Surety bonds are a unique form of insurance

- Sureties focus on prequalifying risks
- A surety incurs a loss only if a principal fails to
  (1) perform its obligations and
  (2) cannot reimburse surety
- Surety is generally a mandatory product not a voluntary purchase
Types of Insurance

- **Property Insurance:** 1st Party
  - Damage to your property

- **Liability Insurance:** 3rd Party
  - Damage suffered by another who may have a legal claim against you

- **Surety:**
  - Damage to a specified other because of your failure to fulfill a duty.
    Often required by the specified other

Surety as a 3-Party Contract

- **Principal**
- **Obligee**
- **Surety**

Surety as a 3-Party Contract

- Surety is a specialized form of insurance in which one party guarantees performance of an obligation of another party
  - Principal/obligor is party that undertakes obligation
  - Surety guarantees that Principal will perform
  - Obligee is party that receives benefit of performance
- In traditional insurance, risk is transferred to insurer
- In surety, risk remains with Principal
  (bond is for the protection of the obligee)
## Surety & Fidelity Association of America
Top 15 Surety Writers
1994 vs 2013

<table>
<thead>
<tr>
<th></th>
<th>1994 Surety ($)</th>
<th>2013 Surety ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Reliance</td>
<td>TRAVELERS</td>
</tr>
<tr>
<td>2</td>
<td>USF&amp;G</td>
<td>LIBERTY MUTUAL</td>
</tr>
<tr>
<td>3</td>
<td>F&amp;D</td>
<td>ZURICH INSURANCE</td>
</tr>
<tr>
<td>4</td>
<td>St Paul Group</td>
<td>CNA INSURANCE</td>
</tr>
<tr>
<td>5</td>
<td>AIG</td>
<td>CHUBB &amp; SON INC</td>
</tr>
<tr>
<td>6</td>
<td>Aetna</td>
<td>IFIC SURETY</td>
</tr>
<tr>
<td>7</td>
<td>Continental</td>
<td>HCC SURETY</td>
</tr>
<tr>
<td>8</td>
<td>Fireman's Fund</td>
<td>HARTFORD FIRE</td>
</tr>
<tr>
<td>9</td>
<td>CNA Insurance</td>
<td>ACE LTD</td>
</tr>
<tr>
<td>10</td>
<td>Safeco</td>
<td>RLI INSURANCE</td>
</tr>
<tr>
<td>11</td>
<td>Chubb</td>
<td>GREAT AMERICAN</td>
</tr>
<tr>
<td>12</td>
<td>Hartford</td>
<td>LEXON/BONDSAFEGUARD</td>
</tr>
<tr>
<td>13</td>
<td>Amwest</td>
<td>NAS SURETY</td>
</tr>
<tr>
<td>14</td>
<td>Capsure</td>
<td>THE HANOVER</td>
</tr>
<tr>
<td>15</td>
<td>CIGNA Group</td>
<td>MERCHANTS BONDING</td>
</tr>
</tbody>
</table>

**Surety underwriting is based on technical capability of surety to evaluate risks in order to avoid any losses.**

- Surety is more like a credit transaction (emphasis is on prequalification and selection).
- If there is an appreciable likelihood of loss, surety will not write bond.
- Traditional insurance underwriting is based on spreading risk of loss.

### Prequalification of Risks

- A surety suffers a loss only if principal defaults on its obligation and cannot reimburse surety.
- Surety theoretically is written to a zero loss ratio.
- In traditional insurance, underwriter takes into consideration that a certain portion of premium will be paid out in losses.
- In surety, premiums are "service fees" charged for use of surety's financial backing and guarantee (cost of avoiding loss).
### 2013 Top 10 Surety Writers

<table>
<thead>
<tr>
<th>Rank</th>
<th>Company Name</th>
<th>Premium</th>
<th>Premium Growth</th>
<th>Net Income</th>
<th>Net Income Growth</th>
<th>Net Profit</th>
<th>Net Profit Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Liberty Mutual</td>
<td>126,611,622</td>
<td>2.4%</td>
<td>111,241,490</td>
<td>4.9%</td>
<td>41,107,600</td>
<td>4.9%</td>
</tr>
<tr>
<td>2</td>
<td>Aon Surety</td>
<td>125,010,060</td>
<td>2.6%</td>
<td>116,000,000</td>
<td>2.6%</td>
<td>45,000,000</td>
<td>2.6%</td>
</tr>
<tr>
<td>3</td>
<td>Swiss Re</td>
<td>124,900,000</td>
<td>3.2%</td>
<td>121,000,000</td>
<td>3.2%</td>
<td>42,000,000</td>
<td>3.2%</td>
</tr>
<tr>
<td>4</td>
<td>Millis &amp; Rambur</td>
<td>123,000,000</td>
<td>2.7%</td>
<td>119,000,000</td>
<td>2.7%</td>
<td>41,000,000</td>
<td>2.7%</td>
</tr>
<tr>
<td>5</td>
<td>Travelers</td>
<td>120,000,000</td>
<td>3.0%</td>
<td>116,000,000</td>
<td>3.0%</td>
<td>40,000,000</td>
<td>3.0%</td>
</tr>
<tr>
<td>6</td>
<td>Partner Re</td>
<td>118,000,000</td>
<td>2.8%</td>
<td>114,000,000</td>
<td>2.8%</td>
<td>40,000,000</td>
<td>2.8%</td>
</tr>
<tr>
<td>7</td>
<td>General Security</td>
<td>117,000,000</td>
<td>2.5%</td>
<td>113,000,000</td>
<td>2.5%</td>
<td>39,000,000</td>
<td>2.5%</td>
</tr>
<tr>
<td>8</td>
<td>Allied &amp; Surety</td>
<td>115,000,000</td>
<td>2.4%</td>
<td>112,000,000</td>
<td>2.4%</td>
<td>39,000,000</td>
<td>2.4%</td>
</tr>
<tr>
<td>9</td>
<td>J.M. Jones</td>
<td>114,000,000</td>
<td>2.3%</td>
<td>111,000,000</td>
<td>2.3%</td>
<td>39,000,000</td>
<td>2.3%</td>
</tr>
<tr>
<td>10</td>
<td>C.R. Garland</td>
<td>113,000,000</td>
<td>2.2%</td>
<td>110,000,000</td>
<td>2.2%</td>
<td>39,000,000</td>
<td>2.2%</td>
</tr>
</tbody>
</table>

### 2013 Combined Ratios
- **Surety:** 70.1%
- **Fidelity:** 85.7%
- **Risky business to write**

### Surety as a Mandated Product
- **Who requires bonding?**
  - Public sector (federal Miller Act and state Little Miller Acts)
  - Private sector (does not mandate bonds but may require them)
  - Private (commercial) owners
  - General contractors
### 3 Types of Surety Bonds

#### Contract Surety
- These are bonds that contractors have to provide under state and federal law to assure that a construction project will get done on time and according to specs and that everyone working on the job will be paid
- Most of surety premium is contract surety

#### Commercial Surety
- These are bonds that public entities require of individuals or entities as a condition for a license or a permit to engage in specified activities or to otherwise assure their compliance with laws and regulations

#### Fidelity Bonds
- These bonds provide indemnification for insured from losses caused by dishonest acts of employees
Contract Surety

- Bid Bonds
  - Guarantee that contractor intends to enter into contract for bid amount and will provide required bonding for job
- Payment Bonds
  - Guarantee that contractor will pay subcontractors, suppliers and laborers
- Performance Bonds
  - Guarantee that contractor will complete job on time and according to specifications

Contract Surety

- Amount of bond is usually 100% of contract price

Prequalification

Capital
- Financial statements
- Working capital
- Work-in-progress
- Indemnity

Capacity
- Resumes
- Contingency plan
- Business plan (short & long-term)
- Equipment

Character
- Reputation
- Relationships
- References
Surety Basics

• Why Prequalify contractors on public projects?
### Role of Producer

<table>
<thead>
<tr>
<th>Producer</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Prepare case for surety underwriting</td>
</tr>
<tr>
<td>• Prepare contractor for prequalification</td>
</tr>
<tr>
<td>• Foster relationship between contractor &amp; surety company</td>
</tr>
<tr>
<td>• Keep &amp; increase surety capacity</td>
</tr>
</tbody>
</table>
• License and permit bonds
  – Guarantee compliance with laws and regulations
  – Source of information:
• Judicial bonds
  – Appeals; attachments; injunctions
• Fiduciary bonds
  – Probate; bankruptcy trustee; executor; guardian

• Public official bonds
  – Sometimes are fidelity bonds
• Miscellaneous bonds
  – Ex. 1: Workers Compensation self-insurance
  – Ex. 2: Funeral Home prepaid burial expenses
  – Ex. 3: Auctioneer
  – Ex. 4: Shipper responsible for import taxes

Commercial Bond Example
U.S. Customs and Border Protection
• If you are importing merchandise into the U.S. for commercial purposes that are valued over $2,500, or a commodity subject to other federal agencies requirements (i.e. firearms or food), you must post a Customs bond to ensure that all duties, taxes and fees owed to the federal government will be paid.
### Commercial Surety Underwriting

- Statutory obligation being bonded
- Bond form—terms and conditions
- Evaluation of principal

### Fidelity Bonds

- These bonds protect against loss from employee dishonesty
- Federal requirements are much more common than state requirements for this type of bond.

### Employee Theft

- Typically not reported
  - Employer may not be able to get $ back
  - Employee may be like "family"
  - Cost of prosecuting can be high
- 40% of what is stolen is cash
Surety as Part of Property-Casualty Insurance Industry

- Surety and fidelity premium volume is between 2% and 3% of property-casualty insurance industry
- Surety issues can be highly visible and politicized

Closing Points

- Surety bonds provide assurance
- Assurance is backed with assurer’s $$$
- Surety bonds facilitate commerce

Acknowledgements

I want to thank the following organizations for providing relevant background information and materials used in this presentation:

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