Although surety is an ancient concept, its prime mission can be stated simply: performing a service for qualified individuals whose affairs require a guarantor.

In the United States, surety guarantees have been issued by corporations for over a century. These corporate sureties are large financial institutions. They have the necessary capital to make numerous commitments in the form of surety bonds.

Because insurance companies issue many surety bonds, some people think that insurance and surety bonds are the same thing. While there are similarities, there are also major differences.

A bond guarantees the performance of a contract or other obligation. Bonds are *three party instruments* by which one party guarantees or promises a second party the successful performance of a third party.

1. The Surety--Is usually a corporation which determines if an applicant (principal) is qualified to be bonded for the performance of some act or service. If so, the surety issues the bond. If the bonded individual does not perform as promised, the surety performs the obligation or pays for any damages.

2. The Principal--Is an individual, partnership, or corporation who offers an action or service and is required to post a bond. Once bonded, the surety guarantees that he will perform as promised.
The Obligee--Is an individual, partnership, corporation, or a government entity which requires the guarantee that an action or service will be performed. If not properly performed, the surety pays the obligee for any damages or fulfills the obligation.

The example below illustrates how a surety bond works:

Joe, the principal, has promised someone (the obligee) that he will do something. If Joe fails to perform as he has promised, financial loss could result to that person.

Consequently, the obligee says to Joe, “If you can be bonded, I’ll accept your performance promise.” Joe goes to a surety and asks to be bonded.

After the surety is satisfied that Joe is qualified and will live up to his promise, it issues the bond and charges Joe a “premium” for putting its name behind Joe’s promise.

Joe is still responsible to perform as promised. The surety is responsible only in the event that Joe does not fulfill his promises.

The Surety’s Job: Protection

The purpose of a surety is to protect public and private interests against financial loss.

Therefore, the surety bonding company must be profitable and must have a strong balance sheet. No one is likely to accept the guarantee of a party with a bad name or a weak balance sheet. The surety bonding company guarantees performance. Its good name and its balance sheet back up that guarantee.
Probate bonds, notary public bonds, court bonds, license and permit bonds and public official bonds all guarantee protection of public interests from financial loss.

Why has corporate surety become such a vital part of doing business in today’s economic society? Because there is no practical alternative for protecting public and private interests from financial loss.

Although surety companies are often regulated by state insurance departments, surety bonding is different from insurance in some ways.

**Some Differences between Surety and Insurance**

**Several Differences**

Insurance is a risk sharing device. It assumes that there will be losses. The expected losses are calculated by actuaries. These losses, coupled with anticipated overhead and other expenses, form the basis for the premium.

Surety is not actuarially rated as is insurance. Both insurance and surety call their fee a “premium.” The surety’s premium is as much a service charge as a conventional premium, which is determined on the basis of actual or anticipated losses. It is based largely on the cost of investigating the applicant and handling the transaction.

**Surety: A Form of Credit**

Surety is as much like banking as insurance. Bankers extend credit in the form of dollars loaned or as a commitment to loan. Every banker granting a loan fully expects to have the loan repaid. He investigates the borrower in sufficient detail to assure that such will be the case. Surety underwriters proceed in the same way.
## Suretyship vs. Insurance

<table>
<thead>
<tr>
<th><strong>Three party agreement.</strong> Most surety bonds are three party agreements. The surety guarantees the faithful performance of the principal to the obligee.</th>
<th><strong>Two party agreement.</strong> Insurance is basically a two party agreement whereby the insurance company agrees to pay the insured directly for losses incurred.</th>
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**Losses not expected.** Though some losses do occur, surety premiums do not contain large provisions for loss payment. The surety takes only those risks which its underwriting experience indicates are safe. This service is for qualified individuals or businesses whose affairs require a guarantor.  

**Losses expected.** Losses are expected. Insurance rates are adjusted to cover losses and expenses as the law of averages fluctuates.  

**Losses recoverable.** A bond resembles a “loan”; the surety is “lending” its credit to the principal. After a claim is paid, the surety expects to recoup its losses from the principal. Unfortunately, actual experience shows few such recoveries.  

**Losses usually not recoverable.** When an insurance company pays a claim, it usually doesn’t expect to be repaid by the insured.  

**Premiums cover expenses.** A large portion of the surety bond premium is really a service charge for weeding out unqualified candidates and for issuing the bond.  

**Premiums cover losses and expenses.** Insurance premiums are collected to pay for expected losses. If an insurance company can get enough average risks of one class, it will always have enough money to pay losses and the expenses of doing business.  

**Sureties are selective.** A surety agent is selective. Like a banker, he is trained not to make any bad loans.  

**Insurers write most risks.** The insurance agent generally tries to write a policy on anything that comes along (at the appropriate premium rate) and allows for a large volume to cover the risk.
When the surety company is called in, the principal has usually paid as much of the loss as he is able. At this point, the surety company must pay the difference. The surety then tries to reclaim its loss from any resources left to the principal. In some cases the surety recoups all of the money it had to pay the obligee. In most cases, however, the principal either cannot be located or proves to be insolvent.

In reality, no obligee wants a claim against a surety bonding company. The obligee wants the principal to carry out his obligation. A surety bond is written because the obligee expects the surety company to weed out any applicant who cannot fulfill his commitments.

The job of the surety bonding company has become as complex as the rest of our economic society. In an age of lawsuits, broken promises, bankruptcies, and a generally high level of financial instability, the surety company provides basic public protection. To do this, the surety must responsibly determine the qualifications of those who wish to be bonded.

A surety provides the best method for guaranteeing performance and protecting public interests. Still, people tend to distrust business—even when history proves that private enterprise has been the consumer’s single most important benefactor.

The government has tried many programs to provide surety guarantees for the public. None of them have worked well.

“Risk pooling” and so-called “state funds” have been tried in all their various forms. Risk pooling is
a government program which “assigns” to surety companies various applicants who are unable to obtain bonds elsewhere. State funds are nothing more than state agencies which go into the bonding business. In almost every case, both concepts have failed.

There are three important reasons for this failure:

1. Insolvency--In many cases, state funds have been underfunded through an inadequate fee structure or too liberal in their claims payment and have faced the risk of insolvency. Several have had to restrict payment of claims or increase the fees charged to belong to the fund. A comprehensive study by the California Contractor State License Board (CSLB) stated that the apparent challenge of a recovery fund is to remain solvent and functioning in order to compensate the financially damaged consumer. The CSLB concluded, after evaluating recovery fund programs in California and other states, that consumers would not be better off with a contractor recovery fund. California currently uses a contractor’s license bond for consumer protection. (Analysis of State Recovery Funds by the California Contractor State License Board October 1, 2001).

2. Difficult Recovery--In other cases, the state has tried to reduce losses by making it so tough for a consumer to get a claim paid that it’s not worth the effort. Many recovery funds require that the consumer obtain judgments and exhaust all civil and administrative remedies before they can submit a claim against the fund.

By comparison, bonding companies are bound by laws that require timely and proper claims handling procedures. The surety always pays promptly upon being shown a minimum amount of proof of loss.
Surety bonding does not depend upon the law of averages. Losses cannot be expected to be covered by “premiums”. Only through proper and exacting underwriting procedures can surety bonding be profitable, reliable and valuable for public and private protection.

In short, corporate sureties have the necessary knowledge, experience and expertise in the especially crucial areas of underwriting and claims handling. State funds are not only lacking in these areas; they also frequently lack the proper staffing.

Public protection can only be maintained by an independent party - the surety. In addition, by taking responsibility for investigation, evaluation, and recovery of loss, corporate sureties keep thousands of cases out of the legal system every year. The result is additional public savings.

Fidelity Bonds

There is always the possibility that an employee will steal. Statistics show a shocking increase in employee theft. They also identify theft as the leading cause of small business failure. The only protections against this kind of loss are good internal control, regular outside audits and a Fidelity Bond.

Fidelity Bonds are often referred to as “honesty insurance.” They cover loss due to any dishonest act of a bonded employee. The employee may steal alone or with others. The loss may be money, merchandise or any other property, real or personal.

The Fidelity Bond is available in a group (blanket) or individual (schedule) form.

The seven families of Surety Bonds

1. Fidelity Bonds

2. Bid Bonds

3. Performance Bonds

4. Payment Bonds

5. Commercial Bonds

6. Public Official Bonds

7. Notary Bonds
2. **Public Official Bonds**

Public Official Bonds guarantee taxpayers that the official will do what the law requires.

A public official is expected to “faithfully perform” the duties of the office. For this reason, bonding public officials is highly important. It isn’t enough to simply buy honesty insurance. “Faithful performance” is not synonymous with “honesty.” It may include honesty along with many other important factors.

For instance, a county treasurer may have lost funds through a failure of a bank he thought was sound. If the treasurer did not obtain proper depository security, he could be held liable for restitution. The county treasurer could easily prove that he did not act “dishonestly.” However, he would have difficulty proving that he “faithfully performed” his duty.

Public Employee Bonds are also available for bonding the subordinates of the public official (those people who are not required by statute to be bonded). Those subordinates need to be bonded for dishonesty only.

Public Official Bonds may be written for individuals or, where the law allows, on a blanket bond form.

3. **Judicial Bonds**

Judicial bonds are written for parties to lawsuits or other court actions (plaintiffs and defendants).

In anticipation of a favorable judgment, plaintiffs often want to take possession of the property, cash or merchandise in question without waiting for the trial. Those who are financially reliable can often
achieve that goal by posting a plaintiff’s court bond.

The plaintiff’s bond is usually required to protect the defendant should the court decide that he, and not the plaintiff, is entitled to the property or the judgment.

Types of plaintiff bonds include Indemnity to Sheriff Bonds which protect the sheriff against suit when dispossessing a person of property or goods and Cost Bonds which guarantee payment of trial costs.

Other types of plaintiff’s bonds include Cost on Appeal, Injunction, Attachment, Objecting Creditors, Replevin and Petitioning-Creditors-in-Bankruptcy Bonds.

The second type of Judicial Bond is the defendant’s bond. A defendant in a court case might want a bond to counteract the effect of the bond that the plaintiff has furnished.

Some common types of defendant’s bonds are Release of Attachment and Counter Replevin. Generally speaking, these bonds have proven to be more hazardous than plaintiffs bonds. Accordingly they can only rarely be written without the posting of adequate collateral to protect the surety from loss.

In criminal actions, bail bonds are the most common type of defendant’s bonds. They guarantee that the defendant will show up for trial.

4. **Fiduciary Bonds**  
A fiduciary is a person appointed by the court to handle the affairs of persons who are not able to do so themselves. The fiduciary is often called a Guardian or Conservator if he handles the affairs of a minor or an incapacitated person. An Administrator is a fiduciary who handles the affairs of some-
one who has died; he or she is known as an Executor if specifically named in the will.

Fiduciaries are often required by statute, courts, or wills to be bonded. Statutes prescribe how fiduciaries should handle others’ affairs. However, the surety company often assists in keeping the fiduciary within the law.

Assistance of a surety is available to the principals or their attorneys. Supervision by the surety helps prevent problems and secure the assets entrusted to the fiduciary. Through careful underwriting practices, a surety also attempts to minimize losses.

In addition to the loss prevention services performed by a surety, the bond creates protection. *If there should be a loss, the surety pays heirs, wards, creditors, and beneficiaries.*

**5. License and Permit Bonds**

A business takes few actions today without governmental permit or approval. Many of these government permits are granted only after the business posts a bond guaranteeing compliance with laws, ordinances, and regulations.

License and Permit Bonds “put teeth” into the laws passed for public protection. For example, sewer builders must conform to city sanitary regulations. They must give a bond to guarantee compliance with city regulations. If they do not comply, the surety pays damages or ensures compliance. The surety’s great care in selecting its risk helps insure that only capable sewer builders will be licensed. License and Permit Bonds are divided into five classes:

(A) Those designed to protect the health and
safety of the public, e.g., a sewer builder.

(B) Bonds required of an individual who has been granted some public privileges which may become a hazard to the general public, e.g., hanging a sign over the street.

(C) Those bonds which protect the public against loss of money or goods entrusted to the licensee, e.g., real estate broker, public warehouseman, etc.

(D) Those required of businesses highly susceptible to unscrupulous practices, e.g., small loan companies, motor vehicle dealers.

(E) Bonds which guarantee payment of taxes collected, e.g., gasoline tax bonds, sales tax bonds.

This latter category represents one of the most important types of surety bonds. These bonds guarantee that the principal will pay over to the state all tax monies received. In the event the principal fails or is unable to pay the tax, the surety company pays for any losses. Without corporate surety, a state program may not be able to collect its revenues.

In all these cases, bonds endeavor to protect the public against irresponsible licensees.

6. **Contract Bonds**  
**Bid, Performance and Payment Bonds**

**Bid Bonds**

Bid Bonds are usually the first step in a bonded contract process. Each bidder for a contract must guarantee the price bid by posting a certified check
or indemnity bond, which is forfeited if the contractor fails to enter into the contract awarded. Usually the amount forfeited is the difference between his bid and the next lowest bid. The charges for Bid Bonds are nominal so as to encourage contractors to use Bid Bonds rather than certified checks.

Bid Bonds guarantee that the contractor will enter into a contract at the amount bid. When he does this, the Bid Bond is released.

**Performance and Payment Bonds**

Typically issued together, Performance and Payment bonds are usually referred to collectively as “final” bonds. The Performance Bond guarantees performance of the terms and conditions of a contract. Payment bonds cover payment by the contractor of labor and materials used in the bonded project. It may be for the construction of a building or road or it may be a supply contract. It may be a transportation contract or almost any kind of contract where one party might experience harm if the other party fails to perform.

These bonds are largely the result of governmental and other public bodies which are required by law to award contracts for public work to the lowest responsible bidder. The requirement of a Performance Bond and the screening process which the surety must do, eliminates unqualified contractors before the bidding process begins.

Performance Bonds are also frequently required in the private sector and by General or Prime Contractors of their subcontractors working on a bonded project. The bonds cover completion of the work and payment of all labor and material costs.
7. Miscellaneous and Federal Bonds

There are almost as many categories of surety bonding as there are categories of agreements, contracts and situations where people may fail to perform as promised.

Some of these are:


(B) Lost Securities Bonds.

(C) United States Excise Bonds. (Includes Brewer’s Bonds, Distiller’s Bonds, Industrial Alcohol Bonds, Wine Maker’s Bonds, and Tobacco Manufacturer’s Bonds.)

(D) Custom Bonds. (Includes Importer/Exporter Bonds, Carrier Bonds and Warehouse Bonds.)

There are many others too numerous to mention. In these special situations, the experience of a corporate surety can be very helpful.

The Surety Bonding Agent

The surety bonding business is hazardous—and always has been. Francis Bacon once said that “Going surety for a neighbor is like putting on iron to swim.” Still, the need for bonding grows daily. Therefore, the number of agents required to service this great need also increases.

Agents are the link between the surety company and those who need bonds. The primary source for bonding agents is established independent insurance
agents. And today, most licensed independent casualty agents write at least some surety bonds. **Only licensed insurance agents can sell surety bonds.**

Licensing individual agents helps keep unscrupulous and incompetent people from doing business on behalf of a surety. Agents must also sign a contract with the company they represent. The contract and the license are necessary because each agent is granted certain authority agreed upon by the company and agent.

Agents are often granted a Power of Attorney which gives them the authority to execute bonds. Each agent is limited in the amount and type of bonds that can be executed.

Powers of Attorney and pre-executed bond forms literally put a surety company in the agent’s office. The agent can execute a bond on the spot. This requires the use of considerable discretion and is an important part of this highly service-oriented industry.

**How is a Surety Bond Sold?**

The typical sales problem of creating a need is not a factor in the surety business. A need for the bond has already been created either by law or by the nature of a particular business.

The surety agent earns a commission providing the customer’s bond. Until that bond is properly executed and filed, it does not begin to function. Therefore, availability is critical.

Since an agent cannot “create a need” for most surety bonds, service and availability are key to becoming the source when bonding needs arise.