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SURETY BONDS: A KEY TO GROWING INTERNATIONAL BUSINESS

INDUSTRY VIEW

As more companies look for ways to expand into new markets, surety bonds provide a valuable safeguard and financial advantage.

Growing revenue is front of mind for most companies looking to recover from a period of contracted business and slowdowns. How can those who want to expand globally and explore new markets make the most of opportunities, avoid risk, and maximize cash flow?

One effective solution is surety bonds. Protecting the customer against supplier default, they offer an alternative to bank guarantees with greater financial flexibility.

In a global infrastructure boom and during a time of ongoing geopolitical and economic challenges, it is no surprise that demand for surety bonds is on the rise. It is expected to grow by 6.4% to reach US$25 billion by 2027. Not only are surety bonds a valuable solution for all parties, but now they are often a mandatory supply condition.

How do surety bonds support the international business?

Like a bank guarantee, surety bonds protect the customer against any loss due to late or incomplete delivery on the part of their supplier. Commonly used in large cross-border projects such as construction, infrastructure, resources, and manufacturing, surety bonds are usually mandatory for public tenders and are increasingly required for private projects.

> *The surety bonds help companies explore new markets, allowing them to successfully bid for work in an increasingly complex global marketplace.*

As a legally binding contract between three different parties (the Obligee, Principal, and Surety), a surety bond reduces the risk of entering into an international contract by comforting the Obligee (the customer) to ensure the Principal (their supplier) will meet the terms of their contract, safeguarding against their failure to do so, for example, meeting the specifications of a construction contract, or supplying goods within a specific timeframe.

Surety companies rigorously evaluate contractors' ability to perform their contracts technically and financially. The Surety (the insurer) is the third party who provides the bond, mainly in the form of a First Demand Guarantee so that if the Principal does not meet the contract terms, the Obligee can claim on the bond to recoup their losses. The Surety pays the value of the bond to the Obligee and then recovers that amount from the Principal.

This is especially useful for long-term cross-border projects where different legal and operating systems are involved and where recovery of debts would otherwise pose a challenge, for example, in the case of supplier insolvency in a country where the legal system does not prioritize debts owed to foreign parties.

The key to driving global expansion

Surety bonds offer several advantages for companies looking to win large-scale tenders and expand their business internationally.

Firstly, they help to improve liquidity by avoiding the need for a bank guarantee. Then, companies can reserve those lines of credit for working capital or to meet their other obligations.

Secondly, surety bonds help companies explore new markets, allowing them to successfully bid for work in an increasingly complex global marketplace, where they may need to become more familiar with operating and legal conditions or during periods of uncertainty.

Thirdly, surety bonds can help foster long-term relationships and trust between the customer and the supplier. Effectively, suppliers can give their customers a high level of confidence in their ability to meet the contract terms and that they will otherwise be compensated. For the customer, the peace of mind that a First Demand Guarantee is generally paid out within 48-72 hours via SWIFT provides added confidence in moving forward with a supplier, regardless of their track record.

Building diversification in financing

As an alternative to traditional bank guarantees, surety bonds offer companies a way to diversify their financing, helping to avoid cash flow shocks by freeing up assets that would otherwise be tied up as security by the bank.

In doing so, companies can reserve their bank credit facilities and corporate assets for other purposes, making managing their cash flow and broader finances easier and enabling them to pursue more projects or expansion plans. Contrastingly, bank guarantees come with liability and can significantly affect a company's borrowing limits and growth capability.

Companies often use surety bonds to support their risk strategy, as they are considered one of the most cost-effective forms of financing. Surety premiums are charged only on usage, with annual premiums including fronting fees paid in advance. They are only valid for the contract period or a maintenance period afterward.

Since surety bonds tend to be long-term, they are not as strongly impacted by economic fluctuation, making them more suitable than other forms of financing in the current global financial climate. With concern around interest rates worldwide, many companies are turning to surety bonds for a reliable and cost-effective solution.

Fronting: the critical factor for cross-border success

In the case of surety bonds for international transactions, an insurer's fronting relationships are critical to winning business.

When an insurer receives a request to issue a guarantee like a bid bond or a performance one for a contract outside of their area or jurisdiction, they need a way of identifying the various legal and operating factors within that country and assessing how they differ to the country where the supplier operates typically. So, they work with a local fronting partner.

A local surety or fronting partner is chosen for their in-depth knowledge and local expertise so that the surety bond can be issued successfully. Without appropriate fronting partners in place, a company risks being denied the surety bond and ultimately missing out on winning new business in that market.

For example, if a French company required a bond to be issued for a public tender in Australia, their insurer would need to have a fronting partner registered in Australia who understands the local operating environment so that the bond can be issued in accordance with Australian law.

With a local fronting partner to advise and negotiate on the conditions and wording of the bond, the supplier is protected against the customer calling the bond without proof of failure. Plus, in the case that the customer does make a legitimate call on the bond, it ensures it is processed smoothly without being thrown out by the local court.

Further, a customer can impose rating requirements on the Surety's local fronting partner, such as AAA. In some markets, there may not be a bank with such a rating, but an insurer can often locate a subsidiary or branch in that country with an acceptable rating. In some cases, the insurer may need to provide several options to the customer. Hence, the insurer's access to well-established fronting networks is critical to the successful issue and acceptance of a surety bond and, ultimately, a company's ability to win that business.

The future of international bonding operations: e-bonds and blockchain

While bonds have for many years been administered efficiently, they are now even faster thanks to the widespread availability of e-bonds. Now, a common bond can be requested seamlessly via smartphone using an insurer's or broker's front-end portal and issued within ten minutes instead of several days. For more specific bonds, a front-end portal allows customized text to be uploaded, reviewed, and issued within a few days.

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The acceptance of e-bonds varies, but it is becoming more commonplace. For example, in France, all public tenders can now accept e-bonds and other forms of digitalized documentation, such as digital signatures by European eIDAS standards.

The result is an acceleration in the pace of international business. This means that suppliers can respond faster to bids as they arise, helping them make the most of opportunities and be more competitive.

User behavior now drives insurers to innovate and provide user-friendly, practical solutions for bond requests. An insurer's key selling feature is not the bond product itself but the speed and usability of its systems. With new players entering the market with entirely electronic operating systems, insurers must rapidly adapt and invest in fast front-end portals.

Brokers are starting to benchmark the speed of the various portals, in many cases creating their multi-issue platforms, serving end-users increasingly driven by speed. For standard bonds, users don't care which insurer issues them; they care more about the speed at which they are issued.

A common challenge has been the need for a streamlined ecosystem. Blockchain solutions in surety bonds are starting to appear, helping both the supplier and their customer to ensure the bond being issued is valid.

The Institutes RiskStream Collaborative (the insurance industry's largest enterprise-level blockchain consortium) and The International Credit Insurance & Surety Association (ICISA) have announced a new working group (of which Tinubu is a member), to streamline the power of attorney registration and verification process for the ecosystem, and to simplify the development and adoption of blockchain technology in the industry.

This is another positive advancement and reason to consider surety bonds for companies wanting to succeed in cross-border business.

The demand for surety bonds will continue to rise. For many companies, it is now the case of "no bond, no market." For those looking to win new business in a global marketplace, the innovation and evolution of the surety industry will no doubt ensure they are positioned to take advantage of future opportunities.

About Tinubu

Tinubu is the business facilitator and exchange enabler that delivers fluidity and simplicity to the insurance industry by using the strength of collective performance.

Our company is an alliance of technology software and insurance expertise offering the best combination to its clients. It covers the entire value chain of credit insurance & surety with one end-to-end platform, connecting every part of your business with one digital highway.

Established in 2000 and headquartered in Paris, France, Tinubu is an independent software provider and employs 170 people, located in Paris, London, New York, Orlando, Singapore, and Montreal. Its clients represent 30 of the top 60 Credit & Surety underwriters worldwide.

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Gilles joined Tinubu in September 2022, taking on the mission of tailoring Tinubu's US-market-leading digital surety solutions for the EMEA and APAC regions and then promoting these innovative solutions among Carriers, MGAs, and Brokers in those markets.

Gilles has built up a 20-year career in the surety industry. He started in the telecom sector as a Product Manager and then joined Atradius as a Market Manager, specializing in Surety & Guarantee solutions. He later founded the Surety department of Euler Hermes France (2008), implementing sustainable digital solutions and building numerous partnerships with Banks & Brokers.

Gilles holds a master's degree in Marketing & Strategy with honors.

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