

SURETY IN THE OIL & GAS INDUSTRY

CHALLENGES FACED BY OPERATORS AND REGULATORS

IOGCC ANNUAL BUSINESS MEETING

MAY 15TH, 2016





- **Sarah Finn – IMA, Inc. - National Surety Senior Vice President**
- **Michael Lischer – IMA, Inc. - Surety Account Executive**
- **Craig Ulmer – Travelers – Vice President, Commercial Surety**
- **Jared Scharton – Travelers – Managing Director, Commercial Surety**

SURETY BOND STRUCTURE



PRINCIPAL

One who is obligated to another party under a contract & surety bond.

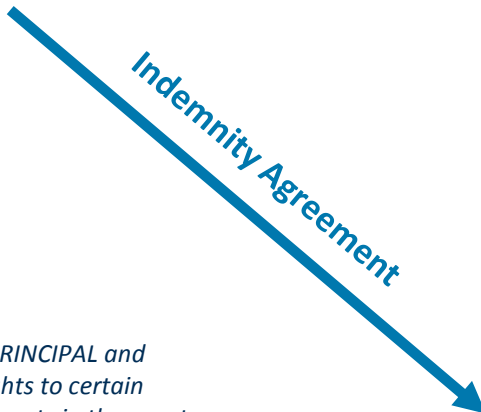
OBLIGEE

A person or entity to whom another is bound by contract or other legal procedure.

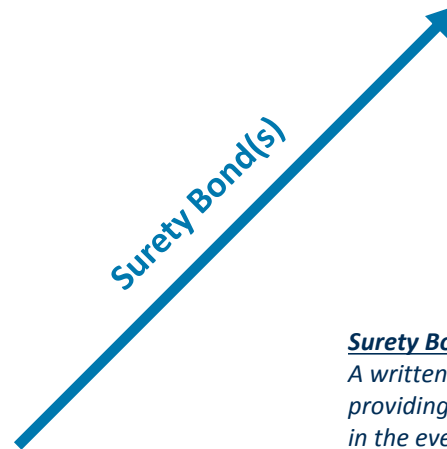
Contract/Obligation



Indemnity Agreement



Surety Bond(s)



Indemnity Agreement

Legal agreement between PRINCIPAL and SURETY giving the surety rights to certain corporate and/or personal assets in the event the SURETY must remedy a default on behalf of PRINCIPAL.

SURETY

One who has contracted to be responsible for another, especially one who assumes responsibilities or debts in the event of default.

Surety Bond

A written three party agreement providing remedy to OBLIGEE by SURETY in the event of performance or payment failure by the bonded PRINCIPAL per the terms of the covered contract.



- TWO (2) Party Agreement (Client – Carrier)
 - *Carrier's duty is to the insured (our client)*
- Generally Term Specific
- Subject to Policy Limits
- Losses Anticipate
- Losses Typically Not Recoverable
- Premium Rated to Cover Anticipated Losses
- Most Risk Accepted

- THREE (3) Party Agreement (Client – Oblige – Surety)
 - *Surety's duty is to the Oblige (NOT our client)*
- Obligation Specific
- Subject to Obligation Requirements (Contract/Statute/Rule/etc.)
- ZERO (\$0) Loss Expectation
- Losses Expected to be Recoverable
- Premium Rated to Cover Prequalification Expenses
- Selective Acceptance of Risk



- **Surety bonds are similar to a loan product**
- **A company's ability to obtain bonds is predominantly based on the company's credit profile**
- **Underwriting is financially driven**
- **Sureties underwrite on the basis of 0% Loss or ability to recoup losses through indemnification**
- **Insurance vs. Bond Pricing vs. Loan/Credit Pricing**
 - Insurance is priced based on the expectation of loss
 - Bonds are priced on the expectation of 0% loss
 - Loans are priced with the expectation of limited losses



- **Advisor and Advocate**
 - Understand client's business model
- **Develop Surety Program for Client**
 - Business Analysis
 - Surety Underwriting Criteria
- **Strategic Guidance**
 - Developing additional capacity
 - Advise Clients on Bonding Options
- **Day to Day Service Management**
 - Bond, Consent, Rider Execution
 - Work with Regulators to fix bond issues
- **Liaison between Client and Surety**
 - Maintain Lines of Communication
- **Provide Qualified Crucial Business References**
 - Bank
 - CPA
 - Attorney
- **Relationship with Client**
 - Owners/Key Management



The Surety & Fidelity Association of America

Top 100 Writers of Surety Bonds
 United States & Territories, Canada & Aggregate Other Alien
 Calendar Year 2015
 3rd Quarter
 (Year-to-Date Totals as of 9/30/2015)

Group Name	Direct Premium Written	Direct Premium Earned	Direct Losses Incurred *	Direct Loss Ratio
1 TRAVELERS BOND	610,036,507	596,508,475	4,613,657	0.8%
2 LIBERTY MUTUAL GROUP	580,993,409	563,065,448	130,589,892	23.2%
3 ZURICH INSURANCE GROUP	347,754,835	369,725,298	89,114,250	24.1%
4 CNA SURETY GROUP	326,552,825	316,248,379	28,096,971	8.9%
5 CHUBB & SON INC GROUP	166,025,177	164,564,302	(795,945)	-0.5%
6 ACE LTD GROUP	137,605,795	128,297,166	417,201	0.3%
7 HARTFORD FIRE & CAS GROUP	135,828,396	132,152,709	38,153,356	28.9%
8 IFIC SURETY GROUP	125,605,933	124,051,965	18,913,562	15.2%
9 HCC SURETY GROUP	121,497,327	122,333,407	24,635,924	20.1%
10 GREAT AMERICAN INSURANCE COMPANIES	97,681,711	93,471,406	26,127,849	28.0%
11 RLI INSURANCE GROUP	91,076,649	88,747,805	2,586,483	2.9%
12 LEXON/BONDSAFEGUARD INSURANCE COMPANIES	80,079,663	80,302,686	10,372,738	12.9%
13 NAS SURETY GROUP	76,624,975	78,212,450	2,756,421	3.5%
14 MERCHANTS BONDING CO GROUP	65,809,046	63,566,517	1,972,772	3.1%
15 ARCH INSURANCE GROUP	65,605,499	62,244,103	25,387,036	40.8%
16 THE HANOVER INSURANCE GROUP	63,283,054	59,622,247	24,734,561	41.5%
17 WR BERKLEY CORP GROUP	63,188,232	59,119,805	8,809,185	14.9%
18 AMTRUST SURETY	59,691,533	51,168,426	4,376,877	8.6%
19 PHILADELPHIA CONSOLIDATED HOLDING GROUP	57,670,138	49,264,523	10,503,010	21.3%
20 SURETEC INSURANCE COMPANY	54,068,431	49,972,085	6,428,450	12.9%
21 ARGONAUT GROUP	45,254,190	42,411,712	5,820,081	13.7%
22 GRTE COMPANY OF NORTH AMERICA USA	44,307,862	40,578,943	7,368,751	18.2%
23 WESTFIELD GROUP	43,533,936	40,324,972	1,315,693	3.3%
24 ONEBEACON INSURANCE GROUP	41,359,480	30,798,596	2,587,616	8.4%
25 HUDSON INSURANCE CO	39,864,511	37,538,276	23,250,312	61.9%



- Of the 100+ Sureties – 9 are active in the Oil & Gas Sector
- The Sureties will consider operators from the small shops all the way to the global E&P's.
- Other sureties will consider oil & gas but for top tier E&P companies.

Sureties

Travelers Bond

Zurich Insurance Group

Ace Ltd Group

HCC/Indemco

RLI Insurance Group

Philadelphia Insurance

Argonaut Group

OneBeacon Insurance

Aspen Insurance Group

WHY ARE OIL & GAS BONDS HARD TO OBTAIN?



- **Non-Cancellable**
- **Long-Tail Liability**
- **Claims occur at the end of the asset(s) life**
- **Paid claims are typically for the face/penal sum amount of the bond amount**
- **Very few sureties have the expertise needed to understand Oil & Gas Companies**



Capital: Financial Strength

- Financial Statements (corporate and/or personal)
- Net Worth
- Reserves
- Cash Flow
- Indemnity
- Credit History

Capacity: Ability to Complete the Project

- Résumés (corporate and individual)
- Contingency Plan
- Business model/business plan (short and long-term)
- Resources (labor, equipment, internal controls and procedures, etc.)

Character: Individual and Corporate Behavior

- Reputation
- Relationships
- References



- **Financial Review**
 - Balance Sheet, Cash Flow, Income Statement
- **Asset Composition/Reserve Reports**
 - Oil vs Gas, Field Locations, Proved Reserves Focus, Non-Core Assets
- **Access to Capital**
 - Reserve Based Lending, Equity/Debt Offerings
- **Debt/Leverage**
 - Ability to Service Maturing Debt, Maintain Current Debt Covenants
- **Sensitivity to Commodity Pricing**
 - Hedging Activities



- Commodity Pricing
- Historical Context vs 5 Previous Oil & Gas Market Cycles
- Access to Capital
- Bank Redeterminations, Limited Traditional Debt/Equity Appetite, Non-Core Assets Sales
- Debt Covenants
 - Non-Compliance/Anticipated Non-Compliance = Renegotiations with Bank (Increased Collateral, Revolver Restrictions, etc.).
- Bond Requirements/Regulatory Changes
 - Elimination of Bond Waivers, Cost of Compliance with New Regulations, Potential New Regulations

WHAT NOW??



- **Increase Bond Requirements**
- **Work with Operators**
- **Build Orphan Well Fund via Sinking Fund**
- **Royalty Override**
- **Other Collateral Options**



- Questions ?
- Contact Information:

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