

# AN ALTERNATIVE TO SURETY BONDS: SUBCONTRACTOR DEFAULT INSURANCE



Subcontractor default presents a high level of risk for any construction firm. Historically, surety bonds have enabled contractors to transfer the risk of subcontractor failure, but they are not the only way to provide this benefit. An alternative solution is subcontractor default insurance (SDI), a first-party insurance policy that indemnifies a contractor for costs incurred as a result of a default in performance of one of its subcontractors. The costs in question may include those directly related to a defaulted subcontract as well as indirect costs.

## SDI PROGRAM OVERVIEW

SDI may be written on a portfolio or on a specific project, making a fixed-dollar limit available to pay claims. The insured contractor is responsible for prequalification of subcontractors and for undertaking all actions to resolve or settle any loss. Insured contractors benefit from a reduction in potential losses, thus keeping jobs on time and within budget. They will also experience more favorable pricing with their SDI programs as their subcontractor prequalification processes are improved.

Managing subcontractor default is a critical part of a comprehensive risk management program. Marsh provides you with access to a highly experienced, global network of SDI and surety consultants to procure coverage alternatives for subcontractor default. We help you mitigate, manage, and reduce your total cost of risk, while also providing consultative advice, program design and placement, and claims preparation and advocacy. And we provide a financial benchmark service that measures financial factors to identify those subcontractors that might present a high risk of failure.

## CONSULTATIVE ADVICE

The Marsh team provides consultative advice to SDI clients in the following areas:

- program brokerage, implementation, and training concerning the benefits of SDI to client's staff, project owners, public-private-partnership (P3) consortiums, lenders, and enrolled subcontractors;
- subcontractor prequalification processes, including financial benchmarking and scoring;
- claim consulting services, including evaluation, document assembly, subcontract balance reconciliation, and negotiation to maximize recovery; and
- market knowledge and analysis of program options from three carriers that serve this market (Zurich, Arch and XL).

## ADVANTAGES OF SDI

- Broader coverage than subcontractor bonding for indirect costs, and with recovery potential up to policy limits for any default regardless of subcontractor value.
- Insured contractor controls claim process when a performance default occurs.
- Supplements bonding capacity with surety dedicated limits endorsement.
- Potentially more cost-effective option than subcontractor bonding.
- construction consulting services, including:
  - project governance and performance audits;
  - dispute resolution and expert testimony;
  - insurance and default claims;
- fraud monitoring and forensic investigation;
- workforce strategies and safety solutions; and
- property and casualty insurance programs.

## ADDITIONAL SERVICES

Marsh offers a variety of consulting, loss control, and insurance services, either individually or as part of a robust risk management program. These include:

- SubSecure<sup>SM</sup>, a financial benchmark service that measures factors to identify subcontractor default risk;
- Contract surety
- Owner directed surety programs, where owners sponsor surety programs for all project participants;

For more information about subcontractor default insurance and other solutions from Marsh, visit [www.marsh.com](http://www.marsh.com), or contact your local Marsh representative.

Marsh is one of the Marsh & McLennan Companies, together with Guy Carpenter, Mercer, and Oliver Wyman.

This document is not intended to be taken as advice regarding any individual situation and should not be relied upon as such. The information contained herein is based on sources we believe reliable, but we make no representation or warranty as to its accuracy. Marsh shall have no obligation to update this publication and shall have no liability to you or any other party arising out of this publication or any matter contained herein.

Any statements concerning actuarial, tax, accounting, or legal matters are based solely on our experience as insurance brokers and risk consultants and are not to be relied upon as actuarial, accounting, tax, or legal advice, for which you should consult your own professional advisors.

Any modeling, analytics, or projections are subject to inherent uncertainty, and the Marsh Analysis could be materially affected if any underlying assumptions, conditions, information, or factors are inaccurate or incomplete or should change.

Marsh makes no representation or warranty concerning the application of policy wordings or the financial condition or solvency of insurers or re-insurers. Marsh makes no assurances regarding the availability, cost, or terms of insurance coverage.

Copyright © 2011 Marsh Inc. All rights reserved. Compliance MA11-11128.

## Who it's for:

- General contractors with annual revenues of \$100 million or more and annual subcontracted values of \$75 million or more.
- General contractors or joint ventures wanting to insure a specific project with subcontract values in excess of \$75 million.

## What you get:

- A first-party insurance policy to respond to a default of contract by a subcontractor.
- A funding mechanism for subcontractor default losses.
- Control of subcontractor selection and prequalification.
- Ability to manage the corrective actions taken to mitigate the effects of a defaulted subcontractor.
- Coverage for direct and indirect costs resulting from the default of subcontractors or suppliers.
- A more direct and less time-consuming process than perfecting a subcontractor surety bond claim.
- Multiple-year programs consisting of annual policies. With underwriter approval, an owner may be added as a scheduled entity via a financial interest endorsement, which triggers in the event of insolvency of the general contractor/insured and provides the owner with rights under the policy, which can be a selling point to an owner when negotiating a project.