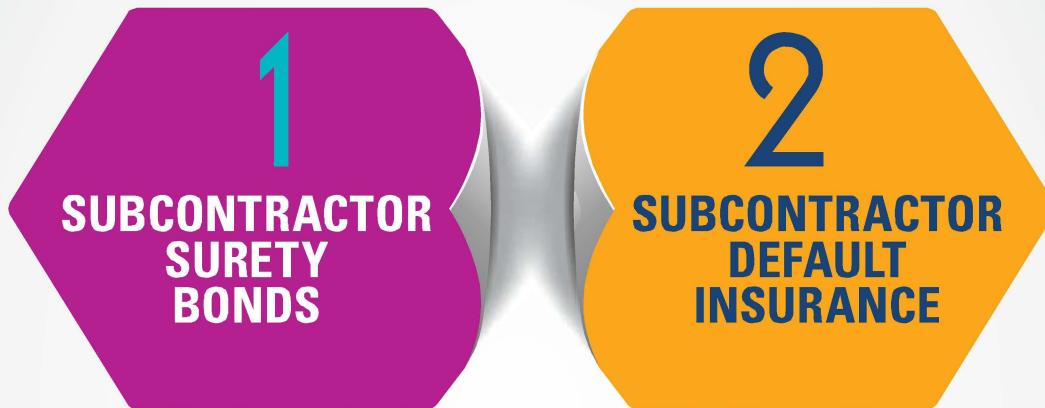


Subcontractor **SURETY BONDING** and **DEFAULT INSURANCE**

The Value (and Risk) of Using Both Resources



BY J. BRAD ROBINSON

WHEN I AM not fulfilling my obligations as the national chairman of the Construction Financial Management Association, I am employed by an international construction manager/general contractor within the finance department. One of my responsibilities is to ensure that our subcontractors are financially sound to perform on our projects. In order to do so, we use both subcontractor default insurance (SDI) and subcontractor surety bonds. I am convinced that **both** are beneficial risk mitigation products **if** they are used in the correct manner.

An SDI program may be attractive to a contractor because of the perception that sureties are typically slow to react to claims AND the potential for additional profit, provided that default reserves reach an acceptable level and losses are minimal. However, this lure of additional profit can be deceiving. It takes a high level of sophistication to actively manage the risk of potential subcontractor default. Best-in-class contractors typically have a function that manages the overall SDI product (enrollment, renewals, claims, etc.) and someone who assesses the financial risks of accepting the subcontractors and their capability of executing the type and size of subcontract they are entering into. My company has been quite conservative in the underwriting and prequalification of our subcontractor partners, and as such the program has been financially and operationally successful. We understand and recognize that we cannot see the same depth of information to which a surety

has access through due diligence and underwriting within their bond program and thus the conservatism we maintain. Committing to an SDI program is not inexpensive in terms of the quality of staffing and resources, let alone large self-retention and co-sharing in losses with the SDI carrier. This is a primary reason only mid-size to large contractors, those that have loss absorption power, engage in SDI programs. If the contractor is not adequately resourced and prepared, with adequate loss funding reserves, then the outcome could be devastating.

What about subcontractor bonding? My company relies on subcontractor bonds when we cannot get comfortable with the empirical data that we have obtained to underwrite the contractor. Generally, the subcontractors with whom we have had the most experience and those trades with the lowest risk of default are those we use to prequalify with SDI. For the balance, we utilize surety

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bonding. One could argue that we are bifurcating our risk across both and taking the "easy" contractors and leaving the "more difficult" contractors for the sureties. This is not our position. We view surety bonds as an integral part of our risk management process. We would never consider managing risk on a project without the availability of surety bonds. It simply is impractical.

I am often asked by sureties what they can do to compete against SDI. I have a simple response. If you remove the perception that sureties are slow to respond to a claim under the remedies afforded by the bond, you are well on your way to healthy competition.

There is space for both in a robust risk management program. It's up to us as contractors to determine the level of financial commitment and risk we are willing to take for the reward. It is up to the surety industry to continually emphasize the value it brings to the contracting community by quickly responding when called upon and doing what sureties have done for decades, which is to provide confidence to the contractor purchasing the bonds that sureties have prequalified the subcontractor accordingly. ●

Brad Robinson, CPA, CCIFP, is the Head of Treasury Services for Lendlease, an international construction management/GC firm. Located in Charlotte, NC, Robinson is responsible for managing all treasury services activities in the U.S. and Latin America and supporting managers in the accounts payable and payroll functions. Robinson has offered his comments in his personal capacity and in doing so, they do not necessarily reflect the opinions of Lendlease Americas. Robinson is currently the national chairman of the Construction Financial Management Association. He can be reached at brad.robinson@lendlease.com or 704.357.6524.



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