

# Subcontractor Default Insurance Newsletter



Insurance | Risk Management | Consulting



## Evolution of Subcontractor Default Insurance

It has been six years since Gallagher's last SDI newsletter, and in that time, the economic environment and the building industry have undergone significant changes. The global health event that unfolded has had a profound impact on contractors, forcing them to adapt and pivot in various ways.

Within the SDI market, we have seen the entrance of Liberty Mutual and Vantage, while saying goodbye to Zurich and "Subguard." Despite Zurich's exit, there are now seven active SDI markets. Personnel changes at companies like Arch, Hudson, and Axa XL have also influenced SDI market share and where general contractors place their SDI programs.

The increase in capacity and insurer competition has had a positive impact on contractors and their SDI programs, even though the risk of subcontractor default has increased. Coverage terms related to scopes, subcontract values, geographies, and project types have become more flexible since 2018, while rates have remained steady.

However, there has been a significant rise in notices to SDI insurers and sureties in the past 18 months. More companies are facing default claims, and this trend is expected to continue. To mitigate the risk of subcontractor default, contractors have focused on enhancing their procedures for subcontractor qualification and award decision-making.

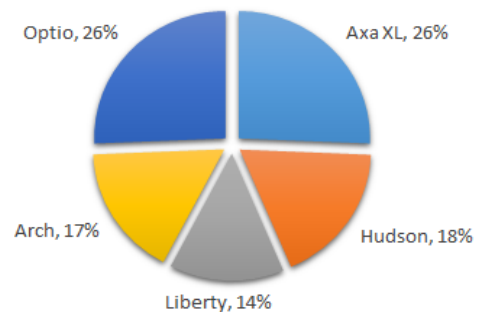
Technology utilization and data capturing have become crucial in the prequal process, with a majority of companies using or considering third-party companies for this purpose.

Another noteworthy development is the creation of a project-specific product by Vantage, catering to projects and contractors that historically did not align with SDI. Over the years, the SDI product has evolved to meet the changing risk environment and protect builders and their balance sheets.

As the SDI world continues to evolve, Gallagher looks forward to assisting you in navigating these ever-changing dynamics.

**Jake Concannon & Josh May**, North American SDI Directors – Gallagher Construction Practice

Approximate % of market share by number of clients



## SDI Claim Update

Claims Information	
Number of claims in subguard/SDI history?	Approximately 1,000 claims (notices over double the amount of claims)
Most common trades to default	Electrical, mechanical, wood frame, curtain wall, steel and roofing
Most common reason for default	Financial insolvency or distress, labor shortages and quality issues
Current trends	Notices have been increasing in the last few years with little sign of slowing down

Despite the growing investment by GCs into qualification measures related to subcontract risk, notices of default and potential claims that follow have increased in the past two years to both SDI insurers and surety companies.

We welcome the opportunity to discuss default loss data and claims resolution ideas with you and your team.

[ajg.com](http://ajg.com)

# SDI Carrier Update



## Nate Espe - Head of SDI



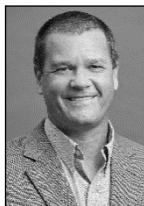
During the past year, the group formerly known as Cove Programs re-branded and adopted the name of their parent company, Optio Underwriting. There were no other changes to the firm's operations, leadership, SDI strategy or capacity, where they continue to offer \$50M per loss and \$150M in aggregate policy limits to target SDI clients.

Optio Underwriting differentiates its proposition in the market through the depth of experience and talent of their SDI team, who have an average of 20+ years of experience in SDI, many of whom began working with the product since it was first launched in the mid-1990s. The group has one of the largest SDI portfolios in the market, currently managing approximately 100 active programs for insureds across the U.S. and Canada.

Authority for the SDI product line at Optio Underwriting is fully extended to and managed within the leadership structure of the SDI team based in the U.S., with capacity backed by a strong panel of syndicates from Lloyd's of London. SDI team members have a broad range of backgrounds in SDI underwriting, claims and risk engineering, many of whom previously worked in the construction and engineering industry. Their collective experiences provide them the capability to underwrite business based on the unique risk characteristics of each individual account. Because of this market experience, they don't have any pre-established referral requirements based on a client's geographic or market focus, type or value of subcontract exposures or project delivery method.



## Jim Richert - Senior Vice President



In 2023, we saw project and subcontract sizes continue to increase. Enrollments have remained very strong – especially for contractors that have market sector or geographic diversity. It's a challenging time for trade contractors. They are on the frontlines of project performance and are being asked to do more and more despite well-known headwinds, such as the qualified management and labor talent crunch, increasing cost of supplies/labor and increasing complexity in managing continued supply chain challenges. All of these put significant stress on their balance

sheets and overall operations. We have also seen banking pressure regarding interest rates and change in portfolio mix, which in some cases has led to banks dropping construction clients, specifically subcontractors. We experienced an uptick in notices in 2022 and similar frequency in 2023 – with roughly 40% of issues being financially driven and 60% operationally driven. This is exactly what we would expect in the current environment and our team of over 30 underwriters, risk engineers and claims handlers are well equipped to support our partners through this time.

AXA XL's goal is to maintain long term partnerships and provide a sustainable product for the long term – being the strongest SDI provider for the strongest contractors. Disciplined underwriting and services are key for our long-term view; therefore, we continue to leverage our depth of services for our partners to focus on core controls such as:

- Are you pursuing projects that fit your company/team's experience and have strong likelihood of being profitable? Are diversification/growth strategies effective?
- Is your prequalification process well managed and support strong award decisions? How is subcontractor aggregation risk being managed?
- How do your project management practices mitigate risk – particularly around management of subcontractors, quality, schedule and supply chain?
- In a default scenario, do you have controls that result in strong leadership support to work through the challenges?

We're always looking at ways to help our clients avoid default losses. Perhaps the most effective way we do this is through the open sharing of our claims data. By promoting early notice on all issues, we capture a wide range of data with and for our partners. Our "peer network" helps each other by identifying trends in the market and offering guidance and best practices to avoid a default situation. For example, we recently saw an uptick in notices regarding electrical subcontractor defaults and immediately issued a Risk Insight to all of our partners.

It is not "news" that there are elevated risks in the construction industry and in the macro economy. Our construction partners experience and manage these uncertainties – and potential impacts to trade contractor performance – on a daily basis. While the risks highlight the importance of a strong SDI program as insulation from catastrophic losses, our top-tier partners are effectively and proactively managing the risks to reduce default losses. If this is true for you, then consistent pricing, terms and conditions should be expected. Our clients do a great job, and we are proud to support them in meeting their business goals!



## Wallace Moreman – Senior Vice President



- Market Update from Hudson: Maximum limits (\$50M/\$100M), partnerships – offer discounts and/or increased capacity to most prequalification vendors and SmartPm, other coverages they offer and approach to writing several lines of insurance in addition to SDI. Our intention is to be chiefly focused on supporting our partners' SDI business and not other LOBs. Hudson does offer GL only wraps, surety and professional liability.
- A benefit of Hudson is that we do not have a “one-size fits-most” model in our underwriting and risk analysis approach. Our enterprise consists of insureds across the U.S. from as little as \$50M in annual revenue to >\$3B. We have a balanced mix of both new and historical SDI buyers, with a strong focus on collaborating with our insureds to improve prequalification and the sub-selection process, while working to raise the bar on all risk identification. Our strength has been working with insured on unique solutions (i.e., dual programs, assistance with prequal, solutions for wood frame, unique reporting methods, etc.)
- Experience with IPD – This delivery model is not regularly deployed, and has a number of hazards with an SDI policy. Hudson is willing to review this on a project-by-project basis.
- Claims Trends – Of all notices submitted, only 20% have materialized to claims in Hudson layer. Most all are in the multi-family market segment, with root cause split between financial distress (insolvency) and operational capacity (inability to staff). Largest losses are primarily envelope, critical path trades with largest losses being the wood frame trade. Recent activity increasing activity with electrical trade and wood frame/multi-family projects.
- Any differences that separate them from competitors – Extensive SDI experience amongst UW teams and risk engineering team, in-house claims with most experienced SDI claims manager in the industry, solution oriented to find best fit for insured vs. one size fits all, very collaborative/consultative working with insureds to refine processes, regularly generate industry thought leadership (quarterly newsletters, market alerts, etc.) to advise clients of issues/trends.



## Juan Quinones - Underwriting Officer



Since its 2019 launch, Liberty Mutual's SDI program has excelled in delivering tailored solutions for general contractors of all sizes, earning a stellar reputation across the U.S. and Canada. Liberty's SDI program being housed within the Global Surety business provides customers with access to surety resources and facilitates greater autonomy for the SDI product placement team.

With a unique blend of backgrounds from both general contracting and insurance sectors, Liberty Mutual's SDI team brings diverse expertise to the table. Over the last year, the team has observed a notable trend: general contractors are reinforcing their subcontractor prequalification framework by intensifying financial and operational reviews.

Moreover, clients have continued to rely on the expertise of the Liberty Mutual's SDI Risk Services team to transfer knowledge and promote awareness in the development and deployment of risk identification and mitigation strategies.

As the construction market evolves, Liberty Mutual remains committed to empowering general contractors with customized SDI solutions. Liberty Mutual's dedication to understanding industry nuances and providing unmatched coverage solutions positions Liberty Mutual SDI as a market leader.

- The Liberty Mutual SDI claims activity has been aligned with anticipated projections. We do note claim notice trends indicate a greater severity in projected loss amongst electrical, building envelope (i.e., roofing, exterior glazing, exterior metal panels, wood framing) trades and a higher frequency in claim notes amongst electrical, finishes (i.e., drywall, flooring, painting), and building envelope trades.

Anne Church - Vice President



Arch has taken a boutique approach to writing Subcontractor Default Insurance, focusing on general contractors who have a regional footprint, know their subcontractor partners well and demonstrate excellent prequalification practices. Building relationships with these contractors has enabled us to better underwrite their business operations, tailor our product offering and further suggest other lines of business which may complement their overall insurance portfolio, such as primary casualty, professional, surety and excess.

We have built out a team of seasoned professionals who have extensive experience with the product, both on the broker and carrier side. Driven to exceed our over 60 clients' expectations, we enjoy creating inventive solutions to unique or complicated contractor coverage issues. In addition, our overall knowledge and experience gives us the ability to develop innovative risk control service solutions, based on the hundreds of contractor clients we have managed throughout our careers.

Though we not have seen a discernible trend in claims related to trade scopes, we have seen claims with higher costs due to lack of proper prequalification resulting in unnecessary losses. Due diligence requires closely watching subcontractor bid spreads, addressing poor quality concerns, monitoring labor fluctuations, in addition to reviewing current financial info. Root cases for claims activity can be attributed to owner-recommended subs, GCs working outside their normal geographical reach with an unknown sub base, and sub's lack of working capital to successfully complete the scope. In these cases, strong prequalification is key, as well as a robust risk mitigation plan if the GC decides to proceed with award.

Our involvement has resulted in our insureds being able to better identify and mitigate their risk, as well as have confidence in their coverage should a loss occur. This level of engagement sets us apart from other markets in this space.

Megan Fletcher - Head of Construction



Since we began writing SDI policies in April 2022, Vantage Risk has proven ourselves as the stable, innovative, technology-driven market for subcontractor performance risk. As of the time of writing, we insure 18 general contractors covering over \$7.4B in annual subcontractor enrollment across a range of products including but not limited to Primary SDI. For Primary SDI, we offer limits as high as \$50M single/\$150M aggregate.

**Primary**

In developing our Primary SDI product, we recognized a fundamental issue with the way SDI is traditionally priced by the marketplace – it treats awards to different subcontractors with the same contract value equally. As anyone who has stared at a balance sheet knows, awarding a \$1M subcontract to an entity with \$100,000 in cash is a completely different risk from awarding to an entity with \$3M in cash. Our solution to this problem, VScore, creates dynamic pricing that rewards insureds who make stronger subcontracting decisions by reducing premium based on the strength of their subcontractor awards.

**Excess**

In today's world, it's no surprise that project and subcontract sizes are continuing to rise steadily. To address this increased risk in the marketplace, Vantage Risk also offers Excess SDI. We've experienced success on projects with specific owner requirements regarding SDI limits, with contractors that are building "mega-projects," and with long-time SDI buyers that want to prudently develop relationships with more than a single carrier.

**Middle Market**

On the other end of the spectrum, we have developed an SDI product called SubSelect that offers middle market contractors catastrophic coverage and balance sheet protection on a project specific basis. Vantage Risk reviews prequalification information directly from subcontractors and makes coverage determinations for the insured.

At Vantage our experienced dedicated team of underwriters, risk engineers and claims adjusters has helped us accomplish all of the above to advance the product. In addition to SDI, Vantage Risk also offers construction excess casualty and construction professional & pollution and environmental solutions. We look forward to hearing from you, our valued partners at AJG, to discuss any of the above and more!

# Subcontractor Prequal Update

## Building Tomorrow: Unleashing the Power of Technology in Subcontractor Default Insurance in the Digital Construction Era



Michael Ho - Chief Executive Officer



In the ever-evolving landscape of the construction industry, technological advancements are playing a pivotal role in reshaping traditional practices. One area that has historically been underutilized, underappreciated, and undervalued is risk management, particularly in the realm of Subcontractor Default Insurance (SDI). As we enter the digital construction era, it is crucial to recognize the transformative potential that technology holds for risk management professionals, paving the way for a safer, financially secure and more profitable construction industry.

One of the key advancements in risk management is the adoption of prequalification technology, coupled with the use of standard data. Traditionally, the prequalification process has been fragmented and time-consuming. However, with technology-driven solutions, risk professionals can now leverage standardized data to make informed decisions, streamlining the prequalification process and mitigating potential risks associated with subcontractors.

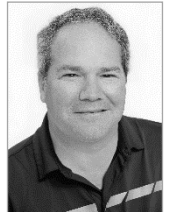
The integration of construction technology into the entire construction life cycle marks a paradigm shift in risk management strategies. Through the utilization of prequalification technology, risk managers can extend their influence beyond traditional boundaries, covering preconstruction data requirements, health and safety considerations, environmental, social, and governance (ESG) factors, certifications, bidding, estimating, and insurance decisions. This holistic approach ensures that risk management becomes an integral part of every phase of construction, minimizing unforeseen challenges.

Artificial Intelligence (AI) emerges as a game-changer in the realm of risk management. The application of AI allows risk managers to analyze larger datasets, stress-test micro and macro variances, and make more accurate predictions. By harnessing the power of

AI, risk management becomes proactive rather than reactive. Predictive analytics enable better decision-making, enabling construction professionals to anticipate potential risks and take preventive measures, ultimately contributing to a safer and more financially secure industry.

The integration of technology, prequalification processes, and AI-driven analytics results in more efficient and effective risk management. The construction industry becomes better equipped to handle challenges, leading to increased financial security and profitability. With a comprehensive understanding of risks at every stage, construction professionals can implement targeted strategies, reducing the likelihood of subcontractor defaults and associated financial losses.

As we embark on the Digital Construction Era, the transformation of risk management practices in Subcontractor Default Insurance becomes imperative. By embracing prequalification technology, standard data, and the power of AI, construction professionals can usher in an era of heightened efficiency, safety and financial stability. The future promises a construction industry where risk is not just managed but becomes an integral part of decision-making across all facets of the construction life cycle. In doing so, we build tomorrow with resilience, foresight, and innovation, ensuring a brighter and more prosperous future for the construction industry.



Lee Blaylock - Co-founder & CEO

ConstructionBevy is a FinTech enabled marketplace for the commercial construction industry.

We strongly believe in these key principles:

- The entire commercial construction industry would benefit from a SEO friendly, open social network of all companies from owners/developers to manufacturers to financial service companies supporting the industry, to even interior decorators so everyone can find new opportunities.
- The industry needs a way for subs to store and share their pre-qual data, and for GCs to view and download that data, in a 100% free tool.
- Different subs want different ways to share their financial data in the pre-qual process and GCs want to know that info is valid.
- Qualifying the same sub to build a convenience store or tilt wall distribution center is entirely different than for a 30-story building.

- Like social networks in other industries, the service should be entirely free at the base level, with premium upgrades for power users.

One key problem we solve is helping GCs rapidly qualify subs with our unique and freemium based [Risk Assessment Configurator \(RAC\) Reports](#). GCs set their own weighted averages in six categories (financials, insurance, safety, legal, bonding & performance) and 50 subcategories to generate their own risk score for each sub and for each job. RAC scores are a passport to financial benefits for subs. Our business model resonates so well that we're the only service that has nine GCs and five subs as investors. See more at [constructionbevy.com](http://constructionbevy.com) or email Lee Blaylock at [Lb@cbevy.com](mailto:Lb@cbevy.com).



Thomas Kellogg - Principal



Over the last five years, the construction industry has felt the lingering effects of major market disruptions and volatility, project delays and subcontractor pool contractions. Developers and construction managers face the pressure of rising costs and interest rates while subcontractors are asked to do more with less. Common “prequalification” processes and tools often generate conclusions from outdated information and applicants are at the mercy of system-generated general risk scores and ranking schemes.

We believe that default risk is dynamic and rapidly evolving – each risk must be quantified and constantly reassessed.

Maple Insight uses predictive analytics to provide default risk measured in percentages, and exposure to losses measured in dollars, specific to each individual contract on each project. We have developed and employ a purely scientific and objective approach to default risk quantification that analyzes business health and key performance indicators, operational capacity, project appropriateness, corporate sophistication and market conditions as they change over time. Further, we calculate the primary, secondary and tertiary economic impacts that each contract’s default may have upon a project.

Users – carriers, brokers, sureties, captives, construction managers, developers and lenders – leverage this intelligence to discern the healthy risks from the unhealthy risks, monitor and quantify project/portfolio risk and assess pricing adequacy and policy exposures. We help clients identify and mitigate major risks before they affect budgets and schedules.

With new insights and visibility, we believe our industry can better promote the right partners for the right projects to reduce default losses and drive profitability.

# Gallagher SDI Expertise

Gallagher’s team was created over 20 years ago when Gallagher wrote its first SDI program. Since that time Gallagher has built the strongest team in the United States. We proudly represent over 50 Builders who enjoy successful SDI programs.

We are in a position to work collaboratively with you to bring our broad and unique experience to your program. Our team’s experience working with some of the most successful risk managers in the construction industry provides us with unparalleled insight into the risk management needs of General Contractors. This facilitates a more knowledgeable and real world dialogue between our teams. The bottom line is that we will make a positive difference in the success of your future program, and your company.

Summary of capabilities and services include:

- Owner Reimbursement
- Internal & External Education
- Negotiating programs
- Claims management
- Contract advice
- Sub Prequalification advice
- Responsive to contract issues
- Negotiations on your behalf
- Market intelligence and Benchmarking
- Day to day administration
- Strategic approaches

Reach out to our team with any questions or concerns regarding SDI. We look forward to exploring how SDI can positively impact your business.