

R. 9.144
167-3

X GENERAL ASSEMBLY

WASHINGTON, D. C.

OCTOBER 19 - 21, 1988



Speaker/Orador

Carlos Hoyos

Company/Compañía

Mapfre Caucion y Credito, S.A.
Compania de Seguros y Reaseguros, S.A.

Country/Pais

Spain

English

UNDERWRITING INTERNATIONAL ACCOUNTS

As a member of this panel, I should like to explain how we in Spain effect bond underwriting for international contractors, whilst making reference to its workings in other countries too.

We think our experience in this field may be of some interest to the audience since we participated in underwriting 87 bonds in 1987 and 50 up to 31 August, 1988.

I believe there are four ways in which a Bonding company can contact international contractors:

- I. The contractor is set up in the country, has properties and usually works therein.
- II. The international contractor, whilst not residing in the country, occasionally works therein and contacts the Bonding company either directly or through its representative's office to apply for a bond issue.
- III. A foreign insurance company introduces us to its customer and asks us to issue the bonds he requires.
- IV. A customer of ours enters into a joint-venture with a foreign contractor to perform some work in our country, for which, of course, bonds are required.

HOW CAN WE EFFECTIVELY UNDERWRITE THESE RISKS OF INTERNATIONAL CONTRACTORS, WHOM WE OFTEN DO NOT KNOW, AND FOR WHOM OUR SERVICE IS VITALLY IMPORTANT AND ALWAYS EXTREMELY URGENT?

Let us analyse the above mentioned four cases one by one:

- I. If the international contractor is established in our country, the underwriting is exactly the same as a Spanish contractor's. That is to say, an analysis of his financial situation and technical capability will lead us to accept or refuse the risk.

Except in cases of recognized solvency (e.g., IBM, General Motors...), endeavour is made in all cases to obtain the parent company's counter guarantee, though not always an easy thing to do. Only if the subsidiary is in a difficult financial situation will this requisite be raised as a "*sine qua non*" condition. However, assuming that the parent company is solvent and the operation acceptable, how do we arrange the counter guarantee with a company not set up in our country? Bearing in mind the theoretical and, particularly, the practical difficulties we would have in the future to execute the said counter guarantee in the case of a claim, the most advisable thing is to make the arrangement through an insurance or reinsurance concern in the parent company's country. This company's action will be as our "verbally appointed agent" since urgency unfortunately makes a more formal empowerment impossible.

Although the operation would be reinsured via the local company's normal reinsurance treaties, the ideal thing would be for the foreign insurance company acting on our behalf to accept part of the risk facultatively in reinsurance, and we would even venture to say that without that reinsurance, the operation should not be carried out since, on the one hand, the efficiency of the representation would be much less and, on the other, non-acceptance of the risk, except for reasons of

accumulation, would be a reason for doubting the solvency of the parent company offering us its counter guarantee.

Needless to say, the information the foreign insurance company could provide to us about the parent company is vitally important in this kind of operation.

It very frequently transpires that very important trading companies in the grain sector, for instance, have overseas subsidiaries requiring bonds for large sums, whose solvency, however, leaves a lot to be desired on occasions.

I would draw attention to the inexcusable need of a counter guarantee in these cases, whatever the name of the company involved, since the multinationals' subsidiaries are often just that: a name and little else. As always, before accepting the operation, the parent company's financial situation will be analysed.

- II. In the case whereby the international contractor does not have offices in our country, or, though having them, has no movables or real property, we only undertake the operation with the reinsurance of an insurance or reinsurance company of the same nationality as the contractor applying for the bond.

Our action method in these cases is as follows: we ask the contractor to have his local insurance company send us a telex saying it accepts up to 100% of the risk we are going to take on by issuing the bonds applied for. We shall only issue these bonds if the reinsurer is known to us and offers us good security, since otherwise we shall not accept the risk. On some occasions, we provide the international contractor with the name of insurance

companies in his country which offer good securities so as to thus facilitate and expedite the arrangements.

In these operations, the possibility of the bond issuing company retaining part of the risk is desirable but difficult in view of the normal urgency in these cases and our lack of knowledge with regard to the international contractor's solvency. We would then be in a fronting situation in which the operation is secured and offered by the issuer.

As far as the premium rate to be applied is concerned, we think it should be that of the issuing company's country and the premium payment will be a single one for the whole period since experience tells us how difficult it is to collect the second and successive payments. The commission to be collected from the reinsurer should be the usual one in facultative business: 25%.

III. The case of an insurance company asking us to issue a bond for a customer of theirs who is going to carry out work or a supply in our country is the well known one of fronting. Although briefly, I would like to point out the different ways of carrying out these operations:

1. The most usual way of carrying out frontings in Europe is with the local company issuing a simple letter of counter guarantee in favour of the fronting company. The latter only collects a commission via the local company, normally varying between 10/20%, and the local company issues a premium receipt on the basis of the counter guarantee it has given, collecting it in the usual fashion from its customer, although as an exception I would say that in our country the premium receipts for bonds or, in the case under discussion, for counter guarantees as

issued in foreign currency must be made and collected in the same currency as indicated in the bond.

There is a more or less standardized counter guarantee model between European insurance companies, apart from mutual knowledge of each other, thus enormously facilitating and simplifying these operations.

2. In America, at least in Central America, with the exception of Mexico, and in South America, with the exception of Brazil and Argentina, these fronting operations have the legal and accounting support of facultative reinsurance operations. That is to say, unlike the case we have discussed above, the fronting company issues not only the bond but also the premium receipt which it usually must also collect in its country, assigning the risk and premium less the fronting commission through a bordereau and subsequent settlement of accounts.

The case of Mexico is somewhat peculiar: it uses the counter guarantee system, which they call a back-up bond, but with the difference that the customer pays twice, once in Mexico to the bond issuing company and again in his own country to his insurance company for the back-up bond, since Mexican companies cannot reinsure themselves abroad until the local market's capacity is exhausted.

In fact, the Mexican system is the one which the banks use in practice, turning to Mexican banks so as to give a service abroad to its customers. The latter must pay twice, once to the guarantee issuing bank and again to their bank for the counter guarantee. Undoubtedly, some of the systems used by

insurance companies are cheaper and I would venture to say quicker also than the bank systems, particularly in Europe.

The practice of fronting operations undertaken as facultative reinsurance operations raises the following questions, amongst others:

- A. What should fronting commission be?
- B. Where and when should the premium be paid?
- C. What should the premium rate to be applied be?
- D. Is it necessary to establish a counter guarantee or specific compensation agreements with our customers for fronting operations.

In my opinion, the answers to these questions might be:

- A. The commission ought to be between 10/20% and, of course, with no premium deposit. If the fronting company requires more participation in the operation's profit, it ought to take on part of the risk. When applying for a fronting, whatever the system used, I would be in favour of furnishing concise information on the customer in the telex or fax itself, including a summary of the last three fiscal years' balance sheets so that the fronting company may accept part of the risk, if necessary and if it deemed fit.
- B. If there are no legal impediments, the premium ought to be paid in the contractor's country, since, in fact, the risk and the premium, except for the fronting commission, are for the insurance company in his country, so payment for the operation is expedited. Unfortunately, this

7.

- C. ¿Cuál debe ser la tasa de prima?. ¿La que habitualmente aplica la compañía fronting o la del país de la compañía que solicita la fianza?. Creo que respecto a esto no se pueden establecer reglas fijas, pero en mi opinión no debe forzarse a la compañía fronting a cobrar tasas que "rompan" su mercado, aunque también creo que si el 100% del riesgo va a cederse vía reaseguro a la compañía local, ésta puede "sugerir" la tasa de prima a aplicar, sobre todo teniendo en cuenta la agresividad de algunos bancos.
- D. ¿Es necesario instrumentar algún tipo de contragarantía, además del ofrecimiento de reaseguro al cien por cien?. Creo sinceramente que desde el punto de vista de la compañía fronting que cede el 100% del riesgo no es necesario, ahora bien, si la compañía fronting va a retener una parte del riesgo, tiene derecho a exigir la formalización de un acuerdo de indemnización entre el cliente y la compañía local que también le ampare a ella. Para la compañía local ese acuerdo o convenio de indemnización es el único instrumento jurídico que le permitirá en caso de siniestro, recuperar de su cliente el importe de lo pagado, por lo que su formalización es de vital importancia.
- IV. Me queda por último comentar el cuarto caso de contacto con clientes internacionales, las "joint-ventures" entre clientes nuestros y contratistas internacionales. En estos casos lo normal es que sea nuestro cliente el que nos solicite la fianza para ellos y su asociado. Si el contrato y la fianza establecen que la responsabilidad es solidaria, que es lo habitual, la suscripción no tiene problemas si disponemos de capacidad de reaseguro para nuestro cliente, ya que al ser éste responsable jurídica y económicamente al 100% podemos considerar que se trata de una fianza normal.

IV. Finally, it remains for me to comment on the fourth case of contacting international customers, the joint ventures between customers of ours and international contractors. The normal thing in these cases is that it is our customer who applies to us for the bond for himself and for his associate. If the contract and the bond lay down that liability is joint, which is usual, underwriting presents no problems if we have a reinsurance capability for our customer, since with the latter being 100% legally and economically liable, we can consider it as a normal bond.

Otherwise, we would refer to one of the other three cases mentioned above, with the indication that here the premium rate should always be that which our customer has, since preferential treatment given to the foreign company would not be reasonable and moreover, will be known to our customer and might bring negative repercussions for our future relations.

In addition to the four cases discussed during this address, there would be a fifth possibility which I have not mentioned beforehand. This would be the international contractor acting as a subcontractor in a contract in our country, for which he must submit bonds to the main contractor. However, I think this situation could be solved according to what has already been suggested in the first three examples, depending on the characteristics of the case.

Underwriting these risks for international contractors naturally leads to a detailed analysis of the contract stipulations, particularly with reference to the contract financing, the existence or not of price review clauses, the cases of *force majeure* provided for, the existence of comprehensive insurance for construction or similar if dealing

with another kind of contract, as well as knowing whether the insured is public or private. All these details, together with the analysis of the contractor's financial situation, should lead us to sound, problem-free underwriting. I hope to have contributed towards this in some way, with my modest address.

I now take my participation as finished but not before thanking you all for your attention. Many thanks.