Make Sure the Relationship Fits: Become an Educated Consumer by Qualifying the Surety Bond Producer and the Surety

Introduction

Would you entrust your rights, your assets, your health to persons you knew nothing about? The answer is "probably not." You know that in today's complex and competitive world "doing your homework" is essential to protect yourself and your business and to ensure that your business relationships will produce beneficial results. Finding and developing the right relationships will often make a world of difference for the success of your business.

The importance of doing your homework is particularly true in finding the right fit in your surety bond producer and surety relationships. For prime contractors and subcontractors seeking to participate in public and private construction marketplaces, successful relationships with a knowledgeable surety bond producer and a financially sound, responsive surety are very important.

Surety bonds are similar to a credit arrangement, and access to surety credit is limited to those contractors and subcontractors that can successfully demonstrate the ability to meet the underwriting criteria of sureties. The surety will carefully assess the three "Cs" of your business: capital, capacity, and character.

Finding the right fit in your bond producer and surety relationships will be beneficial to your growth and development as a construction firm, not only for surety credit extended but also for the ready advice on technical and financial matters impacting your business. The wrong fit could mean that you are not in the best position to take advantage of emerging business opportunities. You want professional surety bond producers and financially sound sureties that offer business relationships built on trust, honesty, and frequent communication.

So how do you go about "doing your homework"? What is the role of bond producers? What is the role of surety companies? What kinds of information should you seek and what kinds of questions should you ask bond producers and sureties? Below are helpful resources about and examples of possible questions to ask bond producers and sureties to learn if a particular bond producer or surety might be the right fit for your business.

The Role of a Bond Producer

Bond producers are business professionals who specialize in providing insurance and surety products to contractors, subcontractors, and other project participants. Some bond producers may only sell surety bonds, but often they sell both insurance policies and surety bonds. They have a broad knowledge of the changing insurance and surety products for construction companies, which have to plan for and manage construction project risks.

The bond producer will be familiar with the surety market and the business strategies and underwriting differences among sureties and will act in many critical roles—guide, educator, adviser, and match-maker—in order to position you to meet the underwriting requirements for surety credit.

It is important to note that bond producers must be licensed by the state in which they do business to provide insurance and surety products. To obtain a license, bond producers typically must complete pre-license coursework requirements and pass a written examination and a background check. Bond producers must then meet annual or biannual continuing education requirements to ensure that they stay up-to-date on issues about their services, products, and businesses and to maintain their licenses.

As licensed individuals, bond producers are subject to control by state insurance departments, which regulate their activities and will act on grievances. State insurance departments often list grievance procedures and other relevant information on their websites. A list of state insurance department websites is available on the website for the National Association of Insurance Commissioners at www.naic.org/state_web_map.htm.

Choosing a Bond Producer

The following are questions to ask or points to consider when assessing whether a particular bond producer might be a good fit for your company's needs. The questions and points are not exhaustive but are intended to provide examples for your use.

- ✓ Is the producer licensed in your jurisdiction and that of the project?
- ✓ What is the reputation of the bond producer? Does he or she have a reputation for integrity and respect in the industry?
- ✓ What percentage of his or her overall business are construction clients?
- ✓ Does he or she have an understanding of the construction industry and of the construction process, particularly the management and administration of construction contracts?

- ✓ Does he or she possess knowledge of construction accounting procedures, especially an ability to analyze financial statements, work-in-progress, and cash flow?
- ✓ With how many sureties does the producer work?
- ✓ Is the producer specifically authorized to issue bonds on behalf of sureties?
- ✓ Has the producer developed solid relationships with surety underwriters?
- ✓ Has the producer developed solid relationships with other professional service providers, such as attorneys, CPAs, and lenders?
- ✓ How aware and interested is the producer in local, regional, and national construction markets?
- ✓ How active is the producer in local or national construction associations, such as the American Subcontractors Association, Associated Builders & Contractors, or Associated General Contractors of America, and in local or national surety industry associations, such as the National Association of Surety Bond Producers?
- ✓ Can the producer demonstrate a commitment to maintain frequent client contact through newsletters, site visits, or visits to client offices?
- ✓ What other services does the producer provide clients to help them with their business needs?

The Role of the Surety

The surety commits its assets to guarantee the performance or financial obligation of others, such as those of a contractor or a subcontractor. That commitment is shown by the surety's issuance of a surety bond, a three-party agreement among the principal, surety, and obligee. The principal is the party that undertakes the obligation. The surety guarantees that the obligation will be performed. The obligee is the party who receives the benefit of the surety bond.

The surety views its underwriting as a form of credit, much like a lending arrangement, and emphasizes the qualifications of the prime contractor or subcontractor to fulfill its obligations successfully. The surety examines the contractor or subcontractor's credit history and financial strength, experience, equipment, work in progress, and management capability. After the surety assesses such factors, it makes a determination as to the appropriateness and the amount, if any, of surety credit.

- **Corporate Surety**

In the United States, the vast majority of surety bonds are written by companies engaged in the regular business of acting a surety insurer. Surety companies must be licensed by the state insurance departments in the states in which the surety conducts business. They must meet certain minimum capital requirements and must file periodic financial reports.

Surety companies wishing to write bonds on federal construction projects must have a certificate of authority from the U.S. Department of Treasury. The Department of Treasury conducts a financial review of the surety and sets a single bond size limit for the surety. A listing of certified surety companies approved to write bonds on federal projects, known as Department Circular 570 (or the "T-List"), is posted at www.fms.treas.gov/c570/index.html. This website also includes a listing of the phone numbers of state insurance departments.

Surety companies also are rated by private rating organizations, which compile financial information and assess financial strength and size. Rating organizations include A.M. Best Company, Dun & Bradstreet, Weiss Ratings, Inc., and Standard & Poor's, which provide useful information.

- **Individual Surety**

In addition to regulated companies, individuals may act as sureties if permitted by applicable law. Unlike surety companies, however, information about the financial strength of individual sureties is not readily available from independent third-party sources. For example, individual or personal sureties are not certified and listed by the U.S. Department of Treasury and are not rated by private rating organizations, such as A.M. Best, that assess financial strength.

The federal government permits individuals to act as sureties on federal projects without being licensed in any state or approved and listed by the U.S. Department of Treasury. Because of concerns about significant individual surety bond fraud, the federal government has stiffened the requirements on the use of individual sureties on federal projects. The rules dictate the specific types of acceptable assets and require that the federal government be given custody of assets pledged by the individual surety.

At least one state, Alaska, permits individuals to act as sureties without being licensed or authorized by the state insurance commissioner. Maryland had such a law, but this law sunset on September 30, 2014. Owners, contractors, and subcontractors always should evaluate and validate the financial strength and integrity of all sureties in order to preserve bond assurances and payment protections. Consult another SuretyLearn resource, "Always Verify Your Bond," to understand a simple means to do so.

Choosing the Surety

The following questions or points are not exhaustive and are intended to provide examples of possible questions to ask and factors to consider when you are assessing whether a particular surety might be a good fit for your company's needs.

- ✓ 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 information exists about the surety?
- ✓ What is the surety's reputation among subcontractors, contractors, bond producers, and lenders?
- ✓ With how many 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 by rating organizations such as A.M. Best?
- ✓ Is the surety certified by the U.S. Department of Treasury to write bonds on federal projects?
- ✓ Is or has the surety been excluded from participating in federal or state procurements?
- ✓ Is or has the surety been subject to a state insurance commissioner cease-and-desist order?
- ✓ What administrative and technical resources can the surety bring the bear when projects turn problematic?
- ✓ Do the surety's personnel demonstrate a commitment to be active in construction industry associations and in surety industry organizations, such as the Associated General Contractors of America?

Conclusion

The success and reputation of your business are too precious to entrust to just anyone. Find the bond producer and the surety that offer the skills, experience, and resources to meet your business needs and that are interested in building a long-term relationship with your firm. "Doing your homework" is an essential step to finding the right bond producer and surety relationships and for safeguarding your business reputation and credit.