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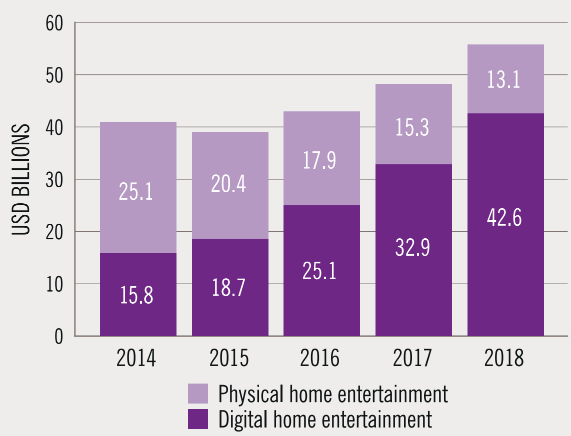
SPECIALTY REINSURANCE: FILM AND TELEVISION PRODUCTION COMPLETION BONDS IN A COMPETITIVE MARKET

Barry Plummer, Senior Specialty Risk Underwriter at Aspen Re, looks at the fast changing landscape of the media industry and the growth of streaming services. Investment in content, both through M&A activity and organically, has been a key strategic goal. This has led some to question the completion bond market and its attractions as a risk management tool for film and television production. (Re)insurers, like the streaming companies, must make sure their products are relevant to changing demand.

A Constant Stream

Combined theatrical and home entertainment global consumer spending totalled USD96.8billion in 2018 as digital home entertainment spending continued to grow strongly[1]. This segment now accounts for 44% of the entertainment market. Its growth since 2014, as shown in Figure 1, has increased by 28% per annum and has more than offset the decline in the physical home entertainment market.

FIGURE 1: GLOBAL HOME ENTERTAINMENT CONSUMER SPENDING



Source: Aspen Re, mpaa.org

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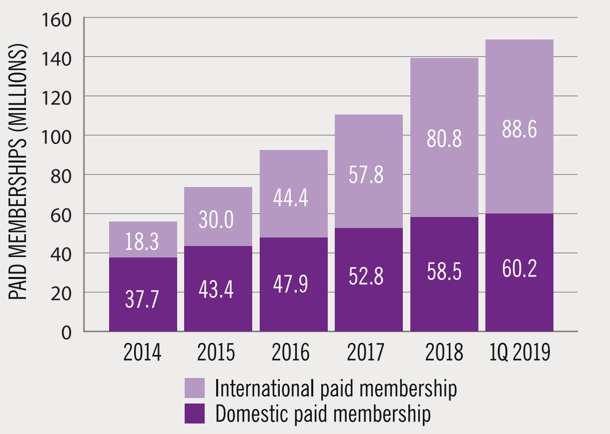
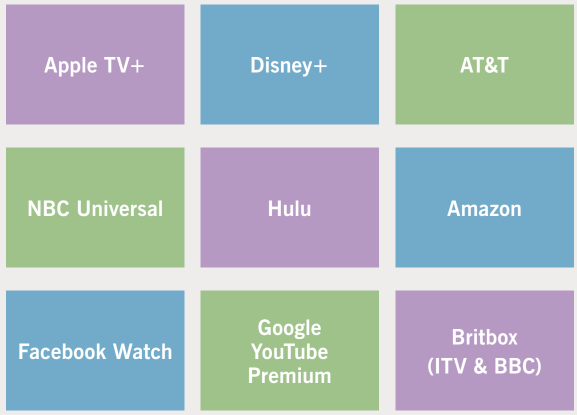
FIGURE 2: NETFLIX PAID STREAMING MEMBERSHIPS



Source: Aspen Re, mpaa.org

FIGURE 3: SELECTED STREAMING COMPANIES



Source: Aspen Re

TV viewers increasingly want more freedom in what they watch and when they watch it. The days of watching scheduled weekly drama are diminishing and binge watching several episodes at once has become increasingly popular. The streaming market has superseded the cable market as both faster internet connections and the number of video streaming devices – most notably smart phones – have enabled viewers to stream “on the go”.

Netflix benefited from first mover advantage in the streaming market and leads the field in subscriber numbers. As shown in Figure 2, subscriber growth has been rapid and the international market has become increasingly important. Netflix has endeavoured to offer a differentiated product based on a high-quality curated offering, which has called for original content as well as access to existing shows. It has raised billions of dollars of debt to fund this content, which includes commissioned work from independent studios and production companies as well as in-house material. It has invested heavily in local foreign language productions especially in France, Germany, Italy, Latin America and Spain. Potential growth areas include India and Africa.

Competitive Market

The streaming market has become more crowded – as shown in Figure 3 – with some very large players now challenging Netflix’s dominance. The success of a streaming service is principally dependent on its library offering, thus the search for high-quality original award-winning content has become increasingly competitive. This helps to explain AT&T’s acquisition of Warner Media, as well as Disney’s acquisition of 21st Century Fox. The emergence of Disney+ suggests a significant change to the market as it is currently a 60% shareholder of Hulu and also licences its material to Netflix. Subscribers to Disney+ will have access to an extensive library of Disney/21st Century Fox movies and TV shows as well as Star Wars, Marvel, Pixar and National Geographic content. Disney’s largest asset is its powerful and well-established brand and they expect to draw between 60 million and 90 million subscribers by the end of 2024[2]. Elsewhere, AT&T can leverage the Warner Bros. franchise, which includes Harry Potter, DC Comics and Game of Thrones.

Apple is well behind the leaders of the streaming pack, however, there is significant potential for Apple TV+ given the 1.4 billion Apple devices currently in active use and a net cash balance of USD130bn as at the end of 1Q 2019[3]. Although it is expected to have dozens of shows ahead of its autumn launch, this will be a fraction of the content available through Disney and Warner Media’s extensive back catalogues.

Completion Risk: On Time and On Budget

The rise of these sizeable companies with access to large cash resources (Apple) or debt (Netflix) and substantial distribution power has implications for the (re)insurance market who have typically helped in the financing of production through the issuance of completion bonds. These can be requested by investors and/or bank lenders and typically are backed by negotiation of a guaranteed distribution fee which is to be paid upon delivery of a completed production. The guarantee is then used as security to raise funds to finance the production. The lenders assume the credit risk of the distributer, as well as the risk of non-delivery. Risk of the latter, however, can be offset through the purchase of a completion bond which guarantees that the film will be delivered on time *and* on budget.

The completion bond has no liability regarding the artistic content or quality of the end product or, indeed, in its ability to generate future revenues as the bond underwriter’s liability ceases on the delivery date of the film or TV series. The completion bond company executes a series of agreements with the owner of the rights and the producer, which give effective and absolute control of all key aspects of the production to the bond company in order to ensure that the delivery date is met. Analysis of the producer’s budget will determine the requisite level of contingencies and funds required to meet the production’s due date. This analysis is based on the requirements of the script, a review of all relevant contracts and obligations, as well as due diligence on any other risk factors such as probable weather conditions, the proposed filming locations and the nature and reputation of the cast and

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filmmakers. Once the budget is approved, the bond company will then require a self-insured retention (contingency) to cover unforeseen costs for which no provision has been made. This will also protect the completion bond's exposure from small attritional claims. As a signatory of the production account, the completion bond company secures and controls the funds.

It is rare for a call to be made on a completion bond given all activity is closely monitored by the bond company and the requirement to purchase a film producers' indemnity (FPI) package. Risks ranging from accidents including accidental death and injury of key cast and crew, physical loss or damage to the set and producers' E&O are all covered under the FPI package. If slippage looks likely, then the bond company can step into the "producer's shoes" to ensure that the production is delivered on time, which could lead the bond company to incur "extra expense" costs. This is the "loss", if any, sustained by the bond company.

Supply and Demand

The bond company market has become increasingly competitive with the entrance of new capacity, which has led to pricing pressure. This has been compounded by a contraction in the number of productions being bonded as these capital rich streaming companies are choosing to retain more risk on their balance sheets. It is difficult to see the trigger for change, but a shock loss or even an escalation in attritional losses could quickly change demand. The cost of self-insurance can be very painful notwithstanding the depth of financial pockets. The completion bond market has been part and parcel of the risk control and, with the increase in the number of films being made, it may simply assume another guise as perhaps the monitoring and control expertise could be taken in-house. This expertise would be employed directly rather than in an independent capacity and the variable premium would become a fixed cost. (Re) insurers will need to retain a disciplined and professional approach, as well as a creative empathy with their clients. Bigger budget productions may hold the key to the completion bond market in the future. If so, the strength of underwriting process, number of people and relevant expertise will remain crucial and a good track record will be just as necessary to win and/or retain the support of the reinsurers. Not only is there still potential in the well developed markets of the U.K. and U.S. but there is also scope in the largely untapped markets of China, Latin America and India, however more stringent controls are needed to bring success.

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[1] https://www.mpaa.org
[2] www.bloomberg.com
[3] www.apple.com