

FINANCIAL GUARANTEE BOND FACT SHEET

For Financial Guarantee Applicants

DEFINITION

Financial Guarantee: A noncancelable indemnity bond, backed by an insurance company, which guarantees that principal and interest will be paid in compliance with the underlying contractual agreement or promissory note. Financial guarantee bonds are used by debt issuers as a way of attracting investors. The guarantee provides said investors with an additional level of security that the investment will be repaid/obligation will be fulfilled in the event that the securities issuer is unable to do so. The bond may benefit the principal by enhancing the principal's creditworthiness thereby lowering the cost of financing. The guarantee "wraps" the security/promissory note with the insurer's good name and creditworthiness. Because the bond represents an UNCONDITIONAL GUARANTEE of compliance/repayment, a preferred interest rate is often offered to bonded issuers/promissors.

OVERVIEW

There are three types of 'financial guarantee bonds'. The first category is small "finite" financial guarantee. These are surety bonds with a payment guarantee element. They may look like license/permit or commonly issued performance bonds. The bonds often have a small penalty (denomination) and are underwritten as standard surety but generally higher standards of principal liquidity are necessary. Examples are lease bonds and energy broker obligations. The second category is bonding of structured finance, and the third public finance.

Bond penalties within these latter two categories can be enormous. As a result of severe losses in the financial guarantee sector New York State passed the 'Appleton Law' restricting financial guarantee business to mono-line carriers with specific surplus and reserve levels. Many state insurance regulators promulgated administrative regulations restricting financial guarantee in a similar manner. In the U.S. market there are very few participants. AMBAC, Assured Guarantee, CIFG, Financial Guarantee Insurance Company, Radian, RAM Reinsurance and Syncora Guarantee carry the majority of this market. These companies specialize in the selection of financial guarantee risks and the ongoing surveillance of their principals.

With very few exceptions, financial guarantee insurers DO NOT PARTICIPATE IN PRIVATE, COMMERCIAL TRANSACTIONS. Financial guarantee insurers in the United States do not have an appetite for private person-to-person or business-to-business transactions. FINANCIAL GUARANTEE INSTRUMENTS FOR PRIVATE CONTRACTS ARE NOT AVAILABLE FROM STANDARD FINANCIAL GUARANTEE MARKETS. The alternative is to approach a captive insurance carrier or specialty insurer based outside of the regulatory jurisdiction of the United States where carriers are not hampered by mono-line restrictions. The few markets that will entertain private financial guarantee severely limit their exposure on each risk accepted. Financial guarantees for non-government issued securities or asset-backed securities with very little worth DO NOT EXIST. Further, private financial guarantees are almost always written with FULL COLLATERAL SECURITY. Financial guarantee insurers are not interested in promises of indemnity based on the speculative assessment that a particular business transaction will be successful or upon speculative representations regarding the ongoing profitability of business operations.

Pursuant to the rights granted to me as an attorney-in-fact for a small pool of international carriers, I am willing to receive and review applications for pure financial guarantee. These instruments are considered to be extremely risky therefore my due diligence must include a review of the proposed contract, the solvency and identity of the underlying indemnitors/promissors, and assessment of the collateral offered in support the bond. Premiums are generally fifteen percent (15%) of the bond penalty per annum for those bonds to one million U.S. Dollars, and ten percent (10%) of the bond penalty for those bonds in excess of one million U.S. dollars. Collateral security in the form of cash, letters of credit, or highly rated debt instruments (i.e., U.S. Treasury issues, notes, bills, warrants, and highly stable, publicly traded stock or bond issues) will be credited at one hundred percent (100%) of current market value. Certain financial guarantee requests may qualify for collateral terms that are less than the full penal sum of the bond. Unacceptable forms of collateral are real property, commodities, "blocked funds letters", and the like.

RATINGS

There are currently only three financial guarantee insurers with an A.M. Best rating which operate in the United States. Two of those entities are absolutely unwilling to write bonds for private contracts, one will consider them. The former two will only issue financial guarantee bonds to municipalities that collateralize the obligation with bonds or other instruments issued by that municipality, leaving only the third as a “rated” carrier from whom I receive authority. I hold authority with three international financial guarantee insurers, two carrying AM Best ratings. Given the severe restrictions of financial guarantee to mono-line insurers, carriers that wish to engage in financial guarantee business in addition to other insurance lines are often forced to move to a domicile without those restrictions. Bermuda, Seychelles, Cayman Islands, the British Virgin Islands and the Dominican Republic are currently the choice destinations for offshore captive insurance companies. There is no ‘automatic’ rating system for non-admitted carriers. In order to obtain an A.M. Best rating an insurer must ordinarily have certain ‘seasoning’ minimums and necessarily come under market surveillance by the rating agency. The carrier’s financial statements and books must be open to the rating agency. These requirements discourage many international carriers from seeking admission and rating. First, by entry (admission) into the U.S. market a carrier invariably subjects itself to the U.S. and local tax regimes, precisely why many insurers do not enter the U.S. domestic market. Second, not all insurers wish to share their financial statements with a market surveillance entity. Those carriers on which we issue financial guarantee that do NOT carry an AM Best rating will provide audited financial statements demonstrating solvency.

NEXT STEPS

I hope that this information is helpful in understanding financial guarantee instruments. Cognizant of the preceding product facts, if you feel that your transaction may fit within our parameters I invite you to email me detail of your financial guarantee need.