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Bonding Basics - Frequently Asked Questions

What is a surety bond?

A surety bond is a three-party agreement between a surety company, an oblige and a principal. The third party (surety company) guarantees to the second party (oblige) the successful performance of the first party (principal). The surety company guarantees that the obligations of the principal to the oblige will be performed in accordance with a contract, statute or regulation. Bonds are used to protect public and private funds from financial loss.

How is a surety bond different than an insurance policy?

A surety bond and an insurance policy are not the same. The cost of assumed losses are calculated into the price of an insurance policy premium. A bond, on the other hand, is an extension of credit with the expectation that the legal obligation will be fulfilled, and subsequently, there will be no loss. Losses are not included in the cost of bond premiums, only underwriting expenses are factored into the rates. A surety company's fiscal results are severely impacted when losses on bonds do occur.

Why do surety bonds need to be underwritten?

A surety company must determine the risk of a loss occurring if the principal is unable to satisfy the obligation under the bond. Since a bond is an extension of credit, the surety company must review the principal's financial information and business experience to determine if certain requirements are met to support the bonded obligation. This procedure is known as the underwriting process. Just as a bank evaluates loan applications, surety company underwriters evaluate risks in a similar way by considering business and personal financial statements, credit reports, credit references and other factors.

What are the benefits of surety bonds?

Surety bonds are a mechanism for transferring risk. The surety company assumes the risk of the principal doing business from the oblige. Federal, state and local governments generally require surety bonds to give certainty that business owners and individuals will adhere with various laws safeguarding public funds. For example, license bonds protect the public from business impropriety. Contract bonds protect taxpayers by pledging that projects are finished appropriately, on time and without liens. Court, public official, government and miscellaneous bonds protect and secure public funds and private interests.

What is indemnity?

Indemnity agreements are a standard of the industry. To indemnify means to make whole. Under common law, the surety company has the right to be indemnified by the principal in the event of a loss. The General Indemnity Agreement (GIA) carries out that right by stating that if the surety suffers a loss while providing a bond to the principal, the principal is obligated to make the surety "whole" by reimbursing any losses and expenses.

Surety companies usually require the president to sign on behalf of the company, all owners with over 10% ownership to sign personally, and the owners' spouses to sign personally. Personal indemnification establishes the principal's private commitment to the business entity and to the surety company.

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For answers to all of your bond questions or more information on how Goldleaf Surety Services can assist you with all of your bond needs - log in to www.bigimarkets.com or email us at bigimarkets@iiaba.net and an underwriter will contact you.