

How to Select a Professional Surety Agent

A reliable source of surety credit is vital to contractors engaged in public and private work. Contractors are increasingly being asked to post a bond as assurance to project owners and lenders that their work will be faithfully completed on time and all bills promptly paid. Contractors should use the same care in selecting a bonding agent as in choosing their bank, attorney, CPA and key managers.

Surety bonds are underwritten by insurance companies and agents legally licensed to produce insurance business. In reality, however, relatively few insurance agents have the training and experience necessary to fully serve a contractor's surety needs. The reason for this is that surety is different than insurance in many ways.

Insurance is a loss-funding mechanism designed to protect the insured against fortuitous adverse events. All insureds in a group pay premiums into a funding pool to cover individual losses as they occur. The individual, in effect, transfers his/her risk of loss to the group. Key to the success of risk pooling is the fact that losses can be anticipated.

Suretyship, on the other hand is a loss avoidance mechanism to prequalify contracting firms based on their credit strength, experience and capability to successfully complete contracts. The economic risk of contract default stays with the bonded contractor, who may be required to sign an indemnity agreement holding the surety harmless. The economic risk to owners, laborers, subcontractors and suppliers, however, is substantially reduced by the surety bond because these parties are indemnified by both the contractor and the surety against loss from contractor default or failure in performance or payment. Since the surety has prequalified the contractor and guarantees the contractor's faithful performance, the anticipation of all parties is that there will be no failure in performance and therefore, no loss.

This fact is reflected in the surety premium, which merely compensates the surety for performing its prequalification service in lending its good name and balance sheet (credit) to the contractor for the benefit of owners, laborers, subcontractors and suppliers. Unlike the rating of insurance coverage, there is no provision for loss payments in surety premiums.

RESPONSIBILITIES

The professional surety agent plays an important role in the prequalification process. Following is a list of the surety agent's normal responsibilities as part of this process:

- Objective assessment of a contractor's qualification for surety credit.
- If the contractor is found to be unqualified, candid appraisal of what the contractor can do to meet standard qualifications.
- For a qualified contractor, assistance in selecting a surety company best suited to the needs of the particular contractor.
- Suggestions for strengthening the contractor's qualifications, wherever possible.
- Recommendation of a responsible line of credit, consistent with the contractor's present capabilities. (The professional surety agent will never recommend surety credit support beyond the client's ability to perform.)
- Preparation of a written analysis of the contractor's operations, including the following:
 - company history
 - organizational structure/management

- key people
- type of work
- track record
- trade and banking relationships
- financial performance and condition
- five-year financial trend
- bidding history
- desired work program
- business plan
- future prospects and
- continuity plan
- Assistance of the contractor in making a formal presentation to the selected surety.
- Once a surety credit relationship is formed, help in maintaining open channels of communication between contractor and surety, with periodic reports on the progress of open work, financial performance and business plans.

THE PROFESSIONAL AGENT

As an integral part of the contractor/client's management team, the surety agent provides professional advice on strategy that will maintain the surety credit needed to support sound management objectives. A contractor can look for a number of things in determining whether a particular agent is a surety professional qualified to handle his/her surety needs. They are:

- An understanding of the construction industry and the construction management process, including estimating, bidding, building and cost control systems.
- Knowledge of construction, subcontracts and contract law.
- An awareness of local, regional and national construction markets.
- An understanding of basic credit principles.
- Familiarity with accounting and finance, with particular emphasis on the American Institute of Certified Public Accountants (AICPA) Audit Guide for Construction Accounting.
- An ability to analyze financial statements, work-on-hand schedules and cash flow.
- Experience in strategic planning and management practices that promote successful contracting.
- Active involvement in construction industry associations.
- Knowledge of the surety market, the surety credit process, and underwriting standards.
- The respect and confidence of surety underwriters.
- A reputation for integrity.

Contractors can identify most of these characteristics in a surety producer by posing a few pertinent questions. After the initial screening, the contractor might want to have his/her financial officer, banker, CPA and attorney interview the agent for their evaluation of the agent's knowledge of contracts, finance and credit.

The professional surety agent should be willing to furnish references, including the names and phone numbers of existing clients, all surety companies represented in the last five years and accountants and bankers with whom the agent has professional relationships.

When the surety agent's professional qualifications have been established, contractor and agent should work closely to develop the agent's complete knowledge and understanding of the contractor's business and his/her goals, plans and aspirations. In this, the contractor must be willing to accept the agent into complete trust and confidence. Any withheld information limits the agent's ability to service the contractor.

Contractors should not change sureties without serious and thorough consideration. Building a surety relationship takes time; once established, that relationship should not be discarded lightly. Surety problems can be a result of failure in communication, for which the surety agent must bear some responsibility. If it is determined that irreconcilable differences with the present surety do exist or that it lacks the capacity to handle the contractor's business, then the surety market should be approached strategically. This means selecting a surety company with the ability to understand the unique characteristics of the contractor's business and the resource and flexibility to respond to his/her particular needs.

All too often contractors let the surety agent serve as their surrogate in all dealings with the surety company. They rely exclusively on the agent's relationship and credibility with the underwriters and never fully develop a relationship of their own with the people who make important credit decisions affecting their business. The conscientious surety agent will insist that the contractor be actively involved in all aspects of the surety credit process.

The agent's goal should be to create and maintain a strong bond between the contractor client and the surety underwriter. One important measure of the surety agent's service is the extent to which this goal is achieved. In the final analysis, unsecured credit is founded on one party's faith in another; it can exist only when both parties know, understand and trust each other. The role of the surety agent, expressed in its simplest terms, is to support and promote this relationship.