BY MATTHEW J. DOBROWOLSKI

Risk Plans Help Sureties Help You

Many remember the 1990s, with a nostalgic smile, when it was easy to qualify for a surety bond. This bubble has burst; the old concepts and practices have become stale and the construction and surety industries need fresh ideas.

Now it's 2003—corporate America is reinventing itself, and the economy is attempting to recover. The construction industry may soon see troubles. According to *The Wall Street Journal* and the *USA Today*, 72 percent of county governments are experiencing significant budget problems, with one quarter of these planning reductions in highway and street construction. Public works and surety capacity is declining. Reinsurers also are experiencing trouble; 70 percent of the world's reinsurance capital has been downgraded once, twice, and, in some cases, three times during the past two years.

What are the effects? Some underwriters are subjecting what once were considered viable accounts to increased scrutiny, a reduction in capacity, or they are denying the bond altogether. Pricing has notably increased, and underwriters are finding that a feasible exit strategy is difficult, if not impossible, without rattling the contractor's foundation.

CRM—AN IMPORTANT COMPONENT

Underwriters and contractors agree that performance capability is critical to their mutual survival. However, if a contractor's money-handling proficiency, cost and bid estimating, and back office are weak, when the contractor falls off the project wall, all the underwriters and all the claims men will never be able to put the contractor back together again.

The right agent, with the credentials, knowledge, guts and ability to educate his clients on the reality of the current market, how it affects them, and the options available to combat changes in the market will benefit both the contractor and underwriter.

In today's market, with losses pushing 80 percent in the last two years, predictability is a necessity for sureties. With a solid Construction Risk Management (CRM) program, predictability is possible.

The success of projects underwritten with CRM tools, such as funds administration, back office outsourced accounting, on-site inspections and project management, speaks for itself. Contractors and underwriters alike have found that using CRM greatly mitigates the potential for payment claims and lien problems. CRM programs are already a staple in the banking industry, providing tools that protect construction lenders from the common pitfalls of the construction industry.

And the trend is spreading. Just as an increasing number of sureties and underwriters are using CRM tools, so too are an increasing number of contractors suggesting their use.

Recently, a large national general contractor requested that the underwriter require funds administration for one of his troubled subcontractors in an effort to proactively avoid trouble down the road. The request was ignored, and eventually the sub failed. Another large national general contractor realized the usefulness of a CRM program as an interim mitigation tool for its subcontractors that, because of the stringent bond requirements of today's market, have been blocked out of the surety market.

CONSERVATIVE LOSS PREVENTION

Using collateral as an underwriting tool is still a consideration; however, its drawbacks are significant. If too much collateral is required, it may actually have an adverse affect on the contractor by diminishing the contractor's available working capital, preventing the potential of acquiring future bank lines, or adding to personal and business financial stress. Too little collateral can provide a false sense of security by not sufficiently covering the losses should problems or default occur.

CRM allows for conservative loss prevention and predictability without the negatives collateral may apply. One situation in which collateral can be effective, however, is through a fund build-up process using the CRM tool funds administration. Pairing these together has proven to be a successful loss-prevention tool.

The construction and surety industries of today are complicated, but the answer is simple. Contractors must be proactive and creative in utilizing CRM tools with their subcontractors, whether they are bonded or not. Underwriters must continue to evolve their underwriting regimen to be more inclusive of CRM programs.

Proactive mitigation through CRM is the best way to protect the contractor's bonding line and the bottom-line results for sureties. Now is the time to discard the stale concepts of yesterday, and adopt a fresh construction risk management solution; CRM programs provide the strength and predictability necessary to successfully maneuver through today's market.

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