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CURRENT SURETY TRENDS

Mega Project/PPP/PFI Issues

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Discussion Outline

- Historical Trends/2007-'08 Surety Results
- 2009 Market Conditions
- Mega Project Issues

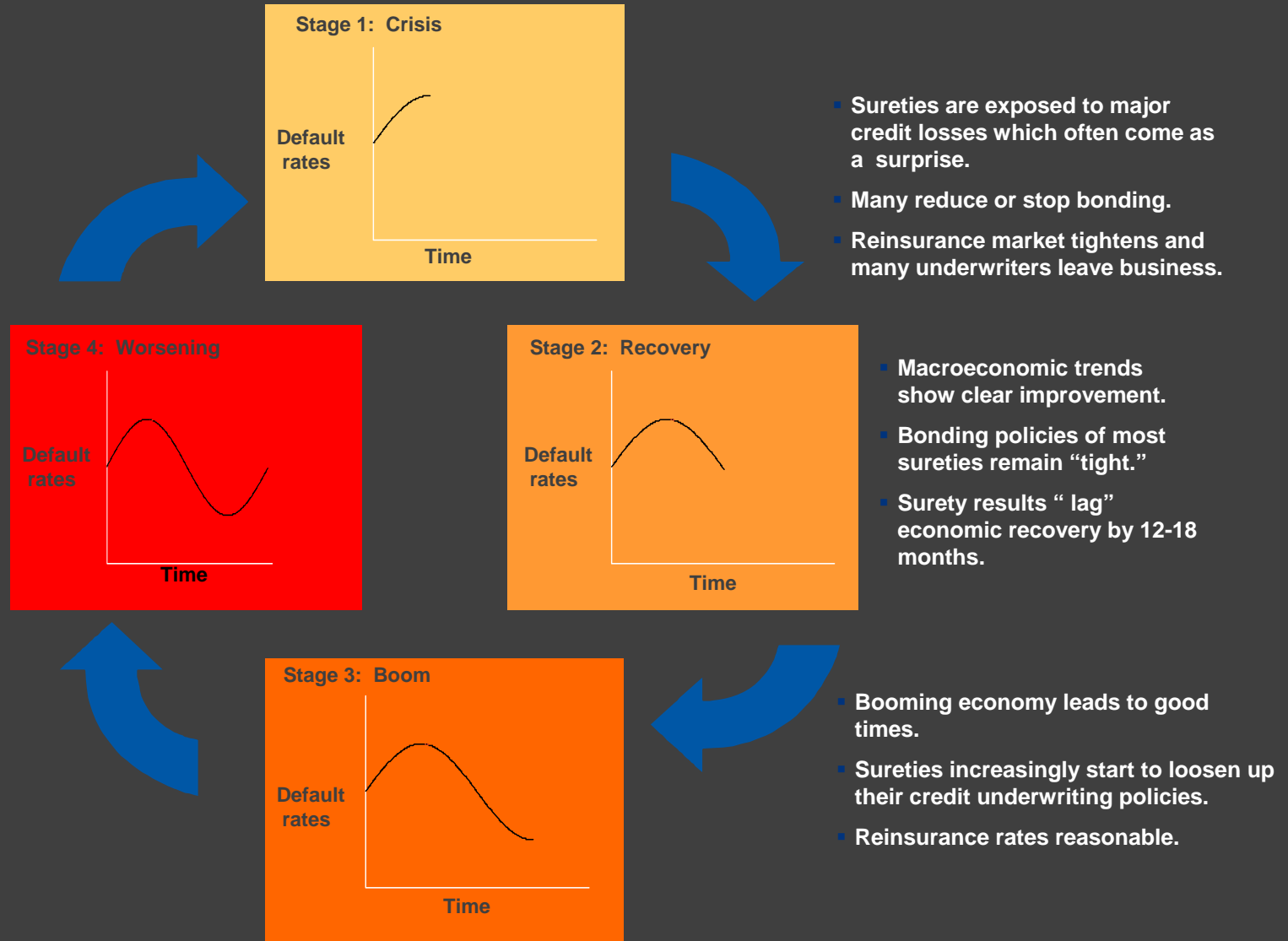
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Historical Trends & Current Results

STAGES OF THE SURETY CYCLE

- Economic boom comes to an end and leads to an increase of default rates.
- Default rates first rise in the lower tier accounts and later across the board.
- Sophisticated players have reduced risk exposure through new risk strategies and increase market share.



US SURETY OVERVIEW

- ❖ **1894**: Heard Act requires Surety Bonds on Federally funded projects
- ❖ **1929-1935**: Industry losses roughly \$80 million and 31 Surety Companies go out of business
- ❖ **1935**: Miller Act passes requiring 100% performance bonds on projects over \$100,000
- ❖ **1988-2000**: 12 consecutive years of industry profitability
- ❖ **1995**: Industry consolidation starts to accelerate
- ❖ **1995-2000**: Heated competition drives rates and underwriting discipline down
- ❖ **2001-2004**: Severe industry losses (\$9.4 billion)
- ❖ **2006**: Most profitable year ever (\$1.7 Billion u/w profit)

US HISTORICAL RESULTS

❑ *Contract surety results from 1965-2007*

- ❑ Total earned premiums of \$41.7 billion
- ❑ Total direct losses of \$16.8 billion
- ❑ 42-year loss ratio of 40%
- ❑ 42-year combined ratio of 92% (50% exp.)
- ❑ 26 years profitable, 16 years unprofitable
- ❑ 1970's worst decade, 1990's the best

❑ *Commercial surety historically profitable*

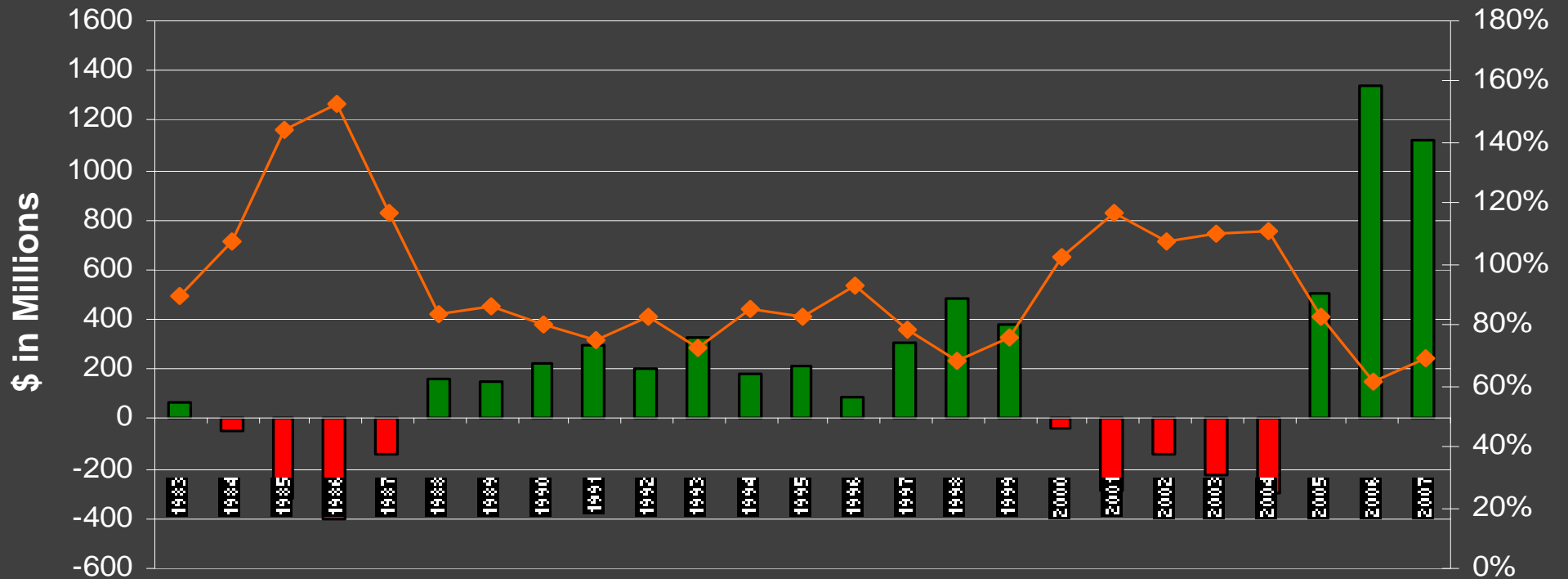
* Source: Surety Association of America

2008 NINE MONTH RESULTS

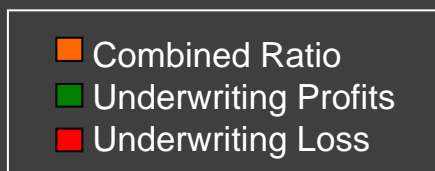
- Direct Written Premiums \$4.3 billion vs. \$4.4 in 2007
- Direct Earned Premium of \$4 billion vs. \$3.9 in 2007
- Direct Losses of \$ \$706 million vs. \$784 in 2007
- Direct Loss Ratio of 17.4% vs. 20.1% in 2007

* Source: Surety Association of America

US CONTRACT SURETY RESULTS 1983-2007



* Source: Surety Association of America



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***GLOBAL SURETY MARKET
Trends & Conditions***

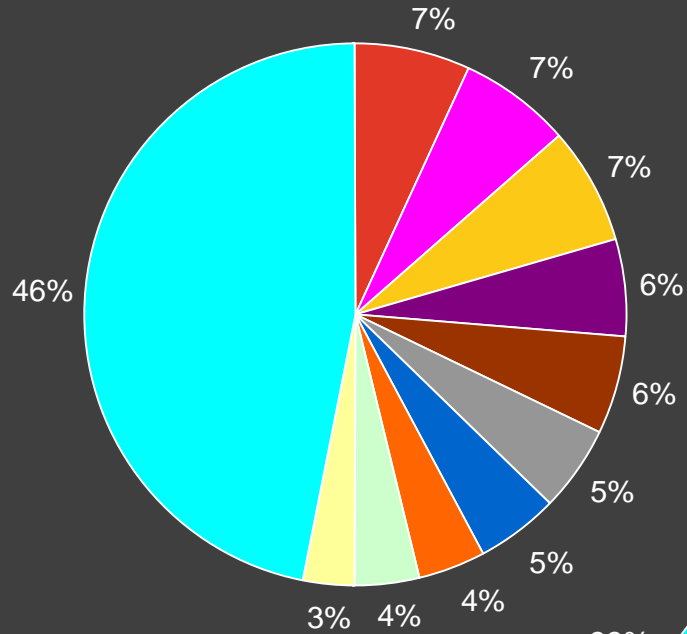
US 2007 TOP 10 WRITERS OF SURETY BONDS

	Group/Company Name	Direct Premiums Written	Direct Premiums Earned	Direct Losses Incurred	Direct Loss Ratio
1	Travelers Bond	\$1,017,180,430	\$951,138,718	229,672,612	24.1%
2	Zurich Insurance Group	448,819,392	427,942,401	60,850,876	14.2%
3	CNA Insurance Group	436,119,894	431,369,635	81,041,013	18.8%
4	Safeco Insurance Group	423,274,038	387,146,301	45,011,662	11.6%
5	Liberty Mutual Insurance Group	341,250,237	314,820,666	54,608,574	17.3%
6	Chubb & Son Inc Group	303639444	287,969,799	(7,512,799)	-2.6%
7	Hartford Fire & Casualty Group	223,298,098	215,924,540	25,089,593	11.6%
8	HCC Surety Group	163,368,470	148,261,043	9,642,776	6.5%
9	Arch Capital Group	126,995,347	132,050,045	151,032,310	114.4%
10	ACE LTD Group	118,743,836	108,579,497	5,408,951	5.0%
	TOP 10 TOTAL	\$3,602,689,186	\$3,405,202,645	\$654,845,568	19.2%
	TOP 100 WRITERS	\$5,385,449,243	\$5,138,673,668	\$937,680,133	18.2%
	GRAND TOTAL OF ALL WRITERS	\$5,432,756,400	\$5,183,048,905	\$979,285,852	18.9%

INDUSTRY MARKET SHARE "SHIFT"

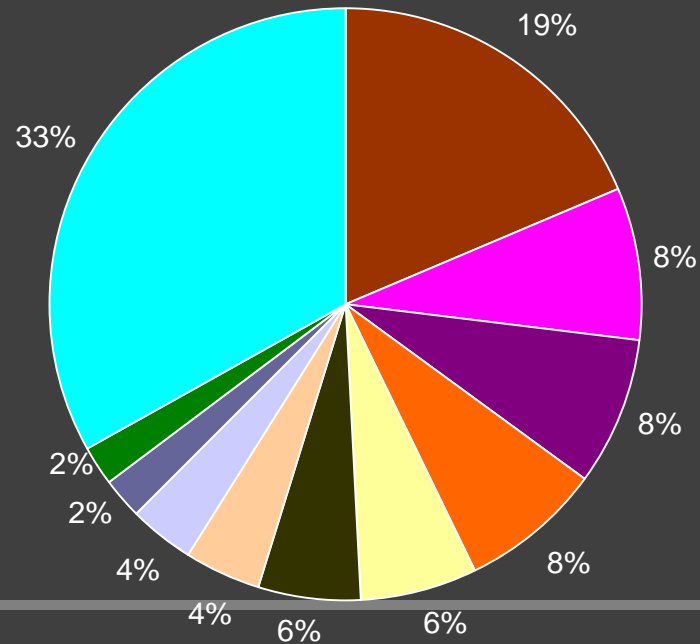
1995

- Reliance
- CNA
- US Fidelity
- F&D
- St. Paul
- Aetna
- AIG
- Safeco
- FFIC
- Chubb
- All Others



2007

- Travelers
- Zurich
- CNA
- Safeco
- Liberty
- Chubb
- Hartford
- HCC
- Arch
- ACE
- All Others



LEADING SURETY COMPANIES

– Leading US sureties

- **AIG**
- **Chubb**
- **CNA**
- **Liberty Mutual** (*reverse flow*)
- **Liberty International Underwriters**
- **Traveler's**
- **Zurich (US)**

– Leading European sureties:

- **Zurich (UK and Europe)**
- **Atradius**
- **Coface**
- **Euler Hermes**
- **Munich Re**
- **Swiss Re**
- **HCC**
- **Export Credit Agencies**

2009 MARKET CAPACITY

□ Estimated Capacity by Surety

- *US Sureties*

- Travelers \$500MM+, large GC, HH, trades
- Zurich \$500MM+, large GC, HH, trades
- Chubb \$500MM+, large GC, HH
- AIG \$500MM+, large GC, HH
- Liberty \$350MM+, large GC, HH, trades
- CNA \$250MM, middle market GC, HH, trades

- *International/European Sureties*

- Zurich (Europe) €200MM +
- LIU \$150MM
- AIG \$750MM +
- Chubb \$200 MM+
- Euler Hermes €200 MM
- ECA's

2008 GLOBAL SURETY TRENDS

□ Expanding Role/Demand for Surety Bonds

- Credit Crisis Impacting Bank Appetite for performance guarantees
- Sureties as participants in bank guarantee facilities
- Deregulation of Brazilian Market = Opportunities
- Adequate Reinsurance capacity, however larger programs may be impacted as aggregation concerns remain
- Growth of “global” contractors
- Surety counter party risk issues

□ Mega projects (\$300–500 million+)

- Growing trend towards larger projects, i.e. Panama Canal
- PPP/PFI opportunities in many countries
- Multi-National Teams/Consortiums
- Larger surety commitments required
- Surety needs must be addressed early, and with right resources!

Surety Market Outlook for 2009-2010

- **2008 very profitable for the US Surety Industry, but caution about 2009-2011**
 - US Economy in worst recession since 1930's
 - Credit Crises at levels not experienced before, private construction severely impacted
 - State funds for new projects and even some ongoing projects in doubt
 - Surety Loss Frequency may increase by 4th Q 2009
 - Expect surety industry to be in the red for 2010-11
- **Other issues**
 - Reinsurance capacity may tighten into 2010
 - Counter party/co-surety issues create capacity issues
 - Frequency of Mega-projects add pressure
 - Upward pricing and flight to quality
- **Federal government stimulus package needed now!**

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MEGA PROJECTS & PPP

Surety Market Response

RECENT LARGE BONDED PROJECTS

<u>PROJECT</u>	<u>CONTRACT AMOUNT</u>	<u>BOND AMOUNT</u>
Bay Bridge Superstructure	\$1.4 Billion	\$350 Million
Croton WWTP – NYC	\$1.1 Billion	\$500 Million
Tom Bradley Terminal (LAX)	\$504 Million	\$504 Million
East Side Access Tunnel (NYC)	\$428 Million	\$428 Million
CTA Blue Line	\$370 Million	\$370 Million
DART Corridors	\$365 Million	\$365 Million
Lake Mead (NV)	\$447 Million	\$223.5 Million
Manhattan Water Tunnel (NY)	\$668 Million	\$668 Million
Metro Gold Line (CA)	\$600 Million	\$600 Million

Surety Issues for Large Projects

❑ *Underwriting approach PPP-PFI Projects*

- Concession Team, Contract with Governmental entity, Financing details
- Design-Build Contractor details
 - Team members, experience, etc
 - Contract with Concessionaire
 - Design Liability Insurance
- Complete Project/Contract Risk Review

❑ *Capacity is available*

- 4-5 top sureties underwrite these projects, depending on DB team involved.
- % bonds
- Indemnity
- Pricing

❑ *Surety requirements need to be addressed early!*

ALTERNATIVE SURETY STRUCTURES

- ❑ Conventional US Surety approach
 - Co-Surety
 - JV Joint and Several Indemnity
 - % P&P bond
 - Flat Rates

- ❑ Use Export Credit Agencies (ECA's)
 - Sovereign Rating
 - Reinsurance support

- ❑ Use Capital Markets
 - Attracted to high quality credit ratings
 - Provide reinsurance or collateral support

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QUESTIONS?



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