

Surety Industry Results for 2007

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The surety industry recently published underwriting results for 2007. As was generally expected the surety industry posted strong profits from underwriting this past year. Direct losses incurred to direct premiums earned, called the net loss ratio, averaged 18.9% for the industry overall. The second component the surety industry looks at when calculating profitability is the expense ratio. This represents overhead related items and is calculated by taking overhead divided by direct premiums earned. The surety industry tends to place a ratio of 50% on overhead. Therefore, we estimate the surety industry posted a combined ratio (net loss and expense) of 68.9%, suggesting the industry had a strong year of profitability.

The top surety companies continue to write a predominant amount of the industry premium. The top ten markets wrote 66% of all bond premiums in 2007. This represents in excess of \$3.6 billion in premiums. These sureties also produced strong results with an average direct loss ratio of 22%. With the estimated overhead ratio of 50%, we estimate the combined ratio for the top ten sureties to be 72%.

Within the top ten surety companies, one market, Arch Insurance Company, was hit with a couple large losses that resulted in a net loss ratio of 104.5%. The problem does not appear to be systemic but rather more of a shock loss as the majority of the loss could be tracked back to a couple major cases. Without this surety company in the top ten calculations the remaining sureties would have had a direct loss ratio of only 11.8% and an estimated combined ratio of 61.8%.

While the top ten markets controlled a large market share of 66%, the top five surety companies represented a market share of 49% or in excess of \$2.6 billion in premiums. Basically half the industry bond premium is being written by five surety companies. The top five had a direct loss ratio of 17.2% and an estimated combined ratio of 67.2%.

Below is a list of the top five surety company results. Surety Company Direct Premium Written Direct Premium Earned Direct Losses Incurred Direct Loss Ratio Market Share Travelers

\$1,017,180,430	\$951,138,718	\$229,672,612	24.1%	18.7%	Zurich
\$448,819,392	\$427,942,401	\$60,850,876	14.2%	8.3%	C.N.A.
\$436,119,894	\$431,369,635	\$81,041,013	18.8%	8.0%	Safeco
\$423,274,038	\$387,146,301	\$45,011,662	11.6%	7.8%	Liberty
\$341,250,237	\$314,820,666	\$54,608,574	17.3%	6.3%	

Just recently it was announced that Liberty (5th largest) had acquired Safeco (4th largest). This will result in these two companies becoming the second largest surety with combined writings in excess of \$760 million and a market share of approximately 14.1%. Revising the 2007 year end results to reflect this acquisition the top five markets would look like below. Surety Company Direct Premium Written Direct Premium Earned Direct Losses Incurred Direct Loss Ratio Market Share Travelers

\$1,017,180,430	\$951,138,718	\$229,672,612	24.1%	18.7%	Liberty/Safeco	
\$764,524,275	\$701,966,967	\$99,620,246	14.2%	14.1%		
%Zurich	\$448,819,392	\$427,942,401	\$60,850,876	14.2%	8.3%	C.N.A.
\$436,119,894	\$431,369,635	\$81,041,013	18.8%	8.0%	Chubb	
\$303,639,444	\$287,969,799	\$(7,512,799)	(2.6)%	5.6%		

Considering this revision the top five surety companies based on 2007 results would have had a market share of 54.6% with a direct loss ratio of 16.6%.

It is pretty clear that 2007 was a solid year for the surety industry and hopes are high that 2008 will remain profitable. With the influx of residential contractors into the surety bond market we expect losses to increase as firms are entering an industry they have not previously worked. In addition, we are seeing some surety companies starting to be more aggressive as they try to grow volume. The timing of this move seems interesting as the economy is shaky and being aggressive during these questionable times could prove risky. However the sense is that the effects of these losses, if they indeed occur, may not be felt until 2009.