

# Navigating Surety Risk: 3 Best Practices for Construction Businesses and Commercial Firms



With high inflation, an increase in claims and more entrants into the surety market, your choice of risk management partners is more important than ever. Here's how to choose wisely.



The surety market is booming with active post-pandemic construction and land development industries, including the infusion of an additional \$1.2 trillion of transportation and infrastructure capital from the Infrastructure Investment and Jobs Act (IIJA).<sup>1</sup> Impacting both contract and commercial sectors, new carrier entrants are increasing options for surety bonds, leading to more diverse offerings, niche markets and potential increased bonding capacity for businesses of all sizes.

However, according to the Surety & Fidelity Association of America (SFAA), the 9% year-over-year direct premium growth in the surety market in the last few years is coupled with a direct loss ratio of 23.5% this year, compared to 16.3% last year<sup>2</sup>, as the market faces more frequent and severe claims.

Macroeconomic challenges such as inflation, higher interest rates, material price increases, supply chain delays and labor shortages directly impact both contractors' and commercial firms' abilities to complete projects on time and within budget, and are also increasing credit default risks.

The rise in loss activity impacts even the most established surety companies – but especially hard hit are those that are newer or less financially stable. Now more than ever, businesses need to partner with stable sureties who can withstand claims activity and continue to provide reliable service and support.



<sup>[1]</sup> Dowling & Partners "IBNR Weekly Vol. XXXI," Accessed June 24, 2024.

<sup>[2]</sup> Surety & Fidelity Association of America "[Providing industry research to the public and our members](#)," Accessed June 24, 2024.

# How to Reduce Surety Risk

A surety bond is more than just a financial instrument; it is a pledge of reliability, capacity and performance. Its effectiveness depends not only on its issuance but on its ability to deliver on what it promises. Here are three ways to ensure your surety program stands up to the task.



## 1. Choose the Right Surety

Selecting the right surety is not just about securing bonds — it's about forging a strategic partnership that enhances your business's stability and growth. A strong surety partner can weather the economic fluctuations and industry challenges alongside you, offering consistent support throughout the partnership.

Here are some key characteristics to look for in a surety partner:

- **Financial Stability and Risk Management:** A reputable surety assures financial backing and stability. They can enhance your credibility as a bidder and increase your chances of winning contracts. Conversely, if your chosen surety lacks financial strength or has a poor reputation, it could signal instability to stakeholders such as clients, suppliers and investors, impacting your ability to secure contracts and financing. Financial stability also demonstrates a surety's ability to navigate challenging economic periods and business setbacks. A strong partner will stand behind you and help to guide your business through them as well.
- **Industry Expertise and Relationships:** The right surety should have deep industry knowledge and understand your industry's specific challenges and regulatory requirements so they can offer tailored solutions and advice. Choosing a surety with limited industry expertise or experience might lead to inadequate guidance or bonding solutions that do not align with your goals or contractual obligations.

- **Service Differentiation:** While bond forms may be standardized, the quality of service and expertise offered by each surety can vary significantly. Look for a surety with seasoned staff who will respond quickly to your needs and offer tailored solutions that go beyond basic bond issuance, such as contract review and claims support, transparency and assistance.

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**Hot Tip:** *The Surety & Fidelity Association of America (SFAA) can provide valuable insights into a surety's performance and reliability.<sup>3</sup> Reviewing a surety's SFAA results can help you make an informed decision based on financial stability and operational competence.*

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## Case in Point: Strategic Partnerships in Action

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A prominent glass and glazing fabrication contractor specializing in design-build projects faced a \$10 million cash flow shortage due largely to the underestimation of production costs on several projects. On the verge of project delays and financial strain, they reached out to IAT Surety for assistance. With a risk assessment, followed by financial assistance combined with strategic operational and contractual advice from the surety, the business improved its project management practices and completed all bonded and unbonded work on time. Years later, the contractor remains one of IAT Surety's strongest account relationships.

<sup>[3]</sup> The Surety & Fidelity Association of America "[Providing industry research to the public and our members](#)," Accessed on June 25, 2024.

## 2. Build a Relationship of Trust

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Once you've found the right surety partner, establishing a foundation of trust is not only important for the successful execution of projects, but also fosters long-term business growth through favorable bonding terms.

One of the most important steps a business can take in building this trust is proactive engagement and communication with their surety partner. Initiating communication with your surety partner as soon as a project is conceptualized or during contract negotiation allows both parties to align expectations and discuss potential challenges with legal counsel and underwriters. Since every project is unique, addressing concerns early can prevent misunderstandings and challenges later.

Recommended touchpoints with your surety team include:

- **Contract Negotiation:** Discuss bond requirements and project specifics with your surety before finalizing contracts to ensure clarity on bonding capacity and terms and to help avoid potential contractual pitfalls.
- **Claims Notification:** Immediately notify your surety of any potential claims or incidents that may impact project performance or financial obligations. Early intervention can mitigate risk and preserve trust.
- **Financial Challenges:** Communicate any early warning signs of financial strain, such as cash flow shortages or performance issues such as unforeseen site conditions or project delays. Timely collaboration with the surety enables proactive measures to address issues and minimize their impact.

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**Hot Tip:** *Provide regular (usually quarterly or bi-annually) progress and financial reports to your surety and when required to build trust and avoid interruptions in your bonding capacity. This includes work-on-hand schedules for bonded and non-bonded projects that indicate progress, completion percentages and any deviations from initial plans.*

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### Case in Point: Trust and Transparency Tailor the Approach

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A client needed a substantial closure post-closure bond for a landfill acquired through a recent acquisition. Although these bonds are

generally considered hazardous, some sureties view them as a good risk for the right account with favorable risk characteristics. With time being critical, the agent of record approached IAT for a swift, uncollateralized solution. While most sureties require collateral to issue a bond, we provided it without collateral due to the quality of the property and with the understanding that the agent and client would balance the bond program with less hazardous obligations. This strategy resulted in a significant win for the agent, client, and IAT Surety.



# 3. Select the Right Bond

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While a bond is a bond, not all surety bonds are truly equal. Here are important distinctions that can significantly impact the effectiveness of your surety program.

**Types of Bonds:** There are various types of surety bonds, each designed to address specific needs and risks. Each type has unique conditions and guarantees, tailored to specific requirements. Here are common bond types that apply to commercial firms and contract accounts.

- **Performance bonds** ensure the contractor or commercial firm completes the project/contract terms.
- **Payment bonds** guarantee that subcontractors and suppliers will be paid.
- **Maintenance/warranty bonds** provide a warranty for workmanship and materials for a specified period after project completion.
- **License and permit/compliance bonds** provide compliance with individual state regulations for work.
- **U.S. Customs bonds** guarantee that the importer and exporter are paying their taxes/duties to the federal government.
- **Court/appeal bonds** guarantee the contractor or commercial firm gets what they are entitled to even when the obligation to them isn't fulfilled.
- **Mechanics lien bonds** release the lien on the property as payment is awarded or settled so the developer can sell it.

**Terms and Conditions:** Conditions can vary based on the project type, scope and specific contractual requirements, while terms may include different limits, durations and obligations of the business. Look for a surety with a consistent underwriting approach. Inconsistent underwriting can lead to unexpected changes in bond availability and/or terms, affecting project planning and execution.

**Stable Surety Market:** A stable surety with a consistent market presence is more likely to honor bonds regardless of economic cycles. New or unstable sureties might not provide the same level of reliability and could potentially leave businesses exposed during critical times.

**Value-Added Services:** A surety's approach toward working with business owners can greatly impact the value derived from the bond. A dedicated claims team specializing in surety claims, for example, ensures that claims are promptly reviewed with you and handled quickly and efficiently. Other services could include in-house accounting, bid review and engineering expertise.

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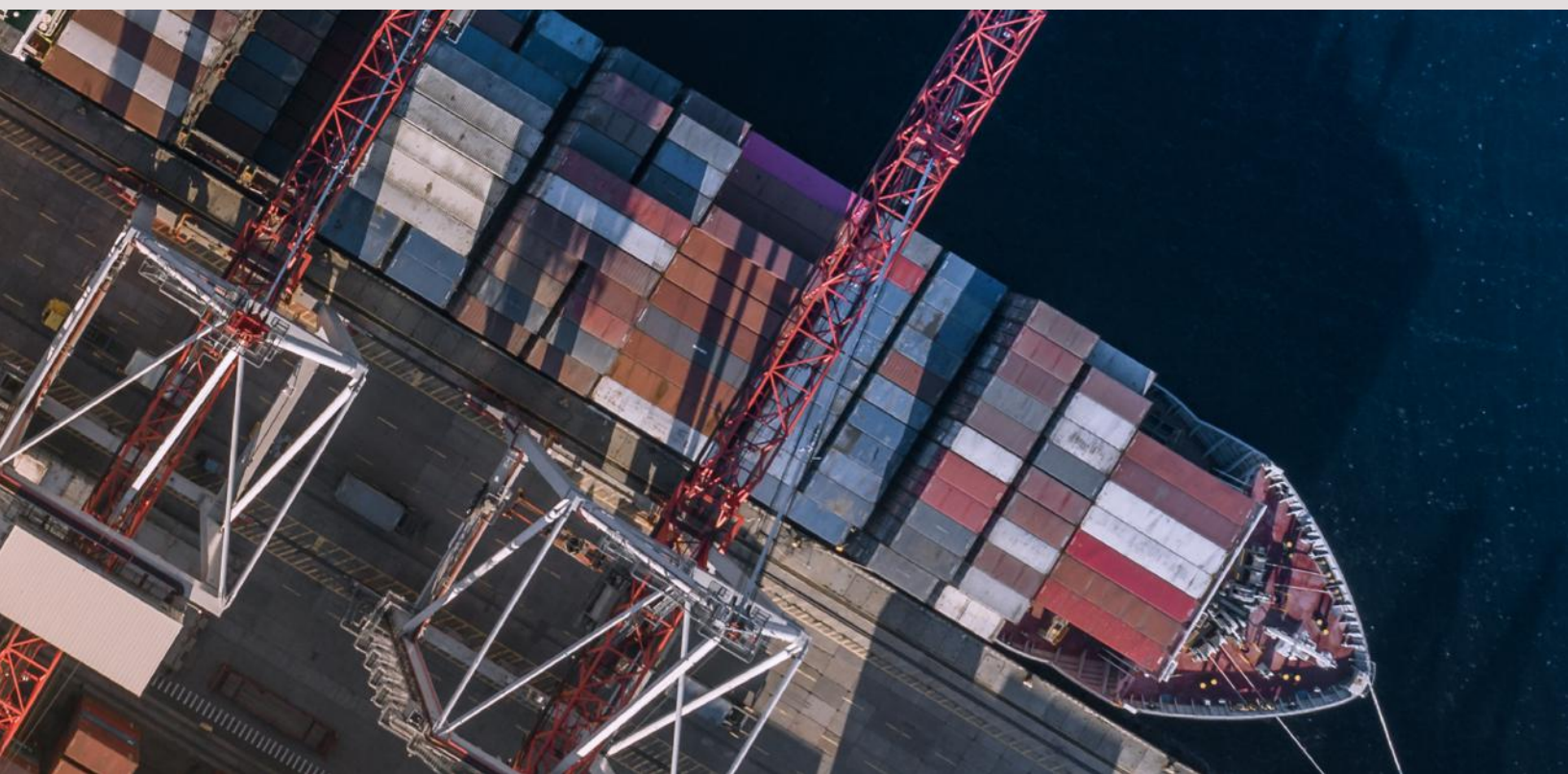
**Hot Tip:** *Sureties with extensive experience and specialized knowledge in your industry can offer more tailored solutions and better risk management.*

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## Case in Point: Navigating Nuances

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To remain operational during a Chapter 11 reorganization, a well-established cosmetics company was required to maintain its commercial bonds, particularly its U.S. customs continuous bond, which is needed for its import activities. The organization and its bankruptcy counsel reached out to IAT Surety to help them navigate the bankruptcy process and maintain their bonding to ensure they could continue U.S. operations without interruption during the reorganization. The customs bond was viewed by the bankruptcy court as a value added and played a pivotal role in the company's journey through financial recovery.



# Positively impact project completion

As industries navigate a surplus of opportunities, new carriers offer more options for bonding, but high interest rates, supply chain disruptions and the labor shortage continue. Choosing the right surety partner is ever more critical. It's important to both your current projects' success and your business's future. Choose wisely.

## CHECKLIST: What to Look for in a Surety Bond Partner

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The expanding surety market presents your business with more options than ever before. New and established players alike may all want to back your next project. However, the growing risk and complexity within the surety market demands careful consideration of your next financial partner.

Ask these questions before committing to a surety partner:

**How long have they been in business?** Look for stability and financial strength. Ensure the surety has a strong credit rating and a solid financial foundation to support your projects through any economic climate.

**What is their industry reputation?** Evaluate their history and reputation in the surety market. Look for a proven record of successfully supporting projects similar to yours. How do previous and current clients talk about them?

**Do they listen to your needs?** Evaluate their responsiveness and willingness to understand and accommodate specific requirements and concerns, fostering a collaborative and supportive partnership.

**How communicative and effective is their claims operation?** Investigate their willingness to support their accounts and where necessary their process for handling claims, including their timeliness, fairness and transparency. A surety that promptly addresses and resolves claims can significantly reduce project downtime and financial stress.

**Are they willing to see you through difficult times, such as reorganizations?** Assess their commitment to providing support during challenging phases of projects or economic downturns, ensuring they have policies in place to assist you in facing unforeseen obstacles. Can they turn your hour of need into a success?

**Is the surety itself growing?** Determine the surety's trajectory in the market, including their expansion plans, financial health and ability to adapt to evolving industry trends and demands. A profitably growing surety may offer greater stability and resources to support your future projects effectively.



# Contact IAT



Contact IAT Surety for information on how our team can support your business's surety needs and growth goals. With 120 years of experience, we provide stability, consistency, and expertise in all our partnerships. When you need us, we're here with answers—it's who we are and always will be.

