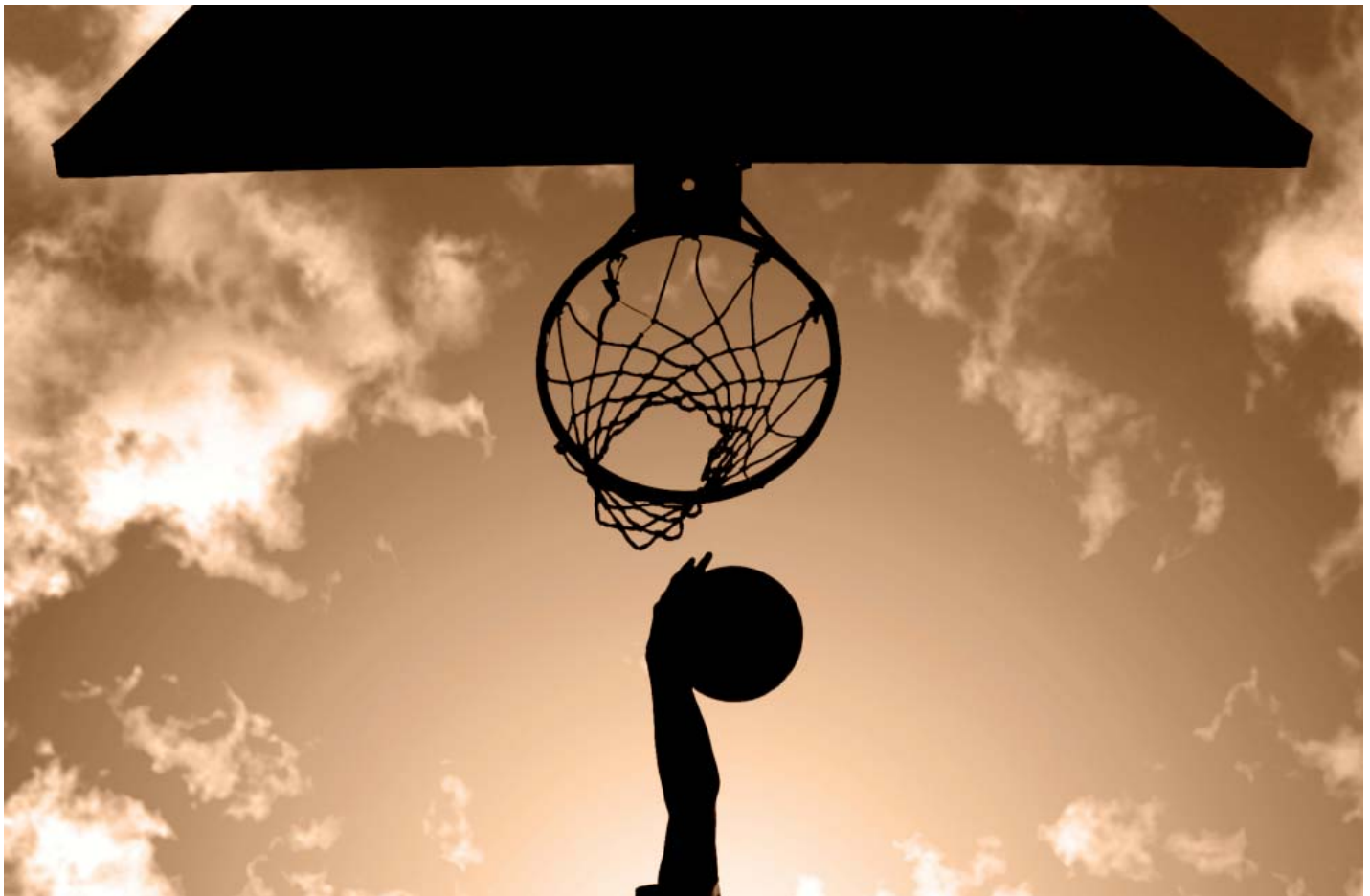


# Surety Industry Rebounds *Keeping the Full Court Press*

by Doug Irvin



*The surety industry appears to have turned the corner. Having returned to steadfast, disciplined underwriting standards in 2001, the industry is just now experiencing profitability, posting modest returns in 2005 and much more robust figures in 2006.*

It's still too early to be certain, but the 2006 loss ratio may be in the 20% range. The break-even point for the industry is in the 35%-40% range, so this would be the first substantially profitable year for the bonding companies since 1999. Compare this with the horrendous results of 2004, when the loss ratio topped 70%, and it's easy to see the reason for optimism in the trend.

### What went wrong?

Essentially, the circumstances that the surety industry encountered from 2000 to 2004 were the result of several factors:

- Insurance company executives, who misunderstood the surety product, demanded market share during a soft insurance pricing cycle throughout the 1990s. This drove down the established underwriting standards and pricing for the surety product.
- During the same period, the overall economic cycle was very strong and construction spending was extremely high.
- The strong construction economy combined with the aggressive surety marketplace, enabling contractors to overextend their work programs.
- The drastic economic downturn caused by September 11, 2001 events left bonding companies exposed on overextended work programs, which eventually led to contractor defaults.
- Corporate scandals resulted in surety losses.

### Where will the market go from here?

We are in a situation similar to that of the mid-1990s:

- Improving capital markets are driving up demand for cash flow within insurance companies.

- The construction economy is strong.
- The surety industry is experiencing solid profitability.

Does this mean we are heading back into the loose underwriting cycle we experienced from 1996 to 2001, when many contractors received surety credit beyond their qualifications? We don't believe so.

## *It is extremely important to work with a professional surety agent...*

The leadership of most surety and insurance companies recognizes that the profits now being realized are the direct result of disciplined underwriting standards. At this point, there seems to be a stable and consistent marketplace for contractors who run profitable operations, have timely and accurate financial reporting and who balance work programs with their financial capacity. In other words, the bonding companies are generally going to stick with guidelines that have brought them back to success. However, the underwriting environment is still not favorable for companies who fall "outside the box" due to losses, leveraged work programs, poor balance sheets or other fundamental problems.

### Playing to win

It is extremely important to work with a professional surety agent to assure the following:

- Your business plan is defined and communicated clearly to the bonding company
- You have access to a wide range of viable surety company relationships
- Your financial presentation and capital structure will maximize surety credit

- You receive sound advice about increasing surety capacity
- You receive consultative input about contracts and risk selection

One way to be confident that your agent has the professional credentials necessary to represent you is to verify their membership in the National Association of Surety Bond Producers (NASBP).

To gain membership, NASBP requires a minimum threshold of experience and surety premium, as well as recommendation by peers. SilverStone Group is one of only three agencies in Nebraska who have been accepted into membership of this organization.

### Summary

We anticipate continued profitability in the surety sector through 2007 and into 2008. Fundamental underwriting standards will continue to be the norm. This should translate into a stable marketplace for our construction clients. However, it is important to remain diligent and proactive with respect to your surety relationship.