal. Further, insurance companies are normally reluctant to write bonds guaranteeing pure financial obligations (financial guarantees) as this

is too close to being a funding substitute.

Surety for banks

Following the financial crisis, regulators have become even tougher with regard to banks' risk management, mainly through the introduction of strict requirements for banks to get a better grip on their use of capital (Basel III/CRD IV).

New regulatory requirements have obliged banks to allocate more risk-weighted assets at higher costs for each transaction. Historically, banks would have come to insurance companies to get rid of country or credit risks they could not accommodate.

With these new regulatory requirements, this has slightly changed to using insurance to get capital relief. It is the perfect cooperation: banks have the origination network, the proximity to the transaction parties, and the liquidity. Insurance companies provide the balance sheet to accommodate the growing needs for capital and the expertise to deal with risk. As a result, cooperation between banks and insurance companies in the field of credit risk insurance has been growing continuously.

Surety is especially adapted to such cooperation, as surety providers are already used to issuing cover under policies with a wording very close to that of bank guarantees. Also, if traditional surety often has a certain conditionality (the insurer would not pay if the principal has a valid objection and the insurer would subrogate itself to the contractor in case of a claim) this is of course not the case when insurers cover banks.

The participation agreements used here are on demand guarantees. Thus, surety cover for banks is mostly CRR compliant, therefore saving up to 80% of capital usage of a bank.

Which bonds can be covered?

All above-mentioned contract and commercial surety bonds can be covered when banks issue them. Of course, above-mentioned guarantees bonds also include the issuance of respective standby letters of credit.

A win-win situation

Cooperation in surety is beneficial for both parties. Banks resolve credit limit and capital constraints; capacities can thus be used for better priced business instead of blocking lines with low priced guarantee/bond facilities. Thanks to insurance cover, banks can get access to positions as key banker or lead arranger; the insurer enables banks to achieve their customers' capacity requirements and improve their relationship with their customers. Banks can thus win market share, improve strategic positioning, or even get access to new customer segments/markets.

This type of risk mitigation is often confidential/silent; the insurer is not a competitor of the bank but a partner, as insurance companies cannot handle cash and clearing needs of corporate customers. Using insurance cover allows the bank to diversify distribution channels for a more cost-efficient portfolio management. The insurer's credit capacity is not as correlated to those of a bank as is the case for other secondary market players. Last but not least, the insurance cover improves key performance indicators (KPIs) of the bank's retained share thanks to commission on covered part.

For the insurance company too, cooperation with the bank is beneficial in that it provides access to markets and products otherwise out of reach for an insurer. The insurer can rely on the product know-how and market access of its bank partners, and it can leverage on its existing product know-how and credit capacities.

Documentation

The documentation is quite straightforward: the bank and the insurer will normally sign a bilateral framework agreement (the Master Risk Participation Agreement or MRPA) at the beginning of the business relationship. This MRPA defines the general terms and conditions which apply to all single transactions which will be concluded between the two parties (e.g. process of issuing guarantees, conditions for claiming, representations

and warranties, applicable law in case of dispute, etc.).

For each single transaction, a short document (two to three pages) specifying the details of each individual transaction such as the amounts, tenors, pricing, etc. will be signed. The underlying documentation such as the bond facility or the credit agreement is signed with the principal.

Reference:

1. See also 'Great client expectations' by Robert Nijhout, executive director of ICISA at **www.tfreview.com/node/11957**

Posted by Alexia Vella at 11:50 No comments:

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Saturday, 16 January 2016

INTRODUCING ZEYNO DE VRIES-DAVUTOGLU (CREDIT EUROPE BANK N.V.); ONE OF THE THREE NEW ITFA BOARD MEMBERS

Zeyno de Vries-Davutoglu is Executive Vice President/Division Director for Credit Europe Bank N.V. and is responsible for Financial Institutions and Forfaiting & EM Loan Trading Departments (originating, managing and distributing of trade related bank risk). Zeyno is based in Amsterdam.

She started her banking career at Kocbank A.S. Istanbul in 1991 in the Financial Institutions Department where she worked for eight years. She was then moved to Ireland to assist with the integration of a newly acquired IFSC trading company; Koratrade Dublin where she spent two years. After her return to the head office, Zeyno took over a new role - Group Manager for the foreign subsidiaries of the bank. In 2002 she was then appointed to Kocbank Nederland N.V. in the corporate banking department and later also assumed responsibility on forfaiting activities of the bank. In 2005, she joined Credit Europe Bank N.V. and undertook various roles, until she was eventually appointed to her current role in September 2008 as E.V.P Bank Relations.

Zeyno received her B.A. degree from International Relations Faculty in Ankara and then got an M.A. degree in European Union Studies from Marmara University in Istanbul.

"During my banking career, I have been in contact with very sophisticated banks in developed countries, but have also dealt with many emerging and developing countries; and also not so sophisticated banks. There were wars, revolutions and too many crises in all these countries. However, I witnessed that trade debts have always been honoured even during the most extraordinary times. Trade finance is an area which keeps evolving; changing faces, developing new products but always going on. ITFA assumes an important role in providing a platform not only to banks but to all the institutions that are active in trade finance, where we meet and discuss common problems in our industry, get inspired through others experiences and most importantly we all learn/pass on know-hows to each other.

Because of the nature of my work, I have been travelling to various countries. I had the opportunity to notice that in certain geographies, banks are quite familiar with managing and distributing risk, however these are not members of the Association yet. I also witnessed that in some other countries, even though banks look for ways to finance and distribute trade finance risks, they are not familiar with "managing trade finance risk" concept yet.

I agree with our ITFA Chairman, Sean, as he mentioned in a previous newsletter, that ITFA is at crossroads and we have to evolve and expand together with the industry. I also believe that the association has the opportunity to play an important part in this dynamic sector. We don't only have great potential to expand, but also great responsibility in passing on the wealth of experience accumulated amongst its members, to be in the centre of the evolvement of the sector.

Prior to my board position I had the privilege to co-chair the Northern European Regional Committee (NERC) together with Dalia Kay from Federated Investors. My period at NERC gave me the chance to get to work closely with very skilled bankers who are eager to work for ITFA and pass on their knowledge to other people.

I am delighted to have been elected to the ITFA Board and have been asked to take over the Educational responsibilities. I will be working closely with Paul Coles and Chris Hall. We have already put together a rather aggressive educational activities calendar. We plan to represent ITFA at various conferences, seminars and ITFA events from Johannesburg to Hong Kong in 2016. We are keen to pass the wealth of experience our members have accumulated throughout the years to new geographies and to new potential members.

I would like to take the opportunity to ask all members of the Association to contact me on zeyno.devries-davutoglu@itfa.org with any educational queries in which ITFA can be of assistance.''

Posted by Alexia Vella at 11:57 No comments:

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NEW ITFA MEMBERS

The ITFA Board is pleased to announce the following three new members.

Falcon Group is a leading specialist provider of bespoke financial solutions that enable manufacturers, producers, traders, importers and exporters to grow their business and penetrate new markets.

Whilst they do not offer off the shelf facilities, their solutions are based upon a range of established financing options, including pre and post shipment, asset backed inventory, receivables based and supply chain financing. Forfaiting is a natural extension of these activities and Falcon has added a dedicated team focusing on non-recourse financing of export receivables, covering extended terms in both mature and emerging markets.

Falcon is expanding its range of activities and geographical coverage.

Ray Webb will be the main delegate for all ITFA related matters.

BPL Global is a specialist credit and political risk insurance (CPRI) broker serving traders, investors and financial institutions that trade, invest and lend internationally, with a strong focus on emerging markets.

Established in 1983, BPL Global is an independent, employee owned, award winning firm, with offices in London, Paris, Singapore, Hong Kong and Dubai, and affiliated offices in Boston, Dallas, Los Angeles, Milan, New York, Sao Paulo and Shanghai.

As an insurance broker, BPL Global acts unambiguously for the policyholder, although when placing insurance they do provide some services to the insurers with whom they place the business. They therefore allow the client, their principal, to fix the basis and amount of remuneration as its agent. When remunerated by commission, they take no secondary payments from the insurers in the form of contingent commissions placement service agreements (PSAs).

Anthony Palmer will be the main delegate for all ITFA related matters.

JLT Specialty provides insurance broking, risk management and claims services for clients across a wide range of business sectors. They have grown by applying their skills where they make the biggest difference for clients and it is this focus which differentiates them from the competitors.

JLT Specialty's Credit, Political & Security risks team advice upon risk and structure solutions that enable trade and investment, mobilise finance and secure people and assets, realising opportunity in volatility.

The team of ninety risk specialists form a global practice across 13 offices spanning nine time zones. They think globally, but act locally; the team delivers consistent best practice, market leverage, and competitive pricing, whilst addressing local nuance. They pride themselves on working for corporate leaders in sectors as diverse as oil and gas, mining, power, telecommunications and transport sectors, and have particular experience in dealing with banks and export credit agencies.

Edward Nicholson will be the main delegate for all ITFA related matters.

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Friday, 15 January 2016

UPCOMING EVENTS - SAVE THE DATE

May we take the opportunity to remind our readers of the GTR Mena Trade Finance Week which returns to Dubai for its 13th year, taking place between 15-17 February 2016. This three-day event is being held at the Jumeirah Emirates Towers, Dubai. For more details regarding the event, visit the GTR website.

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