

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

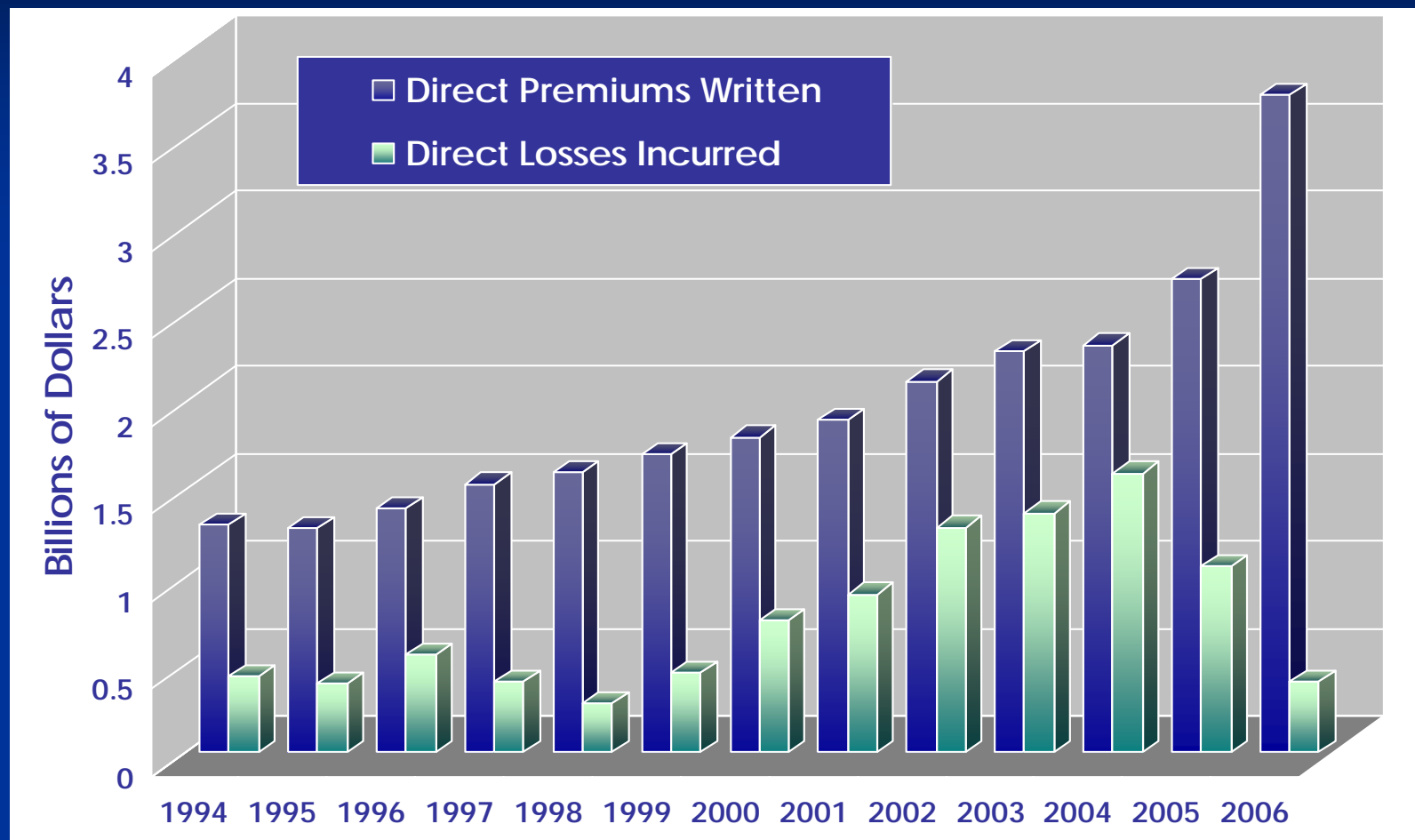
Significant commercial losses

Heavy contract surety losses

Increased failure rates



Contract Surety Premiums & Losses



Source: The Surety & Fidelity Association of America

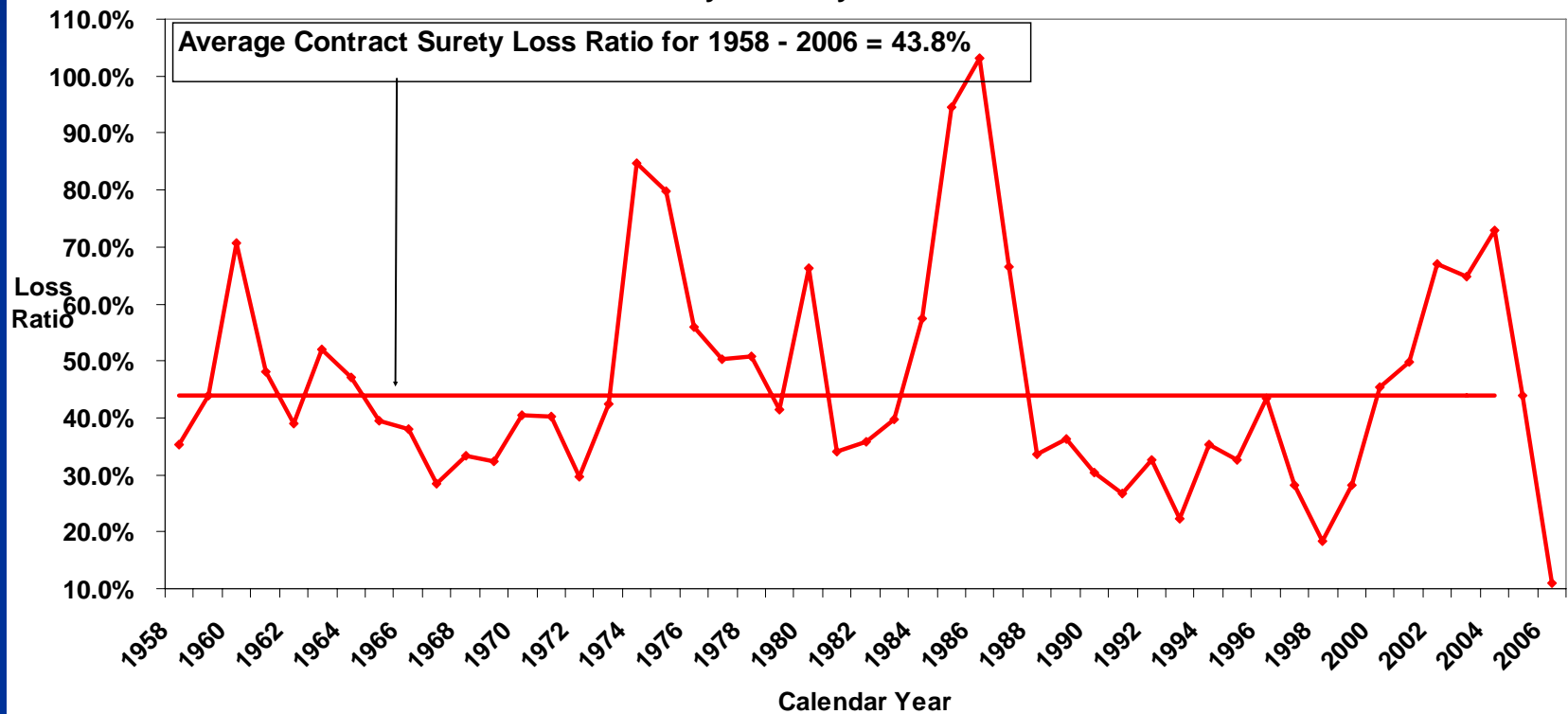
www.surety.org



Surety Losses & Profitability

Contract Surety Industry Loss Ratios CY 1958 - 2006

Source: The Surety & Fidelity Association of America



Surety Challenges – Beyond 2008

- “Credit Crisis”
- Globalization
- Price Escalations on Commodities
- Falling Dollar



Top Ten Sureties - 1992

Top Ten Writers of Surety Bonds in 1992

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

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

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

Source: The Surety & Fidelity Association of America (SFAA) www.surety.org
"Top 100 Writers of Surety Bonds"



Top Ten Sureties - 2002

Top Ten Writers of Surety Bonds in 2002

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

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

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

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 \$28.2 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 \$6.2 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

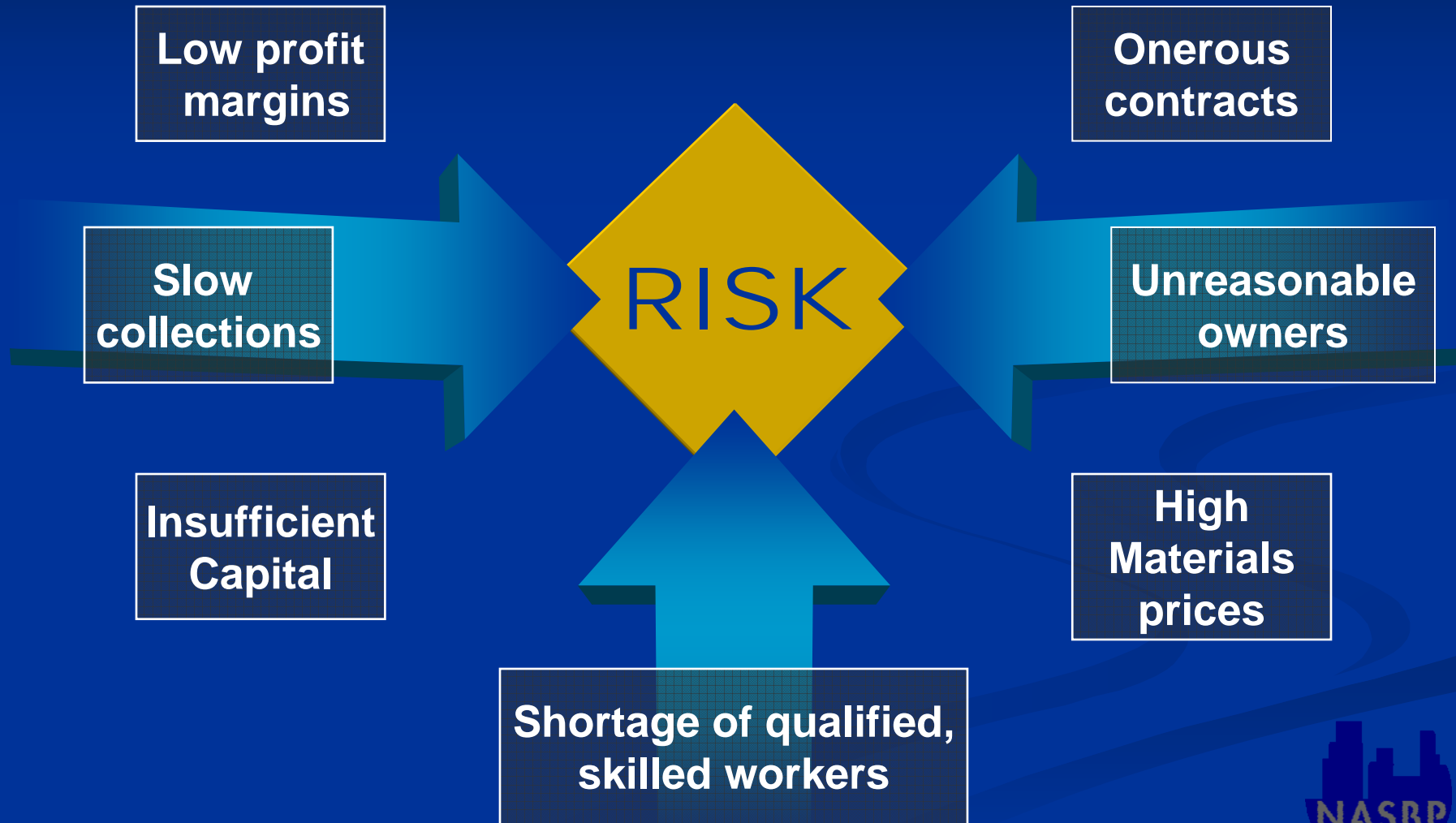
Do They Still Matter?

Yes, They Do!

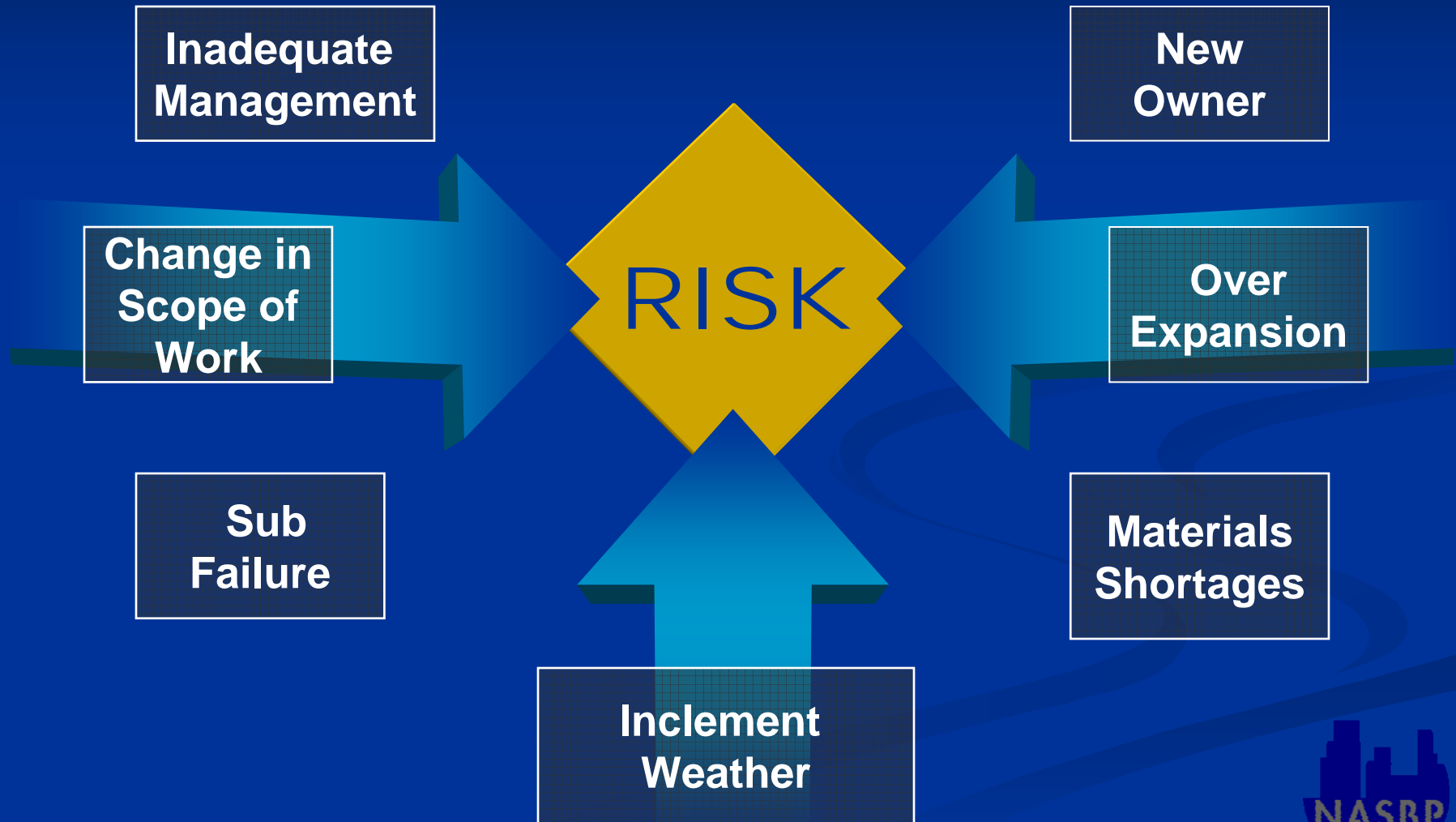
**From Biblical Times
to Enron,
You Had Better Know
With Whom You Are
Dealing!**

**Construction
Contracting Is Risky
Business!**

Contractor Failure Risks



Contractor Failure Risks



**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.moody.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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