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Surety Industry Update

The Surety Industry 2005

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The Surety Industry for 2005, based on industry operating results from 2004, can best be characterized as "settling." The prior four years were fraught with loses, and while 2004 showed a loss for the industry, most of the loss activity was from the reevaluation and adjustment to existing loss reserves, as opposed to new losses. While a few underwriters did suffer through poor experience, the majority of the underwriters made a profit.

The most significant event of 2004 was the merger of St. Paul and Travelers. While the merger became effective at the start of the second quarter, the impact is still being felt. By merging the two largest underwriters of surety bonds, the combined entity represents 30% of the market share. The merger also caused a realignment of people and their responsibilities. By the end of the year things had started to settle out within the newly merged company.

Underwriting Criteria

While St. Paul/Travelers was sorting things out, the other underwriters were solidifying their positions on underwriting criteria. Virtually all the major carriers were holding the line on what they were willing to accept in support of surety credit.

Underwriters were demanding:

- A ratio of at least 5% working capital: work program
- Debt to net worth ratio of 3:1 or less
- Profitable operations
- Stable management
- A reasonable, and well thought out business plan

Underwriters were not willing to support:

- New ventures
- Operations outside of the usual business discipline or geographic area
- Heavy reliance on bank debt to finance normal operations

Capacity

Because there are fewer surety underwriters willing to commit capacity, the largest single bond that the industry is willing to support is approximately $500,000,000. For the owners of "mega-projects" such as the rebuilding of the Oakland Bay Bridge, or the new Seattle Monorail, owners are finding that they either need to split the project into smaller sections, or accept partial bonds.

Contractual Conditions

Underwriters are taking a closer look at General Conditions that the contractors, and, thereby the sureties, are being asked to assume under contract. The termination clause in a Sound Transit contract caused several sureties to refuse to issue bid bonds for their clients until that specific provision was modified. This caused a three day delay in the date of the bid opening while Sound Transit revised their termination provisions.

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Premiums

While there have been some adjustments in the surety rates that underwriters charge, those changes have not been significant.

Indemnity

For the first time in several years, surety underwriters are, at least, willing to discuss limiting personal guarantees for their most favored clients who have strong corporate balance sheets, and a consistent trend of profitability.

Summary

All things considered, 2004 wasn't a bad year for the industry. The general feeling by most underwriters is that the worst is behind them, and the future looks bright. The next big challenge facing the industry is going to be how to maintain and/or attract an adequate number of well-trained professionals. A large portion of those who currently make up the industry are "baby-boomers" due to retire in the next ten years, and there has been little or no training done for the prior fifteen years.

Nevertheless, the Surety Industry is well positioned to move forward. There are few new underwriting companies moving into the business, and no obvious players who appear set to withdraw.

Surety credit is still in limited supply, and contractors should continue to treat their surety relationship with care and respect. Be proactive:

- Keep the surety underwriter apprised of changes in your business
- Provide timely, quality, and accurate financial information
- Continue to look for better operating and reporting systems
- Maintain an active training program for your staff at all levels

If you have questions, please contact a member of the Parker, Smith & Feek Surety Department.

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