

Achieving Financial Close

Sponsors insurance adviser perspective

Executing Projects
December 2017

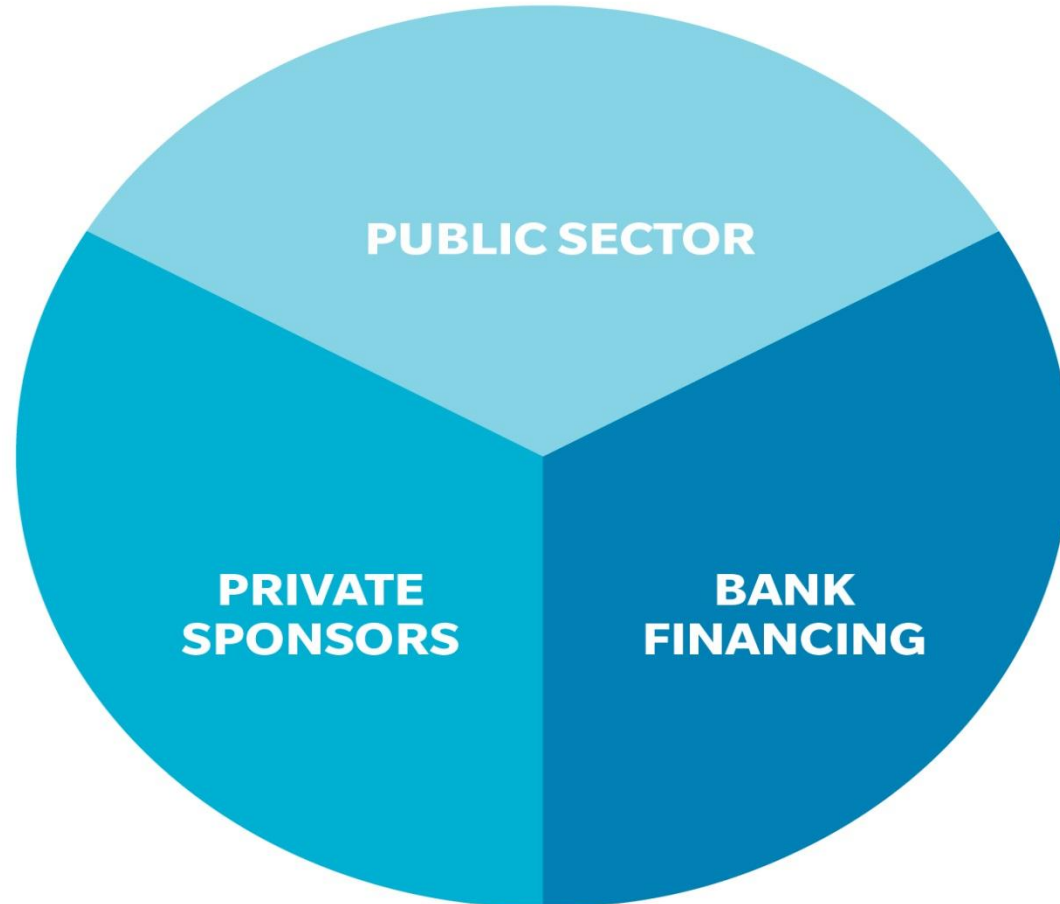
Achieving Financial Close Introduction

Diverse assets and markets



Achieving Financial Close Introduction

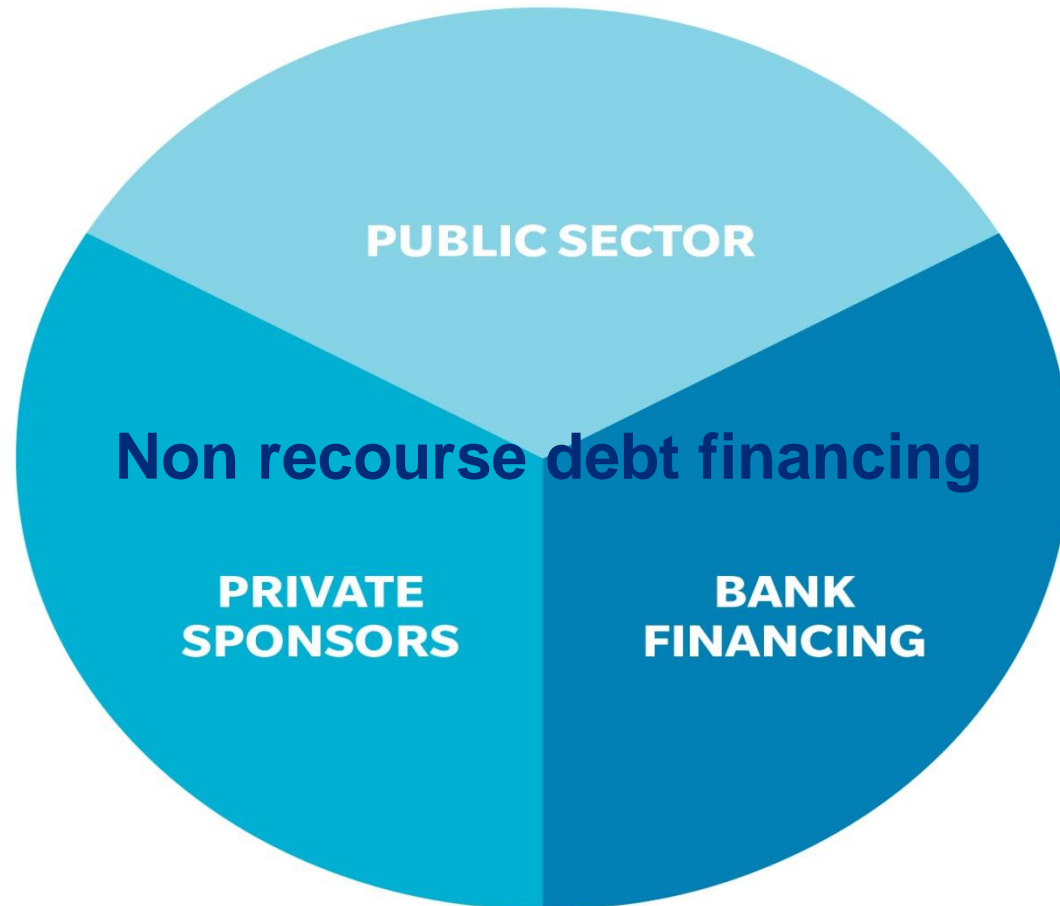
Three way relationship PPP/IPP/PFI



Public sector funds are limited

Achieving Financial Close Introduction

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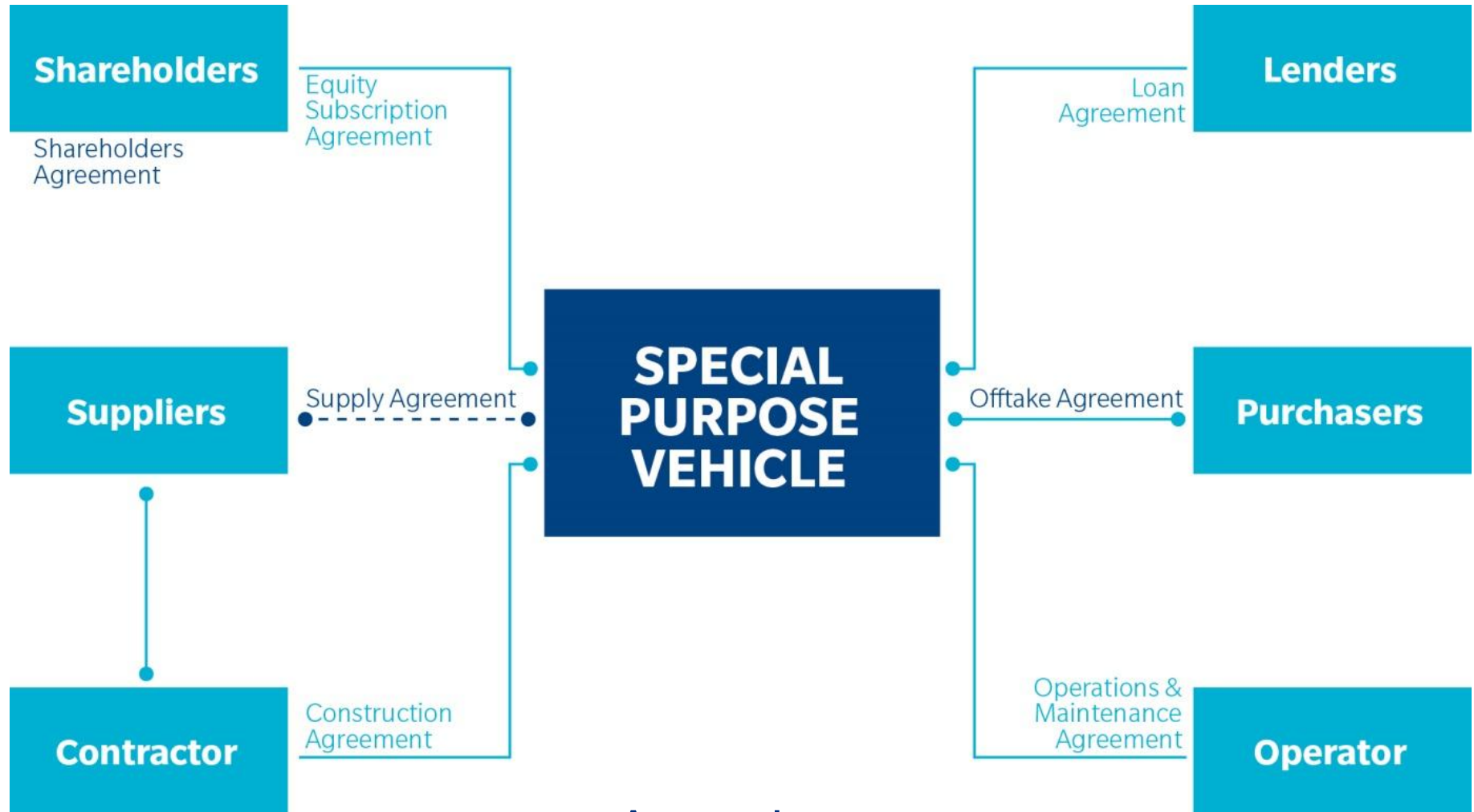
Public sector funds are limited

Achieving Financial Close

Key Aspects

- **Project Finance Assets:**
 - Special Purpose Companies with a single asset.
 - Subject to Limited or non-recourse finance.
 - Financial Model dependent on a **Guaranteed Revenue**
 - Power Purchase Agreement
 - Facilities/Service Charge
 - Tolls
- **Multiple stakeholders:**
 - Owner/Sponsors.
 - Authorities – Transport Ministry, Health Ministry, Energy Distributers
 - Lenders.
 - Contractors.
 - Manufacturers/suppliers.

Achieving Financial Close Introduction



Agreed at
Financial Close

Insurance Advisor Roles (SIA and LIA)

Sponsors Insurance Advisor (SIA)

- Design, broke, place and manage the project insurances.
- SPC's interests/risk philosophy reflected.
- **Duty of care and reliance to:**
 - **SPC equity holders.**
 - **SPC.**
- **Limit of liability for the benefit of equity holders/SPC and lenders**
- Appointment for the Construction term (plus one year of operations is common)

Lenders' Insurance Advisor (LIA)

- Review, assess, comment upon and approve the insurances pursuant to:
 - Project risk review.
 - Contractual risk flow/allocation analysis.
- Only the lenders interests are reflected.
- **Duty of care and reliance to:**
 - **Senior debt providers.**
 - **Export Credit Agencies (ECAs).**
 - **Lenders**
- **Limit of liability for the benefit of the lenders.**
- Appointment for the term of the loan

Risk Allocation & Total Cost of Risk

The background features three overlapping, semi-transparent shapes. The top shape is a dark blue triangle pointing downwards. The middle shape is a teal trapezoid that is wider at the top and tapers towards the bottom. The bottom shape is a light blue trapezoid that is wider at the bottom and tapers towards the top. These shapes overlap to create a layered, abstract design.

Total Cost of Risk – evaluation and transfer

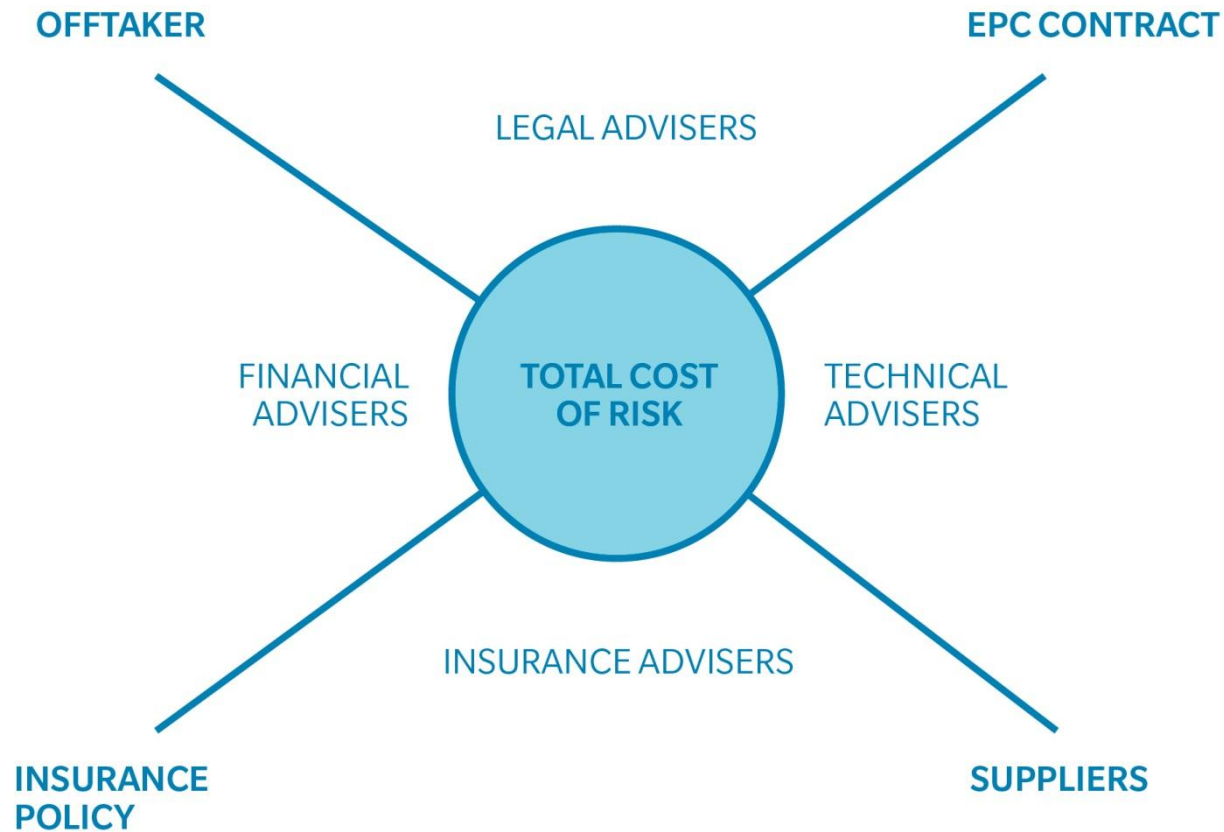
The International Risk Management Institute (IRMI) describes the total cost of risk as:

The cost of managing risks and incurring losses.

Total cost of risk is the sum of all aspects of an organization's operations that relate to risk, including retained (uninsured) losses and related loss adjustment expenses, risk control costs, transfer costs, and administrative costs.

- Insurance budget.
- Fees being charged by the broker
- Bids 70 commercial / 30 technical & experience
- ERM or not to ERM

Total Cost of Risk Transfer by contract & insurance



Workable allocation of risk = success

Total Cost of Risk – EPC Risk of Loss

- *the Contractor shall be responsible for the care and custody of the Works (and all parts thereof) until the earlier of Provisional Acceptance of each relevant Power Unit and the termination of the Contract, and the Contractor shall, make good forthwith at its own cost and expense **any loss or damage that may occur to the Works** (or any part thereof) and/or the Plant (or any part thereof) from any cause whilst it is responsible for the care and custody of the Works*
- *the Parties agree to bear the deductibles, exclusions or excepted risks of policies in the following way:*
 - (a) Policies taken out by the Contractor: deductibles, exclusions or excepted risks of the policies shall be covered exclusively by the Contractor*
 - (b) Policies taken out by the Owner: **deductibles, exclusions or excepted risks of the policies shall be covered by Owner***

Benefits of Manuscript Coverage

Benefitting from Manuscript Policy Coverage

Insurance policy (From Wikipedia)

The insurance **policy** is a [contract](#) (generally a [standard form contract](#)) between the insurer and the insured, known as the policyholder, which determines the [claims](#) which the insurer is [legally](#) required to pay.

Since insurance policies are [standard forms](#), they feature [boilerplate](#) language which is similar across a wide variety of different types of insurance policies.

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- Standard forms of contract / Boilerplate.
- Claims....legally obliged to pay.
- Often market practices favour standard forms of contract
- **As a buyer or insured party, nothing has to be standard or normal.**

Benefitting from Manuscript Policy Coverage

Common forms of engineering contract:

- Insurer templates
 - Standard forms of contract.
 - plus endorsements
- Brokers' manuscript
 - Bespoke forms drafted by insurance brokers
- Hybrids are common
 - Manuscript wordings that adopt Munich Re conditions.
- Manuscript wordings should offer broader cover than any standard form of contract
- **Fire is Fire & Flood is Flood**
- **Taken into use & claims notification**

Benefitting from Manuscript Policy Coverage

Case Study – Underground infrastructure works

- The scope of tunnelling insurance is measured by a specific clause setting indemnity for all underground works.
- Post 2000 claims restricted by a new **Tunnels and Galleries Clause**
 - **Applied to all types of underground works.**
 - **Designed to limit cover for tunnel works to a pre-agreed maximum value.**
 - **120% / 150% of the original construction value of the damaged works.**
- The new clause:
 - Offered poor cover.
 - Offered poor value for money.

Benefitting from Manuscript Policy Coverage

Case Study – Underground Works

Heathrow Express Link UK

- Year 1994
- Project cost USD 600m
- Tunnel contract USD 90m
- Insured loss USD 141m
- Total loss USD 200m

Questions?



Benefitting from Manuscript Policy Coverage

Case Study – Underground Works

Heathrow Express Link UK

- Year 1994
- Project cost USD 600m
- Tunnel contract USD 90m
- Insured loss USD 141m
- Total loss USD 200m*

Question?

- Who would insure a USD90m contract for USD200m?
- What cover could be offered in today's market

* reported estimate by NCE UK



Benefitting from Manuscript Policy Coverage

Underground works – basis of indemnity example

Contract value - USD 100,000,000

Insured Loss amount - USD 40,000,000

Year 2000 no options in cover

Basis of Indemnity:
150% of the original cost of the immediate damaged area.

Damaged area: **200m**
Average cost per metre: USD20,000

Maximum Claim:
200 x USD 20,000 x 150%
= USD6,000,000

Uninsured: USD 34,000,000

Year 2017 with options in cover

Basis of Indemnity:
Loss Limit USD50,000,000

Damaged area: **200m**
Average cost per metre: Irrelevant

Maximum Claim:
= USD 40,000,000

Uninsured: Zero

Max limit achieved \$500,000,000

Benefitting from Manuscript Policy Coverage

Trends in Wordings

Wordings remain the bedrock of our business:

- Poor quality wordings will be used to avoid claims payments
- Margins are leaving the business, some carriers under pressure to scrutinise more claims from a legal perspective
- In underwriting - increased pressure to add:
 - Special Conditions & Warranties
 - **Petrochemicals, dams and reservoirs and ports (wet works)**

Some clients are demanding better products:

- Increased demand for manuscript wordings
 - Client awareness of superior products
 - Claims driven lessons learnt
 - Lenders demands of Project Finance – via Lenders Insurance Adviser

Managing Financial Close



Managing Financial Close Finance Negotiation - Lenders

Why is there so much concern?

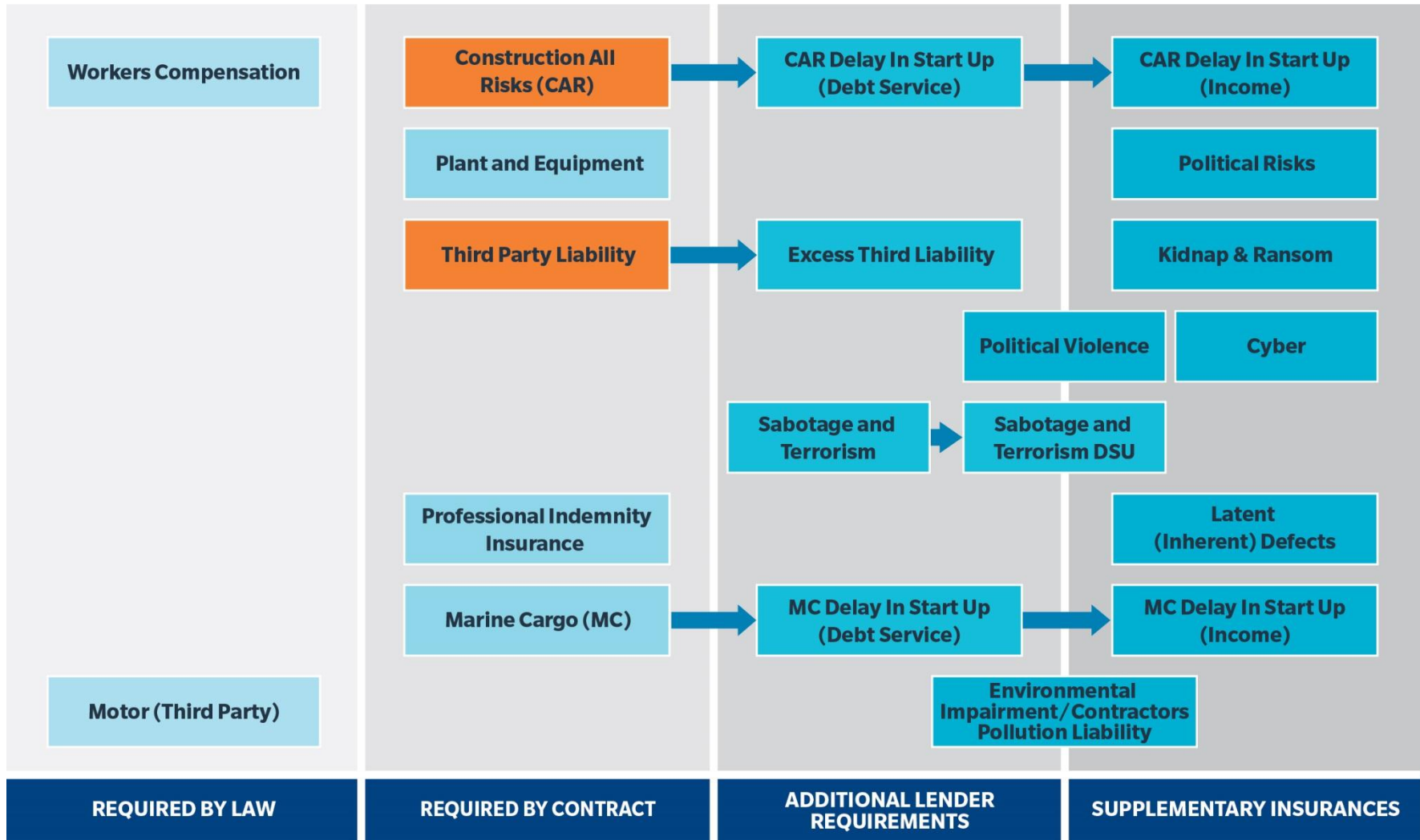
- Lenders only security of repayment resides in the project and the project revenues.
- Any risk which devalues the assets or endangers project revenues reduces the lenders' chances of repayment.
- Insurance plays a major role in reducing (transferring) the project risks the lenders' security is therefore directly enhanced.
- Lenders require the insurance protection to be as wide as is reasonably available from the insurance market, and to include revenues as well as assets (**normally**).
- Lenders are naturally risk-averse.

Managing Financial Close Finance Negotiation

- Key drivers:
 - Who is your lender?
 - Where are they from?
- Three tiers of lender:
 - Local.
 - Typically domestic lenders local banks.
 - Regional/country.
 - Chinese Development Bank (CDB), Brazilian National Bank (BNDS).
 - Credit export agencies - KEXIM, EXIM, JBIC.
 - International
 - Commercial banks - Society General, HSBC, Sumitomo.
 - Development banks - IFC, EBRD.
- Most appoint an Independent **Lenders Insurance adviser?**

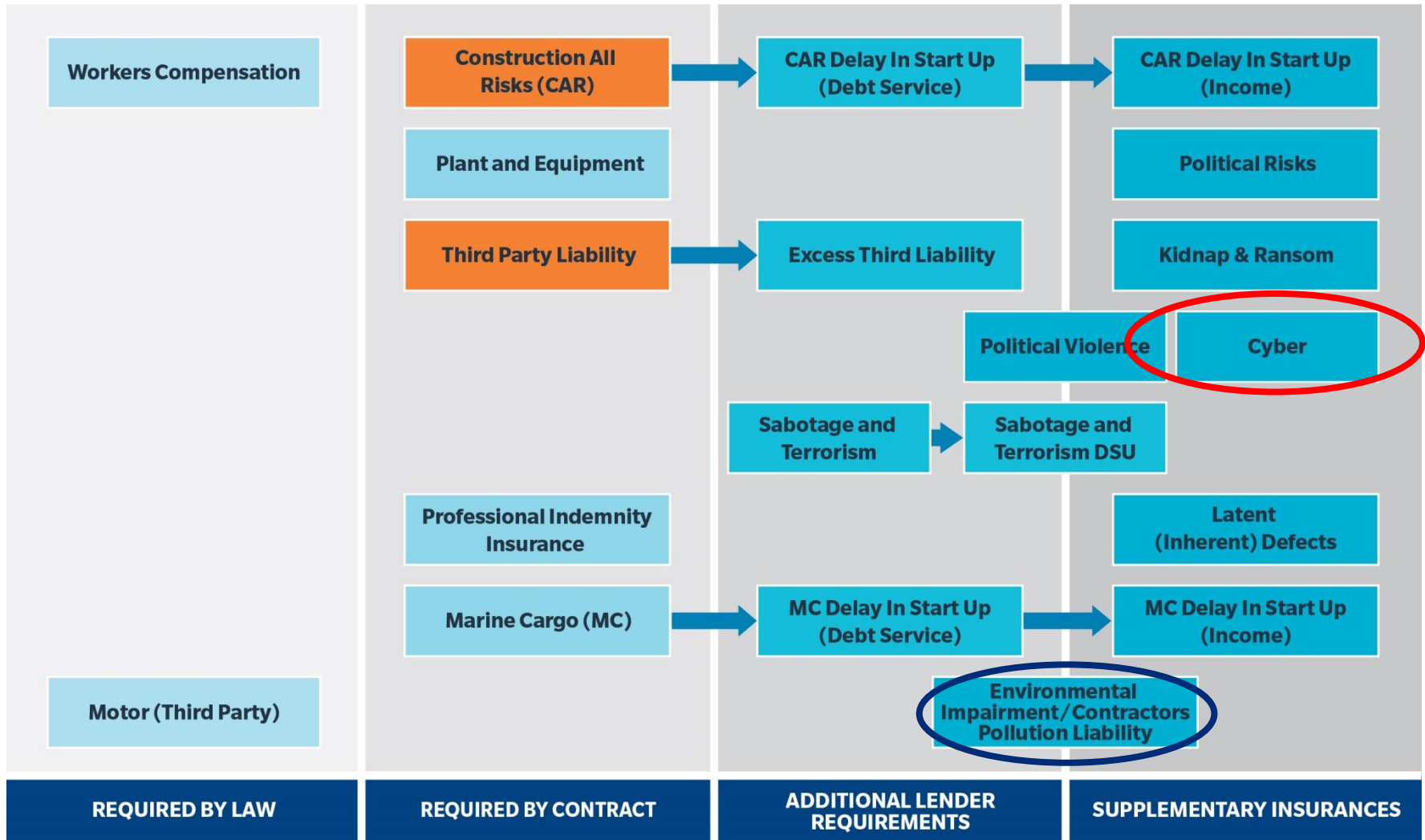


Managing Financial Close LIA - Keeping coverage reasonable



Managing Financial Close

Keeping coverage reasonable



Managing Financial Close

Finance Negotiation - Security and Lender documents:

- Insurance brokers letter of undertaking (BLOU).
- Reinsurance brokers letter of undertaking (BLOU).
- Lenders' endorsements attaching:
 - Direct lenders' endorsements.
 - Reinsurance lenders' endorsements.

Assignments:

- Insurance deed of assignment.
- Insurer assignment of reinsurance.
- Reinsurer notice of assignment.
- Reinsurer acknowledgement of assignment.

Managing Financial Close

Finance Negotiation - Assignments

Assignments:

An insurance company assigns in favor of lenders all its rights, title and interests in the reinsurance policy proceeds.

It's a separate legal document not an insurance policy document.

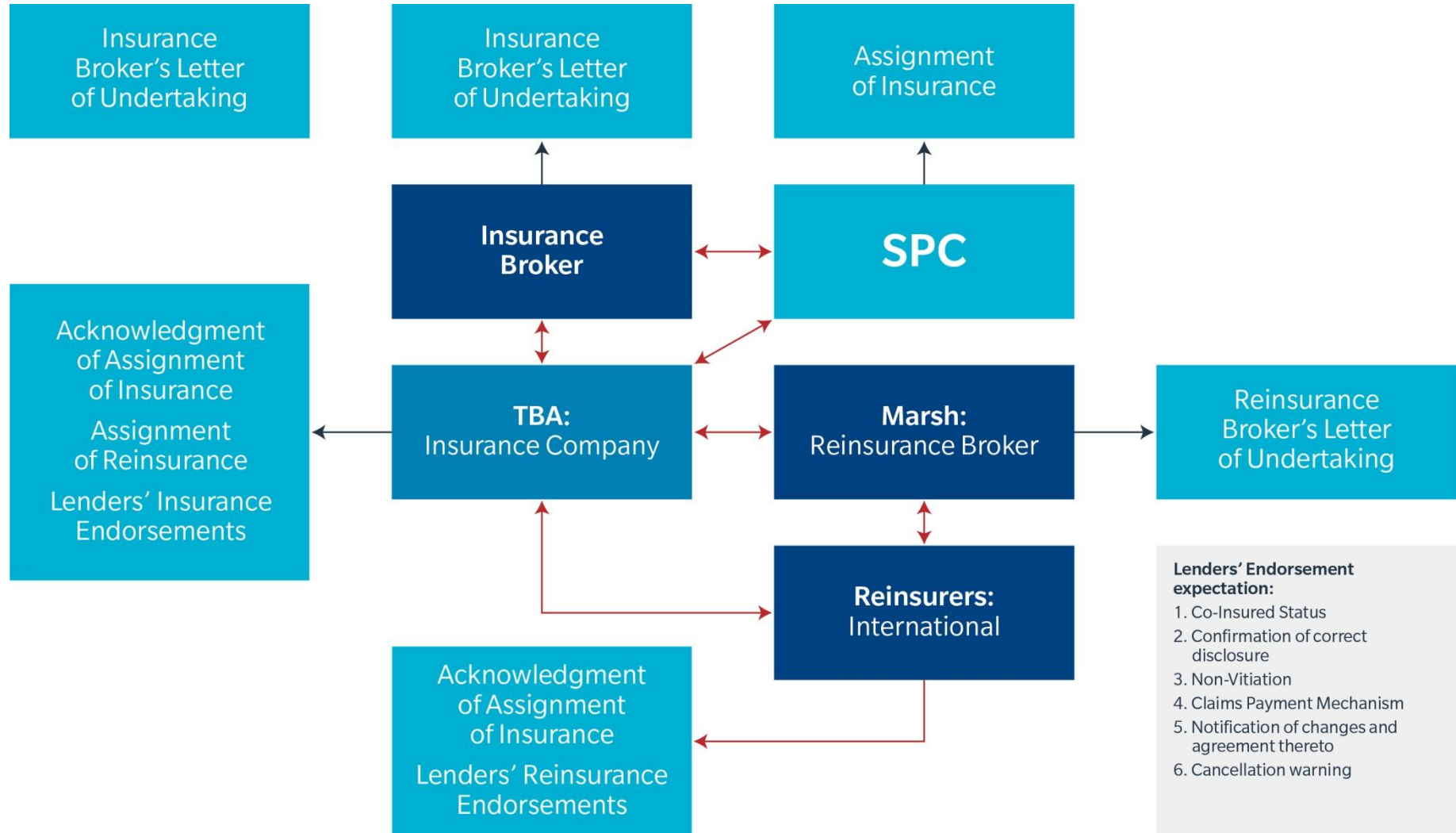
- It requires legal review by insurers and reinsurers.
- It creates the loss payee mechanism.
- It must be legal in the legislation in which it is being issued.
- If you don't want to delay Financial Close it must be drafted weeks before Financial Close.
- As broker you need to ask who is issuing the assignments?

Managing Financial Close Finance Negotiation

Standard provisions of lenders endorsements.

- Non Vitiation
- Lenders named as Insured Parties.
- Notice provisions:
 - Before cancellation.
 - Before change of terms.
 - Downgrade of security.
- Major claims to be paid as instructed by lenders (loss payee provisions).
- Primary Insurance Clause.
- Full subrogation waiver for lenders.
- Minimum security requirements (S&P A-)

Lenders' Required Documents Chart



Managing Financial Close

Managing the Timeline - when to start

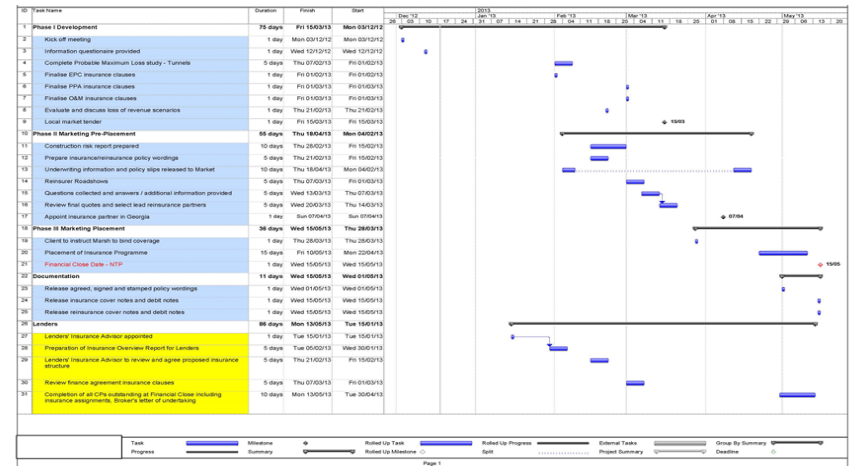
- Appointment six to nine months in advance of Financial Close
- Why: **CCIP vs OCIP**
 - Review bid documents.
 - Engineering Procurement Contract (EPC) tenders.
 - Technology choice and insurability benchmarking.
 - Setting budgets.
 - Engaging with lenders.
 - Designing the programme
 - Marketing
 - Binding
 - Closing
- Financial Close delays of three to six months are typical.

Managing Financial Close

Managing the Timeline – no correct order

- Workflow milestones are not exclusive:

- Insurance critical path.
- **Contracts First**
- Dependent on interaction:
 - Legal (Lender)
 - Financial (Lender)
 - Technical (Lender)
 - Insurance (Lender)
 - Insurance (Contractors)
 - Insurance (Suppliers)
 - Insurance/Legal (Offtakers)



- Insurance is not always high on anyone's priority list until it delays financial close!

Managing Financial Close

Managing the Timeline

- **Insurance can delay Financial Close.**
- Failure to comply with the loan agreement.
 - No evidence of cover.
 - A missing security document.
 - No agreement brokers' letter of undertaking (BLOU).
 - Failure to create a security package that meets local legislation, for example:
 - South Africa 2013 - *Short Term Insurance Act 1998, Section 33*, prohibits any “encumbrance” by an insurer in South Africa of its assets. Anyone breaching the requirement of Section 33 is liable to a fine of USD 1 million.
 - Legal advisers failed to check the assignment package was legal in South Africa.
 - No early agreement of security documents – lawyers left it until financial close.

Managing Financial Close

Making it happen

- Understand, agree and map deliverables.
- Push for early LIA Appointment.
- Set the scene first IOR to LIA
- Ask where is the CTA coming from
- Don't underestimate the legal review process (BLOU, Assignments, Lenders Endos) they take time
- Discuss and set your milestones with key stakeholders.
- Understand what financial close looks like – soft or hard
- Engage Insurance and Reinsurance companies early.

Assume nothing validate everything

Thankyou