

Assignment 4

Surety Bonds

Orient yourself to this assignment by reading the following introduction.

Most producers do not work with surety bonds on a daily basis, and many believe that surety bonds should be handled exclusively by surety specialists. However, although several types of surety bonds require the advice of experts, growth-oriented producers expand their overall property-casualty books of business by soliciting surety accounts, knowing when and how to use specialists.

Read the definitions of the *Key Words and Phrases* that follow. Being familiar with these important words will help you better understand the first part of this assignment. *Key Words and Phrases* appear in bold in the text when they are defined.

Surety bond	A written contract in which one party guarantees another party's performance for a third party.
Contract surety bonds	A classification of bonds that guarantee the performance of the bonded contractor.
Commercial surety bonds (noncontract bonds)	A classification of bonds that guarantee the performance of all obligations that do not arise from contracts.
Principal	The party whose performance is being guaranteed.
Obligee	The party to whom the principal owes a duty and who will benefit from the guarantee.
Surety	The party who answers to the obligee for the principal's failure to perform as required by the underlying contract, permit, or law.
Power of attorney	A written document that authorizes one person to act as another person's agent or attorney-in-fact.

Three Cs of Underwriting (surety bonds)	The principal's character, capacity, and capital.
Bond penalty (penal amount)	The limit of liability for a bond, or the maximum amount the surety is obligated to pay in the event of a loss.
Bid bonds	A classification of bonds that guarantee that the contractor submitting a bid, if awarded the contract, will enter into a formal contract with the project owner and will furnish all required bonds.
Performance bonds	A classification of contract bonds that guarantee performance of the contract. The obligee will be indemnified for any loss resulting from the principal's failure to perform the work according to the contract, plans, and specifications at the agreed price within the agreed time.
Payment bonds	A classification of bonds that guarantee payment for labor and materials in accordance with the terms of the contract.
Miller Act	A federal law that requires contractors to post separate performance and payment bonds guaranteeing payment for material and labor provided on federal construction projects valued over a statutory amount.
Maintenance bonds	A classification of bonds that guarantee that the contractor will correct faulty work and replace defective materials for a specified period.
Subdivision bonds	A classification of bonds that guarantee that the contractor will complete the improvements required by ordinance within a certain period of time in accordance with the governing body's requirements.
Supply contract bonds	A classification of bonds that guarantee the delivery of designated items according to supply contract specifications.
License and permit bonds	A classification of contract bonds required by federal, state or municipal governments that guarantee performance of the laws, regulations, or ordinances relating to what is covered by the license or permit.
Public official bonds (non-federal)	A classification of bonds that guarantee the faithful performance of the duties of a public official and also provide for an honest accounting of all public funds handled by that public official.
Court Bonds (in civil proceedings)	A classification of bonds that include judicial and fiduciary bonds and that guarantee that a person or organization will faithfully perform certain duties prescribed by law, or by a court, or will demonstrate financial responsibility for another's benefit until the final outcome of a court decision.
Judicial bonds	A classification of court bonds that are posted by persons seeking or appealing a remedy in court to protect the party against whom a claim is made from damages sustained if the person seeking or appealing the remedy does not prevail.
Fiduciary bonds	A classification of court bonds that guarantee the faithful performance of duties by persons appointed by a court to administer the property or interests of others.

Joint control (surety) A surety term meaning that both the surety and the fiduciary control the assets of an estate.

Miscellaneous surety bonds A classification of bonds created by the Surety Association of America (SAA) that do not clearly fall within the scope of the other commercial surety bond classifications in the SAA manual.

Study the first part of this assignment, which includes the following sections:

- I. Suretyship
- II. Contract Bonds
- III. Commercial Bonds—
Noncontract

Suretyship

A **surety bond** is a written contract in which one party guarantees another party's performance for a third party. The two basic types of surety bonds are:

1. Contract surety bonds
2. Commercial surety bonds

Contract surety bonds guarantee the performance of the bonded contractor. For example, in a typical contract bond situation, a land owner, called the project owner (the holder of a contract bond in surety bonding is typically called the “project owner”), wants to build a structure or to improve land. The project owner requires a contract surety bond to guarantee that the contractor will perform all obligations under the contract on time, within budget, and according to specifications. If the contractor defaults, the surety guarantees performance of the contract or pays (indemnifies) the project owner for all losses up to a maximum limit of liability (the bond penalty amount).

Commercial surety bonds (noncontract bonds) cover all other situations in which sureties guarantee performance of obligations that do not arise from contracts. Commercial surety bonds include plumbers' license bonds, public official bonds, and bonds for executors of wills. Each type of bond requires a different underwriting approach.

Producers should have a working knowledge of surety bonds for the following reasons:

- To broaden the types of products provided to customers, which allows customers to deal with one producer for both insurance and surety needs
- To gain new customers, who may also need other insurance products
- To increase profits for a new line of business (surety bonds) that typically has higher commission rates and fewer losses than other types of insurance and that could result in profit-sharing bonuses for the producer