Placing Bonds in Difficult Times

Open the newspaper, turn on the television or Google the word "recession." The headlines are brimming with news about job losses, bank closings, foreclosures and government bailouts. The impact is being felt throughout the insurance industry, but nowhere more than in the surety bond arena. This may create additional pitfalls for agents who place bonds and will most certainly subject them to added scrutiny.

As banks tighten their lending requirements and standards due to the home foreclosures, failing companies and credit card and loan defaults, insurance companies will be tightening their underwriting standards on bonds as well. Credit is or soon will be the hottest commodity in the market.

As the economy becomes unstable, the number of new construction projects dwindles. When this happens, opportunities for problems in the construction industry increase. There's a spike in residential builders bidding on commercial and governmental projects for which they're not qualified and underbid due to lack of experience. General contractors may hire unqualified subcontractors, which can lead to poor quality work, delays and inability to pay their workers. All of this can lead to defaults on projects and claims presented against payment and performance bonds. During tough economic times, surety bonds become even more important to the construction industry, and the businesses and individuals that interact with it. Payment bonds guarantee that a payment will be made if the contractor goes out of business and stops paying its vendors or subcontractors. A performance bond will ensure that the work will be completed.

The underwriting process is a very important part of the surety business. As an agent, you can have a huge impact during the underwriting of a bond. As an agent for a surety, you have a duty to know the details of your agent agreement and abide by them.

Many errors and lapses can occur during the application and underwriting stage of the bond. Make sure you have a current copy of the underwriting guidelines and that you and your staff are familiar with them. If you understand the surety's underwriting guidelines, you will be able to assist them and your client through the underwriting process. You may first want to determine your customer's experience in the construction industry; if they're qualified for the job they're bidding for and the bond they're requesting. And if you decide you can't place a bond, make sure you clearly advise your customer that you will not be placing the bond and document your file.

If you proceed with placement of the bond, make sure you've gathered all the relevant information from your client to present to the underwriter—i.e. the construction contract and all necessary financial information. The underwriter also will need to know what coverages are required and if anyone else is to be named on the bond. During the underwriting process it's good to keep the lines of communication open and make sure to document all communications. Also, report everything to the underwriter and allow them to determine what information is important. The underwriter is the person in the best position to determine if the surety is willing to write the coverage, as long as they have all the information. It's better to report all the information to the underwriter and have them decline the coverage than to have an E&O claim.

If an agency is going to place bond coverage, it should be aware of its responsibilities under the agency agreement, as well as under the state law. The agency should be careful to make sure it follows all the appropriate procedures and that all the actions are well documented. IA

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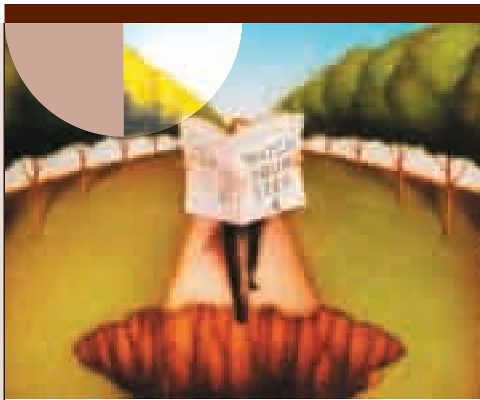

Necessary Follow-Ups

As an agent, your duties and responsibilities do not necessarily end once a bond is placed. Be sure to refer to your agency agreement for the ongoing duties you owe to the surety. If new information comes to your attention after the bond has been placed, such as anything relating to the financial stability of your customer, report it to the underwriter. Remember, it's always better to over report than to under report. If in doubt, send everything to the underwriter and have him or her make the decision.

When defaults on a project start to occur the parties will turn to the surety for coverage under the payment or performance bond. The surety will investigate each claim to determine that the owner of the bond has defaulted and no other party is responsible. The surety will determine if payments need to be made or new contractors hired to complete the project. The surety will also investigate the reason for the default, and whether there were signs of problems prior to the bond being issued that the agent may have been aware of. If the agent did have prior knowledge, the surety will look to the agent and their E&O carrier to indemnify them.

—T.R.

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