

Draft IRDAI (SURETY INSURANCE CONTRACTS) GUIDELINES, 2021

1. Introduction

1.1 The Insurance Regulatory and Development Authority of India (‘‘the Authority’’), having considered it necessary to promote and regulate sustainable and healthy development of Surety Insurance Business, in exercise of the powers conferred under section 14 (2) (i) of IRDA Act, 1999 hereby issues IRDAI (Surety Insurance Contracts) Guidelines, 2021 .

2. Short title, commencement

2.1 These guidelines shall be called the ‘‘IRDAI (Surety Insurance Contracts) Guidelines, 2021.’’

2.2 These guidelines shall come into force with effect from 1st ----, 2021.

3. Scope and Applicability:

3.1 No person shall, after the commencement of these guidelines, transact the business of Surety Insurance in India unless the person is an Indian Insurance Company as defined in Section 2 (7A) of the Insurance Act, 1938.

3.2 All Insurers registered under the insurance Act, 1938 to transact the business of general insurance may conduct the business of Surety Insurance subject to compliance with eligibility criteria as set out in these guidelines.

3.3 Any applicant intending to commence Surety Insurance business can do so by applying for grant of certificate of registration in accordance with IRDA (Registration of Indian Insurance Companies) Regulations, 2000 and amendments thereof. However, the preference to grant certificate of registration shall be given to the applicant whose promoters are already engaged in carrying out Surety Insurance Business in any jurisdiction.

3.4 The applicant who desires to register as specialized/monoline insurer for offering Surety Insurance may also underwrite trade credit insurance subject to the trade credit insurance guidelines and additional capital requirement as may be prescribed by the Authority.

3.5 These Guidelines are complementary to the provisions of any other laws, rules, regulations or guidelines, for the time being in force.

3.6 The essential features of a Surety Insurance contract shall be as follows.

- (i) It shall be a contract of guarantee under Section 126 of the Indian Contract Act, 1872. It 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”.
- (ii) It shall be a tri-partite contract among the “principal debtor”, “creditor” or “obligee” and the “surety” or “Insurance company”, which provides the performance guarantee.

The contract between the principal debtor and the creditor or obligee is primary. Then there must be a contract between the creditor or obligee and the surety by which the latter guarantees the debt. However, in order to constitute a

contract of guarantee, there must be a third contract, by which the principal debtor expressly or by necessary implication, requests the surety to act as a surety.

3.7 The Surety Insurance products shall be subject to all provisions and relevant procedures of File & Use as stipulated under the Guidelines on Product Filing Procedures for General Insurance Products to the extent that such provisions are not inconsistent with the provisions of these Guidelines.

4. The Types and the Definitions of Surety Contracts

(a) In these Guidelines, unless the context otherwise requires, the terms herein shall bear the meanings assigned to them below.

(i) **Advance Payment Bond:** It is a promise by the surety provider to pay the outstanding balance of the advance payment in case the contractor fails to complete the contract as per specifications or fails to adhere to the scope of the contract.

(ii) **Bid Bond :** It is an obligation undertaken by a bidder promising that the bidder will, if awarded the contract, furnish the prescribed performance guarantee and enter into contract agreement within a specified period of time. It provides financial protection to an obligee if a bidder is awarded a contract pursuant to the bid documents, but fails to sign the contract and provide any required performance and payment bonds.

(iii) **Contract Bond:** It provides assurance to the public entity, developers, subcontractors, suppliers that the contractor will fulfil its contractual obligation when undertaking the project. The contract bonds may include: Bid Bonds, Performance Bonds, Advance Payment Bonds and Retention Money.

- (iv) **Customs and Court Bond:** This is a type of guarantee where the obligee is a public office such as tax office, customs administration or the court, and it guarantees the payment of a public receivable incurred from opening a court case, clearing goods from customs or losses due to incorrect customs procedures.
- (v) **Performance Bond:** It provides assurance that the obligee will be protected if the principal or contractor fails to perform the bonded contract. If the obligee declares the principal or contractor in default and terminates the contract, it can call on the surety to meet the surety's obligations under the bond.
- (vi) **Retention Money:** It is the money withheld by the beneficiary that is released to the contractor so that he/she gets sufficient working capital to complete the contract.
- (vii) **Surety Insurance Contract:** A contract of surety shall be deemed to be an insurance contract only if made by a surety who or which, is an insurer registered under the Insurance Act, 1938 to transact the business of general insurance.

All words and expressions used herein and not defined but defined in the Insurance Act, 1938 or the IRDA Act, 1999, or in any Rules or Regulations made thereunder shall have the meanings assigned to them in those Acts, Rules, or Regulations.

5. General Provisions

5.1 A General Insurer shall commence Surety Insurance business subject to:

- (a) Meeting the requirement of maintaining the solvency margin not below 1.25 times of the control level of solvency specified by the Authority. Provided

that where the solvency margin of the insurer falls below the specified threshold limit at any point of time, the insurer shall stop underwriting new Surety Insurance business until its solvency margin is restored to above the threshold limit.

- (b) The underwritten premium in a financial year from the surety insurance business shall not exceed 10 percent of the total gross written premium subject to a maximum of Rs. 500 crores.
- (c) The Authority may impose specific conditions for insurance companies for issuance of Surety Insurance contracts, based on assessment of the insurers' capabilities to handle this business.
- (d) Having Board approved underwriting philosophy on Surety Insurance business, incorporating all aspects for managing this business.
- (e) Having adequate underwriting competence and skills, risk management and required infrastructure for underwriting the surety insurance.
- (f) Establishing risk assessment mechanism/ internal risk management guidelines to evaluate technical/financial strength of principal before and after underwriting the surety insurance business.

5.2 The insurers can work together with banks or other financial institutions such as NBFCs etc to share risk information, technical expertise to monitor projects, cash flow amongst other aspects. The risk information in respect of key financial indicators, contractor's historical payment records to bankers/lenders, their experience of client, promptness of payments, losses incurred, whether working capital account is regular etc., may be shared through this partnership mechanism.

6. Underwriting Philosophy for Surety Insurance Business:

6.1 The Insurers shall have an underwriting philosophy for Surety Insurance business, incorporating all aspects for managing this business and ensure that surety insurance operations are well supported by prudent underwriting practices, sound risk management and internal controls that are commensurate with these operations.

6.2 The Insurers shall set a maximum limit for risk accumulation per Principal and its group companies/firms and maximum retention limit for risk accumulation. The personal guarantees of promoters of principals/contractors as security for issuance of sureties may also be considered.

6.3 The Board of Directors of the insurer shall approve the methodology and procedures to set the maximum limit of accumulation of risks per contractor and these aspects need to be built in by the insurer in their Underwriting Policy and Philosophy.

6.4 The Board of Directors or Risk Management Committee of the insurer shall assess the ability of the insurer to retain surety risks on their balance sheet based on financial strength of the insurer and mandate appropriate reinsurance requirements to ensure that disproportionate surety risks are not written by the insurer. It shall conduct review on quarterly basis.

6.5 The Underwriting Policy and Philosophy, shall amongst other things, ensure to include due diligence relating to the contractor (principal debtor) such as good references and reputation, the ability to meet current and future obligations, experience that matches the contract requirements, the necessary equipment to do the work, 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.

6.6 These Guidelines set out the minimum underwriting safeguards expected of an insurer in accepting business in respect of surety insurance business for the purposes of ensuring its ability to manage the portfolio or fulfil the reasonable expectations of policy holders. It shall be the sole responsibility of the insurers concerned to have due regard to all relevant factors, including the quality of their business portfolio and risk exposure, in determining whether additional level of underwriting safeguards should be maintained.

6.7 The insurer shall not issue any surety insurance contracts on behalf of its promoters/their subsidiaries, groups, associates and related parties.

6.8 Insurers shall, at the minimum, comply with the following.

- a) Market the surety insurance contract only after the same has been filed and noted by the Authority.
- b) Ensure that no surety insurance contract is issued for credit enhancement of any financial instruments.
- c) Not enter into “Alternate risk transfer” mechanism.
- d) Ensure that no single risk and aggregate risk is disproportionate to the capital of the insurer.

6.9 The insurer should provide timely, accurate, independent and objective reporting to Board on the related risks of the surety insurance business, including the procedures and controls in place to manage the risks, and the overall effectiveness of risk management processes.

7. Underwriting of Surety Insurance Contracts:

7.1 Surety Insurance Contracts may be offered to Construction Companies in India that covers road projects, housing/commercial buildings and other infrastructure projects of Government/Private.

7.2 The contract bonds may include Bid Bonds, Performance Bonds, Advance Payment Bonds & Retention Money. Apart from Contract Bonds, the insurers may underwrite customs or tax bonds and court bonds.

7.3 The limit of guarantee shall not exceed 30 % of the project value.

7.4 Surety Insurance Contracts shall be issued only to specific projects and not clubbed for multiple projects.

8. Compliance with Laws:

Surety Insurance contracts shall be issued in compliance with applicable laws. Surety Insurance contracts cannot be issued where the underlying assets / commitment are/is outside India. Further, the payment for risk covered under the surety insurance contracts shall also be made in Indian rupees.

9. Classification of the Surety Insurance Business:

This insurance business shall be classified under Miscellaneous line of business.

10. Maintenance of Centralized Data Base:

The database of the Surety Insurance contracts underwritten by all general insurers shall be centralized at Insurance Information Bureau of India (IIBI). Every insurer shall furnish the customer-wise data and exposures to IIBI as may be specified.

11. Maintenance of information and reports:

The insurers shall maintain the relevant records and data pertaining to surety insurance business and submit to the Authority as and when requisitioned.

12. Powers of the Authority

12.1 The Authority shall have the right to call, inspect or investigate any document, record or communication of the insurer and/or policyholder, if the Authority has reason to believe that an insurer carrying on surety insurance business is acting in a manner likely to be prejudicial to the interests of policyholders or if it is of the opinion that the continued writing of surety insurance business is detrimental to the financial soundness of the insurer.

12.2 Violation of these Guidelines shall invite penal action under the provisions of the Insurance Act, 1938 which includes prohibiting insurer against entering into any new or particular surety insurance business transaction after giving the insurer an opportunity of being heard.

12.3 In order to remove any difficulties in respect of the application or interpretation of any of the provisions of these guidelines and for the purpose of giving effect to the provisions of these guidelines, the Chairperson of the Authority may issue necessary clarifications in respect of any matter covered herein from time to time.

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