

Recognizing the Need for Surety Agency Transformation

by K. Dixon Wright, October 19, 2000

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The splendor of San Francisco Bay makes the warehouse piers that line its embarcadero somehow beautiful in their own right. My father, an owner (retired) of an insurance agency in San Francisco, taught me an early lesson about those piers that was a driving force of how he ran his insurance agency one generation ago. North Coast Surety strives to maintain that momentum so that our family's next generation can enjoy and tackle the challenges inherent in the insurance industry.

The piers that line San Francisco were once the hub of the City's economic activity, and the people that controlled them and made those piers the most valuable strip of land in the city are as legendary as the Barbary Coast during the Gold Rush. The lesson of the piers is in understanding how an attempt to protect a future doomed it instead. It was a business decision to avoid advancements in efficiency to maintain employment levels, based on the assumption that market position would prevail over market efficiency.

When the use of modern, machine-based off-loading systems threatened the viability of manual ship unloading, San Francisco adopted legislation that prevented those new methods from being used on any piers, in order to protect its employees. Right across the bay, however, Oakland adopted the new technology, and now operates one of the most productive shipping operations in the Pacific Rim. San Francisco, on the other hand, lost all of its shipping business, and everyone on the piers lost

their jobs. Today, the piers that had once been the most valuable strip of land in the city now stand in stark contrast to their productive past. My father always pushed his agency forward to the future, and would never look back, nor rest on yesterday's success. Staying ahead meant understanding what was to come.

Major transformations of business means and methods, particularly when employment levels are materially shifted, are generally resisted until inevitability demands their acceptance. The recognition of those transformations, and their early adoption, can often determine the difference between success and failure. The surety industry is currently facing a major transformation, and the agencies which adapt will survive. Those that fail to change will be unable to compete for the types of preferred clients that generate the level of revenue that makes an agency successful. Like the piers in San Francisco, they may remain and may never actually go away, but they won't perform to their potential, surviving instead on a mix of operations, rather than a focused and concentrated specialty.

At forty-two, I am halfway through my career, and have seen the introduction of the computer, the first significant transformation of the surety industry. The transformation evolved over twenty years, its pace accelerating as technology provided the underlying basis. The transformations ahead will eclipse the last two decades in the next twenty-four months. This article addresses the

transformations that have changed the surety industry, explains how we see the current environment, and forecasts what the next transformation will be and how brokers need to respond in order to participate successfully.

The Traditional Surety Agency

When I first entered the surety industry in 1980, as an underwriter, we were taught the three C's of surety: Credit, Capacity, and, most importantly, Character. Emphasis was placed on the character issue because that was the most valuable and tangible aspect that we could determine. There was a review of financial statements and job progress reports, however, which took into consideration that the information available lacked accuracy due to the limited ability of manually-generated data. What younger surety brokers and underwriters may not grasp is that only one generation ago there were no computers, no spreadsheets, no simple accounting systems, and no faxes. Business was done in person, and information was just a best guess. Everyone knew his or her clients, and your reputation was your single most important asset. Communication was verbal, and documents passed by hand. This personal requirement allowed for any number of agencies to develop a client base to support a surety department.

Surety is mentioned in the Bible, and from that time to 1980, there were very few transformations in the means and methods of suretyship. It was a credit decision based on imperfect data, and relied heavily on personal involvement, observation and judgment. Your value as an underwriter or broker was based on

your relationships, and the ability to tap those relationships for their personal observations of a potential new account. The more relationships, the more valuable you were. Where insurance professionals made their impact on tangible statistical analysis and pricing, the surety professional's impact was based on intangibles. As such, surety professionals enjoyed a level of respect within the insurance community distinct from other industry lines.

The First Transformation - Data

The surety industry, like all industries, was greatly impacted by the computer, and how it affected data management. The imperfect information that formed the basis of underwriting was becoming credible, and timely. Accounting and estimating software generated improved reporting, and database software allowed for more efficient handling of the information gathered. The efficiencies generated by the new capabilities had the natural outcome of increasing individual productivity, which had the consequential outcome of needing fewer people to perform the work. Consolidations, mergers, and acquisitions were the mark of the 1990's, both for brokers and surety companies. It used to be said that it was more important to be a good contractor first, and a good businessman second. For the first time it was more important to be a businessman first, and a contractor second. The same was true for brokers.

Data was becoming the basis for underwriting, and as reliance on data grew, reliance on personal judgment lessened. Underwriters and brokers

alike saw their number of accounts grow, leaving little time for the leisurely get-togethers that were once the standard. That is not to say the personal side, or the value of judgment, has perished. On the contrary it is, and always will be, the cornerstone of suretyship. But it is no longer the sole source of input, and now shares, appropriately, a balance of personal observation with hard data.

Data, as a source of underwriting, became more and more of an element as the ability to generate data was improving. In 1984, when the surety market was suffering losses and underwriting was tight, the demands for data became the benchmark for surety credit. Regardless of a contractor's potential, or what their references said, if they could not produce acceptable data, you, as their agent, could not get a bond.

The thriving economy of the 1990's brought back judgment over pure data as surety companies tried to capture the premiums generated by the building boom. The volume of work assumed by the various contractors was driven by their ability to manage data, and the computer reports from that data reflected their success.

The Second Transformation – Generational

Remember that the most important aspect of surety is character. A contractor would do what it took to get a project completed, and everyone would work collectively to achieve that end. Their tenacity, creativity, and knowledge of construction were relied upon to finish a project, and they would be given

leeway for the sake of the project. That's the way people worked.

As computers became more capable, and the people graduating from college employed them as their careers advanced, their data became more credible and relied upon. Facts, supported by data, became dominant business tools, and reliance on data for business decisions became standard practice. This disconnect from the personal aspect of business decisions is more prevalent in the younger contractors than in the older generation, and every passing year the new generation phases out the last one a little bit more.

For yesterday's generation to get a change order approved they gave a price, a best guess, and the owner accepted it. This generation must produce supporting documentation, critical path revisions, man-hour loading, and data, lots of data, to justify the change order. It has become so complicated that owners now regularly hire firms as contract managers, just to review and process the data being supplied by the contractor to the owner. Since computers have given us the ability to generate the data, the appetite for that data grows as the ability to generate it grows. The construction industry is weighed down by information overload, and the appetite for more information will continue.

I do not mean to imply that databased decisions, or practices, are inappropriate, or that reliance on data is less valuable than personal observation. The "good old days" worked then because that was the environment. The environment has changed, and the old methods do not apply anymore. It is not our intent to

bring back the past, but instead to recognize the future. Another old adage stated that people do business with people they want to do business with. Technology has not, and will not, change that.

The generational transformation is the comfort and reliance with impersonal data coupled with the comfort and reliance with automation of concentrated volume.

The Next Transformation – Communication

The transformation into a data driven environment evolved slowly, relatively speaking, as the computer programs and applications themselves were developed and refined, and most importantly, as the generational shift made their usage standard, and ultimately required. The next barrier to achieving the full potential of the computer, and ushering in the next transformation, is for the standardized usage to translate into a standardized communication capability. That is the internet, and its impact is just beginning to develop.

Where the preceding transformations did alter the means and methods of running a surety agency, they will not compare to the communication transformation. Those were evolutions, slowly materializing with each advancement in both technology and the application of that technology. This next period will be marked by rapid adoption, resulting in an exponential increase in efficiency, and a corresponding shift in the employment structures. The traditional surety agency is in the eye of the storm, and will likely be most impacted by the communication transformation. The

future, however, is not bleak for the broker. On the contrary, the broker still holds the most important ingredient in the process -- the personal relationship with the contractor, and the knowledge and ability to provide counsel and guidance that the principle needs and desires. It is still a people business, and people do business with who they want to do business with.

What is important to recognize in the previous paragraph is the definition of what makes the surety agency relevant to the principle: knowledge and the ability to provide counsel. With the future of data transmitted automatically, and bonds issued electronically, the traditional role of typist and document gathering are gone. If that is all the surety agency provides to the relationship, they too will be gone. This may appear to be a distant threat, whose evolution will follow the previous, slower, transformation paces, but beware -- it is not only much closer than you may realize, it's already here, and its total implementation will be counted not in months but in years.

The Communication Evolution

This article is not meant to be a technical piece. However, to understand the potential of current communication trends, and how they will impact the surety industry, some discussion is necessary. Understanding how the data may flow, and the surety broker's position in the data path, will demonstrate clearly how vital it is for brokers not to be complacent.

The key phrase is “data path,” and how that path is changing. Data is nothing

but text and numbers, but various aspects of our job as surety brokers is to accumulate data, provide interpretation of data, produce documents from data, and monitor the aggregation of data. The broker's role in those functions used to be driven primarily by the fact that it had to be done, and brokers were the best suited to do it. Data, in and of itself, is useless. Without a computer application to process it, and someone with the judgment and experience to interpret it, data is meaningless. The numerous players of the construction industry (owner, architect, sub, supplier, etc.) have each developed internal software applications to process their respective component, but the data itself has traditionally been exchanged manually. The manual data input was a major constraining factor to communication.

Welcome XML (Extended Markup Language), a programming tool designed to provide for data transmissions that can be imported logically, instead of manually.

The construction industry is rapidly adopting XML functionality, with its version referred to as aecXML (Architects Engineers Contractors), and the Surety Association of American recently adopted its version -- acordXML (Acord is a standards establishing association of the insurance

industry). The federal government has passed legislation for electronic signatures, and states are quickly following suit. It is not far off that we will see a project posted on the Internet (not in a trade paper), whose project data is in an XML format that can be processed by each application along the path from inception to bond issuance. No redundant entries, no paper documents, and the potential for total automation, including underwriting in some instances.

The catalyst to this trend, we believe, is the various construction sites that exploit the power of data communication to develop more efficient procurement methods by aggregating the vast number of subcontractors, suppliers, and materialmen under a streamlined solicitation system. These aggregating

sites like Buzzsaw.com and Buildpoint.com are demonstrating an ever-increasing ability to reduce project costs by a combination of broader participation, and the willingness of various elements to participate in an

Internet-based procurement system. As acceptance grows, so too will efficiency. With efficiency will come cost savings, and with cost savings will come more usage. It will self-perpetuate until the only efficient bidding system is

Internet-based, and the old method of faxing solicitations and manual data processing will fade away.

Traditional Bidding Data Management/Communication

Architect **develops** written **project data**
Sends written project data to trade publications
Trade publications **enters project data** for publication
Contractor Finds project – orders plans
Contractor **enters project data** into estimating system.
Contractor **enters project data** into bidding schedule log
Contractor **enters project data** onto bond request form and faxes to surety agent.
Surety agent **enters project data** into agents surety management system, faxes information to surety.
Surety company **enters project data** into their system.
Surety agent **enters project data** onto bond form

Electronic Bidding Data Management/Communication

Architect to **develops** written **project data**
Sends written project data to Website
Website **Imports project data** for publication/Posting
Contractor Finds project – **Downloads** plans (data)
Contractor **imports project data** into estimating system.
Contractor **imports project data** into bidding schedule log.
Contractor **imports project data** onto bond request form and e-mails to surety agent.
Surety agent **imports project data** into agents surety management system, e-mails information to surety.
Surety company **imports project data** into their system.
Surety agent **imports project data** onto bond form, or e-mails electronic bond to owner.

A component of the data these sites disseminate is insurance and bonding requirements. Surety brokers must be able to receive the incoming transmission, be able to process it internally, and then respond with a data transmission back to the site. That is the communication transformation this article is about. Its speed in adoption will be based on the fact that everyone has an application that processes data, and XML is simply a translation method, meaning every system can be modified to send and receive in an XML format, just as they can in delimited text. The difference is that with XML, each data element is defined with a universal definition so that the data itself can be imported into the correct field in any system, regardless of where that field is within the application. Therefore when an agency system received a file from its principal to import, it knows to put <<bond amount>>100000 in the bond amount field, and <<bid date>>06152000 in the bid date field. It could then process that data to forward the bond request to the surety, complete the bond form automatically, etc., all without redundant entry. XML makes the data manageable, which is the key difference.

Preparing a Surety Agency for the Communication Transformation

If my crystal ball is right, a contractor may download project data from an owner, transmit the data to their surety broker, and receive back the bond in real time, never seeing or hearing from his broker, or the surety for that matter. Most brokers and surety companies we

talked to were uncomfortable with this scenario, but they need not be. It is where we are heading, and yes, it will remove some of the service elements that we as surety brokers provide. But we will adapt. Those that try vainly to keep the future at bay will find themselves in the same predicament as the pier owners of a half-century ago – and will encounter the same result. Those who engage in the development process will prevail, and their participation will advance the one key remaining service the surety broker possesses -- surety knowledge and the ability to provide counsel.

We recognized this at North Coast Surety and undertook a nationwide effort to talk to the industry leaders about their e-commerce strategies, and to better understand the direction of the industry. What we found was an industry highly advanced in its internal developments, but unsure how the integration within the entire community would evolve. While the surety industry has some very impressive individual capabilities, like Hartford's 1StepSuretysm and SAFCO's Suretylinktm, there is yet to be developed the capability to manage construction-based data flow from its source – the aggregating sites on through the whole cycle of the issuing process. Every company we consulted with has recognized that the ability to send and receive data electronically is critical to the future, and each has undertaken steps to achieve those means.

Data management, including the ability to send and receive manageable data, is the key to an agency's future. Not because its efficiency will make your agency profitable, but because your clients will expect it of you, just as they

expect you to have a fax machine. If you told a quality client that you did not have the ability to receive a fax you would be acknowledging a fatal flaw in your capability. In a very short amount of time, electronic data transfer will be as basic to surety as the fax machine is now. Perception of how your agency is viewed in this regard will be judged the first time a contractor inquires. If that quality account, as a requirement to bidding a particular project, necessitated the ability to transmit data electronically, and your agency had no capability, they would select a broker that could comply with the requirement. The question is not if owners will require that capability, but when.

So how does an agency prepare for this shift to data flow management? First, recognize that there is a difference between data management and underwriting, and don't confuse managing data with managing risk assessment. The role of the surety broker is still, and will always be, to understand the risk behind the numbers and develop a surety program, on behalf of both the surety and the client, that best fits the situation. Never look for an automated

underwriting system, but rather a system that administers the data for an established underwriting program. The measure of a surety agency will be in its

ability to develop a comprehensive surety program; its ability to assist the contractor in the new electronic bidding environment; and its knowledge of the surety product. It will simply be expected that it can manage the data requirements.

Second, managing the data flow is an integration of your agency system with various other systems following industry standards. It is not your responsibility to integrate with all those other systems, just to have yours capable of sending and receiving along the industry standard. It is up to all those other systems to do the same. With the developments being achieved via XML standards, and the adoption of those standards by a wide range of industries, your agency efforts should be internal compatibility, not externally driven.

Third, recognize for the first time that there are several surety management applications for surety agencies to consider. There are excellent programs being offered to surety brokers, from the internally held Surety Simplified, Erlon, Total Automated Bond System (TABS) and Bond Pro, to the Internet-based SurePath and SuretyPro, or the choice of internal or

Internet-based Surety Bond Technician. Take the time to explore their offerings.

Surety Agency Management Applications	
Bond Pro	www.cumberlandtech.com
Erlon	www.dunlap.com/software/erlonforweb.htm
P&C Ins Sys	www.pandcis.com/products_surety_bond.htm
ProSurety	www.prosurety.com
Insurvision	www.insurvision.com
Surety Bond Technician	http://www.suretybondtech.com
Surety Simplifier	http://www.anthonymorgan.com
TABS	www.blairsystems.com

Surety Ecommerce Sites	
Esurety	www.esurety.com
Surety2000	www.surety2000.com
Univec	www.univecinc.com

Surety Company Sites	
CNA	www.cnasurety.com/bondline
The Hartford Fidelity and Bonding	www.1stepsurety.com
SAFECO	www.safecoplaza.com

XML Sites	
ACORD	www.acord.org
AEC	www.aecxml.org
Microsoft	www.biztalk.org

Fourth, recognize that there are two distinct integration requirements, one to the surety and the other to what we refer to as “the point of entry,” which is wherever your client starts the process of the bond request. A point of entry could be an aggregator’s site like Buildpoint or Buzzsaw, or an association site such as AGC or the National Trucking Association. It is up to each surety company to offer the ability for its clients to transmit and receive data to and from them, and those that provide the best functionality will have a competitive advantage over those that do not.

Fifth, the real obstacle is to ensure that wherever your client enters the Internet, and a bond is required, that your agency can be found so that the data can be transmitted, and your agency has the computer application to process it.

Sixth, don’t get overwhelmed. Although integrated data management will come relatively quickly, it is not here now, nor is it even fully developed. It is in development, and although the foundation has been laid, the development has a way to go. Our clients do not express great concern over being Internet ready, simply because it has not been required of them. But they all recognize the need is coming, and will look to our office for advice when the time comes. Now is the time to get involved so that your agency is ready and has implemented the appropriate systems for when the projects ultimately do migrate to the Internet, and your clients seek your counsel.

Seventh, remember to follow the money. It is the owner’s requirement that instigates the bond requirement that

generates the premium. The contractor orders the bond out of necessity, not desire. Strive to develop a capability that works for the project owner, with the least hassle to the contractor, instead of working towards the surety company.

Our Approach at North Coast Surety

When we recognized what the potential shift integrated data management would have on the future means and methods of delivery of the surety product, we analyzed where we wanted to concentrate our efforts. We came to the conclusion that we are brokers, and providing value-added services to our clients, and prospective clients, was our objective. Data management is a function to an end, not an end in itself. We found that the industry was pursuing various strategies, along similar but sometimes conflicting ends. Automation was at the heart of each effort, but a clear path from data inception (the owner posting the bid opening) to the owner receiving the issued bond, was not in effect, nor could we find one being envisioned. Each effort was focused toward a directed niche or functionality. Efforts appeared to be commonly focused on the trees, and missed the forest.

In response, we have initiated an effort referred to as *suretyconnection*, wherein we describe our philosophy of providing service to the client by collectively developing the communication standards, via XML. Our position is that each individual effort should concentrate on being able to send and receive, so that the choice between competitors is open to the client. We titled our position paper “Communistic Capitalism” and distributed it within the surety industry

members active in e-commerce, and to Buildpoint and Buzzsaw.

Both Buildpoint and Buzzsaw had seen surety proposals before, but previous suggestions were for some form of directed, or limited suretyship. Their knowledge of the surety relationship correctly stalled their acceptance of those proposals. They are looking to provide service to their clients, the contractors, and that necessitates open access to the surety agents and markets. Our proposal of creating a portal where contractors can select the broker of their choice, subject only to that broker being able to transmit in a standard format, was "conceptually" desirable, even without specific details on how it would be accomplished. We will continue to work with them, and other sites, to develop a functionality that serves our mutual objectives, and move from concept to formal relationship, while they continue to explore all options to bring surety products onto their sites. With such a functionality the surety industry could tie into the beginning of the data management cycle, the inception of the project data flow.

We have since entered into an agreement with Superior Computer Associates to develop an industry implementation guide that will define how the "points of entry" will integrate with various surety agency management applications. Now we just had to work along the path to get the final issued bond back to the point of entry.

We then explored the various surety agency management applications available to determine which, if any, could receive the data from the point of entry. All of the programs we reviewed

managed data very efficiently, and all had plans to incorporate XML transmission ability in their future. We selected Risk Management Technologies (RMT) "Surety Bond Technician" because of two overriding considerations: their Chief Technology Officer was participating with the Surety Association of America/National Association of Surety Bond Producers Technology Subcommittee, but was personally involved in the drafting of the acordXML implementation guide for the industry. They clearly understood the direction of data management.

Secondly, they offered to extend their knowledge of surety-based electronic data exchange to *Suretyconnection*, and their programmer, Superior Computer Associates, for distribution to any interested parties, including their competitors. We both recognize that we will not monopolize the market in either of our niches -- people will do business with who they want to do business with -- but our involvement in these early stages will make us more proficient, and therefore more competitive. Standards are only effective if they are commonly used, and to realize the competitive advantage we were striving to create, we need the surety market as a whole to participate.

We did not select RMT for their current capability, which is considerable, but rather their vision of the future needs of surety agents, their willingness to adapt to unpredictable technology trends, and their commitment to communication as the basic core value of their program. Data management is expected, so it alone was not a major consideration. Our agency required a management system that was state-of-the-art, would

be ready when our client needed the advancing technology, had the option of being stored on our own internal system (yes, I'm futuristic *and* old-fashioned), and would be fully compliant with both acordXML and aecXML once achievable. RMT's Surety Bond Technician has both today's capability and tomorrow's vision.

Summary

The transformation to automated data management may displace some employees in bond departments, and bond departments themselves will undergo major restructurings as processing no longer requires the manual intervention, particularly with respect to large volumes of statutory, license and permit bonds. The ranks of the industry will shrink considerably, but only in number, not in stature or importance. The value of a professional surety agent will grow with the new technology, as that new technology requires more from the contractors, who in turn will require more from their surety agents.

With a recent article in Best Review detailing how the surety industry is suffering what will be its third losing year in a row for surety reinsurers, it is likely the soft market will turn harder, and surety programs will be more difficult to establish and maintain. Contractors will require the services of a competent surety agency more in the near future than ever before in the history of suretyship. Competency will be judged, in part, by an agency's ability to respond to the ever-increasing demand for electronic communication.

Being ready for the future requires anticipating and responding to it. At North Coast Surety we are anticipating the future, and finding solutions to address it. All agencies should be doing the same, without delay.

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