

# THE BOTTOM LINE



E X C E L L E N C E I N  
B O N D I N G

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## State of the Surety Industry

In the past three or four years we have seen a lot of volatility in the Surety Industry. Markets have pulled out of New York City, many carriers have merged with one another, and there have been quite a few that left the Surety business completely. The Industry is certainly in a state of flux at the moment, even though it does seem that stabilization is taking place.

Recently the NYC Surety Association had a luncheon in which the "State of the Surety Industry" was discussed. The guest speakers were Dennis Perler, President of Liberty Mutual Surety and Terrence Cavanaugh, Chief Operating Officer of Chubb Insurance Company. Their insight regarding the current state of the surety industry is worth noting because of their unique perspective as leaders of two large and involved surety carriers. This was evident by the impressive turnout of 87 surety and associated professionals that were in attendance. The message that we heard is as follows:

There was a cause and effect that lead us to today's turmoil in the industry. The underwriting that took place during the time period between 1988-1999 was the cause leading to the major surety losses from 2001 to 2004. The effect being the volatility we have experienced since late 2003. A number of "reckless sureties put us in a tough situation...." during those times resulting in at least 6 surety carriers leaving the industry and 50 reinsurance firms deciding to exit the surety lines of business as well. Excessive exposure with an undervalued product has put the surety industry in a precarious situation. It has allowed alternate forms of guarantee, such as Sub-Guard and Letters of Credit, to be considered by job owners, general & prime contractors.

Surety companies are now under more pressure to provide an acceptable "rate of return" on the exposure it entertains. Surety premiums represent

less than 1% of the Property & Casualty premium in the U.S. Senior management of major insurance companies today often do not come from insurance underwriting backgrounds where they moved up in the ranks. CEO's today are more finance oriented and look for ways to increase bottom line profits and shareholder return on investment. The surety industry faces much more pressure today to show to these leaders why it should remain a portfolio within the larger organization.

The surety companies are stabilizing and are establishing new foundations to put the business on a firm footing once again. The experiences of the past few years have shown that certain items cannot be ignored when times seem good. They are:

- Proper pricing. Our product is severely undervalued and does not allow for a sufficient underwriting profit. This is needed to meet the requirements of the CEO's who look for minimum profits from each product line.
- Training of young talent. In efforts to cut cost, training programs were cut from surety budgets. The surety underwriters' pool has been severely diminished and is only now being addressed by some companies.
- Improved claims handling. Perhaps the weakest part of surety. The slow claims process of a few irresponsible sureties is what has handcuffed our industry for years.
- Improving individual credit tracking and finding efficient ways to provide detailed portfolio management of existing surety book of business.

### Contributing Staff

Anthony J. Panno  
Louis J. Spina  
Denese Thompson

### Famous Quotes

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When someone hurts us we should write it down in sand where the winds of forgiveness can blow it away.

But, when someone does something good for us, we must engrave it in stone where no wind can blow it away.

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Follow the 3 R's  
Respect for self, Respect for others and Responsibility for all your actions.

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Take into account that great love and great achievement involves great risk.

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Share your knowledge. It's a way to achieve immortality.

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Dalai Lama

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Famous Quotes

There is no such thing as “soft sell” and “hard sell.” There is only “smart sell” and “stupid sell.”

- Charles Brower

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There is only one boss: the customer. And he can fire everybody in the company, from the chairman on down, simply by spending his money somewhere else.

- Sam Walton

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The only place where success comes before work is in the dictionary.

- Vidal Sassoon

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You can use all the quantitative data you can get, but you still have to distrust it and use your own intelligence and judgment.

-Alvin Toffler

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When you cannot make up your mind which of two evenly balanced courses of action you should take—choose the bolder.

-W. J. Slim

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The graveyards are full of indispensable men.

-Charles de Gaulle

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In calm water every ship has a good captain.

-Swedish proverb

# Sometimes The Surety Is Right

Through our experiences with Surety Companies, we learn lessons that can be used to improve our individual situations. As a Surety broker, it is a normal course of business to question the underwriting requirements a Surety may require from an account. After all, what does a Surety underwriter know about being a contractor? Many times, both the contractor and broker get frustrated with the underwriting process. Although we must eventually adhere to the requirements of the Surety, we do so kicking and screaming at first. Yet, if contractors are always right, why is there such a high contractor failure rate? No one plans on failing, yet many do. No one enters into a project saying this project is going to take them under. Yet, projects do fail. The Bottom Line is that the Bonding companies are not always wrong.

First, let’s get something perfectly clear. Surety Companies need revenue just like every other firm, and they do not make any money by saying “NO”. For the Surety, it always faces a small upside (the premium) and a tremendous downside when providing bonds. The average Surety premium is less than 1% of the contract amount.

Just because a contractor is successful does not necessarily mean that the contractor or a particular contract is bondable. If a firm already has bonding credit that does not mean that it automatically qualifies for increased credit, regardless of whether or not it has experienced any problems in the past.

While contractors are correct that most Surety underwriters do not know the contracting business, underwriters do have many years of historic records that help create “underwriting guidelines”. Surety companies study contractor failures to discover the circumstances leading to these failures. This information is documented and compared with other recorded claims. Patterns for failure are found (such as Project sizes, Unfamiliar territory, New type of construction, Key personnel changes, Management immaturity—dubbed **PUNKMan** by one surety) and underwriting guidelines are established.

This enables underwriters to spot these situations before problems result. More recent losses are tracked to see if there is a “current loss trend” in construction taking place. Current trends or “shock losses” are primarily what cause Sureties to suddenly change underwriting guidelines.

You know one construction company very well – yours. The bonding companies see thousands of companies. There are many cases where the contractor would probably be in business today if they had listened to their original Surety company. Instead, they went out in search of a bonding company that would give them the answer they wanted, without really understanding the original surety’s concerns.

Now, hindsight is twenty-twenty. We all know that. However, these contractors probably did not consider the surety’s advice at all. They believed the Surety was the enemy, being too restrictive and that they were causing the problems. Remember, Sureties make NO money by saying “NO”. They do benefit by long-term profitable relationships and a steady flow of income from their contractor clients. Perhaps the biggest difference between contractors and the Sureties is that contractors tend to look at their short-term needs while sureties consider the long-term ramifications of their decisions.

Contractors need backlog to stay in business, while sureties need to avoid claims to stay in business. It would be a good policy for contractors to sit with their Sureties when considering larger growth, geographic expansion, etc. The Surety may not have all of the answers, but it will provide solid examples and valuable information that will allow you to make a well-informed decision.

Not only does the surety provide valuable Surety bonds, but they also have a wealth of knowledge and experience that can aid in your success. The Surety may not know how to build that bridge or building, but they do know how you can avoid the pitfalls that can lead to your failure on such projects. They want to see you succeed almost as much as you do.

## Atlynx Hosts Japanese Delegation

As much as we find fault with our system of competitive bidding and bonding of contractors, other countries find our system to be the most effective system available to protect job owners, subcontractors, suppliers and laborers on a project.

In March Denese Thompson of our office received a phone call from Akiko Fujikawa of Nippon Network, Ltd., in Bethesda, MD asking if we would consider hosting a meeting with a delegation from Japan to explain how the surety bonding system works in the US. Needless to say, Denese was very excited about being able to promote our method of doing business, especially for another country that was interested in learning our system. Ms. Fujikawa explained that the delegation, which consisted of government officials, contractors, and a Japanese surety company, were looking to implement a comparable system in their country and was doing a survey across the US to better understand our system. The delegation had or were having meetings with various government agencies, surety and contractor trade associations, contractors, surety companies and surety agents.

Prior to the meeting, the delegates provided a list of 17 questions that they wanted addressed. Denese invited Louis Spina, Co-Owner of Atlynx Surety Brokers LLC and Joseph Cieri, Contract Surety Manager of First National Insurance Company of America, Mahwah, NJ to assist her providing a complete overview from the surety company and agent's perspective on the topics they requested we cover. These questions covered a broad scope of information on how our industry operates and it's success and failures over the years. We discussed things as simple as how the bonds are rated to more complex information regarding why contractor's fail and how claims from subcontractors are handled.

The meeting was held in our office on Friday, March 31, 2006 and was an interesting, informative exchange of information. They told us, through an interpreter, that although they do not have a system as comprehensive system as ours, they do have a bonding system, of sorts, in their country.

Currently their system provides Performance Bonds to mostly publicly traded companies on some projects. The performance bonds they provide are only 10 to 30% of the contract price and apparently acts more like a letter of credit than as a bond guarantee as the bonds in the US do. For example, they do not provide for the surety to bring in a completing contractor when the bonded contractor defaults. Additionally, they have no mechanism in place for Payment Bonds. Therefore, there is no protection afforded to the subcontractors, suppliers and laborers. They do not have a bid bond requirement, so jobs are not awarded based on a competitive bidding system to the low and responsible bidder. As a result, bid rigging and other forms of corruption are rampant. Subcontractor, suppliers and laborers are at a severe disadvantage and contractor default is high. This has also caused a severe deterioration of the construction and investment industry in Japan.

Another major difference in their system compared to ours is that the way they charge for the bonds. Where we charge a premium on each bond based on the contract price, they apparently charge a rate based on the bond program established for the contractor.

The exchange of information was both educational for both parties and gave us a better appreciation for our system, not matter how flawed we may feel our system is.

### Famous Quotes

I try to take one day at a time, but sometimes several days attack me at once.

-Anonymous

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One of our ironclad rules is "Never do business with anybody you don't like."

If you don't like somebody, there's a reason. Chances are

it's because you don't trust him and

you're probably right. I don't care who he is or what

guarantees you get—

cash in advance or whatever. If you do

business with somebody you don't like,

sooner or later you'll

get screwed.

-Harry V. Quadracci

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Don't believe the world owes you a

living; the world owes you nothing—it

was here first.

- Robert Jones

Burdette

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One machine can do the work of fifty

ordinary men. No

machine can do the work of one extra-

ordinary man.

-Elbert Hubbard

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## State of the Surety Industry

Continued from Page 1

This would help determine how and where to extend surety credit while limiting exposure as much as possible.

- Building up capital base by using scaling models to determine proper pricing, industry risks, expense management and understanding their position within the industry.

The overall message was that our industry is in transition. Both men confirmed their resolve to

work on building this new foundation they spoke of. The future is one in which contractors should expect to see some higher pricing on longer term projects, more effort to confirm credit worthiness, more consistent underwriting and ways in which sureties will work with contractors in an effort to get them to understand the true value of having a surety line of credit.

## WHAT DO YOU DO WITH YOUR OLD CELL PHONE?

Why not donate it for a worthy cause. Atlynx Surety Brokers LLC along with Sprint Phones will be running a Cell Phone Collection Drive in April. You can donate all your old cell phones which will be collected by Sprint, properly recycled and the proceeds used to fund educational initiatives helping thousands of teachers, students and families.

This is an environmentally friendly way to dispose of used phones. Through Sprint Project Connect, donated phones are either recycled or resold. The proceeds from the resale benefit K-12 educational programs through the Sprint Foundation and Wireless Foundation. We will accept all makes and models of phones. You'll be getting rid of unwanted clutter and benefiting a good cause at the same time. Your donation is tax deductible and a Tax Donation Receipt is available upon request.

You can help out by sending us your old phones to our Garden City Office or by dropping them off here or at any Sprint Store. For more information, call Denese Thompson at 516-745-7504

## Company News

**Atlynx Surety Brokers LLC** is pleased to announce the hiring of Jennifer Weingarten. Jennifer has a double Bachelors degree in Math and Economics from C. W. Post and Hofstra University. Jennifer will be working as an Account Manager in our Garden City, NY office, handling both Contract and Commercial Surety customers.

**Contractors For Kids** is holding their 1st Annual Golf Outing on June 12, 2006 at Stonebridge Country Club Hauppauge, NY. The day begins with registration and breakfast at 8:00AM with a shotgun start at 10:00AM. Cocktail Hour and Dinner with open bar follow immediately after Golf. There will be a Silent and Live Auction with many exciting sports and art items. During play you will have an opportunity to win golf vacations on 4 out-of-the five Par 3's and a brand new car on the last Par 3. For more details check the website at [www.contractorsforkids.org](http://www.contractorsforkids.org)

**Construction Financial Management Association (CFMA) LI Chapter** is having the Annual Golf Outing on Thurs. May 25, 2005 at Stonebridge Country Club, Hauppauge, NY. The day begins at 11:00AM with BBQ lunch with a shotgun start at 1:00PM. 6:00PM Cocktails and Dinner begin. For more details or to obtain a flyer please contact Lou Spina at 516-745-7502.

## Letter from the Editorial Staff

This newsletter is designed with our readers in mind. All inquiries and ideas regarding this or future newsletters are appreciated. Please send all inquiries to me at [denese@esuretybond.com](mailto:denese@esuretybond.com). If you know anyone who you feel would like a copy of our newsletter, please let us know so that we can include them in our mailing list. Please let us know if you would like to receive this newsletter via e-mail. Check out past emails at our website at [www.atlynx.com](http://www.atlynx.com).

## Disclosure

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