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SURETY DEVELOPMENT IN EUROPE: WHAT TO EXPECT?

MARKET ANALYSIS THOUGHT

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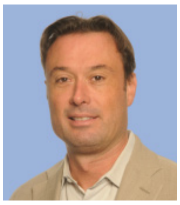

With over 20 years of experience in the surety industry, Gilles Goaoc is now part of a team of key specialists onboarded at Tinubu. He is coworking with customers to tailor Tinubu's digital surety solutions to the European market, participating in the implementation of Tinubu's strategy of building a 360-degree Digital Highway for the commerce-related specialty lines ecosystem participants and internationalizing the footprint of our Surety Solution.

Tinubu, a major player within the surety software ecosystem.

Surety Bonding involves a large ecosystem including Principals, Obligees, Agents and Brokers, Carriers, MGAs, Reinsurers, and Regulators. They all need to collaborate in a fast-evolving environment and cope with demanding users' expectations.

Today, the surety industry is increasingly keen to leverage technology to improve its risk & commercial underwriting processes and increase its market share.

Tinubu Surety is a global end-to-end surety platform covering the entire chain of interactions. It supports 30 of the top 60 credit & surety underwriters worldwide and over 200 brokers and agents.

Question #1 – Could you start by telling us about Tinubu's position in the surety industry today?

Gilles Goaoc: I should start by saying that since its formation, Tinubu has been committed to continuous innovation, and today, we are very active with Surety organizations such as ICISA and The Institutes RiskStream CollaborativeTM to design tomorrow's solutions.

Tinubu is collaborating with some of the largest insurers and brokers, and is at the heart of surety bonds issuance, particularly in the US where the market is the most active worldwide.

As a matter of fact, in 2020, Tinubu acquired eSURETY and SuretyWave, two leading software companies, and invested in their development by involving the customers. As a result, about 40% of US surety bonds

> *The European Surety industry is now at a maturity stage.*

are issued today through a Tinubu platform. Carriers and brokers using our solutions also have significant international market share.

That is why I believe we have the capacity to feel the pulse of this industry and identify trends that are emerging, especially those relating to the outsourcing of surety systems to the Cloud and the search for interconnection between third-party systems.

Question #2 – Diving now specifically into the European surety market, how would you describe its current state?

Gilles Goaoc: Well, after about 25 years of development – since banks started to lose ground to other types of carriers, more markedly after Basel III – the industry is now at a maturity stage, and it continues to expand, thanks to the industrial sector that is still evolving, the increasing needs in the construction and infrastructure sectors – the primary consumers of surety – and the development of technology and economy.

The surety market is primarily a highly competitive market, with 2/3 of the market share still being held by banks. Although on the insurance side, as of 2021, market concentration in specific countries is much higher than the concentration ratio of the European market as a whole. The footprint in Europe as a whole of the top three insurance companies is at about 21.5%.

So, yes, we do have quite a few players in Europe.

Question #3 – What are then the types of bonds most in demand in Europe?

Gilles Goaoc: The primary market segment, by far, is contract surety bonds. According to our last study[1], they represent just over 60% of the whole European market. Commercial bonds then come second with a share of nearly 23%.

Also, an earlier survey[2] showed that almost half of the insurance-backed surety bond market came from construction-related contract bonds.

This survey was conducted in Germany, France, Belgium, Italy, Spain and Poland, as well as in Switzerland and the UK. Across all eight countries combined, the results indicate that contract bonds accounted for a weighted average of 75.6% of the total market in 2019, equivalent to an implied market value of EUR 1.66 billion (with 49.15% or EUR 1.09 billion coming from the construction sector). The remaining 24.4% (around EUR 536.5 million) of the market was attributable to commercial bonds.

Question #4 – And what do these two surety bonds cover?

Gilles Goaoc: Contractual bonds are usually required from a contractor by a government entity or an owner of a construction project, or even for a private transaction, such as the delivery of goods or commodities. These bonds are designed to ensure that the contractor is qualified to perform the necessary work, that he will complete the project in a timely manner, and will also be able to pay his subcontractors, suppliers and laborers. And if the contractor fails to do so, the issuer of the bond must find another contractor to complete the project or compensate the obligee for their financial loss. So, the contract bond is a protection for the buyer, whether it's a State or private entity.

Now, Commercial Surety Bonds – also known as non-contract bonds – are protecting the consumer against fraud or misrepresentation, and so, monetary loss. They secure the compliance with legal or regulatory obligations. Typically, they are required by a court, a government body, a financial institution

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1 Arsta report from 2022.
2 Finaccord report from 2020.

or a private corporation, and they are a guarantee that the business subscribing to the bond is complying with State regulations and is performing as it should. Common examples are customs services requiring a community transit bond to ensure the free movement of goods, or the regional prefecture requiring an environmental guarantee before they can issue an operating permit.

Question #5 – Are there countries that have a higher transaction volume?

Gilles Goaoc: Germany remains by far the leading country with 40% of gross written premium, given that its industrial and construction sectors are amongst the largest in the euro zone with higher premium rates.

Italy comes next with 21% of gross written premium generated. The Italian market is quite active due to the number of legal obligations to be guaranteed, which is greater than in France or Spain. Italy also benefits from a fairly dense fabric of SMEs established in the industrial and service sectors, all of which are huge users of "Tender bonds."

France, the UK and Spain then follow in terms of market size, respectively with 10%, 8% and 6%. The UK and France used to be neck and neck, but France has taken the lead since Brexit.

Switzerland and Belgium are further behind amongst the rest of the players.

Question #6 –As you mentioned earlier, insurers are then not the major carriers on the surety market.

Gilles Goaoc: That's right. Specialty lines insurers only issue a third of the bonds. Banks still issue nearly the other two thirds.

However, what we see today is a gradual shift from the larger market for guarantees issued by banks and other entities to that for insurance-backed surety bonds, and this is linked to the Basel III reforms that came into effect in 2014. Specifically, these Basel III reforms stipulate that banks must hold an amount of capital that is adequate to cover their underlying business risks. On the other hand, insurers are mostly driven by Solvency II regulations, which, for instance, give them more flexibility on capital requirements, so more risk appetite. Of course, with the recent financial default in the US, we have seen how protective these bank regulations can be for corporate clients.

> *Surety players are investing to streamline data flow and verification.*

Question #7 – Now, let's talk about the market dynamics. Have you identified any trends?

Gilles Goaoc: Indeed, we can see three main growth drivers for surety.

First, you have the preservation of borrowing capacity which is a demand driver. Unlike a letter of credit, a surety bond does not count against a company's overall borrowing capacity, which means it can free up capital and credit for more productive uses. Surety bonds also enjoy a cost advantage since their pricing is not tied to interest rate fluctuations.

Then, you have private development. Owners of private projects are not required by law to purchase a surety bond. However, they may require one in the terms of their agreements, such as a lender who is financing a private project. The presentation of a surety bond means security for the project owner or the purchaser as it further substantiates the contractor's ability to fulfill its obligations.

And, as the third driver, you have subcontractor requirements. A prime contractor will often work with a subcontractor who is usually an expert in his field. A contract surety bond from a subcontractor to the prime contractor can be a key risk-mitigation tool.

Question #8 – How will these drivers materialize in terms of opportunities over the coming years?

Gilles Goaoc: What we see in recent years is that software solutions are using APIs to create gateways between the various surety bonding issuance systems, so that clients can have a centralized view of all their bonds issued with their various banking and insurance partners. Surety players are investing in order to streamline data flow and verification, lower operating costs, drive efficiency, and enhance customer experience.

The electronic signature of surety guarantees, and their authentication is another trend of major development. The reason can easily be understood: as of today, according to The Institutes RiskStream CollaborativeTM, only 5% of surety bonds are digitally issued. In France, for example, public tenders already accept dematerialized guarantees, and they are even becoming a standard.

Question #9 – What factors or developments could limit the issuance volume of surety bonds?

Gilles Goaoc: ESG (Environmental, Social, and Governance) is still a hot topic for surety companies – all the more so as it will be increasingly governed by various European and national regulations (SFDR, etc.) in terms of criteria and reporting. There are many valuable global ESG rating initiatives from various surety players which must integrate a wide range of ESG data.

ESG rating methodologies may be based on the counterpart, product or transaction assessment – all of which are valid and valuable.

Also, I think that ESG will be an additional arbitration factor in the sense that carriers will be less likely to endorse projects that have a negative impact on the environment, such as open-pit mining, coal mining, weapons, gambling, tobacco, and so forth. As a matter of fact, carriers will accelerate their involvement in renewables, social infrastructure and 'waste and water' treatment projects.

They could lower their premium rates for such projects, and make sure their ESG analysis and monitoring is as comprehensive as possible, since they're involved in the whole lifecycle of these assets from pre-shipment to decommissioning.

Digital data and standardization would certainly help in achieving this.

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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.

About the Authors

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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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