Surety Market Outlook

THE RUNDOWN ON CAPACITY, AVAILABILITY AND LOSSES FOR EVERY SIZE CONTRACTOR

BY STEPHANIE ROBICHAUX

The construction industry is feeling the strain from tight budgets and lack of public spending on the federal, state and local levels. With a boost in private spending, the outlook is beginning to look a bit brighter. The Architecture Billings Index was 53 in August, demonstrating an increase in demand for design services, with the highest scores in the Northeast (58.1) and South (55.1). Additionally, the unemployment rate for the construction industry has been steadily declining, according to the U.S. Department of Labor. The unemployment rate for construction was down to 7 percent in September, with the addition of 3,200 nonresidential construction jobs. The temptation is for businesses to overextend themselves as the economy picks up, but contractors that managed the downturn well and remain disciplined are in a good position to attain surety credit and successfully complete work as economic conditions improve.

Stephanie Robichaux is communications associate at The Surety & Fidelity Association of America. For more information, email srobichaux@surety.org.

SURETY CAPACITY

SMALL
(LESS THAN $10 MILLION)

For small contractors, surety capacity is abundant and the available capacity is more than the market requires.
– Henry Nozko W., Jr., President, ACSTAR Insurance Company

Many would say that both capacity and availability of surety credit for small businesses are too plentiful in parts of the country. With the growing number of programs that are issuing bonds on very limited underwriting and the entry into the small contract market in general by many new players, it is getting very crowded.
– Thomas M. Padilla, Senior Vice President, HUB International Insurance Services of Albuquerque, NM, President, National Association of Surety Bond Producers

MIDDLE
($10 MILLION-$100 MILLION)

When commercial construction activity slowed way down in 2009, the national sureties developed a sharper focus on medium-sized contractors, many regional bonding companies targeted contractors at the upper levels of the $10 million-$100 million range, and some new sureties have been formed that are also competing for contractors in this space. All of these activities translate into sufficient surety capacity for medium-sized contractors.
– Mike Specht, Vice President – Surety, Minard-Ames Insurance Services / INSURICA

Virtually every surety writer is operating in the middle market category. The issue going forward will be how long the excess capacity in the middle market exists before companies decide that they can find more attractive returns in other insurance lines. Ultimately, companies with a proven track record of profitably underwriting surety through different market cycles will take a longer view of the business.
– Stephen Ruschak, President & COO, The Guarantee Company of North America USA

LARGE
($100 MILLION-$250 MILLION)

Surety capacity is readily available and at even higher levels. Losses have begun to pick up, a predictable outcome of the downdraft in construction since 2007 combined with too-easy surety credit.
– Rick Ciullo, Chief Operating Officer, Chubb Surety

MEGA
(MORE THAN $250 MILLION)

Contractors with a strong credit profile are enjoying very strong surety industry support. Project sizes are bigger than ever, so this surety capacity is a key advantage for firms to acquire new projects.
– Mike Bond, Head of Surety, Zurich North America

SURETY AVAILABILITY

SMALL
(LESS THAN $10 MILLION)

The industry surety results have been very positive for most companies in the past few years. Competition for the less than $10 million segment is high. Sureties are offering various "small contractor programs" with limited underwriting information needed to qualify. The SBA program is another option for new and emerging contractors. Surety credit in the less than $10 million segment is readily available for contractors that have maintained their balance sheets during the past few years.
– Josh Penwell, Vice President, Contract Underwriting, Merchants Bonding Company

Availability of contract surety capacity in the small market segment is more than ample. More surety companies are abandoning cessionary agreements as they are more willing to carry the full risk associated with their contract surety books. The reinsurance markets are now feeling the pinch of this move toward much greater or complete retention.
– C. Constantin Poindexter, Managing General Agent, Chief Underwriter Officer, Surety One, Inc.

MIDDLE
($10 MILLION-$100 MILLION)

The total surety market is very saturated; however, it is important to distinguish there are two very different segments providing a market. The carriers specialized in the middle market offer plenty of availability and also bring deep expertise and a proven track record of delivering on their commitments. The other group of carriers is new entrants to surety, adding to the availability, but have little or no experience in the market. Contractors should carefully look for carriers that have the experience,

knowledge and financial backing to ensure their success.
– Robert Thomas, President, Hanover Surety

LARGE
($100 MILLION-$250 MILLION)
A number of major sureties focus on the large contractor market segment. Sureties are competing heavily in this arena, and the financially sound contractor will not have issues in securing necessary surety credit.
– Doug Hinkle, Chief Underwriting Officer, CNA Surety

MEGA
(MORE THAN $250 MILLION)
We are seeing more sureties becoming more active in this market, though some have yet to develop the resources often required to support mega, nationally based or internationally based contractors.
– Larry C. Mitchell, Chief Underwriting Officer Western Region, Construction Services, Travelers

SURETY LOSSES

SMALL
(LESS THAN $10 MILLION)
Loss activity in 2014 for small to mid-sized contractors appears to be consistent with last year. Efforts by sureties and agents to continually educate contractors about the benefits of managing backlog, bonding back significant subcontractors and identifying onerous contract terms continues to have a positive impact on results. Mitigating risk for the contractor involves not only identifying and minimizing risks in the execution of the work, but also understanding the terms of the contract and selecting the right owners to work for. When interest rates begin to rise during the next few years, we expect to see an increase in claim activity for contractors that have not properly managed their debt loads and do not have proper expense controls in place.
– Mike Cifone, Senior Vice President – Surety, Hudson Insurance Group

MIDDLE
($10 MILLION-$100 MILLION)
The losses that were predicted to occur due to the great recession did not materialize. One of the main reasons for this is that, by and large, the surety industry maintained underwriting discipline. Now with the sustained but slow recovery, we have to continue this discipline in the face of mounting pressure for growth.
– Alan P. Pavlic, President & COO, Old Republic Surety Company

Overall loss development has been better than planned. There has been some frequency in the subcontractor segment, but there was a lack of larger losses, which should result in reported loss ratios for the middle market at or around 20 percent.
– Edward Titus, Senior Vice President, Surety Division, Philadelphia Insurance Companies

LARGE
($100 MILLION-$250 MILLION)
Surety loss activity resulting from the great recession has peaked and is trending downward. There have been a few industry losses in the large segment, but most have been in the small and middle market construction segments. Contractors still remain vulnerable, however, because of weakened balance sheets, and

will need to be careful not to over stretch their resources as the economy and related construction opportunities improve.
– Rod Williams, Chief Underwriting Officer, Liberty Mutual Surety

MEGA
(MORE THAN $250 MILLION)
The mega segment appears to have emerged from the great recession relatively unscathed. Industry loss data submitted for the upcoming revision to the SFAA Construction Loss Severity Study shows little new claim activity in this category since the early to mid-2000s. Most of the recent claim frequency impacted the middle segment, although with a lower average severity indicating fewer large losses.
– Alan Clark, Actuary, The Surety & Fidelity Association of America