



## Contact



**Jeff Carey**

Assistant Vice President  
Construction Specialist  
Kansas City, MO

Telephone: 816.960.9360  
E-mail: [jcarey@lockton.com](mailto:jcarey@lockton.com)



**Doug Irvin**

Vice President  
Unit Manager  
Kansas City

Telephone: 816.960.9085  
E-mail: [dirvin@lockton.com](mailto:dirvin@lockton.com)

In the sport of fencing, a displacement is a move that avoids or dodges an attack. There is a similar move in the surety business when underwriters attempt to avoid an attack on their financial results by displacing accounts from their portfolio. Many of the displaced contractors will still be viable entities, but they fall into a risk category that is no longer acceptable to the surety. It is the proverbial “throwing the baby out with the bathwater” scenario.

During Lockton’s recent meetings with surety executives at the Associated General Contractors of America (AGC) national convention, displacement was the underlying theme. The consensus among all of the sureties was that industry results would start to deteriorate rapidly later in 2010 and into 2011, which will lead to displacement. At the same time, each surety expressed a healthy appetite for new business, especially those clients displaced by other sureties. The status of the surety market could best be described as “the calm before the storm.”

While it is estimated that the surety industry contracted by nearly \$1 billion in premium, most sureties will show strong underwriting profits in their 2009 results. This comes on the heels of record-setting profits in 2006–2008 from the combination of a strong construction market and disciplined underwriting. According to the Surety and Fidelity Association of America, the direct loss ratio increased from 12.7 percent in 2008 to 23.9 percent through September 2009. It is likely much of this increase is comprised of loss reserves companies are using to prepare for some anticipated tough years ahead.

There continues to be an ample number of sureties in the mid-market, which ranges from \$10 million to \$250 million in surety capacity. For surety program needs above \$250 million, there are only a handful of sureties with the capacity and willingness to participate in this range. Environmental contractors must also look to a very limited number of sureties willing to support bonds on remediation projects. Accordingly, we do not anticipate industry-wide capacity issues, but we do expect very disciplined underwriting, which will lead to displacement.

Now, more than ever, it is critical for construction firms to evaluate their contractual risk and make tough business decisions. Owners know the pendulum has swung in their favor, and some have exercised their leverage to secure onerous contract terms and conditions. Competition is fierce: if one contractor will not accept the owner's terms, others stand ready to seize the opportunity. This can put sureties in a difficult position: stick to time-tested underwriting principles or support their good clients. Open communication with the surety, while working collaboratively with a knowledgeable surety broker to assess and manage the additional risks, is vital in these situations.

The fundamentals of surety remain the same: contractors with a proven track record and strong financial performance will continue to receive ample surety credit. Honesty, integrity, and full disclosure carry significant weight in a surety relationship... especially in these times. Sureties are bracing for tough times ahead, but most are positioned to weather the storm without material changes to their clients.

During a surety market cycle such as the one we are currently facing, the ability to enable the surety to make a sound business decision is the difference between receiving surety support versus displacement. Lockton is positioned to help our clients navigate this market dynamic based on:

- ❖ Development of proprietary software that provides the analytical capacity to tell your story in a more meaningful presentation.
- ❖ Consulting services designed to mitigate business risk.
- ❖ Investment in talented surety professionals who have experience in all market cycles.
- ❖ Credibility throughout the surety community based on relationships and results.

The combination of analytical tools, expertise, and relationships promotes a partnership environment between our clients and sureties. Partnerships endure through difficult market conditions, while transactional business arrangements tend to get displaced.