



CONSTRUCTION **SUPER**CONFERENCE

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Subcontractor Default Risk and Insurance: What every project stakeholder needs to know

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Agenda

- Subcontractor Default Insurance (SDI): Product and Coverage
- SDI Market
- Default Risk Mitigation
- Proving and Pricing Claims
- Complex Loss Case Discussion



Subcontractor Default Insurance: Product and Coverage

What is a Subcontractor Default Insurance?

Subcontractor Default Insurance (SDI) is a first-party insurance policy that protects you, as a contractor, for costs incurred due to a subcontractor's default, eliminating the need for subcontractor bonds while providing an opportunity for profit.

The Coverage Trigger is the Default.

Subcontractor Default Insurance (SDI) – Product Overview

- ✓ Costs include **direct costs** for both performance and payment obligations the subcontractor has failed to meet, as well as **indirect costs** including extended overhead, inefficiencies, or delays.
- ✓ The coverage **trigger is the Default**, and the claim must show the losses were a result of the default. The SDI underwriter will NOT deny coverage over the merits of the default. The loss is funded when a default occurs.
- ✓ A “Default of Performance” is defined in the policy and generally means a failure to fulfill the terms of the subcontract. Failure to cure a notice may be considered a default.

Subcontractor Default Insurance (SDI) – Product Overview

- ✓ All enrolled subs are covered; bonded subs are normally excluded.
- ✓ Limits are fully available for default loss, regardless of subcontract value (may be subject to a cap of 3X subcontract value depending upon carrier).
- ✓ Single subcontractor failure on multiple projects in one policy year is considered single loss.
 - ✓ Multiple defaults of separate subcontractors on the same project are separate losses.
- ✓ SDI carriers have contractual subrogation rights.

Why SDI? – The Power to Choose

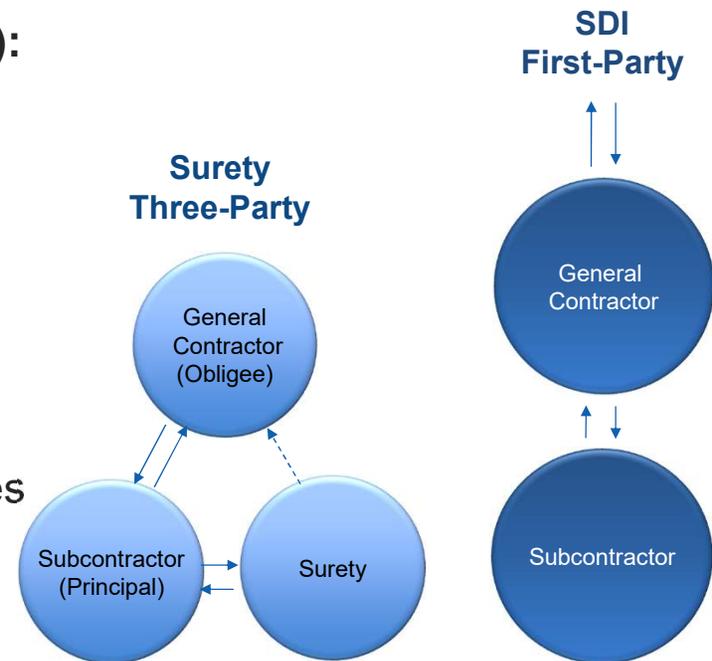
- **SDI restores control to the General Contractor (GC):**

- ✓ GC controls sub evaluation and selection
- ✓ GC controls the default process
- ✓ GC controls the claim process
- ✓ GC can start remedying the Default immediately

- GC benefits financially from management best practices instead of the surety.

- Coverage for up to 10 years completed operations.

- Cost to the Project Owner is competitive to subcontractor bonding.



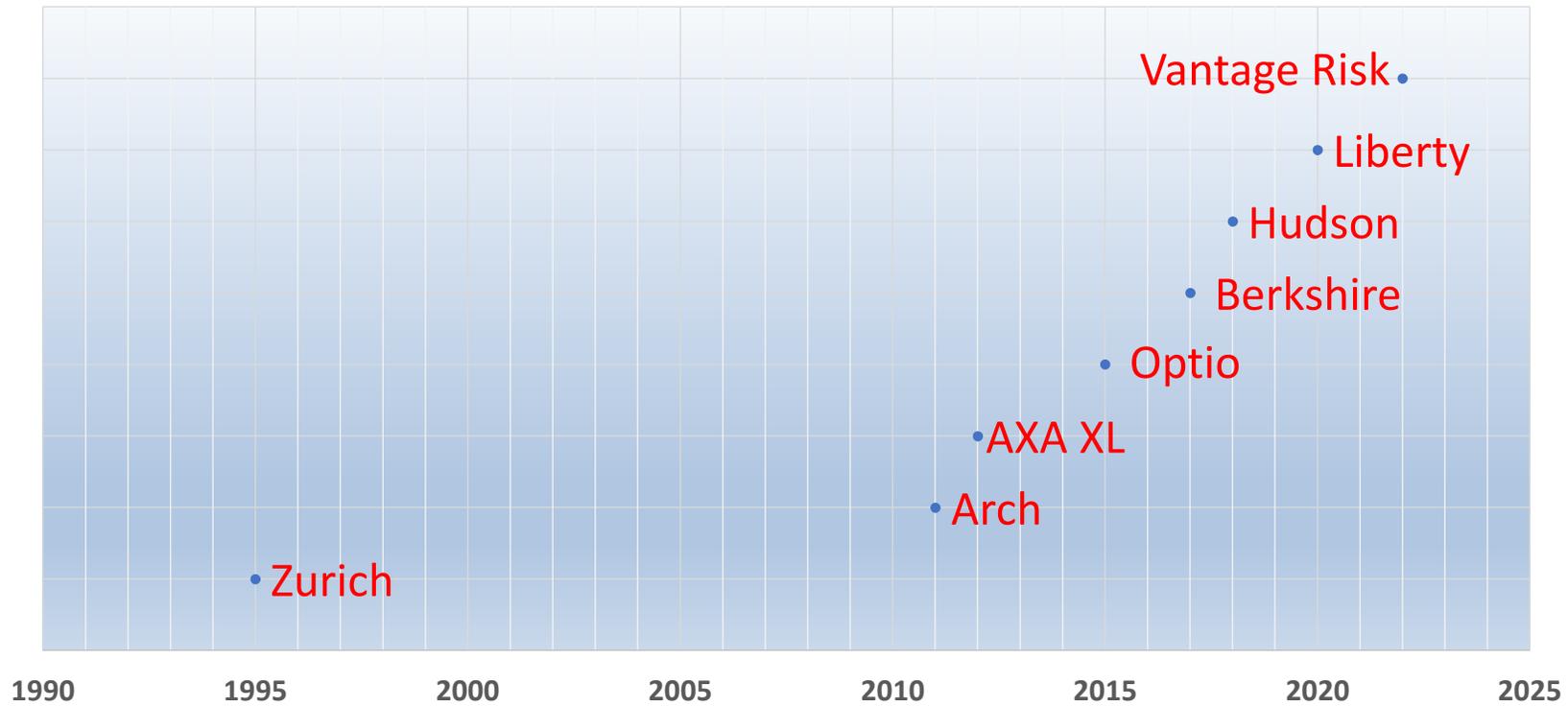


Subcontractor Default Insurance:

The Market

SDI Market Overview

Year SDI Carrier Entered SDI Marketplace



SDI Market Overview

- 7 carriers currently in the market
- One carrier generates over 50% of the market premium
- Only 2 or 3 provide significant capacity in the wood frame market
- Only 2 can provide more than \$50M per claim capacity
- Estimated market size is as follows:
 - \$500M - \$600M of total fixed premium
 - \$1.8B combined fixed and deductible premium
- Underwriting focuses on prequal, quality control, payment application process, loss history, subcontract distribution, bid leveling, operating territory, labor curve analysis, project delivery (hard bid v. negotiated) negotiated) and size of projects

SDI Market Overview

Carrier	Limits Available	Comments/Annualized Fixed Premium
AXA XL	\$75M Per Claim/\$225M Aggregate	Largest carrier in the market. Close to 100 programs and \$200M annual premium .
Optio	\$50M Per Claim/ \$150M Aggregate	Second largest carrier in the market. 80 programs and \$70M of annual premium
Hudson	\$50M Per Claim /\$150M Aggregate	Approximately 50 programs and \$45-50M of annual premium.
Liberty Mutual	\$100M Per Claim/\$300M Aggregate	Approximately 80 programs and \$60 - 70M of annual premium
Arch Insurance	\$50M Per Claim/\$150M Aggregate	Approximately 45 programs and \$50M of annual premium
Vantage	\$50M Per Claim/\$150M Aggregate	Approximately 35 programs and \$45M of annual premium
Berkshire	\$50M Per Claim/\$150M Aggregate	XS SDI Market Only going forward

SDI Loss History

- ✓ Losses exceeding 200% of Subcontractor Value = 13.3% of Total (Most losses in this category are for subcontract values of \$5M or less).
- ✓ Losses between 100% and 200% of Subcontractor Value = 12.8% of Total (Most losses in this category are for subcontract values of \$5M or less).
- ✓ Losses less than 100% of Subcontract Value = 73.9% of Total.
- ✓ Subcontract Values over \$10M rarely lead to loss exceeding 100% of Subcontract Value.
- ✓ Alliant MPL actuarial study on \$5B Project revealed .01% chance of default loss exceeding \$75M on subcontract values of \$400M or less.
- ✓ Surety losses are generally 30% of the Subcontractor Value or less. SDI's added coverage and claim process provide added coverage.

SDI Market Trends – 2025

- **Data Centers have pushed the capacity limitations in the market because of the size of the contracts.**
- Prime contract values on Data Centers are approaching \$10B in value with individual subcontract values for MEP trades in the \$500M range or more. SDI carriers will generally require approval of all subcontract awards exceeding \$60M in value.
- **SDI Carriers are forming strategic alliances to present options for Quota Share SDI programs**
- Per Claim Policy Limits of \$125M to \$200M are available with aggregate program limits to \$500M or more. Alliant recently put together an SDI program with limits of \$200M Per Claim and \$600M Aggregate Capacity on a project specific basis using 3 SDI markets.
- **Carriers recognize the default risk profile in the Data Center market is more favorable than traditional commercial construction**
- The financial strength of the owners involved and their interest in getting the projects open as soon as possible to generate highly profitable revenue from operations reduces the default risk. The owners are able to finance work from their own balance sheet including change orders to meet schedule demands as needed.
- **There has been minimal project litigation with Data Center contracts and no known SDI default losses** since the SDI carriers starting writing policies in this market over the past two years..



**Subcontractor Default Insurance:
Default Risk Mitigation**

Strategies of CM's and GC's that implement an SDI program

- The market has shifted from a strategy of accepting the lowest bid to win contracts and using SDI to mitigate risk, to a strategy focused on managing risk effectively for profit.
- The SDI underwriters tightened standards. The market responded with improved prequalification, quality control, and a focus on profit from the product.
- SDI has proven to be an effective risk management tool helping the Insured avoid cost overruns and maintain or grow their surety programs.
- Most clients agree that once an SDI program has been implemented, their subcontract risk control procedures improve dramatically.

Data Center SDI Key Underwriting Considerations

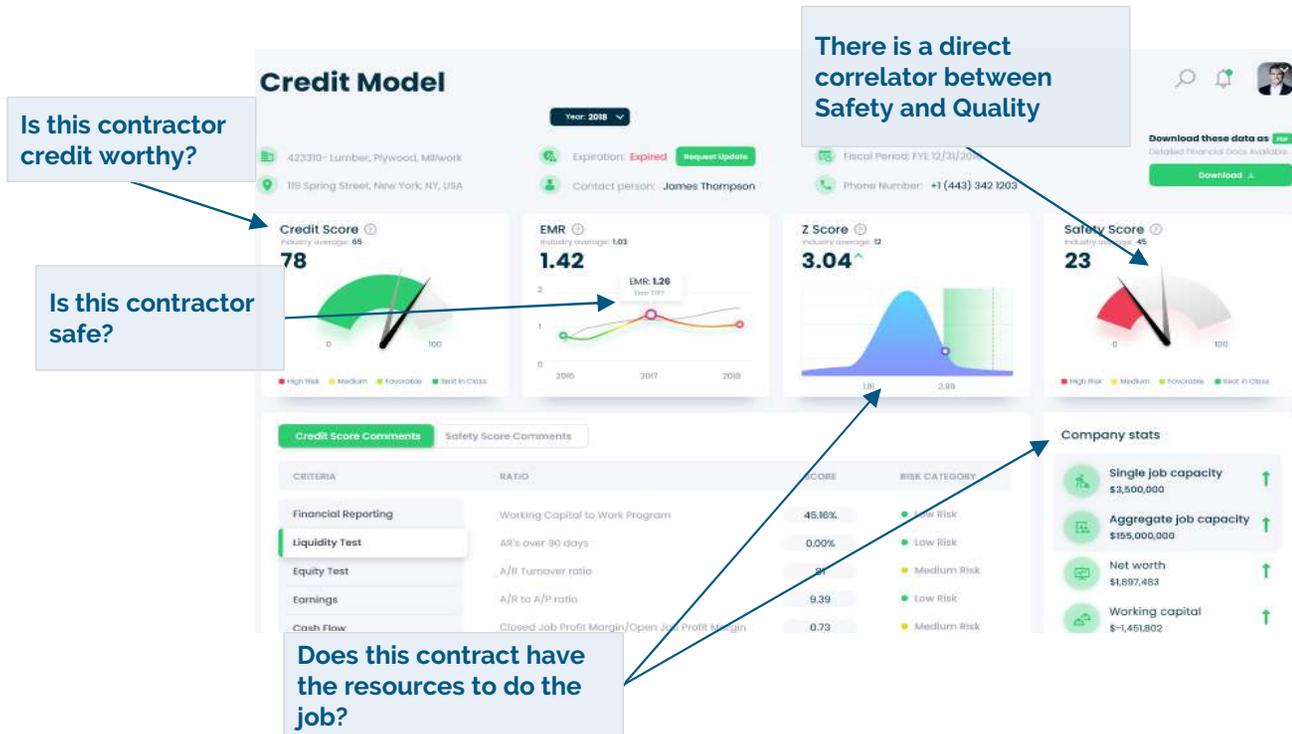
- Prior Experience – including team commitments
- Supply Chain Management – to align with tight schedule
- Labor Availability – Labor curve demands and local market capacity

Industry Forecast

- ✓ Subcontractor insolvencies often peak after a recession (economy recovers).
- ✓ Subcontractors take on expanded job sizes when their financial and operational resources may be eroded as a result of a recent recession.
- ✓ This trend appears to be displaying itself again in the post COVID recovery and has been driving subs to record backlog levels from 2023 through 2025.



Contractor Credit Model™



Score Ranges	
High Risk	0-24
Watch List	25-49
Better Risk	50-74
Best in Class	75-100

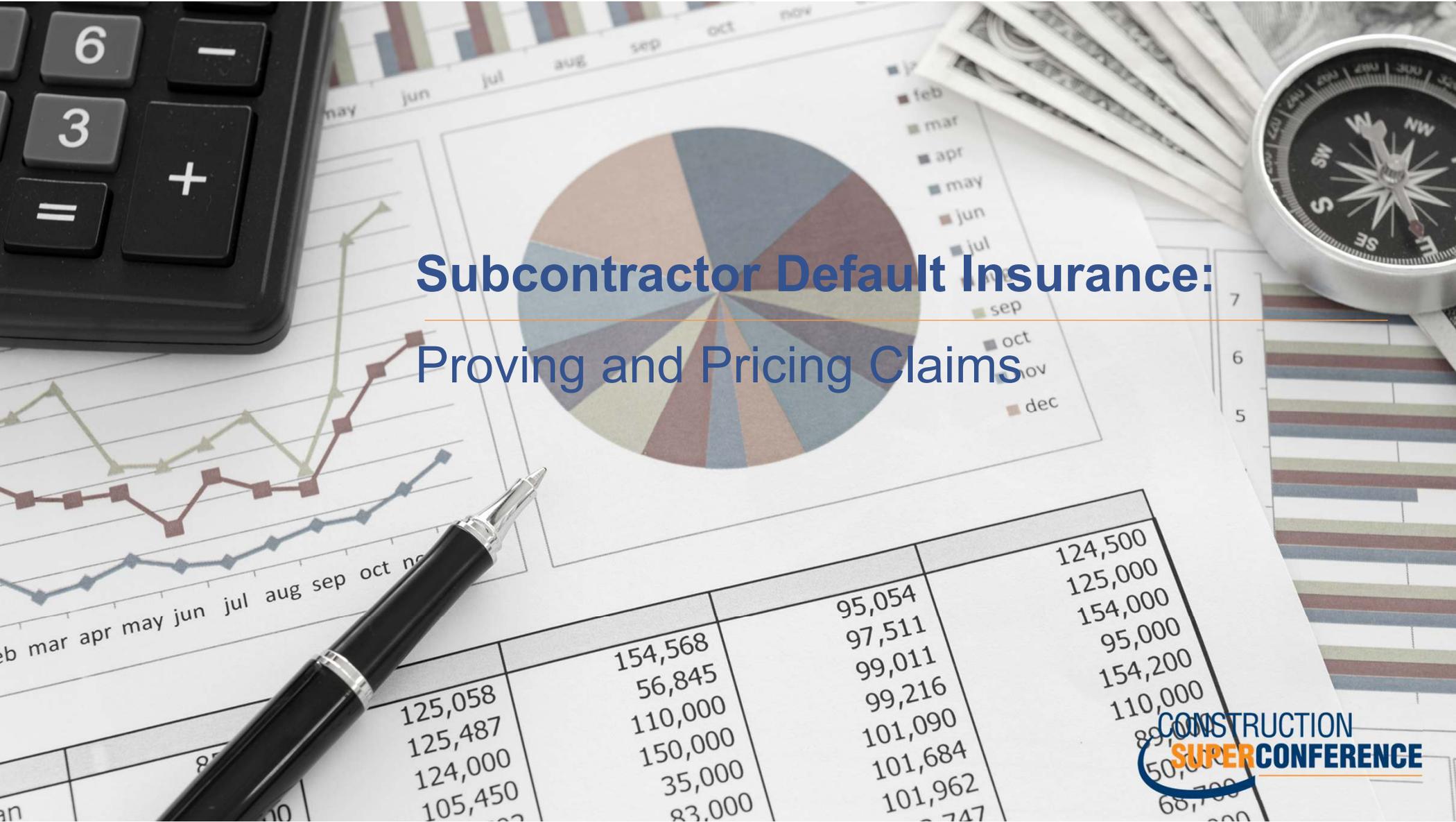
C2M Benchmark Study Trend Analysis

Year (Sample Size)	Average Liquidity Test Ratio	Average BLOC Available	Average NIBT/ Revenue	% of Subs Losing \$	Average C2M Score	Average Z Score
2024 (1,181)	10.05%	71.94%	6.83%	10.92%	43.98	8.56
2023 (1,403)	11.11%	75.17%	8.17%	11.97%	48.60	6.91
20202 (1,459)	9.83%	80.80%	6.63%	12.75%	50.44	9.68
2021 (989)	11.34%	74.65%	7.50%	7.17%	52.61	6.57
2020 (589)	12.43%	70.60%	6.82%	9.83%	50.34	5.88
2020 - 2024 (5,621)	10.84%	75.42%	7.18%	10.89%	49.00	8.02

SDI Best in Class Operating Strategies

1. Prequalify and set insolvency score and capacity limits
2. Catch all unprequalified subs at enrollment or sooner
3. No payment until prequalification is completed, with the option to demand surety bonds if prequal fails
4. Development of Risk Mitigation Plans and Triggers
5. Development of Claims Reporting Notices and Processes
6. Field Education and Roll Out of SDI Program

Subcontractor Default Insurance: Proving and Pricing Claims

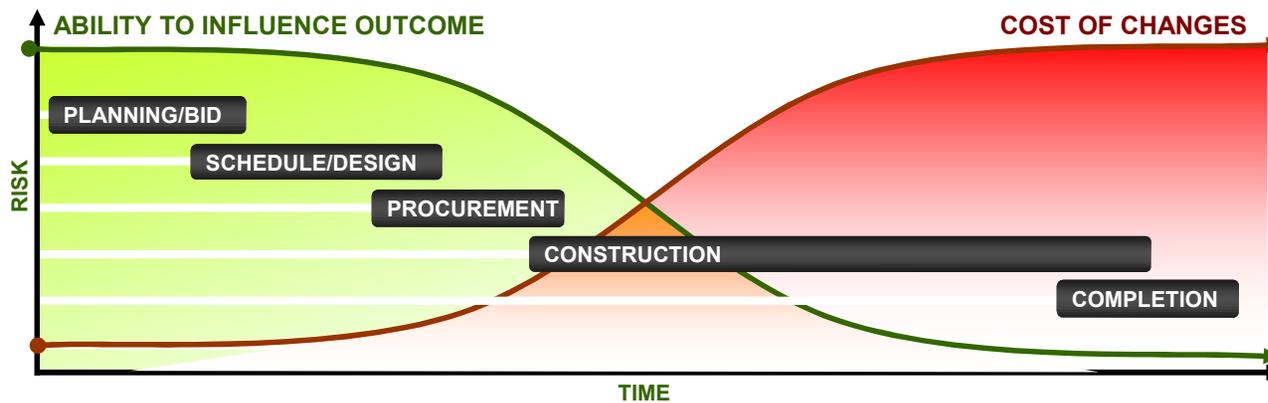


125,058	154,568	95,054	124,500
125,487	56,845	97,511	125,000
124,000	110,000	99,011	154,000
105,450	150,000	99,216	95,000
	35,000	101,090	154,200
	83,000	101,684	110,000
		101,962	89,000
		747	50,000
			68,700
			000



Claims

It Costs More to Complete a Sub Work Once the Project is Underway



*“The ability of the stakeholders to influence [the finished project] is **highest at the start and gets progressively lower as the project continues.**”*

A major contributor to this phenomenon is that the cost of changes and correcting errors generally increases as the project continues.”

A Guide to the Project Management Body of Knowledge (PMBOK® Guide)
by Project Management Institute

Claim Process – Key Terms - Notice

Written notice must be provided:

“as soon as practicable after you become aware that a Subcontractor/Supplier is in Default of Performance . . . or is Insolvent.”

“within [180 / 90] days from the time you send written notice to a Subcontractor of Default of Performance.”

“within [90 / 180] days from an issuance of a notice of Default of Performance to a Subcontractor . . . or from the time the Insured becomes aware of the Financial Distress of a Subcontractor, whichever is earlier.”

“within 180 days from the time you send written notice of Default of Performance to a Subcontractor/Supplier who (i) is in Default of Performance . . . or (ii) you become aware is Insolvent”

“within [30 / 60] days from the time the Insured becomes aware that the Subcontractor/Supplier is in Default of Performance or is Insolvent.”

Claim Process – Key Terms

“Loss” / “Direct Costs” means:

“costs of completing Subcontractor/Supplier’s **obligations** under the Covered Subcontract . . . , including amounts the defaulted Subcontractor/Supplier is required to pay under the Covered Subcontract . . . to third parties.”

“costs of completing the defaulted Subcontractor’s **obligations** under the Covered Subcontract (including amounts the defaulted Subcontractor is required to pay under the Covered Subcontract) . . . Direct Costs include: [enumerated items]”

“the cost of completing the defaulted Subcontractor’s **scope of work** under the Covered Subcontract . . . Direct Costs are strictly limited to: [enumerated items, such as labor, materials and equipment]”

“costs paid by the Insured, either subcontracted or self-performed, for labor, materials, and equipment necessary to complete the actual construction work within the scope of work of the Covered Subcontract . . . ”

“the following costs and expenses that you incur, after the Notice of Default issued and prior to the end of the Extension Period, only to the extent that the rise of the Default of Performance... [and are] strictly limited to: [enumerated items, such as labor, materials and equipment]”

Claim Process



- Establish a Loss Measurement Team
- Create Segregated Cost Coding and Instruct Project Team
- Establish Document Recording and Management Procedures
 - ✓ Strictly Adhere to All Record Keeping Procedures
 - ✓ Carefully Track and Monitor T&M Work
- Follow Prudent Decision-Making Processes
 - ✓ “If you were paying for the loss – would you take the action?”
 - ✓ Be Prepared to Justify and Explain Decisions
 - ✓ i.e.: premium time, acceleration, delay, etc.

Subcontractor Default

Proof of Loss Costs

Direct Costs

- Completion Costs – Executed subcontracts, change orders, invoices, proof of payment
- Material Costs – Supply/Purchase Agreement, invoices/pay apps, proof of payment
- Equipment – Purchase/Rental Agreement, invoices/pay apps, proof of payment
- Self Performed Labor – Daily Timesheets, Payroll reports
- Staff Labor – Daily Timesheets, Payroll reports, General conditions ledger
- Subcontracts – Executed subcontracts, change orders and pending claims, change order log, invoices/pay apps, proof of payment

Indirect Costs

- Delay Analysis
- Extended general conditions
- Liquidated Damages

Other Costs

- Legal and other professional costs
- Unpaid Vendors

Subcontractor Default Insurance:

Complex Loss, Case Discussion

Complex Loss Case

LLC v. Hudson Excess Insurance Company, Defendants, and The Pike Company, Inc., Additional Defendant on the Counterclaims. (2025)

Supreme Court, Monroe County, New York.

Lecesse Construction Services, LLC, Plaintiff, v. Hudson Excess Insurance Company, Defendants, and The Pike Company, Inc., Additional Defendant on the Counterclaims.

Index No. E2024003268

Decided: April 30, 2025



Complex Loss Case - Background

Plaintiff – Construction Manager (SDI insured)

Defendant – SDI carrier, also counterclaimed against Plaintiff

Stipulated Facts (key points/not all)

- Plaintiff - defaulted its wood framing subcontractor during the construction of a retirement community project and submitted 16 PoLs to the SDI Carrier.
- Defendant paid \$8,078,929.95 for the first 12 POLs.
- Plaintiff and Defendant entered a joint prosecution agreement to subrogate against the defaulted subcontractor.
- Arbitration award for \$2,502,785.88, directing sub to pay.
- Defendant claimed recovery of the full damages award and repayment of amounts paid to Plaintiff.
- Plaintiff rejected Defendants claims and demanded payment for additional PoLs
- Defendant submitted that it did not direct or participate in the subrogation arbitration. It notified Plaintiff that Plaintiff owed more than \$8M and no further PoL payments would be paid.

Complex Loss Case – Decisions

Arbitrator's Decision

- Default/termination was justified.
- Plaintiff failed to mitigate its damages, including work it should not have let the sub perform.
- Plaintiff and subcontractor contributed to the delayed and defective work.
- Financial damages were not sufficiently delineated as to causation.
- Plaintiff's claim documents lacked detail and support. No delineation between base work, changes, repairing defective work, repair for other trades, or acceleration and delay related costs.
- Panel disagreed with claim magnitude – 8x the remaining subcontract balance.

Court's Decision

- Plaintiff is required to repay the defendant \$5,576,144.07.

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Thank You!

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