The Surety Industry: Changes and Challenges

AASHTO Meeting
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San Antonio, TX

Howard Cowan
Howard Cowan Bond Agency, Inc.
Lubbock, TX
Surety Industry 2008

- 5.4 Billion Industry
- Most surety companies are divisions of large insurance carriers.
- Typically surety companies divide their business into two segments.
  - 30-35% Commercial
  - 65-70% Contract
Surety In the Early 1990s

- Strong economy
- Excess capacity in surety market
- Low premiums
- Relaxed underwriting
- Commercial surety expansion
Surety in the Early 2000s

Sagging economy

Significant commercial losses

Heavy contract surety losses

Increased failure rates
Contract Surety Premiums & Losses

Source: The Surety & Fidelity Association of America

www.surety.org
Contract Surety Industry Loss Ratios
CY 1958 - 2006
Source: The Surety & Fidelity Association of America

Average Contract Surety Loss Ratio for 1958 - 2006 = 43.8%
Surety Challenges – Beyond 2008

- “Credit Crisis”
- Globalization
- Price Escalations on Commodities
- Falling Dollar
## Top Ten Writers of Surety Bonds in 1992

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Direct Premiums Written</th>
</tr>
</thead>
<tbody>
<tr>
<td>St. Paul/Seaboard Group</td>
<td>$148,894,821</td>
</tr>
<tr>
<td>Fidelity &amp; Deposit</td>
<td>$137,305,805</td>
</tr>
<tr>
<td>Reliance Insurance Group</td>
<td>$128,056,603</td>
</tr>
<tr>
<td>United States F&amp;G Group</td>
<td>$119,502,476</td>
</tr>
<tr>
<td>Aetna Life &amp; Casualty Group</td>
<td>$102,973,652</td>
</tr>
<tr>
<td>American International Group</td>
<td>$98,210,281</td>
</tr>
<tr>
<td>Continental Insurance Companies</td>
<td>$93,303,961</td>
</tr>
<tr>
<td>Fireman’s Fund Companies</td>
<td>$83,943,008</td>
</tr>
<tr>
<td>CNA Insurance Companies</td>
<td>$81,472,867</td>
</tr>
<tr>
<td>Safeco Insurance Companies</td>
<td>$77,857,712</td>
</tr>
</tbody>
</table>

Source: The Surety & Fidelity Association of America (SFAA)  www.surety.org

“Top 100 Writers of Surety Bonds”
## Top Ten Sureties - 1997

### Top Ten Writers of Surety Bonds in 1997

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Direct Premiums Written</th>
</tr>
</thead>
<tbody>
<tr>
<td>CNA Insurance Companies</td>
<td>$218,470,641</td>
</tr>
<tr>
<td>Reliance Insurance Companies</td>
<td>$193,621,757</td>
</tr>
<tr>
<td>U.S. Fidelity &amp; Guaranty Group</td>
<td>$151,278,874</td>
</tr>
<tr>
<td>Fidelity &amp; Deposit Group</td>
<td>$151,278,874</td>
</tr>
<tr>
<td>Travelers Property Casualty Corp.</td>
<td>$147,479,769</td>
</tr>
<tr>
<td>St. Paul/Seaboard Group</td>
<td>$138,973,440</td>
</tr>
<tr>
<td>American International Group</td>
<td>$126,974,037</td>
</tr>
<tr>
<td>New Hampshire Group</td>
<td>$106,948,282</td>
</tr>
<tr>
<td>Fireman’s Fund Insurance Companies</td>
<td>$102,408,696</td>
</tr>
<tr>
<td>Safeco Insurance Companies</td>
<td>$96,670,164</td>
</tr>
</tbody>
</table>

Source: The Surety & Fidelity Association of America (SFAA)  www.surety.org
“Top 100 Writers of Surety Bonds”
## Top Ten Writers of Surety Bonds in 2002

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Direct Premiums Written</th>
</tr>
</thead>
<tbody>
<tr>
<td>Travelers Property Casualty Corporation</td>
<td>$522,288,148</td>
</tr>
<tr>
<td>The St. Paul Companies</td>
<td>$450,448,789</td>
</tr>
<tr>
<td>CNA Insurance Companies</td>
<td>$360,372,339</td>
</tr>
<tr>
<td>Zurich Group</td>
<td>$260,158,209</td>
</tr>
<tr>
<td>ACE USA Group</td>
<td>$202,140,844</td>
</tr>
<tr>
<td>Chubb Group of Insurance Companies</td>
<td>$172,651,420</td>
</tr>
<tr>
<td>Safeco Insurance Companies</td>
<td>$164,611,345</td>
</tr>
<tr>
<td>Liberty Mutual Group</td>
<td>$150,209,449</td>
</tr>
<tr>
<td>Kemper Insurance Companies</td>
<td>$122,815,820</td>
</tr>
<tr>
<td>The Hartford Insurance Group</td>
<td>$122,075,060</td>
</tr>
</tbody>
</table>

Source: The Surety & Fidelity Association of America (SFAA)  
www.surety.org  
“Top 100 Writers of Surety Bonds” June 4, 2003
# Top Ten Sureties - 2007

## Top Ten Writers of Surety Bonds in 2007

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Direct Premiums Written (Preliminary)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Travelers Bond</td>
<td>$1,017,180,430</td>
</tr>
<tr>
<td>Zurich Insurance Group</td>
<td>$448,819,392</td>
</tr>
<tr>
<td>CNA Insurance Group</td>
<td>$436,119,894</td>
</tr>
<tr>
<td>Safeco Insurance Group</td>
<td>$423,274,038</td>
</tr>
<tr>
<td>Liberty Mutual Insurance Group</td>
<td>$341,250,237</td>
</tr>
<tr>
<td>Chubb &amp; Son Inc. Group</td>
<td>$303,639,444</td>
</tr>
<tr>
<td>Hartford Fire &amp; Casualty Group</td>
<td>$223,298,098</td>
</tr>
<tr>
<td>HCC Surety Group</td>
<td>$163,368,470</td>
</tr>
<tr>
<td>Arch Capital Group</td>
<td>$126,995,347</td>
</tr>
<tr>
<td>ACE Ltd. Group</td>
<td>$118,743,836</td>
</tr>
</tbody>
</table>

Source: The Surety & Fidelity Association of America (SFAA) “Top 100 Writers of Surety Bonds—United States & Territories & Canada,” (Preliminary); www.surety.org
Surety Consolidation Continues
Announced Purchase of Safeco by Liberty Mutual

Press Releases

Liberty Mutual Group to Acquire Safeco Corporation For $68.25

April 23, 2008
Keywords: Acquisitions, Financial Strength

Liberty Mutual Group Will Become Fifth Largest U.S. Property and Casualty Insurer Based on Combined 2007 Direct Written Premium of $26.2 Billion

Boston, MA, Seattle, WA – Liberty Mutual Group ("Liberty Mutual") and Safeco Corporation ("Safeco") (NYSE: SAF) today announced that they have entered into a definitive agreement pursuant to which Liberty Mutual will acquire all outstanding shares of common stock of Safeco for $68.25 per share in cash.

The proposed transaction, which is valued at approximately $5.2 billion, has been approved by the Boards of Directors of
Reinsurance

Availability of Reinsurance is an Important Factor to Most Surety Companies!
The Three C’s of Suretyship

Do They Still Matter?
Yes, They Do!

From Biblical Times

to Enron,

You Had Better Know

With Whom You Are Dealing!
Construction
Contracting Is Risky
Business!
Contractor Failure Risks

- Low profit margins
- Slow collections
- Insufficient Capital
- Onerous contracts
- Unreasonable owners
- High Materials prices
- Shortage of qualified, skilled workers
Contractor Failure Risks

- Inadequate Management
- Change in Scope of Work
- Sub Failure
- Inclement Weather
- New Owner
- Over Expansion
- Materials Shortages
Capital
Capacity
Character
Capital
- Financial statements
- Working capital
- Work-in-progress
- Indemnity

Capacity
- Resumes
- Contingency plan
- Business plan
- short & long term
- Equipment

Character
- Reputation
- Relationships
- References
Surety – Does It Add Value?

- Meets Statutory Requirements
- Represents Good Business Practice
- Prequalification
- What if Prequalification is Wrong?
  - Backed by Bond
  - Counsel & Capital
Surety – Does It Add Value?

- **Claims**
  - **A loss-free business?**
    - Losses from 2001-2005
      - Approximately $5 billion of direct losses
    - The Big Dig
    - Midwest Highway Contractor
    - Enron
    - A Simple Claim is the Best Claim
Highway Construction and The Surety Industry

Are We Traveling the Same Road?
Common Goals

- Let’s Keep America Moving!
  - Aging Infrastructure
  - Politics of Transportation
  - Adequacy of Funding
Not A Problem

- Routine DOT Projects
- Different Delivery Methods
The Critical Issues

- Capacity on Jumbo Jobs
  - Probably More Than 750MM, Less Than 1B

- Time
  - Length of Project
  - Length of Warranty
  - Length of Total Commitment

- Legal Restraints
  - Statutory Requirements for 100% Bonds
    - How to Handle?
  - Treasury and Aggregation Limits on Surety
The Critical Issues

- **Competition**
  - **Contractors**
    - Possibly Less than 10 Consortiums at Upper End
    - Shutting Out of MBE’s and Small Business
  - **Sureties**
    - Limited Number of Participants
      (In 2007, Top 5 Sureties Wrote 49%; Top 10 Sureties Wrote 66% of Total.)
    - Joint and Several Liability
  - **People**
    - Contractors
    - Department of Treasury
    - Sureties
What Makes a Jumbo Project Doable?

It Must Have

“The Right Stuff”
“The Right Stuff”

- Project Team
- Contract Terms and Conditions
- Owner
- Financing
- Sharing of Risk
  - Contractor
  - Surety
  - Owner
Avoiding Problematic Language in Your Bond Forms!
Problematic Language

- Terms that make it easier to invoke the surety’s liability (e.g., “any breach will do”)

- Terms that increase the surety’s monetary liability beyond that originally stated in the bond (e.g., contract changes automatically increase penal sum)

- Terms that vary the burden of proof (e.g., determination of default is at sole discretion of obligee; surety waives any notice of default)
Problematic Language

- Terms that limit the surety’s options (e.g., no options--forfeiture of entire penal sum)
- Terms that broaden the obligations covered (e.g., copyright infringement; obligee is intended beneficiary of payment bond)
- Terms that lengthen the time the surety remains liable (e.g., claims period in bond tied to expiration of any warranty period in contract, such as 20 yr. roofing warranty)
Know What Surety Bonds Are and Are Not!

- Don’t Place New and Unquantifiable Risks Into the Bond Product
- Surety Bonds Are Not –
  - Insurance Policies
  - Financial Guarantees
  - Guarantees of Output or Result
Qualifying the Surety

- Is the surety admitted in the jurisdiction of the project?
- Is surety financially sound?
- Is the surety established and reputable?
Qualifying the Surety - Resources

Information resources:

- State Insurance Departments  
  www.naic.org/state_web_map.htm
- US Treasury Department  
  www.fms.treas.gov/c570/c570.html
- A.M. Best Company  
  www.ambest.com
- Dun & Bradstreet  
  www.dnb.com/us
- Standard & Poors  
  www.standardandpoors.com
- Moody’s  
  www.moodys.com
For More Information
On Suretyship

National Association of Surety Bond Producers (NASBP)
202-686-3700 www.nasbp.org

Surety Information Office (SIO)
202-686-7463 www.sio.org

The Surety & Fidelity Association of America (SFAA)
202-463-0600 www.surety.org
Thank You for Your Time and Attention.

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