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WHAT IS THE BIG DEAL ABOUT SUBCONTRACTOR DEFAULT INSURANCE?

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Have you ever heard of a product that most people are aware of, but don't have any actual idea what it is or why it is purchased? Well, if you've heard of subcontractor default insurance (SDI), then you definitely have. Most contractors are aware that this coverage exists, or even have purchased it, but do not fully understand what value it brings to their organization.

SDI BACKGROUND

SDI originated in the late 1990s as a result of general construction industry frustration with the slowness of the surety claims process, and an overall desire by the brokerage community to offer their general contracting clients an alternative to surety bonds. The intent was to transfer the subcontractor's significant risk of completing their work in a timely fashion per the contract terms with a product that kept the project on time and within budget.

The first insurance company to offer the product was Zurich Insurance. They called it Subguard, and many people in the industry today incorrectly refer to the product generally as Subguard as opposed to the proper name of SDI. Zurich was the only company to offer the product for many years until the last decade, when several others entered the marketplace.

In fact, for many years, it was common knowledge in the brokerage community that Subguard was the most profitable product Zurich offered to contractors. It was surprising that competing insurance companies took many years to offer the product and, as expected, they have helped improve SDI and make it available to many more contractors.

WHY SDI IS MISUNDERSTOOD

There are many reasons why SDI is widely known, but still misunderstood. Surety bond producers were taught to sell against it, because it was perceived as a threat to the industry. I have been to numerous conventions where they offered classes to arm the surety bond broker against the threat of SDI. Property and casualty producers, on the other hand, associate it more closely with a surety bond than an insurance product, so they struggle with it when they are unfamiliar with the technical characteristics of surety bonds. The combination of construction insurance professionals and sureties viewing the product with the above lenses has led to the general contractor and subcontractor communities getting mixed messages rife with misinformation when asking questions.

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The SDI product has proven to be a terrific risk transfer mechanism for general contractors' subcontractor risk. I haven't worked with any general contractor that views the significant backlogs for subcontractors or the common issue of finding enough quality employees to finish the work as one of their biggest risks keeping them up at night. I believe the product has grown tremendously in popularity over the last ten years for a few basic reasons:

1. The general contractor controls the default process and remedy, which keeps the project on time. This includes the schedule, mitigation, and other costs not necessarily covered by a surety bond.
2. The general contractor shares risk with the insurer via a deductible and co-pay. This eliminates the adversarial relationship often found in general contractor-surety claims situations when dealing with a subcontractor problem.
3. Each carrier can offer their clients significant benchmarking information on subcontractor prequalification processes. This is powerful information that can be utilized to improve processes!

UTILIZING SDI MOVING FORWARD

SDI adoption is increasing due to less subcontract value required by general contractors to place within a program. The entry of several more competitors into the SDI marketplace, along with significant demand for SDI as a result of subcontractor issues, has led many contractors to question their brokers on whether SDI makes sense for them and their company.

I recently met with the CFO of a major general contracting firm, who reached out to Parker, Smith & Feek to review the SDI product and whether it made sense for their operations. They wanted to know if they were big enough to qualify, what the associated costs were, and how it compared to a surety bond. When I got to the meeting, the CFO stated:

> "I asked a question about SDI to my broker (who had never sold this kind of policy), and he sent me a white paper he couldn't explain. I know it is out there being utilized by more and more general contractors, and we need to know if it will work for us in our niche and with our volume. What can you tell us about SDI and whether it will work for us in our market and with our revenue?"

We spent over an hour discussing the product and how it might fit in their operations. He was relieved to have had a valuable conversation about the product with a broker whose general contracting clients utilize SDI as one of their tools to manage risk. If you're curious how and if SDI might fit into your operation, call a knowledgeable broker that is familiar with the product and get the straight scoop on subcontractor default insurance.