The Complete Buyer's Guide to SURETY BONDS

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FOREWORD

A surety bond is a standard requirement in many industries and yet, it is often misunderstood.

As a surety bond company, one of our roles is to educate our clients about surety bonds. Client education is something we take seriously. We want you to understand this legal contract before you procure one.

It is our duty as a surety to give you as much information as we possibly can about surety bonds—from its definition to the claims process.

On top of that, trust is at the forefront of our business dealings. One of the best ways to ensure that is through transparency. We want you to know how our company performs and operates.

We hope that you will learn a lot from this surety bond guide. If you have further questions, please contact us. We're happy to answer any of your queries.

Thank you for considering **Surety Bond Authority** to be your partner in reaching your business goals.

To your success,

Greg Rynerson, CPCU
CEO Surety Bond Authority, Inc.

I

CHAPTER

Brief History of Suretyship & Surety Bonds

A surety bond is not a modern concept. The first-known surety bond agreement happened in 2750 B.C.

The three-party agreement happened among a farmer who was entering a King's army, a second farmer who promised to cultivate the soldier's farm and give half of the produce to the soldier, and the merchant from Accad who guaranteed the performance of the second farmer.

William L. Haskins was the first person to present the idea of suretyship in America through a pamphlet entitled "Considerations on the Project and Institution of a Guarantee Company on a New Plan with Some General Views on Credit Confidence and Currency." He also proposed the creation of the New York Guarantee Company. Unfortunately, the company never materialized.

"

SURETYSHIP WAS DEVELOPED IN *EUROPE*. IT WAS THE GERMAN IMMIGRANTS WHO BROUGHT THE CONCEPT TO ENGLAND IN THE 18TH CENTURY.

New York was the first state that enacted a law that allows the creation of corporate surety firms. In 1884, the first surety firm was incorporated: American Surety Company. The first contract surety bond was written in 1887.

The Heard Act was passed in 1894. The Heard Act authorizes the use of corporate surety bonds for federal construction contracts. In 1935, the Miller Act replaced the Heard Act.

The Towner Rating Bureau was created in 1909 to ensure that there would be a set of standard rates for surety bonds. Eventually, the Towner Rating Bureau merged with the Surety Association of America.

To this day, the laws that pertain to surety bonds continue to evolve to ensure the safety and security of all parties involved.

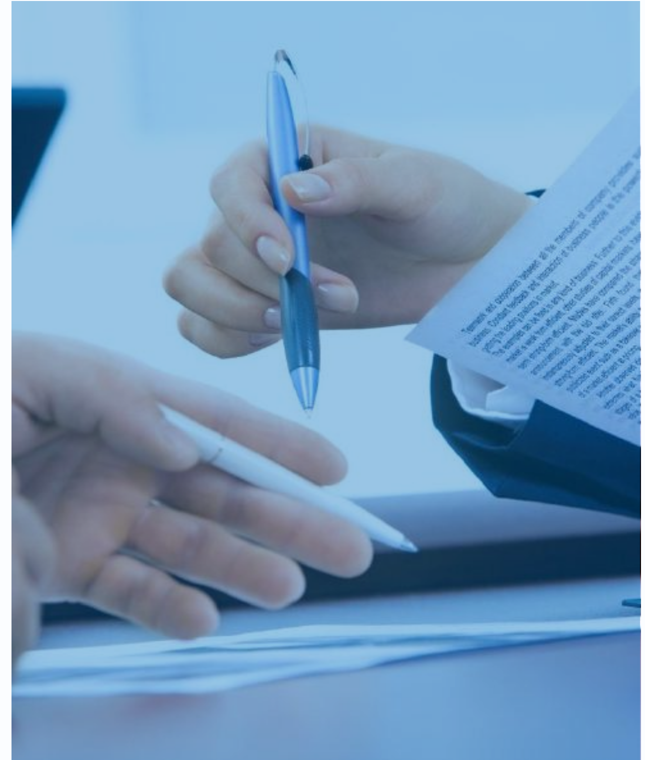
II

CHAPTER

Surety Bond Basics

II.1 What is Suretyship?

Suretyship is a concept of being liable for the default of another.



II.2 What is a Surety Bond?

A surety bond is a legally binding written form of suretyship.

A surety bond is a three-party indemnity contract. The contract states that one party (Surety) is guaranteeing the performance of a second party (Principal) to the third party (Obligee).

It is also stated in a surety bond that the party guaranteeing the performance of the second party will be liable in case the second party fails to fulfill the bonded obligations.

There must be an obligation between the Principal and the Obligee before there can be a bond.

II.3 Who are the parties involved in the Bond?

There are three (3) parties to a surety bond: Principal, Obligee, and Surety.

1. Principal

The Principal (You) is the person who is primarily responsible for fulfilling the obligations stated in the bond. The Principal is also the party who will apply for and pay for the bond.

When the Principal enters into an Indemnity Agreement with the Surety, the principal must indemnify the Surety for any loss the Surety will pay due to the Principal's default. Whether granted under common law or through an Indemnity Agreement, the right of the Surety to be subrogated is *absolute*.

Aside from fulfilling the obligations in the bond, the Principal is required to perform other duties, some of which are listed below:

THE PRINCIPAL

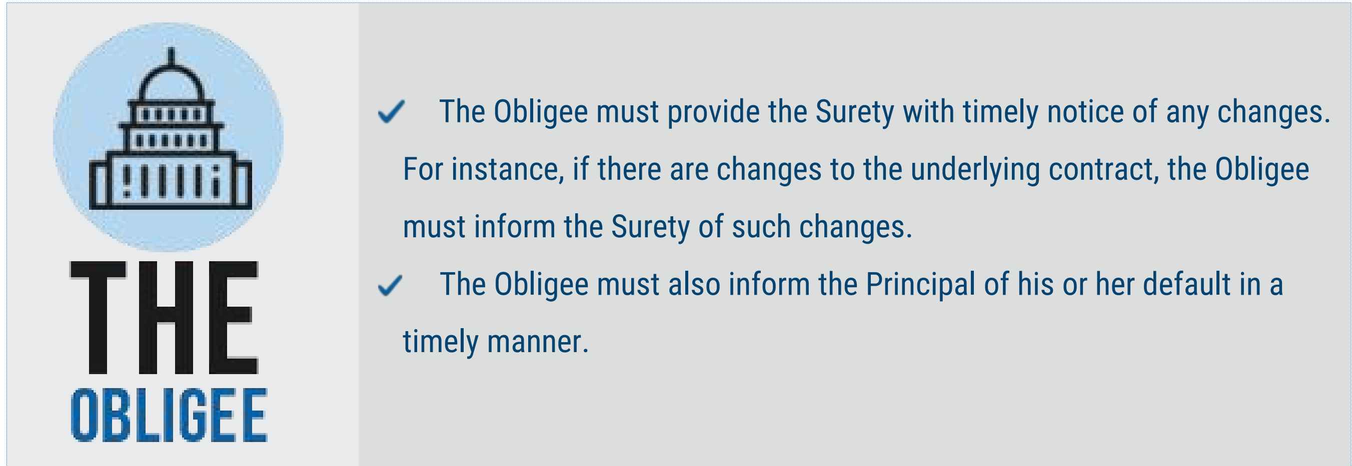
- ✓ Reimburse the Surety for all expenses the Surety paid for because the Principal failed to perform the bonded obligations.
- ✓ Place funds with the surety in an amount sufficient to discharge any claims.
- ✓ Allow the Surety to hold the collateral deposited by the Principal until the Surety has been released of all its obligations.

2. Obligee

The obligee is the beneficiary of the bond. The Obligee is the party requiring (asking for) the bond. If the Principal defaults on the bonded obligations, the Obligee will be paid for the loss it has sustained up to the maximum amount of the bond.

An Obligee can be a business entity, a government authority, or an individual.

Just like the Principal, the Obligee has to perform certain obligations as well; some of which are as follows:



If the Surety's rights have been prejudiced because the Obligee failed to inform the Surety on time of any changes, the Surety may be released from its obligations.

3. Surety

The Surety is the entity backing the bond for the principal and guaranteeing payment to the obligee if a claim is made.

Through the bond, the Surety is assuring the Obligee that the Principal will fulfill the bonded obligations.

The obligation is not that of the Principal alone. Upon default of the Principal, the Surety incurs the obligation. Hence the bonded obligation is known as "joint and several" liability.

A surety bond grants the Surety three (3) rights that have been granted under common laws, namely:

- **Rights of Exoneration** - the Surety has the right to require the Principal to perform the obligations the Principal is responsible for.
- **Rights of Reimbursement** - the Surety has the right to be reimbursed by the Principal.

- **Rights of Subrogation** - the Surety has the right to stand in the shoes of the Principal for its protection and to preserve funds necessary for the Surety's reimbursement.

The Surety's obligations are as follows:

THE SURETY

- ✓ Perform an independent investigation of a claim.
- ✓ Pay the Obligee if the claim has been found to be valid.
- ✓ The Surety has a duty to the Principal to hold any payment to the Obligee if defenses exist. If the Surety makes a "volunteer payment," this may release the Principal from the indemnity agreement.
- ✓ The Surety should never expose the Principal to a liability that is not part of the underlying agreement or the bond.

II.4 Why are Surety Bonds required?

"

SURETY BONDS ARE OFTEN *REQUIRED BY LAW*. THEY ARE NEEDED IN COMPLEX UNDERTAKINGS THAT INVOLVE RISK.

In these kinds of situations, a third party is needed to ensure the fulfillment of obligations of one party to another party in accordance with mutual terms.

Surety bonds are required to mitigate the losses that the Obligee might incur due to the default of the Principal.

Examples of losses that Obligees might protect themselves against—or protect the general public against—includes the following:

- A business that fails to pay taxes owed to the government
- Importers who fail to pay custom duties
- A health club that fails to deliver the services promised to a consumer
- A bank issuing a duplicate cashier's check to replace one that has been lost or stolen

II.5 How do Surety Bonds work?

A surety bond is a legal promise in the name of the surety company on behalf of the principal in favor of the obligee.

Obligees require it because they want to be certain that if a failure happens, they will be compensated for the losses they have incurred.

When the Principal is asked by the Obligee to procure a bond, the Principal will seek the help of a reputable Surety.

For example:

If you're a contractor (Principal) who is about to bid for your dream project, you will be asked by the project owner/developer (Obligee) to secure a Bid Bond.

The Bid Bond is an assurance to the project owner/developer that you (Principal) will honor the terms of the bid—that includes, continuing with the project if it's been awarded to you.

If you fulfill all the obligations of the bid bond, no claim will be made against it. Your obligations and that of the Surety's will be released once the term of the bond is finished.

However, if you default on any of your bonded obligations (i.e. if you decide not to pursue the project), the project owner/developer will file a claim against the bond since your action is against your bonded obligations.

The Surety will first conduct an independent investigation to see if the default is covered by the surety bond. If the claim is valid, the Surety may simply pay the Obligee. Alternatively, the Surety may find another way to indemnify (make the principal whole) such as completing the terms of the surety bond.

Under the terms of all surety bond agreements, the Principal must indemnify the Surety for all payments that have been made to the Obligee.

II.6 What is an Indemnity Agreement?

An Indemnity Agreement is an agreement between the Principal and the Surety. As the Indemnitor, the Principal is required to reimburse the Surety of all expenses the Surety paid on behalf of the Principal.

Sureties follow certain rules when it comes to indemnity agreement. **Some of which are as follows:**

- An indemnity agreement must be signed by both the Principal and the Surety before a bond is issued to avoid the possibility of "past consideration."
- The involved parties must follow the instructions of the Surety when preparing and signing the indemnity agreement.
- Secure authentication of signatures.

There are three (3) standard indemnity agreement forms that Sureties use. These are the following:

- ### Individual Application

  This type of form is used for each bond. Individual applications are also used if the bond needs are minimal—usually, once or twice per year.

- ### General Indemnity Agreement

  This is used to cover multiple bonds. This type of indemnity agreement is also used if there are multiple indemnitors, multiple bonds that have aggregate liabilities in significant amounts, bonds that guarantee different obligations with varying degrees of risk, or if the Surety required collateral.

- **Subordination Agreement**

  The form used to prevent payment of debt to the lender

II.7 How to Look for a Reputable Surety

A simple online search will provide you with dozens of stories about surety bond frauds, so it's very important to look for a legitimate and reputable Surety. When looking for one, checking online reviews is not enough. As a Principal, it is your duty to dig deeper.

A surety bond provider can either be...

- A corporate surety
- An individual surety
- An agent

One way to verify the legitimacy of a surety bond provider is to contact your state insurance commissioner. Ask if the Surety can issue bonds in your state. Legitimate sureties must be licensed to become recognized in various states or jurisdictions.

Once you've verified the legitimacy of the Surety, you must look for these qualities:

Knowledgeable

The Surety must be knowledgeable about the intricacies of suretyship to ensure that the clients' needs will be fulfilled. The Surety must continuously acquire knowledge and adapt to changes as well.

A good Surety will have a thorough understanding of the following:

- The surety product
- The underwriting process and underwriting standards
- Terminologies
- Bond form terms and conditions
- The client's business or profession
- Credit principles
- Accounting methodologies and finance
- Strategic business planning and management

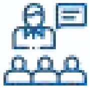
Experienced

Theoretical knowledge will only take a person so far. That knowledge must be used daily to become an expert. There are a lot of situations that a Surety will encounter that are not written in books. It is only through experience that a Surety's acumen will be sharpened.

Critical Thinker

The Surety is faced with multiple decisions that will have a direct effect on another party's business and life. The Surety must be able to effectively analyze the situation in order to come up with the best solution. This is especially true when assessing risks.

A potential client that poses low risk doesn't mean that he or she will not default on the bonded obligations. A good underwriter must tie together facts that are presented to him, then form a logical and objective conclusion based on those.



Educator

Since surety bonds are complicated products, the Surety must ensure that the client understands the bond that he or she is purchasing. The client should know what the bond is for, how it works, what the conditions are, what his or her obligations are, and what will happen if he fails to do those obligations.

Has Integrity

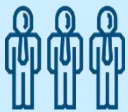
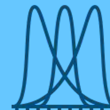
Integrity is defined as being honest and having strong moral principles. This should be the foundation of the Surety's relationship with the Principal as well as the Obligee. Transparency should also be part of that partnership.

III CHAPTER

Difference between Surety Bond & Insurance

The similarities between surety bonds and insurance policies have led most people to believe that they are the same. While it's true that they are both risk-transfer tools and that the primary issuers of surety bonds are insurance companies, surety bonds are not synonymous with insurance policies.

SURETY BONDS vs INSURANCE

SURETY BONDS	INSURANCE
 Involves 3 parties (Principal, Obligee, & Surety)	Involves 2 parties (Insurance Company & Insured)
Sureties don't expect claims	Insurance companies expect claims
Surety selects qualified Principals	 Relies on the probability theory of large numbers
Losses are not calculated in the premium	Losses are calculated in the premium
Low premium	High premium
The Principal is expected to indemnify the Surety in the event of default	The insured is not expected to indemnify

IV

CHAPTER

Classes of Surety Bonds

There are two classes of surety bonds that have been differentiated by the Tower Rating Bureau**: Contract Bonds and Commercial Bonds**. Each class has various subclasses.

IV.1 Contract Bonds

Contract bonds are also known as Construction Bonds. These bonds are used to manage the risks of construction projects. About two-thirds of the surety bonds generated by the industry are contract bonds.

This three-party surety bond involves:

- The Project Owner (Obligee)
- The Contractor (Principal)
- The Surety

In contract bonds, the Surety will not only be liable for paying the Obligee upon the Principal's default. The Surety may also be bound to perform the underlying contract that the Principal failed to do.

Types of Contract Bonds

Contract suretyship--in the form of bid, performance, and payment bonds--provides specific benefits to project owners, contractors, and other parties. A contract bond is a surety bond given to secure the performance on a construction contract.

Frequently, two bonds are required: one to cover performance (performance bond) and another to cover payment of certain labor and material bills (payment bond). Most contract bonds are written on public work, which includes federal, state, and local projects.

IV.1.1 Bid Bonds

A bid bond is required of contractors when submitting a bid. This type of bond guarantees that if the project is awarded to the bonded contractor, the said contractor will enter into the contract. If the contractor refuses, the Surety must pay the Obligee the penal sum of the bid bond.

A bid bond doubles as a pre-qualification method since the Surety will determine if the contractor can fulfill the required obligations.

IV.1.2 Performance Bonds

A performance bond is an assurance that the Principal will perform all the obligations of the contract.

IV.1.3 Payment Bond

This is a guarantee that the suppliers of construction materials, laborers, subcontractors, and rental of construction equipment will be paid on time and in full by the Principal.

IV.1.4 Maintenance Bonds

This is a bond that protects the project owner against the quality of the completed project for a specific time. If there are any defects on the project within the time frame specified on the bond, the project owner can file for a claim.

IV.1.5 Supply Bond

A type of bond that ensures that the supplier of construction materials will supply the materials specified in the contract.

IV.1.6 Site Improvement Bond

Required of renovation contractors who are asked to update an existing structure or property.

IV. 2 Commercial Bonds

Commercial bonds were originally referred to as "miscellaneous bonds" or bonds that are not part of contract bonds.

Types of Commercial Bonds

IV.2.1 License and Permit Bonds

These types of bonds comprise a large and diverse number of bonds that are required by the government to issue a license. Usually, the primary obligation of license and permit bonds is to comply with an applicable ordinance or statute.

Even though most have nominal penalties, some license and permit bonds are very risky. One example is a Tax Bond which requires the Principal to pay taxes to a governmental entity. Bonds such as these require careful assessment and more information from the Principal.

Examples of License and Permit Bonds:

- Auctioneer Bond
- Auto Dealer Bond
- Cannabis Bond
- Collection Agency Bond
- DMEPOS Bond
- Energy Broker Bond
- Federal Maritime Commission (BMC-48) Bond
- Freight Broker Bond
- Insurance Broker Bond
- Medicaid Bond
- Money Transmitter Bond
- Private School Bond
- Surplus Lines Broker Bond
- Travel Agency Bond
- Used Car Dealer Bond
- Wine Surety Bond

IV.2.2 Court Bonds

It's an umbrella term for different types of bonds that are required in court proceedings. **There are two types of court bonds: Judicial Bonds and Fiduciary Bonds.**

Judicial Bonds

Ensures financial compensation required in a court case.

Appeal Bond

It's required by the court to cover the appellant's (party who filed for an appeal) court costs during the length of the appeal. If an appeal bond is not posted, the court ruling will be enforced in a manner or days. Since this type of bond is very risky, the Surety requires the Principal to put up collateral.

Bail Bond

Guarantees the appearance of the defendant when called by the court after he/she is temporarily released from jail.

Child Custody Bond

Ensures that the child will be returned to his/her proper residence after traveling internationally with one parent.

Injunction Bond

Ensures that the plaintiff will compensate the defendant for damages resulting from the unjust filing of an injunction.

Plaintiff's Attachment Bond

A guarantee that the plaintiff will pay damages to the defendant if the court rules in favor of the defendant.

Replevin Bond

It is an assurance that the defendant will receive the asset in good condition if he/she wins the case.

Supersedeas Bond

There's a gross misconception that an appeal bond is also a supersedeas bond. A supersedeas bond performs a different function. This type of bond is used to obtain a stay of execution (writ of supersedes).

If there's a supersedeas bond in place along with an appeal bond, the assets will not be given to the appellee (respondent to the appeal) until the appeal is over.

Custodian Bond

Ensures that the person will be properly taken care of by the custodian assigned to him/her by the court.

Guardianship Bond

Ensures that the guardian will properly care for the person which includes managing the person's property and finances.

Executor Bond

Guarantees that the execution of the will would be in accordance with the term of the deceased.

Receivership Bond

Ensures the faithful performance of the receiver's fiduciary duties.

Trustee Bond

Ensures that legally appointed trustees will perform their duties in compliance with court instructions.

VA Fiduciary Bond

It allows a disabled veteran to have control of his/her finances, estates, and benefits without paying large fees charged by fiduciaries.

IV.2.3 Public Official Bonds

It's one of the oldest forms of bonds in the United States. It is required of public officials to guarantee that they will faithfully discharge their duties.

Since public officials are responsible for the acts of their deputies and subordinates, this bond generally extends to them. A public official's deputy or subordinate can also procure their bonds.

This bond will also provide protection from any fraud or misconduct that the public official might make. For example, if the public entity suffers a financial loss because the public official failed to execute his/her duties properly, both the Surety and the public official will be held accountable. A claim can be made against the bond if that happens whether dishonesty was involved or not.

IV.2.4 Federal Bonds

These are bonds required by statute or regulation. Some examples of federal bonds are as follows:

Excise Tax Bonds

These are bonds issued on behalf of manufacturers, distillers, processors, brewers, winemakers, and dealers or carriers of products who are seeking federal licenses.

U.S. Government Customs Bond

These bonds are for importers of merchandise. It guarantees the following:

- That the importer will make pay the estimated duty amount on time.
- That the importer will pay any additional duties that U.S. Customs may require at a later date.
- That the importer will pay any liquidated damages due to a violation of import regulations.

Immigration Bond

A surety bond required of persons who are sponsoring immigrants to legally enter the United States. This bond will ensure that the immigrant will depart the country on time and that he or she will not be a burden to the country.

IV.2.5 Supply Contract Bond

This type of surety bond covers the delivery of materials or products. It does not include the actual installation of the material or product into a project.

The contract can include materials and supplies that are “off the shelf” and those that are special order.

IV.2.6 Service Contract Bond

Service contract bonds are for Principals who are performing a service. Examples are janitorial services and waste hauling.

IV.2.7 Miscellaneous Bonds

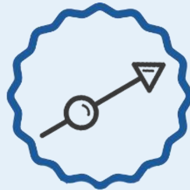
Some bonds cannot be filed under any of the given categories above; hence they are collectively referred to as “miscellaneous bonds.” Some miscellaneous bonds are required by a statute, ordinance, or regulation. Others are contracts between two private parties. The latter is most commonly used in business transactions. One example of a private transaction that requires this type of bond is a lease guarantee.

V

CHAPTER

Surety Bond Application Process

The process per surety bond company varies. In our case, we've made the process simpler and we continue to do so each year. We also use various technological tools to ensure that the information given to us will always be secured.



Simplicity, seamlessness, privacy, and security are our top concerns when it comes to surety bond application.

V.1 How to apply for a Surety Bond

STEP 1: Know your bond

Before you apply, make sure that you are 100% certain about the surety bond you are applying for. Some look the same, but in reality, they perform different functions.

STEP 2: APPLY FOR YOUR BOND

- Simply go to our **website** then choose the state where you are in or where your bond is needed.
- Pick your bond from the list of bonds for that particular state. If the bond that you need is not part of our list, please contact us. We can still issue your bond even if it's not listed on our site.
- Click "Apply" or go to the "**Get a Quote**" page from the menu bar.
- Complete the form. You can also upload any required file/s.
- Click "**Contact Us**".

That's it! We will inform you about the necessary information that you need to submit to move forward once we have received your application.
We can process your application in as little as 24 hours as long as we have all the necessary information needed to issue the bond.

V.2 What information is needed?

The information needed depends on the type of bond you are applying for. The information will be provided by the Principal to the Surety.
Some bonds require basic information. We require more information for high-risk bonds. Some of the basic information for bonds are as follows:

THE
PRINCIPAL

About the Principal

- ✓ Exact legal name
- ✓ Current mailing address
- ✓ Email address
- ✓ Phone number

About the Obligee

- ✓ Exact legal name (individual, government agency, or business entity)
- ✓ Mailing address
- ✓ Email address
- ✓ Phone number

About the Bond

- ✓ Exact bond form (if provided by the Obligee)
- ✓ Bond penalty/amount
- ✓ Date of effectivity
- ✓ The obligation's description

The underwriter will focus on the penalty of the bond and the description of the obligation. The underwriter will assess if the bond is required by a private entity or by the government.

The underwriter will usually draft bonds required in connection with private agreements. Bonds required by law, statute, or government regulation are often provided by the Obligee.

Bonds with larger penalties are considered as high-risk bonds. For this type of bond, the underwriter will require more information from the Principal.

There are cases, however, wherein additional information is required even if the bond penalty is small.

Here are some of the additional information that may be required of the Principal:

- ✓ An actual copy of the underlying agreement or statute
- ✓ A signed application or indemnity agreement
- ✓ Credit reports
- ✓ Financial statements

VI

CHAPTER

Surety Bond Collateral

VI.1 Is collateral required in every surety bond?

Most surety bonds don't require collateral. It is only required if the underwriter believes that it is necessary because the degree of risk when extending credit to the Principal is high enough. Collateral is used to secure the Surety's credit risk in case the Principal defaults on his or her obligations.

Some examples of situations wherein collateral will be required are the following:

- The Principal doesn't have the financial strength
- The underlying obligation is untenable
- The obligation's length is too long
- The bond's conditions are very difficult
- The bond cannot be cancelled

VI.2 Types of collateral

Cash

It's the most common collateral used for surety bonds. The Principal can wire-transfer the cash or write a cashier's check to the Surety's name.

Cash is the simplest and fastest collateral that a Principal can put up. The downside to this is that a certain amount will be tied to the Surety until the obligations of the Surety is exonerated. The Principal will not be able to use that amount for other purposes.

Irrevocable Letter of Credit

An ILOC is a letter written by a bank guaranteeing the obligation of the bond. It is considered by most sureties as the safest form of collateral. ILOCs are private contracts between the bank and the surety. Aside from that ILOCs are not subject to Section 547 of the Bankruptcy Code.

It is as secure as cash. But unlike cash, ILOCs are harder to obtain. The Principal must have a good relationship with the financial institution in order to obtain an ILOC. Financial institutions also want a 100% certainty before they issue an ILOC.

Certificate of Deposit

The CD's aggregate limit held for an account should not go beyond the coverage provided by the Federal Deposit Insurance Corporation (FDIC). This is to ensure that the failure of the bank will not reduce the collateral below the required limit.

Fixed Assets

Fixed assets, such as real estate, are considered riskier than most. This is why a Surety uses extra precaution when accepting this type of collateral. The Surety will check the following before accepting a fixed asset as collateral:

- ✓ Perfecting of lien rights through a UCC filing
- ✓ The property is protected by adequate insurance
- ✓ Potential loss or reduction in value
- ✓ Senior lien holder actions

Marketable Securities

Just like fixed assets, Sureties consider these as risky because of market fluctuations. If the Principal uses these as collateral, Sureties usually require additional collateral.

VI.3 Releasing of Collateral

A typical general indemnity agreement condition requires the surety be provided with satisfactory evidence that it has been released and discharged from all liability under its bonds and that the surety shall have sole discretion in the decision. This can become particularly difficult when the obligations have a continuing exposure by contract or due to various state or federal statute of limitation rules and regulations.

For example:

Construction contracts often include a maintenance guarantee. The surety may require that collateral be held until the maintenance period is complete. Also, federal statutes carry a six-year statute of limitations in the event of fraudulent transactions.

VII

CHAPTER

Underwriting Process

VII.1 What is underwriting?

It is the process of evaluating risks. Underwriters carefully research and evaluate how much risk is involved.

Some underwriters earn the CPCU (Chartered Property Casual Underwriter) certification. It is the most credible type of designation within the insurance industry. It means that the person has exemplary skills when it comes to risk management.

As mentioned earlier, surety bond is a risk-transfer mechanism. The Obligee is transferring the risk to the Surety. The Surety will stand as the Principal's debt guarantor.

Because of this, the underwriter will check the degree of risk (high to low) and decide which ones to accept and which ones to decline. The underwriter determines the level of risk involved through the following:

- Evaluation of the obligation
- Checking the underlying regulation or agreement and the bond form
- A thorough analysis of the principal's ability to perform

In order to determine the last one, underwriters will look into what is known as the Three C's of underwriting.

VII.2 What are the three C's of underwriting?

The three C's of underwriting are:

- ✓ *Character*
- ✓ *Capacity*
- ✓ *Capital*

CHARACTER

Among the three, character is by far the hardest one to assess because it cannot be quantified. There is no rating system that indicates if the person is honest or has the integrity to do what he or she is obligated to do.

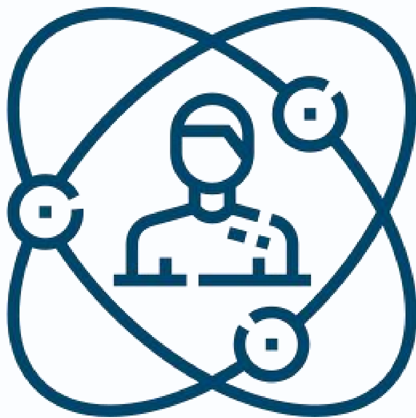
Character is also the most important out of all three. It is the biggest indicator for a person or business's success or failure.

It takes a long time to truly understand someone's character. Unfortunately, sureties don't have the luxury to check someone's character for a long period of time because surety bonds are very time-sensitive. It needs to be issued within a brief time period.

Because character is hard to determine, some underwriters put character as an afterthought—relying heavily on the Principal's financial strength instead. Unfortunately, this can lead to losses.

CAPACITY

Capacity means that the Principal is equal to the task that he or she has undertaken. There are several ways in which capacity is measured. Here are some of them:

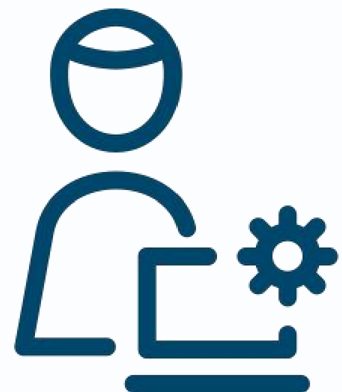


The Principal's Experience

The underwriter will check if the Principal has enough experience in the endeavor that he or she is about to undertake. The degree of risk will be based on the Principal's level of experience.
For example, an underwriter will consider an auto dealer with no prior experience a high-risk surety bond buyer than an auto dealer with 8 years of experience.

The Principal's Expertise

One of the ways in which an underwriter will check a Principal's level of expertise is if he or she was able to produce profitable results. For example, a spa business that has been cash positive within a year is a good indicator of the Principal's expertise.



The Industry's Stability

There is no certainty in every industry. But there are valuable, time-tested industries. Such industries have a lower degree of risks than industries that are still in the infancy stage.

Facilities

Businesses that have excellent facilities and equipment are less risky than businesses that do not update their facilities. The underwriter will also check if the business has a good plan to continuously update their facilities in the future.

Managing Personnel

A strong business result is an indicator of effective management. Bad managers breed frustrated employees, and that snowballs into a bad workplace habit. A business that's constantly losing employees is a red flag.

The Principal's Credit History

As mentioned earlier, the Principal's premium is based on his or her creditworthiness. The higher the credit score, the lower the bond premium will be.

A good credit score shows that the Principal is reliable when it comes to fulfilling his obligations on time.

CAPITAL

Capital means that the Principal has the financial strength to see the business through. Financial strength depends on the level of credit risk. The higher the risk, the more financial strength will be required of the Principal.

For example, if the bond penalty is higher, that means the degree of risk is higher as well. The Surety will require higher proof of capital.

An underwriter can assess a company's capital by checking the Principal's financial history. The underwriter may ask for the Fiscal Year-End (FYE) Financial Statements from the previous year or within the last five years.

These financial statements will reflect a twelve-month accounting period. When assessing these financial statements, the underwriter will usually focus on the company's balance sheet, income statements, and statement of cash flows.

There are two types of capital assessments: vertical and horizontal. For vertical assessment, the account entries per FYE financial statement will be checked. This type of analysis is often used when extending limited surety credit over a short period of time.

Horizontal assessment, on the other hand, requires a comparison of the financial ratios to understand the Principal's financial performance trend.

VIII

CHAPTER

Surety Bond Rates

VIII.1 How much does it cost to get a Surety Bond?

It depends on several factors such as the type of bond, penal sum of the bond, and the Principal's character, capital, and capacity—most especially, the Principal's credit score.

The penal sum of the bond is different from the bond premium. The penal sum of the bond is the size of the bond penalty required by the Obligee. It is a reflection of the perceived exposure to aggregate liability.

For example:

For money transmitters in Florida, the penal sum of the bond is $300,000. The Principal will not pay this amount to the Surety. The Principal only needs to pay a small percentage of it. This is known as the bond premium.

For *low-risk bonds*, the starting premium can be as low as 1% of the penal sum of the bond or the bond amount. This is for individuals with excellent credit scores (750 to 850).

Based on our previous example, if you are a money transmitter in Florida who is applying for a bond and your credit score is 800, you might pay the Surety $3,000 as the bond premium.

For high-risk bonds, the minimum percentage for bond premium will be higher. One example is contract bonds. For bid bonds, a Principal with an excellent credit score might be expected to pay a minimum of 5% of the total bid amount.

VIII.2 Can you get a Surety Bond with bad credit?

Yes, it is possible to obtain a bond despite having a bad credit score. A FICO score of 650 and below is considered non-standard credit.

Principals who have this type of FICO score will be considered high risk regardless of the type of surety bond they are applying for. As mentioned earlier, the higher the risk, the higher the bond premium will be.

Some Sureties might also require collateral for Principals with bad credit scores, especially if the penal sum of the bond is high or if the underlying obligations of the bond pose too much risk.

IX

CHAPTER

Surety Bond Execution

Since a surety bond is a legally binding document, the Principal must check the following once the bond has been executed or issued.

Bond Number: Check the bond number on the top of the form on all final bonds. It is placed on either the left or right side of the bond.

Principal Name: Check your (Principal) name. The name must match the underlying agreement, application, or proposal.

Surety Name: Check the legal name of the Surety. Surety bond companies may have more than one writing entity.

State of Incorporation: Some bond forms require the state of incorporation for the surety. State of incorporation may also be required for the principal.

Obligee Name: Check if the legal name of the party requiring the bond is correct.

Bond Liability Amount: This is written out and numerically as well.

Signed Sealed Date: On some bonds, this will be used as the effective date of the bond unless a specific contract date is required per the underlying agreement or regulation.

Bond Requirement: This is where the act or performance being guaranteed will be described.

Principal Signature Name: Check if you've signed the bond.

Surety Name: The legal name of the surety should be typed above the signature line.

Attorney-in-Fact Name: Check your name that appears on the Power of Attorney. The title "Attorney-in-Fact" should be present under the signature line.

Corporate Acknowledgment and Surety Notarization: Surety bonds issued in California must have both Corporate Acknowledgment and Surety Notarization whether specified on the form or not.

Seal the Bond: Check the Surety's corporate seal to the bond.

Power of Attorney: The person signing on behalf of the Surety must have a valid Power of Attorney for the bond to be legally binding. The Power of Attorney should be attached to the bond and dated, and the date should match the signed sealed date on the bond form. Check the Power of Attorney to make sure the notary is still active.

X

CHAPTER

Modifying a Surety Bond

If you need to change a piece of information on a surety bond that is still in effect, you need to request a bond rider from your Surety. A bond rider is the only way to modify or update a surety bond.

What type of information can be changed using a bond rider?

- Name of the Principal. This requires underwriting approval and a new indemnity agreement. The indemnity agreement must be executed before executing the rider.
- Address of the Principal
- Increase or decrease the bond amount. Underwriting is required when increasing the bond amount. To decrease the amount, the Surety will require an "accepted" copy from the Obligee. It must state that the Obligee has received and agreed to decrease the bond amount.
- Change the effective date of the bond
- Change the bond number
- Change specific language in the bond form

How to request for a bond rider

- Contact your Surety. Your Surety will give you a bond rider form. Some Obligees require that the bond rider be issued using their own form.

- Complete the bond rider form and send it back to your Surety.

- Pay the bond rider fee.

XI

CHAPTER

Renewing or Extending a Surety Bond

Can a bond be renewed?

Yes. Most bonds can be renewed or extended using a continuation certificate. In cases like these, the renewed bond will have the same bond number as the original.

In other cases (i.e. when an Obligee requires a renewal), a new bond with a new bond number must be issued.

Some bonds don't need to be renewed every year. These bonds are continuous in nature. If it is, it will be stated on the bond form as required by a statute, ordinance, or regulation.

What is a Continuation Certificate?

A continuation certificate will extend the bond's term for a year. This should be filed with the Obligee every year the bond is required to be in effect.

Not all bonds can be extended. A bond extension will appear on the "Provided, However" clause on the bond form. The clause will state if the bond can be extended using a continuation certificate.

What is a Verification Certificate?

This is used for continuous bonds. The Obligee will require the Principal to submit a verification certificate to ensure that the bond is still in effect.

XII

CHAPTER

Cancelling a Surety Bond

How to cancel a surety bond

A bond can be cancelled through any of these ways:

- The Obligee will send a release letter. The letter will state that the bond can be cancelled.
- The Principal & the Surety will send a Notice of Cancellation to the Obligee.
- The bond has reached its expiration date.
- The Obligee returns the original bond to the Surety.

The provisions for cancelling a bond will depend on the type of bond. Below are the requirements that the Surety needs in order to cancel a specific bond:

- **License & Permit Bonds:** This can be cancelled through a letter from the Principal or Obligee stating that the Surety can cancel the bond.
- **Financial Guarantee Bonds:** This can be cancelled through a letter from the Obligee. If there's none, the Surety can send a Notice of Cancellation. The Obligee must sign the notice before the Surety cancels the bond.
- **Court Bonds:** Generally, the surety will need something in writing from the court that the bond has been exonerated. The original bond should be returned to the Surety.
- **Bid Bonds:** The Surety will check the bid status first to cancel the bond.

- **Performance/Payment Bonds:** A bond can be canceled once the Obligee has requested a Consent of Surety to finalize the payment. If no request has been made, the Surety can require a release letter from the Obligee.

- **Supply Bonds:** Most of these are Term Bonds, which means, they have expiration dates, therefore, no cancellation request is required.

XIII

CHAPTER

Surety Bond Claims

XIII.1 What is a claim?

A claim is a request that will be submitted by the Obligee—or individual beneficiaries—to the Surety in order to be compensated for a loss due to the default of the Principal.

XIII.2 The Claims Process

1. The claim will be received by the Surety

Under the Unfair Claims Settlement Practices Act, the surety must do the following once a claim is received:

- Acknowledge the claim
- Provide a proof of claim form
- Inform the claimant of the documents and information needed for the claim
- Start the investigation immediately

A notice of claim can be received through the following ways:

- **Email -** The surety agent who received the claim will immediately make a copy of the claim before forwarding it to the claims department of the surety bond company.

- **Telephone -** The surety agent will carefully take notes of the entire conversation, make a copy of the notes, and then forward it to the claims department. Once the surety's claims department has received the claim, it will immediately gather all the necessary paperwork that is relevant to the claim.

2. The Surety Will Investigate the Claim

The surety has the right to perform a just and fair independent investigation in order to verify a claim.

A surety cannot be biased towards one party because they will be subjected to a claim of bad faith; which means, they will lose their reimbursement rights.

Several steps happen during the investigation process. These are as follows:

- The surety will review the conditions of the bond, its coverage, and all the regulations, rules, and laws that pertain to it.
- The surety will check all the evidence that has been submitted by the claimant that shows the Principal's violation. The surety will also interview the claimant regarding the matter.
- The surety will ask the Principal about the claim. The surety will require the Principal to submit documents applicable to the claim in order to determine the Principal's stance.
- If there are other parties involved, the surety will interview them and ask for supporting documents as well.

3. The Surety Responds to the Claim

All the information gathered from the parties involved will be thoroughly checked by the surety before a verdict is given. The surety will first check if all the information that they have received in defense of or in support of the claim is valid.

Next, the surety will check whether a violation was indeed committed by the Principal and if the bond covers the violation. If the claim is not valid or if the bond does not cover the claim, the surety will immediately deny the claim.

However, if the claim is valid, the surety will determine the amount that will be paid to the claimant. Since a surety bond is an indemnity product, the surety has the right to seek reimbursement from the Principal after the claim has been settled.

If other parties are involved, the surety can exercise its subrogation rights. This allows the surety to legally assert the rights of the Principal and the Obligee when seeking reimbursement from other parties.

XIV

CHAPTER

Basic Surety Bond Terminologies

Aggregate Liability: The Surety's maximum amount of liability in the event of a loss under the bond, no matter how many years it has been in force and renewed

Annual Bond: A bond that covers contracts or bids awarded or submitted during an annual period or within a fiscal year.

Beneficiary: A person who is entitled, by law or bond language, to claim against a bond.

Blanket Bonds: Covers multiple persons, businesses, articles, or projects.

Bond Application: A form that the applicant must complete in order to obtain the necessary information needed for underwriting.

Cancellation: Termination of a bond.

Cancellation Clause: A clause in a bond that permits the surety to terminate its future liability.

Cardinal Change: A change developed in federal courts. It is defined as a "change that is so profound that it is not redressable under the contract, and thus renders the government in breach."

Claimant: A term used to describe one making a claim against a bond.

Claims-Made Policy: A type of insurance coverage that is usually purchased when there is a delay between the filing of the claim and when the claim occurred.

Co-Fiduciary: One who serves as a joint fiduciary.

Compliance Bond: A type of surety bond that will ensure the compliance of the Principal to the underlying statute, ordinance, regulation, or policy.

Condition: The technical name of one of the four parts of a bond. The condition is not a qualification of coverage as in the case of an insurance policy but is the essence of the guarantee.

Consent of Surety: A written confirmation from the Surety to perform a certain action.

Corporate Surety: A surety which is a corporation, licensed under various insurance laws, and has under its charter the legal power to act as surety for others.

Co-Surety: A Surety that will partner with another Surety for the purpose of directly participating in a bond.

Cumulative Liability: Also known as stacking liability. When the full bond penalty is required each year the bond is in effect.

Cut-Through Clause: A clause, rider, or endorsement occasionally found in treaties that allow the obligee on a bond to recover directly from the reinsurer in the event of a failure by the surety (reinsured) to pay a loss due to specified circumstances.

Do-Nothing Option: After carefully investigating and considering all issues associated with a default, a surety may determine that it, indeed, has no obligation to perform and may communicate to the obligee that it will not perform. This is the surety's "do nothing" option. Although it will usually be doing something like preparing for the litigation that often results when the obligee takes exception to that position. This term has often been misunderstood to refer to a surety's supposed option to simply stand by its principal's position without the benefit of further investigation and analysis. Most responsible sureties would suggest the latter option does not really exist.

Earned Premium: The earned premium on a bond is at any time the amount which would compensate the surety for the protection furnished for the expired portion of the term of the bond.

Effective Date: The date on which coverage becomes effective.

Errors and Omissions Insurance (E&O): An insurance policy that will cover damages resulting from mistakes. These mistakes may be unintentional, due to negligence, or due to a failure to take appropriate action.

Excess Bond: A bond or policy covering the insured against certain hazards, applying only to loss or damage in excess of a stated amount, or primary insurance.

Impossibility of Performance: In contracts in which the performance depends on the continued existence of a given person or thing, an implied condition is that the perishing of the person or thing shall excuse performance. One is not excused from performance merely because performance becomes more expensive than originally contemplated. Mere unforeseen difficulty or expense does not constitute impossibility and is not ordinarily an excuse.

Incentive Clause: A contractual provision that provides payments beyond the stated amount in the contract if completion is ahead of schedule or if other objectives are reached which may involve cost savings, safety, quality or absence of disputes.

Indemnification: An agreement to hold another harmless for a loss.

Liability: This is a broad term denoting any legally enforceable obligation.

Long-Term Bond: (Fiduciary) A bond required of a fiduciary whose duties are normally expected to extend over a considerable period of time. (See also: "Short-Term Bond")

Look See Money: Money spent by the surety to finance the principal while the surety is investigating a default or potential default and analyzing its options.

Minimum Premium: The smallest amount of premium acceptable for a specified period.

Onerous Bond Conditions: The conditions of the bond are too difficult that it increases the risk of the Principal's non-performance.

Open Penalty: The fixed sum of money stated as the amount of coverage is not stated on the bond. In other words, the Surety's liability does not have a limit.

Penal Sum of the Bond: The size of the bond penalty being required by an obligee may be a reflection of the obligee's perceived exposure to aggregated liability and the degree of concern on the part of the privilege- granting agency in the event of non-performance by the principal.

Per Occurrence Limit: A bond limit that is applied to each loss/occurrence that is incurred during the term of the bond. For example, if a surety receives 10 claims of $5,000 each on a bond with a per-occurrence limit of $10,000, the surety would pay out $50,000.

Power of Attorney: Authority that is given to one person or corporation to act for and obligate another to the extent laid down in the instrument creating the power. In corporate suretyship, an instrument under seal which appoints an attorney-in-fact to act on behalf of a surety company in signing bonds.

Premium: A non-refundable amount paid to the Surety extending its credit. An insurance premium includes a factor for the payment of losses.

Pre-qualification: A screening process wherein the owner or his/her appointed representative gathers background information from a contractor or construction professional for selection purposes. Qualifying considerations include competence, integrity, dependability, responsiveness, bonding rate, bonding capacity, work on hand, similar project experience, and other specific owner requirements.

Risk: Any chance of loss. The insured or the property to which the bond relates.

Term of the Bond: The length of time the bond will be in force. There are 4 classifications: Continuous until cancelled, Continued and renewed by certificate, Definite stated term, and Non-cancelable.

Underlying Contract: An underlying agreement, statute, regulation, or ordinance upon which the bond is conditioned.

Undertaking: This is similar to a bond except it is a two-party agreement between the surety and the obligee – the principal is not named on the form. Under such an agreement, the obligee can make a demand on the surety without first looking to the principal for action.

XV

CHAPTER

About Surety Bond Authority

We're **Surety Bond Authority**, a leading surety bond company in the United States. Our company offers a wide range of surety bonds to various business entities and individuals across various industries. Our company has a significant financial capacity that provides a strong guarantee to our clients.

We are authorized to issue bonds in all 50 states and continues to be in good standing with the Surety and Fidelity Association of America as well as the Surety Underwriters Association of Southern California.

Helmed by a second-generation surety bond agent, our company has written thousands of bonds that have helped small to large businesses attain their goals.

Over the past 30 years, focusing on providing exemplary customer experience has helped our company become one of the most trusted surety companies in the country.

Our talented team of surety bond agents and underwriters continue to learn, evaluate, and apply the latest information in order to provide our clients with the service that they deserve.

We're ready to help you fulfill your surety bond needs!