UNDERWRITING CONSIDERATIONS

Contract surety underwriting is the process of pre-qualifying a specific contractor for a particular project or a number of projects. We therefore consider the company's history and its overall organization as much as we consider its financial strength. We refer to these factors as the three "C's":

<table>
<thead>
<tr>
<th>Character</th>
<th>Capacity</th>
<th>Capital</th>
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<td>This includes the contractor's personal and professional history, integrity, frequency of legal disputes and behaviour under adversity.</td>
<td>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) they employ.</td>
<td>Essentially the company's tangible net worth, working capital and debt load. It also includes financial trends, non-construction investments and contingent liabilities.</td>
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**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.

**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 of 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. A copy of The Guarantee's standard Indemnity Agreement is available for downloading, however, the agreement is normally prepared by the local branch and sent to the broker.

**Monitoring**

Almost all contractors these days have sophisticated accounting systems. The Guarantee 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 & related companies
- Year-end aged listing of receivables and payables
- Year-end work on hand report
- Bank Terms & Conditions letter
- Personal financial statement