The State of the Surety Industry and You

PARKER | SMITH | FEEK

April 2012

By Scott Fisher, Principal

For the most part, with a few notable exceptions, sureties have had a good run over the last few years. It is somewhat counterintuitive that surety results would be so positive during this very challenging economic period, but that can be understood chiefly by two things: surety results historically lag the general economy by 18 months or more and surety underwriters have been relatively disciplined.

The Surety Association of America regularly publishes the self-reported results of the top sureties in the country. The latest data we have is through the third quarter of 2011. And the story it tells is generally a very good one for the industry. The loss ratio for the entire industry for this period was 11.8% for the top 100 sureties, and 12% for all reporting sureties.

But let's break that down even more.

The Top 10 writers of surety account for almost 68% of the total surety premium generated and combined have a loss ratio of 4.3%. All the rest of industry has a loss ratio of 27.9%. Expressed slightly differently, the Top 10 sureties collected almost 68% of the total premium but had only 24.5% of the total losses. While the rest collected under 33% of the premium and had 75.5% of the total losses. The pain was not shared equally.

This is confirmed in that the losses until now generally have not been among the large contractors, but among the smaller ones, which are predominantly subcontractors. For a long time now the sureties have been most concerned about subcontractors, and the numbers confirm their fears.

But there is increasing evidence that the pain is migrating to the Top 10 sureties now. Whereas the industry has been dealing primarily with frequency (number of claims), there is growing concern that the industry may be facing some severity (magnitude of losses) challenges as well.

The practical lesson from all of this is that the surety marketplace is dynamic. The market appetite and the underwriting posture of any individual surety will naturally be impacted by their loss experience.

How many times have we seen the external issues of a surety warp their perspective and distort their interactions with solid clients?

Good contractors are still getting the bonding they need, and overall capacity is not an issue. If you have a surety that has experienced some elevated losses lately, then don't be surprised if they may change the way they treat you. However, it may literally be them, and not you. A good surety broker will be able to discern this and filter inappropriate reactions from the surety. If the surety does not (or in their mind, perhaps, cannot) adjust in their approach to you, then your surety broker should find a better fit for you.

Where Do You Turn?

If you have questions regarding your banking relationship, or perhaps your CPA or attorney, where do you turn? You may have a broad exposure to the marketplace and know who you will turn to on a contingency basis, but we have found recently that many contractor clients do not.

As construction professionals providing a service to contractors, we regularly interact with the other professionals doing the same thing. We make it our business to know and cultivate relationships with the top service providers for contractors in each of those professions.

We find ourselves from time to time in a position to refer contractors in all three areas, but in the last few years there have been more issues with banks than the others. Certainly, such moves are made deliberately and after taking counsel with those you trust, but don't forget about consulting a capable surety broker. We can provide a valuable perspective and tell you the pros and cons of all the major players in each area.

Third Party Indemnity

An area of increasing interest to be aware of is what is known among sureties as Third Party Indemnity (TPI). This situation arises when a contractor due to a specially recognized status has access to work opportunities (typically Federal) but cannot qualify for the required bond on their own. Moreover, the restrictions on forming an Open Joint Venture with another contractor are prohibitive. So the contractor seeks out another contractor with sufficient bonding to back them on the project in a TPI arrangement. However, the contractor providing the bonding must overcome significant risks inherent in a TPI structure. Those risks include no privity of contract, little or no control over the flow of payments and increased disclosure requirements from the surety that is wary of the extreme penalties associated with running afoul of the rules, which are not always clear and seem to change.

We have managed TPI scenarios with several sureties on hundreds of millions of dollars in projects – all successfully. Whether you are a contractor that needs to find bonding assistance, or you a contractor weighing the option of providing support in a TPI structure, we can help. A capable and informed surety broker makes a significant difference in navigating the challenges of a TPI arrangement.