Avoiding Surety E&O Claims

By Jack Anderson

With the vast number of surety bonds available agents need to be cautious when working with customers to meet their needs. Claims data from Swiss Re and Big "I" Professional Liability Program shows that bond related E&O claims have roughly three times the claims severity as other claims. Like with any coverage or customer exposure agencies need to feel comfortable and have the expertise to understand the process of writing a bond and the coverage they afford. If they don't the chances of an E&O claim increase dramatically. Working with a broker that can assist you through the process of placing bonds can make the difference between a satisfied customer and a future E&O claim.

This article looks at the common missteps that could lead to E&O claims that agents can make when handing surety bonds. Also provided are some ways to protect the agency, including some sound risk management procedures to follow.

Common Surety Handling Missteps

Failure to Advise Proper Rate - Often times agents feel compelled to communicate a rate to a client. In many cases, that rate ends up being below what can actually be obtained.

Failure to Properly Execute Bid Bonds - If a bond is not prepared in strict accordance with the owner's requirements, the client runs the risk of presenting a bid that may be determined "nonresponsive" even if that client is the low bidder.

Failure to Deliver Bid Bonds in a Timely Manner or to a Proper Address - Bid bonds sent via regular mail run the risk of being delivered late. Regular mail might be less costly up front, but could end up being very expensive in the long run when a client misses a bid date due to late delivery. This could also result from someone in your office using an incorrect address.

Failure to Give Proper Advice Regarding Bid Security - A bid bond assures that a performance bond will be put in place by the authorizing surety, while using a cashier's check as bid security does not. Advising a client to use a cashier's check might be perceived as expedient, but the amount of the check is ultimately at risk of being forfeited.

Failure to Receive Approval from the Surety - By improperly issuing a bond, an agent exposes him/herself to potential E&O claims from both the carrier and the client. The surety will seek recourse from the agent if the unauthorized bond goes into claim. If the client's bond program is disrupted as a result of an agent's actions, the client might have recourse for lost financial opportunity.

Failure to Adhere to Conditions & Exclusions of Line of Authority - In instances where a surety has extended a line of authority to an agent and the agent has issued a bond that falls outside the line of authority, the agent will be held accountable for any loss a surety experiences as a result of the agency mishandling his/her authority.

Failure to Provide Timely Information to the Surety - An agent is responsible for communicating all information to the surety that is relevant to the surety's decision to authorize a bond. The surety may have recourse against the agent for information that is omitted if that information would have been material to a surety company's ability to avoid a claim situation.

These are only a few examples of situations that create E&O exposure for agents. By implementing internal risk management policies and standardized procedures, and addressing proper steps and expectations for associates who handle bonds for your clients, you can significantly mitigate your E&O risk.

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Producer and CSR Tips for Avoiding Surety Claims

The relationship between a customer and an agent that helps them secure bonds for their projects is vital to their success. By being aware of the possible pitfalls that can create E&O claims, you will be able to provide bond services to your clients without interruption, and mitigate serious E&O exposures for your agency. Remember working with surety bond is a specialized process in which dabbling can land you in the middle of an E&O claim. It is strongly recommended that you work with an experienced and professional broker that can assist you though the process.

E&O Tip #1: Obtain Specific Rate Approval from a Surety - If a client pressures you for a rate, provide a range that includes a low and high estimate (e.g. 1% - 5%). Communicate that you cannot give an exact rate without knowing credit history and other underwriting information.

Benefit: By receiving a specific rate from a surety, a contractor will be able to include a more exact amount in his/her bid estimate, and the agent avoids providing inaccurate information.

E&O Tip #2: Establish a Checklist for Bid Bond Preparation - The checklist should include the following:

- → Verify bond form
- → Verify bid bond amount/percentage
- → Attach a separate notary signature page for contractor’s signature
- → Attach Power of Attorney showing name of person who signed bond
- → Independent review of bid bond to ensure accuracy
- → All requirements included

Benefit: Establishing a checklist will help eliminate the possibility of a contractor’s bid being rejected as a result of bid bond mistakes. This will also eliminate your agency’s exposure to a claim involving a contractor’s lost profit and its ability to cover fixed overhead.

E&O Tip #3: Assure Proper and Timely Delivery of Bid Bonds - Confirm delivery address ahead of time and use a reliable overnight delivery service.

Benefit: Taking steps to assure proper and timely delivery alleviates the possibility that your client will miss a bid deadline. Delivery date and time will be specified and status can be tracked if reliable overnight delivery is utilized.

E&O Tip #4: Never Advise a Contractor to Use a Cashier’s Check as Bid Security in Lieu of a Bid Bond - Notify clients that they must request a bond as soon as they are aware one will be required. If a bid bond cannot be secured in a timely fashion, a cashier’s check should only be used when the surety provides written approval stating that they will support the bid bond. Never assume that the surety will support a bid bond for which a cashier’s check was provided.
Benefit: By verifying that a surety will support a bond, the contractor will avoid the possibility that he/she will be out the amount specified in the cashier’s check, triggering him/her to file an E&O claim against the agent.

E&O Tip #5: Establish a Written Procedure Requiring Verification of Surety Approval - Set up guidelines regarding what constitutes authorization from the surety and how it should be documented. Agency staff who issue bonds must be notified of this policy and adhere to all requirements prior to delivering bonds to your clients

Benefit: By having agency staff receive prior approval, the surety’s trust in your agency will be maintained, and your client’s future surety relationships will not be jeopardized.

E&O Tip #6: Train Associates on Specific Criteria Granted by Bond Lines of Authority - Don’t focus solely on single bond size and aggregate limits authorized under the line. Know and understand the other conditions and exclusions before issuing a bond under the line.

Benefit: When a line of authority is given by a surety company, it gives the agent authority to issue bonds that fall within the scope of the line. Verifying that the project meets each and every item on the bond line of authority is critical to maintaining the confidence of the surety and protecting your agency against an E&O claim if the project ends up in claim.

E&O Tips #7: Deliver All Relevant Information to the Surety in a Timely Manner - Create and adhere to a procedure that calls for providing all known information to the surety that may impact their decision for both bond approval and for the handling of a claim.

Benefit: This requirement is included in the agency agreement that is signed with the surety, and honoring it is critical to maintaining the relationship with the companies with whom you do business.