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Surety bonds: Insurers to compete with banks

OUR BUREAU

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Insurers may give a tough competition to banks when it comes to providing financial backstop to clients.

Finance Minister Nirmala Sitharaman, on Tuesday, said the use of surety bonds (issued by insurers), as a substitute for bank guarantee (BG), will be made acceptable in government procurements.

"Business such as gold imports may also find this useful. The IRDAI has given the framework for issue of surety bonds by insurance companies," said the Minister in her Budget speech.

Joydeep K Roy, Partner and Leader - Insurance, PwC India, observed that overall growth of infrastructure projects will automatically increase premiums in this regard, but the promulgation and introduction of Surety Bonds will open up a fresh stream of insurance revenue and capital and can even attract many specialised insurance companies to come into India with foreign capital.

Rakesh Jain, CEO, Reliance General Insurance, noted that the move on the Surety Bonds front recognises the ability of the insurance industry to provide alternative products to the banking sector, thus paving the way to reduce the cost and diversify risk.

Banking expert V Viswanathan said insurance companies will get new business. BGs require a customer to provide a margin (of 10-25 per cent) and commission (2-3 per cent) to the bank. However, in the case of surety bonds, a customer only needs to pay premium to the insurer.

"But, I think, there is a cap on issue of Surety Bond in a project. Notwithstanding the cap, this move is likely to impact bank guarantee business.

"Probably banks may try to compete with less margin and commission requirements, at least in respect of reputed contractors of long-standing," said Viswanathan.

However, insurance companies might not have the expertise that banks have in evaluating credit risk. So, surety bonds might encounter delays in sanction.