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Surety bonds: General insurers seek clarity on various provisions from IRDAI

Surabhi(Https://Www.Thehindubusinessline.Com/Profile/Author/Surabhi-8993/) | Mumbai | Updated On: Apr 15, 2022

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Pricing, reinsurance, default, solvency margins are the key concerns

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General insurance companies have sought clarity from the Insurance Regulatory and Development Authority of India (IRDAI) on various provisions relating to surety bonds.

While the product came into effect from April 1, most general insurers have evinced interest, but have indicated that they cannot move ahead without more clarity on the structure and pricing of these bonds. There are also concerns relating to default, reinsurance support as well as experience and capacity to underwrite such bonds.

“We are working with the IRDAI and have sought clarifications,” said executives with two general insurance firms.

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Risk assessment

A top concern is that general insurers do not have the same understanding of customers as banks. “We are not placed at par with banks in terms of assessing risks and underwriting for such products. We need to understand how to move forward on this,” said one executive.

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Another insurer noted that there has to be clarity on where these bonds stand under the Insolvency and Bankruptcy Code.

“Without any clawback that banks have through the IBC process, we can’t offer these bonds,” he noted.

The industry is hopeful of IRDAI’s quicker response after which insurers plan to take a call on offering such products.

IRDAI guidelines

The IRDAI had in January this year issued guidelines to regulate and develop the surety insurance business.

A surety is a contract to perform the promise, or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the Surety; the person in respect of whose default the guarantee is given is called the principal debtor, and the person to whom the guarantee is given is called the creditor.

General insurers can offer surety insurance contracts to infrastructure projects of the Government and Private in all modes, it had said.

Finance Minister Nirmala Sitharaman had in the Union Budget 2022-23 announced that to reduce indirect cost for suppliers and work-contractors, the use of surety bonds as a substitute for bank guarantee will be made acceptable in government procurements.

“Business such as gold imports may also find this useful. IRDAI has given the framework for issue of surety bonds by insurance companies,” she had said.

Experts take

Experts said that while the bonds will benefit smaller companies, especially MSMEs, there are some ground challenges due to which its acceptance is slow.

Saurabh Bhalerao, Associate Director – BFSI Research, CARE Edge Ratings said, “There are questions about how the product will be priced and how would reinsurance support will be available. Further, under IRDAI guidelines, insurers need to maintain 1.25 times solvency margin to offer surety bonds. This requirement, in effect, will mean that the effective solvency margin needed would be 1.875 times,” he said.

Another question is what happens in case of a default and where do these bonds and the insurer offering them stand in the IBC, he further said, adding that the pricing will also have to be built accordingly.

“Insurers also need to develop the capability to assess the risk for such bonds. This will take time,” he said.

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According to some players, there are also some concerns about the size of the business

IRDAI norms stipulate that the premium charged for all Surety Insurance policies underwritten in a financial year should not exceed 10 per cent of the total gross written premium of that year, subject to a maximum of ₹500 crore.

This would mean that only few players would be interested in the product as for smaller general insurers, the 10 per cent cap would limit the product size significantly.

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