INSURANCE

Surety industry moving forward

by Robert M. Overbey, Jr.

In general, the surety industry has rebounded from issues that had plagued numerous surety companies since 2000. The issues are well-known and are mentioned as follows for documentation purposes:

ß Enron, K-Mart, and large construction losses throughout the U.S. resulted in reserves for surety losses exceeding $2.2 billion in 2001 and 2002. The loss ratio for the surety industry during this time was in excess of 79.2%.

ß Due to losses, primary re-insurers were reduced by more than half.

ß Sarbanes-Oxley restrictions have been implemented, and repercussions are now nominal as any perceived constraints are merely a way of doing business in the new millennium.

ß As a result of these losses, the surety industry is somewhat averse to certain risks, including 1) financial guarantee bonds (without collateral); 2) start up construction operations; 3) some types of specialty contractors; 4) international risks.

ß Conversely, the surety companies have, overall, realized a profit over the last 2 years, with loss ratios on the decline.

Further, after a certain amount of attrition within the industry (the demise of Atlantic Mutual and Kemper, the merger of St. Paul and Travelers, etc.) there appears to be a growing confidence and settling within the surety marketplace. Thus, surety companies are looking for new business within both the contract and commercial marketplace.

There are several keys, however, insofar as establishing a relationship with the surety is concerned. The contractor's surety agent/broker has a responsibility to represent his/her contractor client on a level of professionalism that should never be compromised nor taken for granted. Some of the important aspects of forging long-term and productive relationships are as follows:

1) Make certain the contractor has the opportunity to visit with the surety company representatives on a regular basis – not just the local branch managers/VPs, but the home office personnel as well. By regular basis – this means at least 2-3 times per year with the local representative, and once a year with the home office. The more the surety knows of the contractor's business, including work ethics, long-term goals, and other pertinent information, the more responsive the surety can be. This is probably the most important aspect of the surety company/contractor relationship.

For example when a contractor wants to stretch or increase the program that has been provided, or in the event of a losing year, the surety becomes much more amenable to increases or perpetuating the program if a positive and ongoing relationship has been established.

2) Provide the surety company with all data relevant to the surety's underwriting procedures, and make sure that the information is provided on a timely basis, is complete, and is totally accurate. It is both unfortunate and unnecessary that decisions as to surety lines of credit and simple contract approvals may ultimately be based (and in most cases this would mean a declination) on incorrect and/or untimely information. This is especially true on initial submissions to a surety, i.e. if the surety company representative receives a complete submission, which would include all applicable data, (e.g. last 4-5 years corporate fiscal year-end data, current corporate statement, web page information, bank letters of reference, background resumes on key personnel, copies of continuation agreements, insurance certificates outlining coverage, personal financial statements on privately held entities, tax returns, job schedules, etc.) which is properly documented, the underwriter will be more inclined to provide a thorough review as opposed to one that does not adhere to these preconditions.

3) The surety agent should know the marketplace: when reviewing a prospective contractor's financial files (even for the first time), he/she should immediately be able to ascertain which market(s) would be most responsive, either from a capacity or specialty perspective.

4) Once a surety account is placed, the surety agent should similarly make certain that a commitment is provided by a back-up surety in the event that the first line surety withdraws for whatever reason.

5) Make certain the contractor chooses a CPA and attorney for the same reason the surety agent was chosen: knowledge of and expertise in the construction industry.

6) Lastly, be attentive to the contractor/client. This is probably the easiest, but nonetheless the one element that is most readily disregarded. By understanding your client's goals and overall business philosophy, the agent/broker is more adept at accurately representing the client's actual needs to the surety.

Again, as surety bonds provide the lifeblood for a large percentage of contractors, especially those that operate in the public spectrum, the necessity for establishing a strong relationship between the contractor and surety is paramount, and it begins with the surety agent's knowledge of the industry, markets, and construction.

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