

# TAKING CHARGE OF SUBCONTRACTOR PERFORMANCE



Annual construction spending in the US hit a record \$1.26 trillion in January 2018, according to the US Department of Commerce. But for project owners forging ahead with new hospitals, labs, commercial buildings, and other projects, boom times also bring new risks. Sophisticated project owners understand that subcontractors have historically become overextended during times of rapid growth, taking on more work than they can handle. This leads to defaults that can trigger serious delays and cost overruns.

To help project owners better protect themselves, Marsh has developed a new risk mitigation product, the owner/general contractor combined subcontractor default insurance (SDI) policy. This first-of-its-kind policy offers a greater degree of protection against the risk that a key subcontractor will become overextended and unable to complete its work.

## GIVING PROJECT OWNERS A SEAT AT THE TABLE

Owners of major projects are increasingly looking for more effective ways to deal with the risk of subcontractor default, and for good reason. In projects involving

hundreds of millions in construction and development costs, the stakes are high, with the potential for millions in cost overruns and business disruptions costs should a subcontractor in charge of erecting steel or installing HVAC systems suddenly collapse.

There is a growing understanding among project owners that preventing subcontractor defaults — or quickly remedying the situation if a default occurs — is crucial in keeping increasingly complex construction jobs on track and on time. Subcontractor defaults that are not dealt with swiftly can often snowball, causing disruptions and delays down the line in myriad other areas of the project.

### Who it's for

- Institutional builders and other large project owners seeking to mitigate the risks of subcontractor default.
- Project owners focused on timely delivery and quality, as opposed to cost cutting.

### What you get

- The ability for an owner to prequalify subcontractors.
- Risk sharing, with the general contractor helping with losses.
- Leverage when dealing with a subcontractor default.
- Owner participation in any insurance savings generated.

Yet traditional coverage often leaves project owners in a double bind. Project owners are on the hook for potential revenue losses if a new lab complex or hospital opens late. However, decisions on which subcontractors to hire — or how to go about replacing a sub should it default — are left to the general contractor.

Marsh's new owner/general contractor combined SDI policy addresses this imbalance in the following ways:

- **Risk sharing:** Under the policy, the general contractor assumes the first layer of risk in the event of a default and the owner assumes a specified level of risk above the general contractor. This aligns the interests of the general contractor with the project owner by requiring both parties to collaborate extensively in the selection and management of subcontractors to protect both the project schedule and financial exposure to the retention layers under the policy.
- **A voice in the pre-qualification process:** The project owner, not just the general contractor, can prequalify subcontractors, potentially heading off later problems by weeding out subs with past business and performance issues.
- **Quick response to subcontractor issues:** If a subcontractor does later run into problems, the project owner will also have leverage, under the combined policy, to ensure the issue is dealt with as quickly and efficiently as possible.
- **Benefiting from the upside:** Project owners also get to participate in the upside of a successful subcontractor insurance program as well. The project owner on the first combined SDI policy recently issued by Marsh has netted \$3 million in savings based on insurance premiums that were successfully avoided.

## WHY MARSH?

Marsh's Surety Practice can deliver seamless service through local specialists and corporate resources across North America and around the world, supporting a variety of industries. Our specialists have unique backgrounds in banking, broking, and underwriting, giving them a depth of understanding unparalleled in the industry. Through our strong relationships with top surety bond markets and our market knowledge, technical acumen, professional esteem, trust, and experience, we can help you succeed by defining, designing, and delivering innovative solutions that can help you effectively manage your surety, construction, and project risk.

**For more information, contact your Marsh representative or:**

DAVID HEWETT  
US Surety Practice Leader  
+1 410 347 3617  
david.hewett@marsh.com

The policy is issued in the name of the general contractor controlled by the owner. The general contractor maintains responsibility for the management of subcontractors, while the owner assumes the first layer of exposure above the general contractor.

## HELP WITH SCREENING

The ability for project owners to thoroughly screen subcontractors is a major component of Marsh's combined owner/general contractor combined SDI policy. However, owners don't necessarily need to have their own screening process in place to participate. With our SubSecure program, Marsh can assist with the screening, either putting a new system entirely in place or augmenting a project owner's current vetting system.

SubSecure is a credit-scoring system that rates subs on ten different dynamics, which are then used to award a SubSecure score with which to measure the financial health of the contractor. Marsh worked closely with credit rating agencies and the surety marketplace to develop this credit rating product. Accompanying each metric is a detailed analysis.

The areas rated by Marsh include:

- Liquidity.
- Equity.
- Cash flows.
- Earnings.
- Credit facilities.
- Supplier payments.
- Prior project experience.
- Surety relationships.

Marsh is one of the Marsh & McLennan Companies, together with Guy Carpenter, Mercer, and Oliver Wyman.

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