General Insurers should be allowed in surety bond biz- IRDAI working group

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A working group of the insurance regulator, tasked with giving recommendations on Indian general insurers offering surety bonds, has said insurers should be allowed to enter into surety bond insurance business with solvency margin above a certain threshold.

This is because surety bond insurance is yet to develop in Indian market and the risk exposure under this business is significant compared to other lines of business which are reasonably mature in Indian insurance market.

"If the insurer's solvency ratio falls below the specified threshold limit at any point in time, the insurer shall stop writing new surety bond business until its solvency ratio improves above the specified threshold limit," the working group said in its recommendations.

A surety bond is a contract between three parties, wherein the third party provides financial guarantee on behalf of a seller/contractor to the buyer of his services. It is similar to bank guarantees.

The regulator may give specific approvals to insurers for issuance of sureties based on their capability to handle the business. According to the working group, the insurer should get capital relief to the extent the exposure is reinsured through the reinsurance structure.

It has also recommended that the exposure of an insurance company in the surety bond business needs to be regulated through a cap on its exposure under this business as a proportion of its net worth.

"It is emphasized that regulatory framework is extremely important for encouraging the surety business with recourse mechanism", the working group said.

Furthermore, the board of the insurance company has to assess the company's ability to retain the surety risks based on financial strength of the company. They also need to mandate appropriate reinsurance requirements to ensure that disproportionate surety risks are not written by the company. The board will need to conduct a review of the business on an annual basis.

Before underwriting a surety risk, the insurers will adjudge the risk based on conditions such as the contractor has good references and reputation, has the ability to meet current and future obligations, has experience that matches the contract requirements, has the necessary equipment to do the work, and has the financial strength to carry and support its share of the project work.

"The underwriting process shall include review of contractor's financials, cash flow, tax returns, liquidity and debts", the working group said.

They have also recommended that the surety bonds should be included in the Insolvency and Bankruptcy code and given equivalent status as bank guarantees to ensure speedy and effective resolution and enforcement of indemnity by surety providers.

The bonds that can be offered to construction companies include: Bid Bonds, Performance Bonds, Advance Payment Bonds and Retention Money. The guarantee may be limited to maximum 30 percent of project value.

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The insurance regulator had set up a committee to examine the possibility of general insurance companies issuing surety bonds. In 2016, the department of financial services, had written to the insurance regulator to explore the possibility of introducing surety bonds and due to the covid19 pandemic and consequent economic impact on liquidity and cash flow issues the Ministry of Road Transport and Highways, Government of India, had requested IRDAI to examine possible offering of Surety Bond being issued by general insurance companies.

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