



## Underwriting Considerations

Contract surety underwriting is the process of pre-qualifying a specific contractor for a single project or a number of projects. It is therefore important to consider the company's history and its overall organization as much as we consider its financial strength. These factors are referred to as the three "Cs";

### Character

This includes the contractor's personal and professional history, integrity, frequency of legal disputes and behaviour under adversity.

### Capacity

This refers to the company's ownership, management and staff, and the extent to which they can manage the company's operations and the systems (accounting, estimating, scheduling and job cost tracking) that they employ.

### Capital

Essentially, the company's tangible net worth, working capital and debt load. It also includes financial trends, non-construction investments and contingent liabilities. If the Surety is satisfied that the contractor has the character and capacity, it can establish a facility based on the contractor's Tangible Net Worth and Working Capital.



### **Tangible Net Worth (TNW)**

This is defined as the sum of retained earnings, capital stock and subordinated shareholder or third-party debt, less intangible assets (goodwill, licenses, etc.) and discounted assets.

### **Working Capital (W/C)**

This is defined as current assets minus current liabilities. Current assets include cash, receivables, work-in-progress and inventory. Current liabilities include short-term bank debt, payables, billing-in-excess, current portion of long-term debt, shareholder loans, income tax payable and the current portion of deferred taxes.

### **Monitoring**

Almost all contractors these days have sophisticated accounting systems. The Surety normally monitors each contractor's financial performance on a quarterly basis. Contractors provide the Surety with:

- In-house financial statement (balance sheet & income statement)
- Aged listings of receivables and payables
- Work-on-hand report

The year-end analysis requires:

- Externally prepared year-end financial statements of all operating and related companies
- Year-end aged listing of receivables and payables
- Year-end work on hand report
- Bank terms and conditions letter
- Personal financial statement

### **Indemnity Agreement**

Surety is unlike insurance in that the contractor or client provides the Surety with a legal commitment to hold the Surety harmless for any losses and costs it suffers in connection with the bonds it has issued.

This indemnity agreement typically includes corporate guarantees from all the contractor's companies and personal guarantees from the shareholders.

The indemnity agreement should be carefully read and reviewed by the signatories prior to signing.