Prequalification Is a Two-Way Street

The Importance of Assessing a Surety

BY MARK H. McCALLUM

Bonded contractors and subcontractors understand the rigorous process involved in obtaining surety credit. In today's market, a surety scrutinizes operations from top to bottom, requests a considerable amount of company records and information, and conducts a detailed review of financial statements.

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A surety must see a complete picture of a company's financial soundness and its ability to carry out contract obligations. Among other information, a surety likely requests résumés of key personnel, trade references, financial statements and contracts-in-process schedules.

While preparing a case for surety credit, contractors likewise should seek information about a surety to make sure it is a good fit. Performing an in-depth analysis of a surety's qualifications can help solidify a decision of whether to start a business relationship.

Sureties provide companies with important credit to pursue contracts requiring performance and payment bonds. It takes time and effort to establish, maintain and increase that credit. Contractors should establish a relationship with a surety that is invested in long-term business success and demonstrates its commitment through assistance, responsiveness and resources.

Contractors may decide to handle the risk of subcontractor default—especially for key trade contractors that could pose a significant risk to the project's completion—through inclusion of subcontract requirements for performance and payments bond. It is in a contractor's best interest to make sure subcontract bonds are issued by reputable and financially sound sureties. Knowing the reputation and financial strength of sureties issuing payment bonds on projects in which it is a subcontractor or material supplier is important as well.

On public work, contractors have no mechanics lien rights. In the event of insolvency of the prime contractor, the payment bond may be the only recourse available to a subcontractor for obtaining payment.

Not all sureties are the same. They differ in their underwriting philosophies, markets served and claims-handling practices. Sureties also differ in financial strength and in the number of jurisdictions in which they can conduct surety business. Just as a surety scrutinizes the three "Cs" of a contractor's business—capital, capacity and character—contractors should place a surety under similar scrutiny, assessing its financial strength, reputation and ability to conduct business lawfully in a specific jurisdiction.

Information addressing these factors often can be found in public sources or from bond producers, but contractors must make the effort to get the information.

IS THE SURETY AUTHORIZED TO CONDUCT SURETY BUSINESS IN THE JURISDICTION?

In the United States, the vast majority of surety bonds are written by companies regularly engaged in the surety business. Surety companies generally must be licensed by the state insurance department in the states in which the surety conducts business or where the obligation guaranteed by the bond is to be performed. Typical licensing stipulations require sureties to meet certain minimum capital requirements and file periodic financial reports.

In addition, the insurance department of the state in which the surety company is domiciled performs periodic examinations to accumulate information about the company. State insurance departments often post on their websites lists of companies admitted to act as surety insurers. Or, contractors may contact the department directly to speak with someone about a specific surety, including whether it has ever been subject to a cease-and-desist order. A listing of state insurance department websites is available through the National Association of Insurance Commissioners (www.naic.org/state_web_map.htm).

Surety companies that write bonds for federal construction projects must possess a certificate of authority from the U.S. Department of Treasury, which conducts a financial review and sets a single bond size limit for the surety. A list of certified surety companies approved to write bonds on federal projects, known as Department Circular 570, is updated twice a year and is posted by the Financial Management Service, Surety Bond Branch of the Department of Treasury at www.fms.treas.gov/c570/index.html. This website also includes a listing of state insurance departments' telephone numbers.

Because failure to furnish bonds required of admitted or approved sureties can result in significant consequences, such as rejection of bids, contract breaches or the inability to discharge liens, contractors must pay attention to these requirements.

IS THE SURETY FINANCIALLY SOUND?

A number of private rating organizations offer financial information about companies providing surety bonds. A.M. Best Company, for example, gives each company an alphabetic rating and a financial size category. Other rating organizations include Standard & Poor's, Dun & Bradstreet, Weiss Ratings Inc. and Moody's Investor Services.

These rating services provide a valuable third-party review of the financial stability of companies providing surety bonds.

IS THE SURETY ESTABLISHED AND REPUTABLE?

Most surety companies only accept business through bond agents or producers who typically work with a number of companies. A producer assembles underwriting information and helps a construction firm make its case for surety credit. As a professional working with the surety community, a producer knows the characteristics, histories and reputations of different sureties and can function as an indispensable resource.

Contractors also may contact the Surety & Fidelity Association of America for more information about sureties.

Knowing with whom to do business is a critical component of a successful construction business' risk management program. A risk management program should include evaluating a surety—and the sureties of others with whom a company intends to conduct business—to ensure it is duly authorized, financially stable, established and reputable, and that the surety credit extended or the payment obligations guaranteed are available, if and when they are needed.

Questions to Ask

The following are possible questions to ask, and factors to consider, when evaluating the qualifications of a particular surety.

- Is the surety licensed and qualified to do business where it is domiciled and in the jurisdiction of the project?
- Does the surety have an established history of writing bonds for construction projects?
- What level and quality of information about the surety exists?
- What is the surety's reputation among subcontractors, contractors, bond producers and lenders?
- With how many bond producers does the surety conduct business?
- Is the surety financially sound? What evidence can the surety offer about its financial stability?
- What are the surety's financial strength ratings?
- Is the surety certified by the U.S. Department of Treasury to write bonds on federal projects?
- Has the surety been excluded from participating in federal or state public procurements?
- Has the surety been subject to a state insurance commissioner cease-and-desist order?
- What administrative and technical resources can the surety offer when projects encounter problems?
- Does the surety's personnel demonstrate a commitment to construction and surety industry organizations?

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