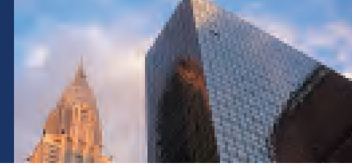
2008 SURETY MARKET REPORT



SURETY MARKET REPORT

In Today's Economic Climate, Surety Plays Even More Important Role

By Marc Ramsey, Surety Information Office

The U.S. nonresidential construction market is under pressure. With oil around $130 per barrel, sub-prime and mortgage losses still negatively affecting bank credit lending and an increasing number of states with growing deficits, the strong construction expansion seen over the past several years is quickly coming to an end. If prior economic downturns are any indication, fewer construction projects will lead to more bidders, lower profit margins for contractors and increased defaults. In this changing environment, the role of surety industry in prequalifying and bonding contractors becomes more important.

Economic pundits differ as to whether the U.S. economy is in recession or how long it will last. The current weakening state of the economy, however, is expected to increase risk for owners, their contractors and the sureties that bond them. Surety remains at its core a credit product and is subject to substantial volatility over time. Following significant losses early in the decade, the surety industry returned to the basics of sound underwriting, exposure management and project analysis. These actions stabilized capacity by restoring profitability and preserving the capital necessary to manage the product over time. Moreover, the excellent results posted by the surety industry in 2005, 2006 and 2007 position companies to ride out the current economic downturn.

What can owners and contractors expect from sureties in the near future? Overall, most surety executives expect 2008 to reflect good underwriting results as most contractors began the year with solid backlogs. The surety industry should be sustained by the nonresidential construction market that is projected to grow in nominal terms through 2008 and into 2009. As public works projects are completed and public funding for new projects continues to be limited, executives anticipate a slowing in nonresidential construction in late 2009 with nominal growth returning in 2010-11.

Two areas of concern are consumer spending and inflation. As gas prices push into the $4.00 range, the Michigan Index of consumer's confidence has hit 30-year lows. This translates to reduced spending and ultimately negatively affects construction as fewer retailers and manufacturers spend to build or expand stores and factories. For the government, less spending drives lower sales and income taxes, resulting in reduced longer term infrastructure spending. Rising inflation, or what some call stagflation – the combination of a stagnant economy and inflation – is further holding executives' optimism down.

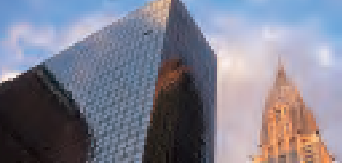
To survive and succeed in today's challenging construction marketplace, contractors are advised to continue doing what they do best, stay lean, procure materials and lock in prices and maintain profit margins. Project owners, meanwhile, are finding greater value in requiring surety bonds to protect their investments and are using a combination of their own prequalification process along with the surety's underwriting to assure the contractors they hire are capable of executing the work.

CONTRACTOR FAILURE

Contractor failures dropped from 28.5% in 2002-04 to 23.6% in 2004-06, according to BizMiner. Surety executives attributed the decline to a robust construction economy, disciplined underwriting, better job selection by contractors and improved profit margins. "After the recession of 2001-02 and managing the subsequent construction material inflation of the past four years, our contractors today are better capitalized, more sophisticated and better prepared to ride out a weakening economy," observes Dennis Perler, president, Liberty Mutual Surety. "Yet, even with sound contractors and responsible underwriting, the current economic trend points to higher contractor defaults."

Factors suggesting increased contractor defaults include increased competition, tightening credit terms, inflation and the weak U.S. dollar. While today's contractors are better businesspeople – with more sophisticated systems for estimating, monitoring and constructing projects – and sureties have implemented tools to better judge the credit and performance worthiness of their clients, the economy is still the primary driver of contractor success. "We can't control defaults any more than we can the weather," notes Rick Kinnaird, chair, The Surety & Fidelity Association of America (SFAA), and senior executive, surety, Westfield Group Surety. "We will see lower profit margins and less room for error. Some contractors will not make it."

Generally, most surety executives see increased risk coming but believe the construction and surety industries are better prepared to manage the cycle. Sureties note that contractors continue to carry strong backlogs with good profit margins well into 2008. This indicates that short-term default activity should remain low. While many sureties also believe that strong cash flow earned



during more robust times may be keeping some contractors afloat during the current downturn, they recognize the cash flow requires a sufficient number of new project being let to sustain the construction industry. "We believe that as the slowdown persists you'll see an increase in defaults, because part of what may have been keeping defaults at bay is cash flow," says Jim Altman, senior vice president and chief underwriting officer, Chubb Surety. "As that cash flow slows down people are going to have problems."

Thomas Kunkel, president and CEO, Travelers Bond, agrees, "The economy is no longer covering for the mistakes that some contractors make when times are good."

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—Dennis Perler, president, Liberty Mutual Surety

The emerging trend of an increase in contractor defaults translates into more work-out risk for owners who do not bond projects. Owners that bond projects mitigate risk by shifting default exposure to sureties. Owners that do not bond retain heightened risk of contractor defaults and uncompleted projects. For sureties, an increase in contractor defaults means more surety losses, but perhaps not until late 2009 or early 2010, and likely not as severe as in prior loss cycles. "While we have not seen an increased level of defaults to date, it is still early," says Doug Hinkle, chief underwriting officer, CNA Surety. "We do expect to see increased loss activity."

Michael P. Foster, executive vice president, Merchants Bonding Company (Mutual), adds, "We do not think there will be a significant impact until 2009."

There has been some surety industry "profit slippage," as surety executives call it, but nothing significant. Executives anticipate accelerating slippage over the coming two years as competition heats up, but the industry should remain profitable as a whole as the economy transitions through the slowdown and begins its recovery.

"With investment returns down, the pressure is off from senior property and casualty management to turn dollars for the sake of investment returns," SFAA's Kinnaird says. "'Smart' growth is encouraged, but it is recognized that we need to make money from underwriting. We can no longer rely on investment dollars to offset, or temper, poor underwriting results."

Tim Mikolajewski, senior vice president, Safeco Surety, adds, "We are still bullish on the surety industry in 2009 and beyond. Clearly there will be challenges from a growth standpoint, since there will likely not be as many projects to bond, but profitability should remain solid. Underwriting should remain sound and capacity will be available to those contractors that deserve it."

CONSTRUCTION COMPETITION

Surety executives confirm that the overall economic slowdown is adding to contractor competition. Adding to this, the substantial drop off in residential construction is generating more competition as residential contractors enter the nonresidential sector. One indicator of the increased competition is the abundance of bidders, which has gone from as few as two to three in recent years to more than a dozen. "This is a combination of the slowdown in work coming out for bid and new market entries on small and mid-size public projects," SFAA's Kinnaird explains. "Construction has historically offered an 'ease of entry' for new players."

Many new market entrants come from the residential and small commercial market areas. While some of these contractors are successfully testing the water in the public bidding arena, many are unfamiliar with the policy and procedures involved with public work. Executives warn that insufficient experience and financial capacity can lead to inadequate pricing and quality of work issues. "The largest oversight that we commonly see from contractors moving from the private to public sector is that they often have a naive approach to the complexities of working with public owners," says William A. Marino, chairman and CEO, Allied North America.

"All stakeholders of a construction project," adds CNA's Hinkle, "are at risk if they choose to involve an unqualified contractor. Performance issues such as quality of construction and time for completion as well as proper payment of subs and suppliers can create significant additional costs, delays and litigation."

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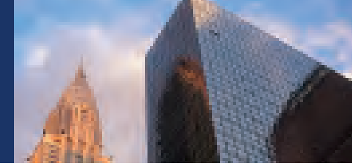
Surety executives caution project owners, developers and investors not to view this increased competition as an opportunity to take advantage of the market and get a cheaper product. "If they select the right architects and engineers they can manage the risk, but they have to be extremely careful," warns William Cheatham, president, Zurich North America Surety. "This is where the surety industry can bring enhanced value through its prequalification process."

"The owners, developers and investors' first line of defense in managing risk on a specific project is their selection of architect and engineers," Cheatham continues. "The surety industry enhances the integrity of project completion through the prequalification process in selection of contractors."

When a construction company engages with a new owner, location or different scope of work, the probability of encountering project-related issues rises. "Contractors working outside of their normal territory, or in new sectors within the construction market, will face the challenge of establishing



relationships with new owners, architects and subcontractors," says Michael J. Cusack, senior vice president, managing director and operations board member, Aon Construction Services Group.

Construction has many variables and hidden risks. Even with established contractors, risk exists. The risks are compounded when owners contract with new, unproven entities in a new market or territory. "Risk to owners increase exponentially when contractors lack local knowledge of and relationships with critical sub-trades, labor sources and suppliers," Liberty Mutual's Perler notes.

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New entrants may miss costs that lead to change order requests. Substandard performance may surface. The contractor may be inadequately financed. Experience may be lacking for the scope of work they are attempting. Access to qualified labor may not be available. Material and resource suppliers may not have experience with the new player, leading to material scarcity and difficulty in locking down prices. Additionally, banking relationships may not exist to cover payment terms on larger, or public, projects. "This is not to say new contractors can't make the switch to nonresidential work," SFAA's Kinnaird says. "Many of today's strongest nonresidential contractors have done that very thing."

The transition of labor from low- to mid-rise construction projects to high-rise structures also has had an effect in certain markets from a safety standpoint. Surety executives urge more safety education and training of labor transitioning to commercial construction for the industry to maintain a strong safety record.

A residential contractor who enters the nonresidential sector and obtains surety bonding makes an important statement to project owners about the construction firm's qualifications. "If an owner requires a contractor to be bonded, that means that contractor has gone through a prequalification process by a surety," explains Henry W. Nozko, Jr., president, ACSTAR Insurance Co. "If the residential contractor has gone through this vigorous process by the surety, the surety has deemed the contractor qualified to perform the contract."

The U.S. Census Bureau reports that the seasonally adjusted value of nonresidential construction spending grew 11.6% in April 2008 over April 2007. Nonresidential construction spending marked 25 consecutive months of double-digit growth, peaking at 18.1% in November 2007 over November 2006. In April 2008, lodging (41.8%), public safety (27.4%), manufacturing (25.7%), power (22.5%) and transportation (20.9%) construction performed the strongest.

"There is still a pent-up demand for projects, particularly in the infrastructure sector," Safeco's Mikolajewski observes. "State budget issues will cause a temporary slowdown in projects hitting the market, but those issues will be overcome as more creative project financing alternatives surface."

Much of the long-term economic outlook for the construction industry depends on the resiliency of the credit markets and the outcome of the presidential election. Surety executives say that without any meaningful infrastructure economic stimulus, the construction economy may experience a slump that could last 18 months to three years.

"The key to any successful business – construction or other – is to be able to adjust through various cycles and overcome obstacles," says Anthony Romano, senior vice president, surety, American International Group (AIG). "Being able to spot trends, maintain margin discipline, remain agile from a cost-structure perspective and adjust practices to coincide with differing situations is the key to remaining successful over various periods of the cycle."

With fewer jobs available and more players, competition in the nonresidential construction market may not slow for some time. "We've really not seen a material decrease in the backlog of our contractors," says Terry Lukow, executive vice president, Travelers Bond, Construction Services. "Granted, a lot of this work was procured last year."

"It depends where you are and the type and size of work you're bidding," adds Travelers' Kunkel. "In many areas it's still very robust. There are areas that are not as robust."

Aon's Cusack has noticed a decline in backlogs and reduced cash flow, "We are concerned that the liquidity crisis may lead to tougher credit conditions for contractors with respect to their working capital credit facilities. Any sector pull-back from financial institutions away from the construction industry will be detrimental to firms that need bank support to survive the slowing cycle."

ADVICE FOR CONTRACTORS

Most contractors work on fixed contract prices. Over the past five years, contractors learned to manage material inflation, and as global emerging economies, bid the costs of critical construction materials. A growing concern is an extended period of stagflation similar to that of the 1970s. With a stagnating construction outlook and continuing material inflation, contractors' ability to pass on material and labor costs is diminished just as the availability of less work increases pressure to lower contract bid prices. "Contractors should adjust their business plans to manage for fewer opportunities," suggests Liberty Mutual's Perler. "Reducing overhead and conserving cash will allow contractors flexibility to bid projects that can better support their operations."

ACSTAR's Nozko agrees, "Contractors may be stuck with thinner margins than they have been used to because construction costs are increasing rapidly. Contractors should be prepared to understand that their revenue will most likely be less than it has been. Contractors must prepare for less work by reducing fixed charges and overhead as much as they can, so their operating cost will be lower and they will be able to operate profitably at lower revenue."

"Bid the job, not the competition. We recommend our clients bid the job on their own terms, not like their competitors would bid on the job."

—Terry Lukow, executive vice president, Travelers Bond, Construction Services

While managing overhead is critical, just as important is the need to protect talent in the organization. "When the market turns more positive, you'll need that top talent," Safeco's Mikolajewski tells contractors. "Additionally, top talent always seems to manage projects well no matter what the market conditions."

Contractors also are encouraged to look for ways to improve project work flow and bottom line results. One example is to pay closer attention to material needs and working smarter at anticipating price increases. In other words, secure resources and lock in prices where possible.

"Bid the job, not the competition," Travelers' Lukow emphasizes. "We recommend our clients bid the job on their own terms, not like their competitors would bid on the job. If they keep that as a standard over time they have a good opportunity to do well."

It also is essential for contractors to maintain constant open communications with their surety agent and underwriter. These advisers must be aware of a contractor's short- and long-term business plans – and how they are prepared to support these plans.

"In the long run, contractors should stick to what they do best," Merchants' Foster recommends. "They need to maintain their profit margins. They need to review their overhead costs to determine if any reductions can be made to help them withstand what is most likely a temporary reduction in margins."

As a part of their overall business plans, contractors should have an option that involves the need to downsize their organization. "The increased number of bidders in certain segments of work is here to stay – at least for a while," CNA's Hinkle says. "Depending on the financial strength and staying power of any given firm, rightsizing the firm to better match available work is often necessary and will result in less financial stress long-term."

In addition, Aon's Cusack recommends contractors remain patient, "The two biggest issues for contractors in a slowing construction economy are avoiding the 'bad job' and vigilant management of overhead. Agreeing to take on a challenging job based on a thin margin and unreasonable terms and conditions usually drains resources, serves as a distraction to management and may often result in a financial loss."

IMPACT ON OWNERS & SURETIES

Sureties manage for the long term. By building balance sheet strength through adding to capital surplus and reserves in good years, the surety industry is prepared to pay losses in poor years. Bonded losses to sureties translate into dollars saved for public and private owners of bonded construction projects. "Project owners need only to look at the historical economic cycles and surety experience to realize what the surety industry has contributed as far as solutions to problems – solutions that owners wouldn't have access to otherwise," says Zurich's Cheatham. "The surety product is a proven method. Sureties have been in business for more than 100 years and our role has only grown in importance. Sureties provide a method of integrity to the bid process, which in today's compliance world is very critical."

AIG's Romano says there are scores of positive examples of projects that were successfully completed through the surety's involvement, "Although a surety's completion participation occurs only in a very small percentage of those projects that are undertaken, when we are called upon to respond, the need is generally significant and the stakes high."

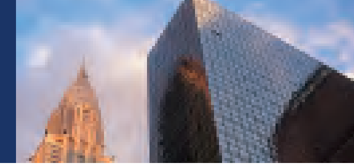
"Is it not better to have the peace of mind that no matter the obstacle a surety stands behind your construction partner with the means and capability to help a project reach completion?" Romano asks. "In the final analysis of a project's cost, it really is a small price to pay for that peace of mind."

"Owners should undertake an extensive review of any prospective contractors before they enter into a contract. In most cases owners are not experienced in this process and they can use the surety industry, and more specifically surety bonding, to assist in this process."

—Michael P. Foster, executive vice president, Merchants Bonding Company (Mutual)

For both government and private owners, the surety safety net is there if needed, but the ultimate goal is to avoid contractor default and complete the job on budget and on time. "Project owners expose themselves to significant risk if they are not familiar with the skills and qualifications of the firms that they are looking to award work," Allied's Marino says. "A combination of an owner-driven prequalification process supplemented with bid bonds provides a reasonable level of assurance that firms submitting proposals have the necessary skills to execute on awarded work."

Other surety executives also emphasize that owners should think more about prequalification based on a contractor's background in addition to the surety's to minimize the probability of getting a marginal contractor on their job. "An owner needs to prequalify its bidders in a different fashion than they have before," Travelers' Lukow says. "Not just a bid bond. Resumes, what they've done in the past. They almost need an RFP to qualify to bid. That would help them immensely in separating the contractors with excellent experience."



Merchants' Foster concurs, "Owners should undertake an extensive review of any prospective contractors before they enter into a contract. In most cases owners are not experienced in this process and they can use the surety industry, and more specifically surety bonding, to assist in this process."

CONSOLIDATION

Of the $5.4 billion in contract and commercial surety written in the United States in 2007, the Top 5 surety companies wrote almost half, according to The Surety & Fidelity Association of America (SFAA). The Top 10 companies combined wrote two-thirds of all U.S. surety. There are more than 150 insurance groups currently writing surety bonds. Since 1994, 10 of the top 15 writers of all U.S. surety have merged or left the market.

The latest merger announcement occurred when No. 5 on the list of top writers, Liberty Mutual Insurance Group, acknowledged its intention to acquire No. 4 Safeco Insurance Group. The move would propel Liberty Mutual into the No. 2 spot behind Travelers Bond, ahead of No. 3 Zurich Insurance Group, No. 4 CNA Insurance Group, and the new No. 5, Chubb & Son Inc. This new Top 5 would write 55% of all surety premium written. While Liberty and Safeco executives were unable to discuss details, other surety industry executives say consolidation may affect the surety industry.

"Consolidation continues to take place in our industry," Chubb's Altman notes. "Although capacity was beginning to return to the surety market, consolidation could slow that growth. Going forward, it is difficult to assess what will happen. Previous experience has shown that consolidation has a tendency to reduce capacity."

"The moves for consolidation and mergers are more aimed at strengthening the market rather than diminishing it."
—William Maroney, president, National Association of Surety Bonds Producers (NASBP), and senior vice president, City Underwriting Agency Inc.

The specter of consolidation is always there. And, given the abundance of capital in the insurance marketplace, surety executives would not be surprised if another acquisition is announced by the end of 2008. However, executives observe that the process appears to be more controlled and statically driven by parent property and casualty companies than in recent years.

"The moves for consolidation and mergers are more aimed at strengthening the market rather than diminishing it," notes William Maroney, president, National Association of Surety Bonds Producers (NASBP), and senior vice president, City Underwriting Agency Inc.

SFAA's Kinnaird agrees, "These will probably continue, but at a controlled, slower pace. Capacity is out there. The concerns from past years have forced the industry to respond with very workable arrangements and alternatives."

Adds Maroney, "The capacity issue is more of a contrivance than a reality. The vast majority of work being performed is well-handled by the surety marketplace. The sporadic need to address the mega projects is being tackled as they develop and to date, all has been addressed accordingly."

In contrast to the upper end of the surety market, the smaller surety market also is seeing some movement. Just in the last several months, executives note, a number of smaller new markets have entered the business, while more established smaller carriers have redefined their approach to the business. "The entrance strategies of these new carriers could have a significant impact on the terms and conditions that are being offered to smaller and mid-sized contractors," says Allied's Marino. "Program structure remains largely unchanged for those contractors that utilize co-surety or are considered large users of capacity." ■

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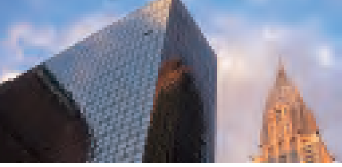
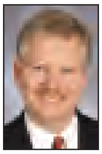
TOP 10 WRITERS OF SURETY BONDS—2007*

Companies	Direct Premium Written (Millions $)
Travelers Bond	$1,017
Zurich Insurance Group	$449
CNA Insurance Group	$436
Safeco Insurance Group	$423
Liberty Mutual Insurance Group	$341
Chubb & Son Inc.	$303
Hartford Fire & Casualty Group	$223
HCC Surety Group	$163
Arch Capital Group	$127
ACE Ltd. Group	$119

*Includes contract and commercial surety
Source: The Surety & Fidelity Association of America (SFAA), "Top 100 Writers of Surety Bonds—United States & Territories & Canada," 2007 (Preliminary); www.surety.org



EXECUTIVE VIEWPOINTS



Thomas Kunkel
President and CEO
Travelers Bond

Terry Lukow
Executive Vice President
Travelers Bond, Construction Services

There will be a new president in 2009. We have an economy that is alive but not as healthy as it should be. If history repeats itself, when you look at the country and other recessionary times, the government always uses public works to create jobs. I can't say this will happen in 2009, but I would not be surprised to see some significant public works coming out in 2009. That's been the history since I've been in business.

Many construction sectors are still very strong. It really goes to the economics of the state and public bodies more than anything else. We are seeing more contractors bidding. We are cautioning our contractors to make sure they are qualified.

Contractors should key in on the risk. They should think of the one area they would be most likely to shrink in competition. Contractors need to go in with adequate margins based on adequate continuity and margin to compensate for the risk.

When the economy is great and booming, it's amazing how financing organizations waive bonds. When the economy tightens, they require bonds. We'll start to see more requests for bonds and dual obligee bonding.

The truth of the matter, recently you saw nearly the entire surety industry performing well. Some companies will retain good results, but others will not and losses will go up for some.

William Cheatham
President
Zurich North America Surety

The federal government is obviously overextended. Inflation is becoming a bigger factor. Lending institutions are tightening credit. And there is increased bid competition. So it doesn't set up for a very pleasant construction cycle. Who knows what the election is going to bring.

The risks to contractors are multiple including more bidders, leaner profit margins and willingness to accept more onerous contract terms and conditions.

Some of the onerous bond form and language issues Zurich is seeing include unlimited, unqualified damage provisions, which contain consequential damages; long-term warranties; automatic increases in the bond penalty; and financing issues, where the bond picks up financing obligations. Zurich looks for anything that puts the surety in front of the contractor – the surety should be secondarily liable.

'Cash is king.' Contractors should reduce their debt and have a strategy in place to manage overhead as revenue drops. Don't compromise profit margins if at all possible.

Project owners should utilize the surety product as a prequalification mechanism. They should rely more heavily on outside professional expertise for the prequalification process and that includes the surety.

Doug Hinkle
Chief Underwriting Officer
CNA Surety

Going forward, our declining economy and its effect on the construction industry is a concern. While to date, many contractors have not been negatively affected by the decline in residential construction, this will vary greatly by contractors' niche of work, the strength of local and regional economies, state fiscal responsibility and the construction delivery methods employed by public bodies.

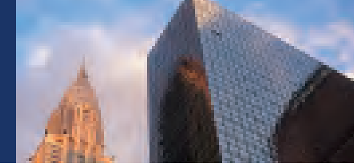
Ultimately, an economic downturn will depress state tax receipts and unlike the federal government, most states require a balanced budget. This generally leads to cuts in spending rather than increased taxes. I believe 2009 will prove to be the transition year where a combination of slower growth in public spending along with greater competition, further aggravated by the increased number of residential contractors bidding public work, will lead to increased loss activity.

2009 sets the stage for what could be a difficult 2010. There are numerous wild cards in play that will determine 2010 results – to name just a few: the length and depth of the current economic downturn, the federal government's commitment to construction spending and the ability of states to match funds, and continued consolidation within the surety industry, which tends to mitigate the perils of excessive competition.

Timothy Mikolajewski
Senior Vice President
Safeco Surety

There is no question we'll see contractor defaults increase. There are many contractors who undoubtedly have not gotten their balance sheets in shape to have the financial flexibility to survive in a downturn. With credit markets continuing to deteriorate, there will not be access to capital to get contractors who need it through a downturn. The result will be more defaults.

Selecting the right contractor for the project will certainly minimize the potential for default. Additionally, if the project is bonded, keep the surety involved in communication if it appears as though the project is beginning to experience problems. Many times a surety can assist in resolving project-related issues and getting a project back on track.

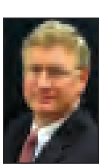


There are many risks associated with contracting with a less qualified contractor. To start with, less qualified contractors would likely have fewer relationships with the top quality subcontractors in their area. This could lead to delays in completing the project, claims and poor quality workmanship. The less qualified contractor's price may be lower on bid day, but it likely would be much higher at project completion.

Dennis S. Perler
President
Liberty Mutual Surety

Construction is a long-term business. Contractors expect to make solid returns in growth years and then need to bank sufficient assets to ride out leaner years. With recession and other economic pressures mounting, contractors are advised to manage their overhead and conserve cash. As many banks have tightened lending, both project owners and contractors may have fewer external credit options to fund their operations. This increases risk to contractors of owner non-payment and to owners of contractor default. In these situations, the surety can play an important role keeping all parties on-track and communicating to ensure successful completion of projects.

If owners and contractors don't already possess the resources to manage adversity, then both should look to mitigate the default risk of subcontractors, labor and suppliers on projects. As the economy moves through the current cycle, contractors should prepare for the pent-up demand that builds during recession. With world demand creating shortages in materials and equipment and domestic demographics shrinking the pool of qualified workers, contractors have a critical need to protect their core resources through the cycle in order to retain the ability to bid work when the economy rebounds. Through any economic cycles, the surety remains a critical partner who can help both owners and contractors manage the changing economic environment.



James Altman
Senior Vice President, Chubb & Son
Chief Underwriting Officer, Chubb Surety

From what we hear from most of our customers, 2008 appears to be in solid shape. Education, healthcare, and heavy/highway construction are strong. We anticipate a major slowdown in the latter part of 2009. One indicator, where in the past you see three bidders at most, you're now seeing a dozen to 15 bidders showing up for work.

We tell our contractor clients to stay the course, maintain risk management discipline and be driven by the bottom line results. Constructors must ensure that they assess the risk of the project itself, their overall portfolio, but also drive the return on their capital that they've built during the robust economy.

We are spending more time reviewing contract terms and conditions. With innovative structures and a disproportionate share of the risk being shifted to our client's balance sheet, we are working with our customers to help mitigate and alleviate some of these onerous obligations. It is essential we understand these exposures, so we can support our clients and their needs. This will become even more challenging as the construction market slows and competition heats up.

It is imperative we maintain underwriting discipline, practice sound risk management and continue to generate adequate returns. Inevitably losses will occur in the surety business given the cyclical nature of results. We need to adhere to a sound long-term operating model that takes into account the returns needed over the long haul and couple that with flexible, yet prudent underwriting standards and account selection and qualification.

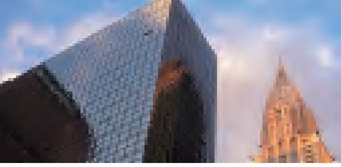
Anthony Romano
Senior Vice President, Surety
American International Group (AIG)

Within the construction industry, expertise in one discipline, or specific geography, does not always easily translate to another. Surety claim departments are littered with examples of contractors who have tried to make such a leap only to find: the subcontractor market not always welcoming to perceived outsiders; owners' expectations and customs significantly different from region to region; or the natural learning curve needed to meet the challenges of new disciplines and/or areas substantially greater than anticipated.

As a result, the value associated with the surety prequalification process becomes even more crucial to owners, developers, investors and lenders. This is true because the surety will utilize its diverse experience as well as focus its resources on understanding and evaluating a contractor's ability to manage staff and prosecute work in unfamiliar sectors and geographic locations.

Underwriters, recalling the pain the industry felt just a few years back, will not be so quick to support contractors leaping from one sector to another without possessing the necessary experience, skill set and capital requirements.

Although surety pricing has held, underwriting discipline concerning the amount of credit extended relative to a contractor's financial position is beginning to creep farther and farther, stretching industry norms. This is generally the first warning sign that the cycle is beginning to climb to the point where it begins its next downward decline. "Work-program stretching will continue and intensify then likely be followed by pricing pressure just beyond 2009."

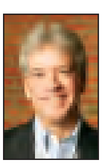


Michael J. Cusack
Senior Vice President, Managing Director and Operations Board Member
Aon Construction Services Group

We have seen a migration of residential contractors and labor move from homebuilding toward the commercial construction sector. The risks to owners, developers and banks when contractors need to perform in less familiar markets involve poor trade coordination, lower quality, slower payments to subcontractors, missed milestones and delayed delivery of construction projects. Contention on the job-site created by poor communication and coordination may lead to slow payments and claims.

The best way for owners, developers and banks to mitigate these and other construction risks is to have been prudent at the start of construction by having made the decision to purchase performance and payment bonds. In addition, there are things that owners can do to avoid or minimize the frequency of defaults. Owners should do their homework on the front-end and work with contractors who possess strong reputations and sound track records of project performance. Additionally, owners should consider alternative procurement methods, as it is far too common for owners to jump at the lowest fee proposal. There is little relationship between the 'best value' for the owner, as determined at the end of the job versus the lowest bid received prior to the commencement of construction.

In the event of contractor default, working with a responsive surety will enable the job to be completed at the lowest cost to the owner, as well as ensure that all subcontractors are paid and the project is completed lien free.



Rick Kinnaird
Chair, Board of Directors,
The Surety & Fidelity Association of America (SFAA)
Senior Executive, Surety, Westfield Group

With the credit market worries that are out there, constructors should be judicious with their use of credit. Surety underwriters are taking a more proactive approach in their assessments of contractors' borrowing habits. Special attention is being given to accounts with high interest-bearing debt. Repayment terms are being scrutinized, and bank working lines are reviewed to make sure they are truly working lines that are paid down over the course of the year.

As the market becomes more competitive and margins diminish, a contractor's debt load may be difficult to support. As this expense load increases, bids become less competitive. Those that are accustomed to living off of borrowed money may have a hard time surviving as terms tighten. Good results are hard to come by when a large amount of a company's resources must be directed to cover institutional debt. Borrowing habits and how the current market might affect cash flow are concerns that need to be managed.

We are seeing material scheduling elevated even more in importance as shortages develop and prices escalate. Material scarcity is as much of a factor as ever. Diesel fuel has elevated in concern to where steel pricing was a few years back, and as we all know, fuel costs drive multiple facets of a construction project.

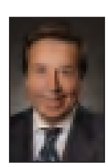
We also continue to stress project safety. Safety impacts profit margins.

Michael P. Foster
Executive Vice President
Merchants Bonding Company (Mutual)

Owners need to team up with contractors, subcontractors, architects and engineers and work together to complete a successful project that everyone can be proud of. If there is an adversarial relationship between the owner and the contractor, or the architect and the contractor, it will most likely lead to a poor project and potentially a default.

We predict that nonresidential construction put in place in 2009 and 2010 will show only a slight increase. Tighter lending requirements will make it more difficult to qualify for privately financed work. Less revenue in the public sector will reduce the amount of work put in place in this sector. There is some concern that it will be more difficult and expensive to issue municipal bonds, which are frequently used to finance public work. Higher building costs, primarily as a result of higher fuel costs, will take up a larger piece of the 'smaller' pie. Contractors that survive this downturn are those who can manage their costs, control their debt and stick to what they do best.

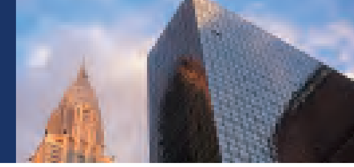
The industry has had two consecutive years of great success. Because of this there is some new capacity entering the industry. As an industry we need to maintain our underwriting discipline or we will see a repeat of the historic losses suffered by the industry in 2001 and 2002.



William A. Marino
Chairman and CEO
Allied North America

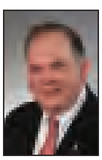
Generally speaking, construction companies tend to be relatively flexible organizations. Although it may take a period of time to develop the necessary level of proficiency required to successfully perform work that falls outside of a firm's traditional skill set, with the appropriate guidance and planning it is not an unachievable objective.

There are currently a number of very strong construction companies that are well into the process of broadening the



construction capabilities of their businesses to respond to market opportunities. We have seen firms looking to reduce their reliance on residential backlog in markets where there has been a sharp downturn in projected sector revenue, but we have also seen a movement among regional contractors that are looking to develop the necessary skill sets and financial resources to pursue projects that are consistent with traditionally completed projects but have become much larger or involve some form of alternative procurement like PPPs or Design/Build/Finance.

One of the largest exposures to a contractor is the structure of their contractual relationship with an owner or a GC/CM if a subcontractor. It is imperative that a contractor review their contracts, make sure that they possess all of the documents that comprise the 'Contract Documents,' and when necessary through negotiation create an environment of equitable risk sharing among all of the parties. Surety companies are very familiar with equitable contract structures and will not knowingly provide bonds in support of imbalanced agreements.



William Maroney
President, National Association of Surety Bonds Producers (NASBP)
Senior Vice President, City Underwriting Agency Inc.

Construction segments have their own unique set of disciplines and challenges. Transitioning from one form of construction to another can be difficult. The learning curves involved include differences in labor force and different owners and financiers. All can cause confusion, delays, loss of profits and possible defaults.

If a contractor feels the need to pursue work of a different discipline, he or she should: 1) Study the new marketplace in great depth. Know what you are getting into. 2) Start off slowly with smaller jobs so as to 'get your feet wet.' 3) Consider a strategic joint venture with a local contractor if you are pushing the geographic limits and/or working with a contractor who has experience in the type of construction you are undertaking. 4) Always make sure the project funding is in place. This is particularly true for contractors going from public work projects to private work.

One-sided contracts are being required by some Construction Managers and general contractors, which makes the process of construction much more cumbersome and attorneys rich. The contracts need to be fair and equitable.

The lack of defined liquidated damages and consequential damages creates angst with all parties concerned. While the intent may not be to be overbearing, seeing it in black and white is a much more acceptable matter.

Henry W. Nozko, Jr.
President
ACSTAR Insurance Co.

Contractors need to be prepared to operate with less revenue and less work. Reduce fixed costs and overhead. Sell equipment, sell buildings – it makes sense to liquidate assets, even at losses, because it will outweigh any significant losses resulting from maintaining the fixed costs and overhead in the long run.

For the first time we're seeing many government contracts being awarded in segments. The Corps of Engineers, for example, might need to build 10 barracks for $1 million each packaged as one $10 million contract. Now these contracts are including funding clauses that say only $3 million has been made available for this project. They caution the contractor that if they proceed beyond the funding clause the onus is entirely on the contractor. This is among the new and considerable risks that contractors are going to have to take. ACSTAR now asks, 'How much of this contract is funded by the government?' If $3 million is funded, ACSTAR limits the bond to the amount funded. This is another dynamic that will and is affecting the surety industry.

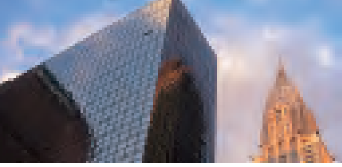
Contractors should be very careful. Some of the new bond forms are including unlimited legal expenses and costs and include very broad hold-harmless clauses which typically reach beyond what the contractors are providing. An example of a dangerous warranty provision is one that could make the contractor responsible for a manufacturer's 20-year warranty if the manufacturer goes out of business during that time. ■

"The Surety & Fidelity Association of America has been the melting pot for the industry. The organization started off as a statistical agency only. Now, SFAA is in a mode of being an industry spokesperson along with SIO, NASBP and AGC. In my years being involved with the organization, it's gone from being basically a database organization to an organization that has assumed a leadership position. SFAA does not run away from an issue."

—Terry Lukow, executive vice president, Travelers Bond, Construction Services

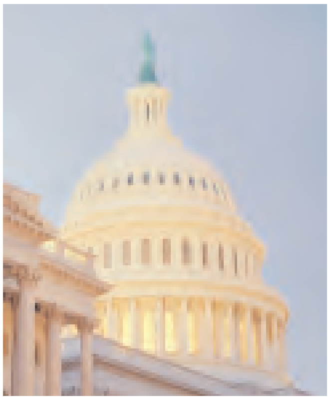
"For such a little known, little understood and under the radar industry, the amount of service the SFAA has provided to the United States is impressive. It's indispensible. People should feel really great about this level of service."

—Thomas Kunkel, president and CEO, Travelers Bond



SFAA CELEBRATES 100TH ANNIVERSARY

By Lenore Marema, The Surety & Fidelity Association of America (SFAA)



King Solomon cautioned the people of Israel to take surety seriously when he said, "My son, if thou be surety for thy friend, if thou hast striken thy hand with a stranger, thou are ensnared with the words of thy mouth, thou art taken for the words of thy mouth." (Proverbs 6:1-2)

While not quite as ancient as the Old Testament, The Surety & Fidelity Association of America (SFAA) recently celebrated 100 years of service to its company members and its role as the collective voice of the underwriters.

The Surety Association of America (SAA) was formed in 1908 in New York City with a focus on data collection, filing rates, drafting and filing forms and monitoring the issues facing the industry. Its first annual meeting was October 29, 1908. The initial membership fee was $50 to join the association, with annual dues of $50. There were 13 sureties represented at the first annual meeting:

- American Surety Company
- Aetna Indemnity Company (now Travelers)
- American Bonding Company
- Bankers Surety Company
- Citizens Trust and Guaranty Company
- Empire State Surety Company
- Fidelity & Deposit Company (now Zurich)
- Massachusetts Bonding Company
- Metropolitan Surety Company
- National Surety Company (now Firemen's Fund)
- Peoples Surety Company
- United States Fidelity & Guaranty Company (now Travelers)
- United Surety Company

It was resolved at that first annual meeting that a minimum of $250,000 in capital would be required and that no surety company should be allowed to transact the surety business in any state unless it has paid in cash capital of $250,000. This was in response to pending insolvencies in the industry of sureties that were under-capitalized. The SAA grew substantially in size and functions when it bought the Towner Rating Bureau in 1949 for $100,000.

During the 1970s, SAA moved to Iselin, NJ, when New York City attempted to tax non-profit associations located in the city. Facing an enormous annual tax, SAA moved to New Jersey. In 1997, SAA moved to its current location in Washington, D.C.

Today, SFAA retains its original focus on data collection, filing rates, drafting and filing forms, monitoring the issues facing the surety industry and communicating those issues to member companies. In Washington, D.C., SFAA developed a lobbying function, including Congressional Action Day, tracking more than 3,000 bills annually relating to surety and fidelity products, being actively involved with advising many congressional and state legislative staffers in drafting and editing legislation and regulations and in testifying before legislative and regulatory bodies and actively coordinating industry lobbying efforts.

PEOPLE

The most well-known surety executive was Franklin Delano Roosevelt. At age 38, FDR was selected as the vice presidential candidate to run with Ohio Governor James Cox for president in 1920. After losing the race to Ohio Senator Warren Harding, FDR went on to become a vice president of the Fidelity and Deposit Company of Maryland (now Zurich), taking charge of the New York office. That stint lasted only until 1921, when FDR was struck with polio at age 39. He fought back and became the only U.S. president to serve more than two terms – actually winning four presidential elections in a row.

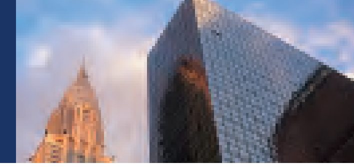
The surety industry also claims a Pulitzer Prize winner among its ranks. Poet Wallace Stevens, a Hartford Bond attorney, won the award in 1955.

SFAA continues to evolve through the creation of new committees to deal with emerging issues in an ever-changing business environment. Committees have been established on human resources, e-business, and development and diversity. Today, SFAA is busy advocating surety bonds and fidelity policies over alternative products, filing amicus briefs on critical legal issues and negotiating improvements to onerous bond forms and policy language.

SAA became SFAA in 2006. SFAA has always represented both surety and fidelity. The name change reflects the fact that fidelity now is generally written in a separate division/operating unit or in a separate company in a holding company system.

For the past 100 years, SFAA has been the collective voice of the surety and fidelity industry. The value of the association going forward is directly linked to company support and involvement. The future challenge will be to continue to heed the caution of King Solomon to carefully make and keep its commitments and to build on SFAA's great legacy of the past. ■

Lenore Marema is vice president of government affairs for The Surety & Fidelity Association of America (SFAA) in Washington, D.C. She can be reached at (202) 778-3637 or lmarema@surety.org.



CARDINAL CHANGE AND ABANDONMENT: APPLICATIONS FOR CONTRACTORS, OWNERS, SURETIES

By Marilyn Klinger and Matthew R. Hicks, Sedgwick, Detert, Moran & Arnold LLP

The concepts of cardinal change and contract abandonment are important to all of the main players in private construction – contractors, subcontractors, project owners and performance bond sureties. For contractors, cardinal changes or contract abandonment can result in the court tossing aside the contract allowing the contractor to recover damages on a quantum meruit or total cost theory. These theories can result in owners facing potential exposure for monetary amounts significantly above the original contract price. Those same owners may look to their design professionals for indemnity or contribution. As to the performance bond surety, a change that is substantially outside the parties' contemplation when the contract was executed may constitute a material departure that will discharge and release it from its bond obligations.

General Rules

Generally, a cardinal change is more than a mere alteration in the underlying contract, in some instances it amounts to a completely new contract. It is an alteration on the work so drastic that it effectively requires the contractor to perform duties that are materially different from those for which the parties originally bargained. (See for example, Allied Materials & Equip. Co. v. U.S., 569 F.2d 562, 563 (Ct. Cl. 1978); L.K. Comstock & Co. v. Becon Constr. Co., Inc., 932 F.Supp. 906, 931 (E.D. Ky 1993).) Many jurisdictions hold that a massive amount of changes rising to the level of a cardinal change results in contract abandonment. (See for example, C. Norman Peterson Co. v. Container Corp. of America, 172 Cal.App.3d 628, 218 Cal.Rptr. 592 (1985)[in California, owner-imposed changes were of such a magnitude as to change the scope of work originally contemplated, the contract was held abandoned and the contractor was entitled to recover on a quantum meruit theory]; L.K. Comstock, supra, [in Kentucky, both abandonment and cardinal change may properly be utilized to establish a basis for recovery outside original contract].) Whether the drastic changes are called cardinal or qualify as a contract abandonment, they have important application to contractors, owners and performance bond sureties.

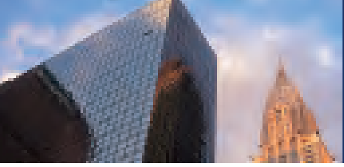
Application to Contractors

When owners impose changes that are cardinal or major, such that the magnitude of the work is radically different from what the parties contemplated at contract time, it would not be fair to limit the contractor to the original contract price. Often in those situations, simply following the contract's "extra work" or "change order" provisions becomes problematic as there are so many changes that following the process called for in the contract may grind the project to a halt. Often, the parties will initially try to follow the change order process but find themselves overburdened by the drafting of change order proposals, pricing them, negotiating the price and getting the final decision-makers to execute them.

While the owners may insist that the parties follow such procedure, the contractor has leverage at that point to argue that there has been a cardinal change or contract abandonment resulting in a material breach of contract. The contractor also will have leverage to argue that in its keeping the project moving toward the finish line, the owner has relieved the contractor of the obligation to follow the written contract provisions relative to changes or extra work. There is substantial legal authority on the contractor's side for this proposition. (See for example, C. Norman Peterson, supra; Daugherty Co. v. Kimberly-Clark Corp., 14 Cal.App.3d 151, 92 Cal.Rptr. 120 (1971)[industrial piping subcontractor, who proceeded with work notwithstanding that poor engineering increased the subcontract by $1.6 million, not precluded from arguing contract abandonment]; Campbell v. Blount, 24 N.C.App 368, 210 S.E.2d 513 (1975)[contractor entitled to quantum meruit recovery where contractor and owner made 33 changes to plans/specifications without following contract requirement for written change orders thereby indicating intention to abandon contract]; Baerreldt & Honig Constr. Co. v. Dye Candy Co., 357 Mo. 1072, 212 S.W.2d 65 (1948)[original contract so changed that amounts recoverable by general contractor should have been adjusted on a quantum meruit basis].)

Application to Owners

On traditional design-bid-build private works projects where cardinal changes or contract abandonment arises, owners are in a very tough position. Owners often find themselves stuck in the middle between a contractor and the owner's design team. The contractor is receiving instructions to perform massive amounts of extra work, wants to receive reasonable payment for that work and is struggling to comply with the contract's inefficient change order requirements. On the other side, the design team failed or did not have enough time to adequately design the project in the first place such that the project requires massive changes. Adding to the situation is the prospect of having the performance bond surety discharged from its bond obligations. If the owner demands that the contractor adhere to the contract's change order protocol, it could very well delay the project or even worse, drive the project to a standstill. If the owner points its finger at the design team and essentially concedes that the parties have abandoned the contract by allowing the contractor to ignore the change order protocol, then it unwittingly risks making the contractor's and surety's case for them.



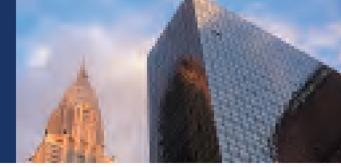
The owner may best handle this situation by being up front early about the changes required and sit down as early as possible with all of those involved, contractor, design team and surety, to see if the parties can come to a meeting of the minds as to how the contractor will receive payment and that the performance bond will remain in place. Unfortunately, there are no judicial decisions that provide a model of the owner's best course of action when finding itself in this difficult position. The cases that address cardinal change and abandonment discuss factually whether the changes were significant enough to rise to the level of a cardinal change or abandonment.

Application to Performance Bond Sureties

Cardinal changes may result in the performance bond surety's obligations being released. (See Restatement (Third) of Suretyship & Guaranty (1995), section 41(b)(1), stating that the surety is discharged if the contractor and owner agree to a modification to the contract that imposes risks on the surety "fundamentally different" from those imposed pursuant to the transaction prior to modification].)

Historically, even a minor change to a contract could have the effect of exonerating the surety. The comment to section 37 of the Restatement of Suretyship notes the problem with that rule stating, in relevant part: "The problem was that rigid application of the doctrine resulted in [sureties] being discharged from substantial [bonds] because of minor, immaterial changes in the relationship between the principal … and the obligee."

For example, in In re Liquidation of Union Indemnity Ins. Co. of New York, 632 N.Y.S.2d 788, 220 A.D.2d 339 (1995), change orders substantially expanded the scope and cost of work by adding stonework that the original contract excluded, adding $350,000 to the contract price. The court found sufficient prejudice to justify the surety's release from its $195,000 performance bond obligation. (632 N.Y.S.2d at 788-790.) Also, in Employers Insurance of Wausau v. Construction Management Engineers of Florida, 377 S.E.2d 119, 297 S.C. 354 (S.C. Ct. 1989), the court discharged the performance bond surety from liability on its bond where the principal's contract increased from $2.3 million to $6.2 million. (See also Chas. H. Thompkins Co. v. Lumbermens Mut. Cas. Co., 732 F.Supp. 1368 (E.D. Va. 1990)[material alteration will excuse compensated surety].) There have, however, been instances where courts have found no release of the surety. (See for example, Wagner v. Frazier, 712 S.W.2d 109, 116 (Tenn Ct. App. 1986)[holding that $77,000 extra for rock removal on a $250,000 base contract did not increase the risk to the surety so as to constitute a discharge] and Millgard Corp. v. E.E. Cruz/NAB/Frontier Kemper, 2002 WL 31812710 (S.D.N.Y.



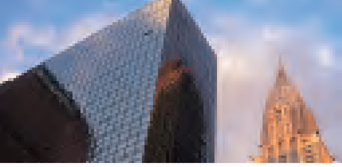
December 12, 2002)[court rejected surety's argument that owner's request for cardinal change excused contractor's and surety's performance].)

For performance bond sureties, there will be situations where the increase in the contract price caused by massive changes will make it relatively clear there has been an abandonment (for example, in the Employers Insurance case scenario above), but there may also be situations where it will be too close to call and up the judge or jury to decide (as in the Wagner case scenario above). ■

Marilyn Klinger heads the construction practices group and Matthew Hicks is special counsel for Sedgwick Detert Moran & Arnold LLP in Los Angeles, CA. Klinger can be reached at (213) 615-8038 or marilyn.klinger@sdma.com and Hicks can be reached at (213) 615-8009 or matthew.hicks@sdma.com.

"The Westfield Insurance Company would like to congratulate The Surety & Fidelity Association of America (SFAA) on its 100th anniversary. The Association's support and leadership have assured a collective voice has been heard since 1908 on the benefits of fidelity and surety products. These products and initiatives represented by the Association to both the private and public sectors have provided a great public service. Best of wishes for your continued success!"

—Rick Kinnaird, chair, board of directors, The Surety & Fidelity Association of America (SFAA), and senior executive, surety, Westfield Group



UNIQUE PARTNERSHIP FOSTERS NEW YORK BONDING & FINANCIAL ASSISTANCE PROGRAM

By Sam Carradine, The Surety & Fidelity Association of America (SFAA)

An unusual teaming of state government, the surety and financial industries, nonprofits and educational institutions has resulted in an effort in New York to make bonding and financing more accessible to small, minority and women contractors in that state.

What began as a relatively modest pilot effort between The Surety & Fidelity Association of America (SFAA) and the Jamaica Business Resource Center (JBRC), a Queens, N.Y.-based nonprofit business development organization, to marry SFAA's Model Contractor Development Program with JBRC's already existing technical assistance offerings has grown into a broad initiative that now involves two departments of government, the largest lending facility for small businesses in New York, as well as the statewide network of Small Business Development Centers administered by State University of New York.

> "This new collaboration between the lieutenant governor, the superintendent of insurance, the surety industry and other stakeholders represents a model for how government should work to solve longstanding problems. The creation of our new capital access pilot program together with this new bond access initiative will open up unprecedented opportunities for minority- and women-owned businesses."
>
> —Michael Jones-Bey, executive director, New York State Division, Minority and Women's Business Development

At a news conference in February announcing the program, insurance department superintendent Eric Dinallo stated, "For too long, women and minority business owners have been held back from participating in state projects and other large undertakings, because they had difficulty getting the necessary surety bonds. I am pleased to announce a new program to help change that. The New York State Bonding Initiative will open up new opportunities and give these business owners the chance to tackle more and larger projects, to grow their businesses, to create jobs and foster economic development all across this state."

Also attending the news conference was then-Lt. Governor David Paterson, Timothy Marshall of JBRC and Michael Jones-Bey, executive director of the New York State Division of Minority and Women's Business Development, part of Empire State Development Corporation, that spearheaded the implementation of this bonding initiative.

That day, Jones-Bey proclaimed, "This new collaboration between the lieutenant governor, the superintendent of insurance, the surety industry and other stakeholders represents a model for how government should work to solve longstanding problems. The creation of our new capital access pilot program together with this new bond access initiative will open up unprecedented opportunities for minority- and women-owned businesses. I commend the Jamaica Business Resource Center, the Women Builders Council, the New York State Business Corporation, the Small Business Development Centers and the Small Business Administration in helping to make this day possible."

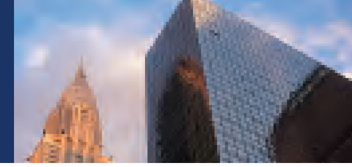
JBRC's Marshall echoed those remarks, "The Jamaica Business Resource Center is enormously grateful to Lt. Governor David Paterson and Insurance superintendent Eric Dinallo for their visionary leadership in assuring that minority- and women-owned businesses now have real access to bonding for their businesses. Historically, this has been a major inhibitor to success; therefore we are very pleased to work with Mr. Michael Jones-Bey, The Surety & Fidelity Association of America and the U.S. Department of Commerce in delivering a program that we believe will have positive and productive results for the M/WBE community."

In addition to SFAA, the Empire State Development Corporation and the New York State Insurance Department, there are several other program partners involved in the implementation of the bonding initiative. JBRC (a grantee of the U.S. Department of Commerce/Minority Business Development Agency) is serving as program coordinator for the Downstate program, providing outreach, administrative and logistical support and technical assistance to participating contractors.

SFAA also has partnered with the New York State Small Business Development Center (NYS-SBDC), a network of 23 regional offices administered by State University of New York and financed by the U.S. Small Business Administration, which provides expert management and technical assistance to startup and existing businesses across the state. NYS-SBDC is providing outreach, administrative and logistical support and technical assistance to the initiative in the four Upstate locations.

In addition, members of the National Association of Surety Bond Producers (NASBP) have been crucial, participating in each of these programs by conducting intake interviews, developing prescriptive plans to address contractor bonding deficiencies and introducing the contractors to the various surety markets that they represent.

On the financing side, SFAA is partnering with New York Business Development Corporation (NYBDC) and the Business Consortium Fund (BCF). The NYBDC mission is to promote economic activity within New York by providing innovative loans to small and medium-size businesses, while the BCF, a minority business development company created by the National Minority Supplier Development Council (NMSDC), provides contract financing to NMSDC-certified minority businesses through a network of local participating banks and NMSDC affiliates. Both of these organizations are part of a new Capital Access Program, established by Empire State Development Corporation, designed



to increase access to capital to those contractors participating in the bonding initiative who need additional capital in their business to qualify for surety bonds.

The initiative, still in its early stages, not only has a program in Jamaica, Queens, but is operating in Buffalo, Rochester, Syracuse and Albany, and thus far more than 100 contractors are participating in the workshops and counseling that the programs offer.

The New York State Bonding Initiative includes:

• An educational workshop series designed to provide information to contractors to improve their operations and make it easier to be bonded or to increase their bonding capacity.

• One-one-one interactions with bonding professionals who will work with the business owner to assess bond readiness, identify and remedy deficiencies and assemble bond applications.

• Increased participation of the U.S. Small Business Administration's (SBA) Surety Bond Guarantee Program in guaranteeing bonds on New York state projects.

• A commitment by the surety industry and companies with programs designed specifically for small and emerging contractors that every contractor who successfully completes the program will have an opportunity to obtain a bond or bond line.

• Establishment of an Advisory Oversight Committee made up of representatives of Empire State Development Corporation and the Department of Insurance to monitor the progress and success of the program.

In addition to New York, SFAA has successfully implemented its Model Contractor Development Program in cities in Texas, Mississippi, Illinois and Ohio. ■

Sam Carradine is director of development and diversity for The Surety & Fidelity Association of America (SFAA) in Washington, D.C. He can be reached at (202) 778-3638 or scarradine@surety.org.

"I take great pride in having been a part of the surety industry and being affiliated with the SFAA. I've always felt that we brought integrity and honesty to a business industry and assisted people, whether they are the principals or the obligees. I take pride in driving by projects we have bonded and realizing we had touched them in a small way through the bonding process. I want to thank SFAA for their being the center of excellence for the surety industry."

— William Cheatham, president, Zurich North America Surety

SURETY INDUSTRY TIMELINE

1880—United States Fidelity and Casualty Company of New York is established as the first corporate surety in the United States

1894—Congress passes John T. Heard's legislation, known as The Heard Act, mandating the use of surety bonds on federally funded projects

1908—The Surety Association of America (SAA) is formed in New York City

1917—Aetna and U.S. Fidelity & Deposit bond most major post-WWI infrastructure projects and the Empire State Building

1930—The Federal Building and U.S. Courthouse in Minneapolis are bonded by many sureties

1930s—The first public official bonds are issued

1931—The Hoover Dam is bonded by 21 sureties

1935—The Golden Gate Bridge is bonded by The Hartford

1935—The Heard Act was replaced with the Miller Act, which requires a separate payment bond

1942—The National Association of Surety Bond Producers (NASBP) is formed

1959—The St. Lawrence Seaway construction is bonded by The Hartford

1970s—The first ERISA bonds are issued

1977—Federal Surface Mining Control and Reclamation Act is signed, requiring reclamation bonds for coal mining companies in all states

1978—The Miller Act is amended to increase the bonding threshold to $25,000

1993—The Surety Information Office is created

1994—The Miller Act is amended to increase the bonding threshold to $100,000 for performance bonds, but the $25,000 threshold for payment security is retained

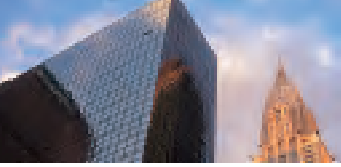
1997—The 9th Ward Levy in New Orleans is bonded by Liberty Mutual

1999—The Miller Act is amended to require that the amount of the payment bond be equal to the contract price

2006—SAA changes its name to SFAA, The Surety & Fidelity Association of America, to reflect changes in the corporate structure of the surety industry and how bonds are marketed

2008—SFAA celebrates 100th anniversary. The surety industry enters the year having written $5.4 billion in premium volume in 2007

Sources: The Surety & Fidelity Association of America (SFAA), www.surety.org, and Surety Information Office (SIO), www.sio.org



SIO: 15 YEARS SERVING CONSTRUCTION, SURETY INDUSTRIES

By Surety Information Office

The Surety Information Office (SIO) was formed in 1993 to raise awareness about the value and benefits of contract surety bonds in private and public construction.

Supported by The Surety & Fidelity Association of America (SFAA) and the National Association of Surety Bond Producers (NASBP), SIO provides free brochures, CDs and presentations on surety bonding to construction project owners, lenders, contractors, subcontractors, design professionals, and others involved in construction. These materials can be viewed, ordered or downloaded via the SIO Web site at www.sio.org. Examples include:

- "Contract Surety Bonds: Protecting Your Investment" (Booklet)
- "Why Do Contractors Fail?" (Brochure)
- "Importance of Surety Bonds in Construction" (Brochure)
- "Surety Companies: What They Are and How to Find Out About Them" (Brochure)
- "An Overview of the Contract Surety Bonds Claims Process" (AGC Booklet)
- "Surety Bonds: A Guide for Private Owners" (CD)
- "Surety Bonds: A Guide for Public Construction" (CD)
- "Surety Bonds: A Guide for Contractors" (CD)
- "Surety Bonds: A Guide for Students" (CD)
- "Surety Bonds: A Guide for Lenders" (CD)
- "Contact Surety Bonds: Understanding Today's Market" (PPT)
- "When You Build … Bond" (PPT)

In addition to offering these and many more valuable resources, SIO assists those involved in construction with questions about surety. SIO staff handled more than 1,600 requests in 2007, and more than 200,000 visited the SIO Web site for additional information!

SIO helps contractors find NASBP-member surety bond producers in their communities and provides surety professionals to speak on numerous surety topics at conferences or meetings.

For questions or more information about surety bonding, contact Marla McIntyre, executive director, at (202) 686-7463 or mmcintyre@sio.org. ■

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The Surety Information Office (SIO) is the information source on contract surety bonds in public and private construction. SIO offers complimentary brochures and CDs and can provide speakers, write articles and answer questions on contract surety bonds. SIO is supported by The Surety & Fidelity Association of America (SFAA) and the National Association of Surety Bond Producers (NASBP). All materials may be accessed at www.sio.org.

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The Surety & Fidelity Association of America (SFAA) is a District of Columbia non-profit corporation whose members are engaged in the business of suretyship worldwide. Member companies collectively write the majority of surety and fidelity bonds in the United States. SFAA is licensed as a rating or advisory organization in all states, as well as in the District of Columbia and Puerto Rico, and it has been designated by state insurance departments as a statistical agent for the reporting of fidelity and surety experience. SFAA represents its member companies in matters of common interest before various federal, state and local government agencies.

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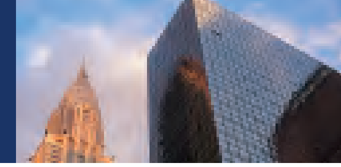
The National Association of Surety Bond Producers (NASBP) is the association of and resource for surety bond producers. NASBP members are professionals who specialize in providing surety bonds for construction and other commercial purposes to companies and individuals needing the assurance offered by surety bonds. NASBP members have broad knowledge of the surety marketplace and the business strategies and underwriting differences among surety companies. As trusted advisors, professional surety bond producers act in many key roles to position their clients to meet the underwriting requirements for surety credit.



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