Agenda

- **Overview of Surety Bonds**
  - Definition of surety bonds
  - Surety bonds vs. insurance
  - Indemnity, exoneration, joint and several liability
  - Different types of bonds
    - Commercial surety
    - Contract surety
- **Basic Underwriting**
  - Underwriting the obligation
  - The 3 C's of Suretyship

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Definition

sur·e·ty bond (sh*oo*r-ĭ-tee | bŏnd)

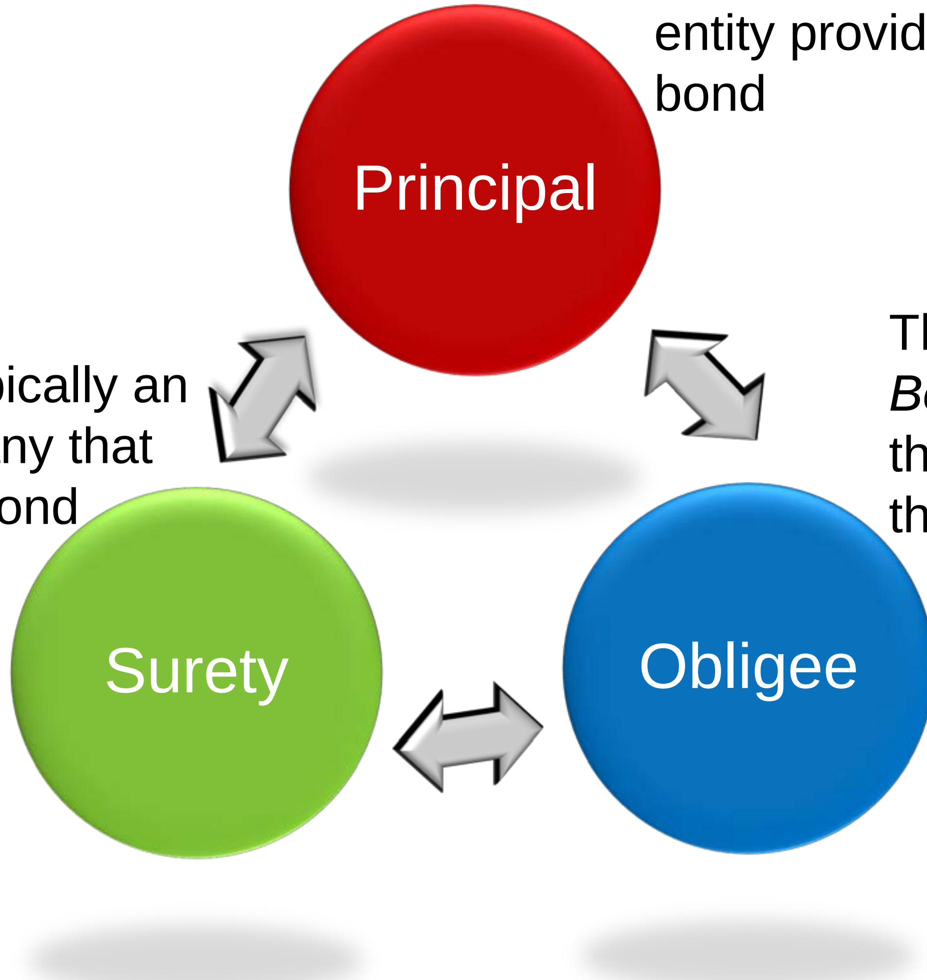
Noun

A written document that guarantees the performance of the obligations of one party, the **Principal,** to another party, the **Obligee**. The **Surety**, through its bond, provides a guarantee to the Obligee that the Principal will fulfill its obligations.

A Surety Bond Is A Three Way Agreement

The **Principal** is the entity providing the bond

The **Surety** is typically an insurance company that guarantees the bond



The **Obligee** or *Beneficiary* is the party that may benefit from the bond

Surety vs. Insurance

Surety

- 3-party contract
- No losses expected
- Premium = fee for extension of credit
- Principal retains economic risk through indemnity

Insurance

- 2-party contract
- Expect losses
- Premium = based on actuarial likelihood of loss
- Insurance company assumes economic risk

Indemnity Agreements

- **Indemnity** is the *Principal's* promise to pay the *SURETY* for any loss it sustains by virtue of having written bonds on behalf of the *PRINCIPAL*.

- **Applications** – Single or specific indemnity for a particular bond.

- **General Agreement of Indemnity** – A blanket agreement that covers all bonds written for the *PRINCIPAL* from the date of the agreement.

Indemnity, Exoneration, Joint & Several Liability

- **Indemnity** – A promise to reimburse the Surety because of a loss suffered by the default of the Principal.
  - Indemnitors are typically the company and its owners

- **Exoneration** – Becomes the right of the Surety to force the Principal to perform its obligations if the Surety is called on to respond.
  - The Principal's resources should be exhausted first

- **Joint & Several Liability** – All indemnitors hold a responsibility to make the Surety whole in the event of default. Each party is equally liable for the entire obligation.
  - All Principals hold a duty to make the Surety whole

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Contract Surety Obligations

Bid Bonds	guarantees the low bidder will enter into a contract with the owner and provide final performance and payment bonds
Performance Bonds	guarantees that the contractor will perform all specifications of the contract
Payment Bonds	guarantees to third parties that all labor and material suppliers will be paid
Maintenance Bonds	warrants that faulty workmanship and defective materials will be corrected

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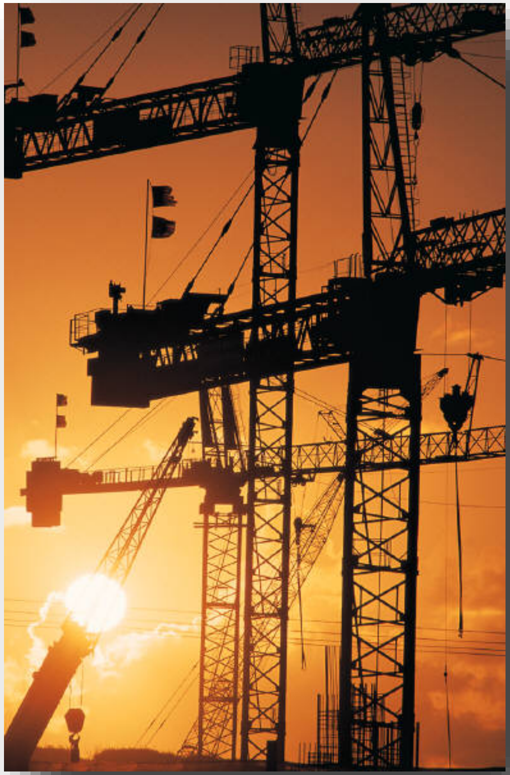
Contract Surety Bonds

The ***Surety*** guarantees the Contractor's performance of the bond obligation

The ***Contractor*** is the party who has the primary responsibility to fulfill the bond obligation

The ***Bond*** protects the Owner from default by the Principal



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Why are Contract Bonds Required?

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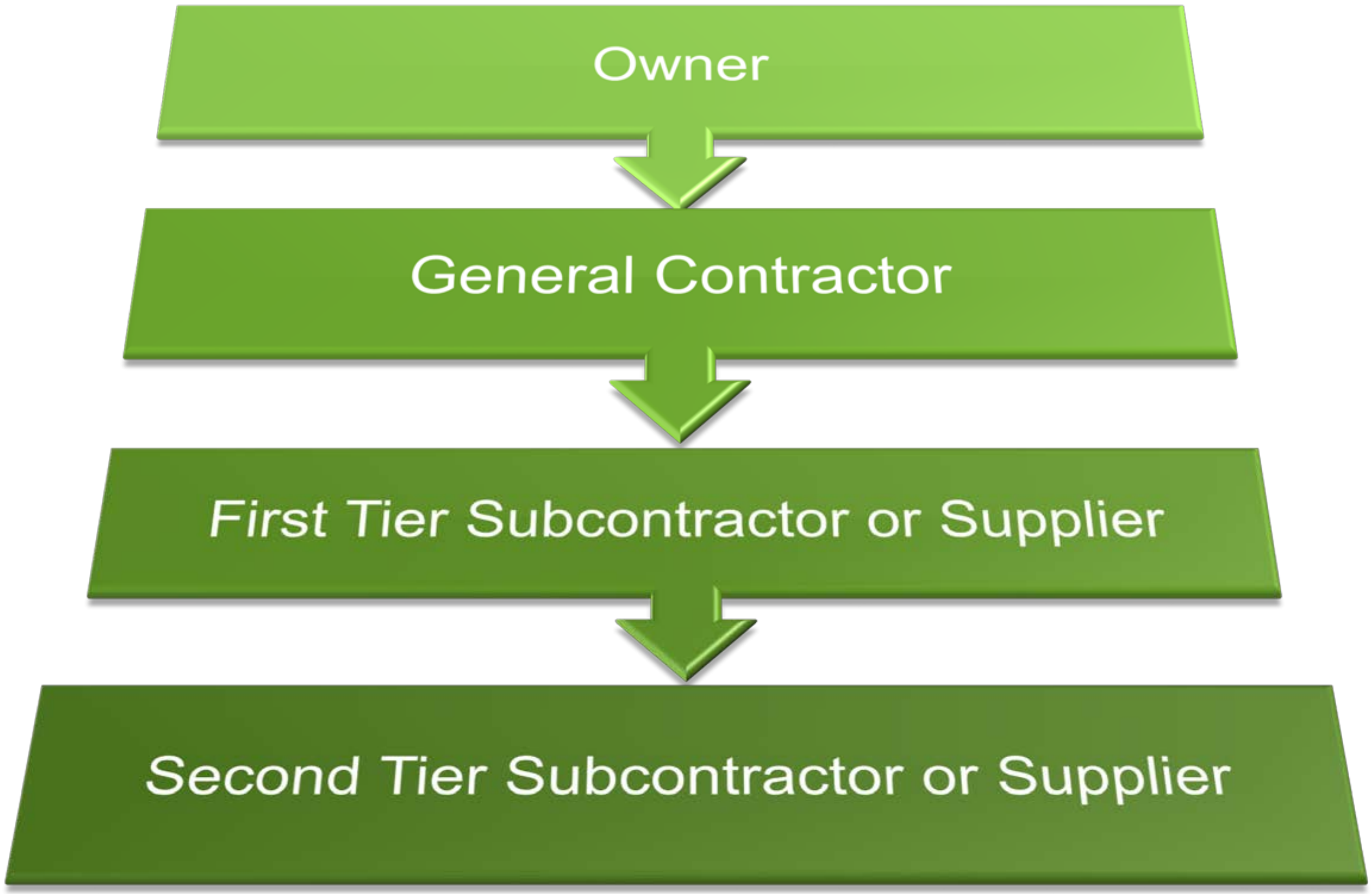
The Miller Act of 1935

- This Act requires the use of performance and payment bonds on all Federal projects in excess of $150,000

- Why is this important to the general public and the construction community?
  - Acts as a pre-qualifier for responsible bidders
  - Protects the taxpayer's dollars by guaranteeing completion
  - Protects first and second tier subcontractors and suppliers from non-payment
  - “Little Miller Act” addresses requirements on the state level

The Miller Act of 1935



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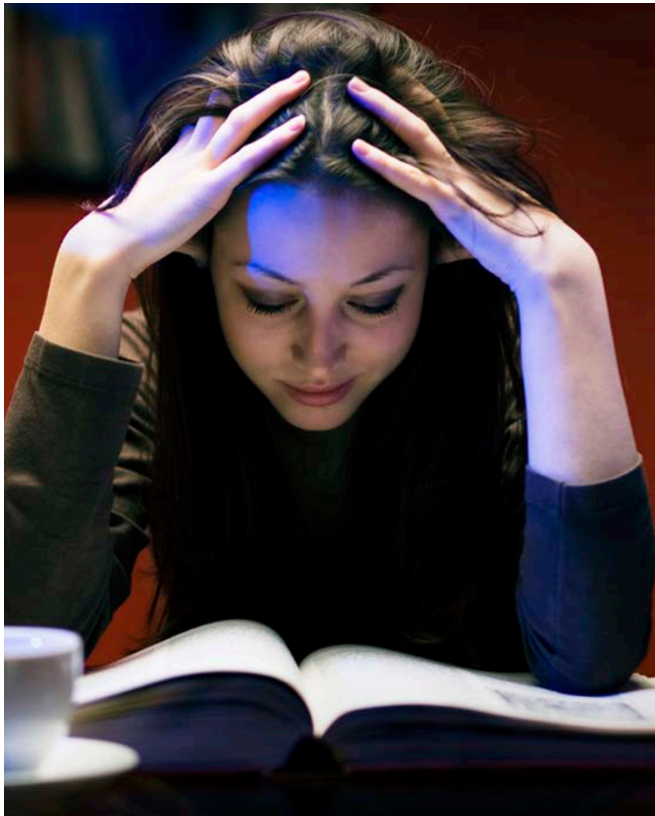
Underwriting Surety Bonds



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Understanding the Obligation

- What is the nature of the obligation?
- What are the terms and conditions?
- Duration: cancellable or non-cancelable?
- What is the likelihood of default?
- What are the remedies to default?

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Underwriting Considerations

The 3 C's of Suretyship

- **Capital** – does the applicant's financial condition support the size and nature of the obligation?

- **Capacity** – does applicant posses the skill, experience and knowledge to perform the obligation?

- **Character** – is the applicant trustworthy, of good character

The 3 C's of Prequalification

Capital

Capacity

Character

Analyzing Financial Strength

Capital

- Financial Resources
- Working Capital
- Liquidity
- Net Worth
- Operating Ratios
- Indemnity

Evaluating Ability To Perform

Capacity

- Resumes
- References
- Business Plan
- Continuity

Assessing Reputation

Character

- Reputation
- Relationships
- References

Questions/ Discussion

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