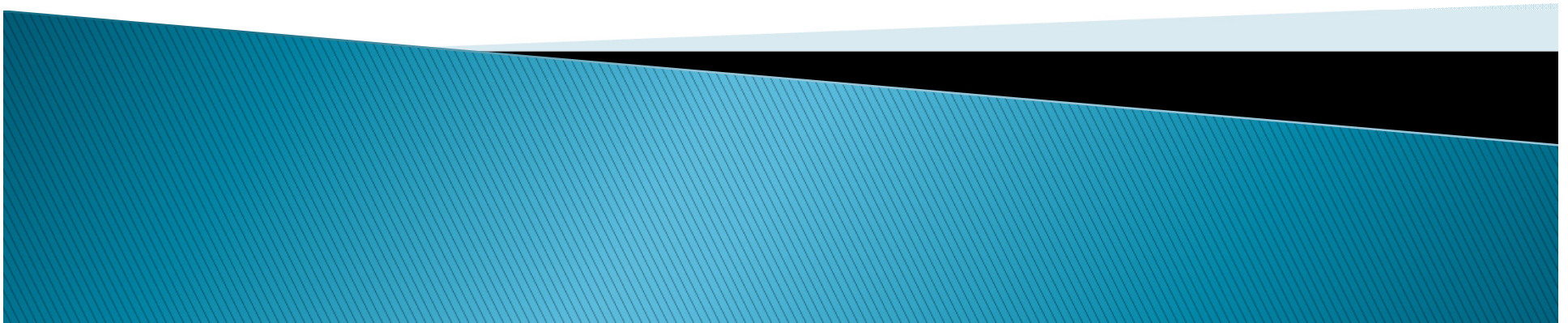


Surety

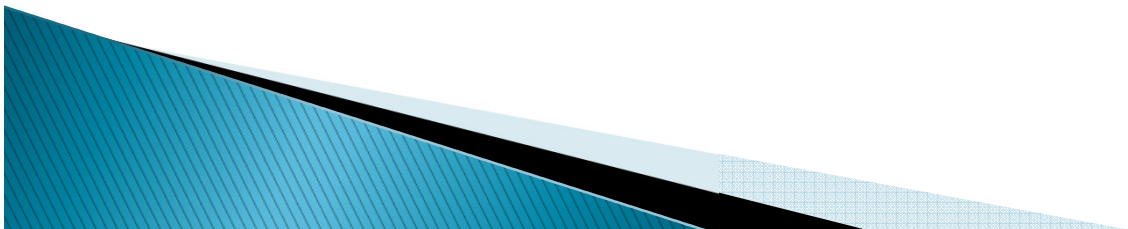
Randy Murray

September 10, 2015



Agenda

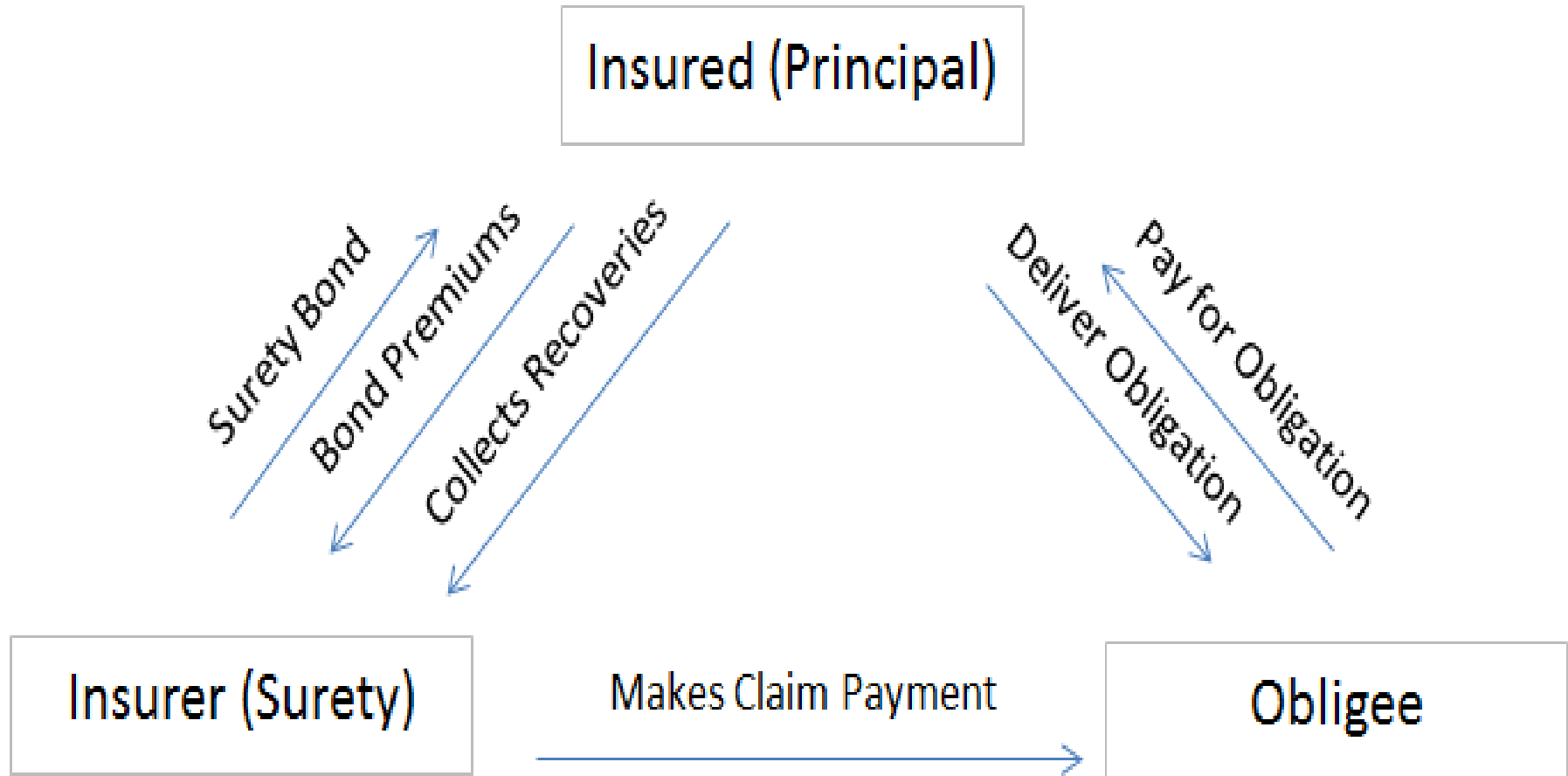
- ▶ Definition
- ▶ Compare Insurance and Surety
- ▶ Types of Surety Bonds
- ▶ Collateral
- ▶ Reserving



Definition

- ▶ Surety Bond is an agreement, issued by an insurance company, that promises to pay one party (the *obligee*) a certain amount if a second party (the *principal*) fails to meet some obligation.
 - Obligations can either be negotiated (as in a contract) or can have a statutory (legal) character.
- ▶ Parties to the Surety Bond:
 - Obligee – the party who is the recipient of an obligation
 - Principal – the party who will deliver the obligation
 - Surety – who assures the obligee that the principal can deliver on the obligation

Relationships Between Parties



Liability Insurance vs Surety Bonds

▶ Liability Insurance

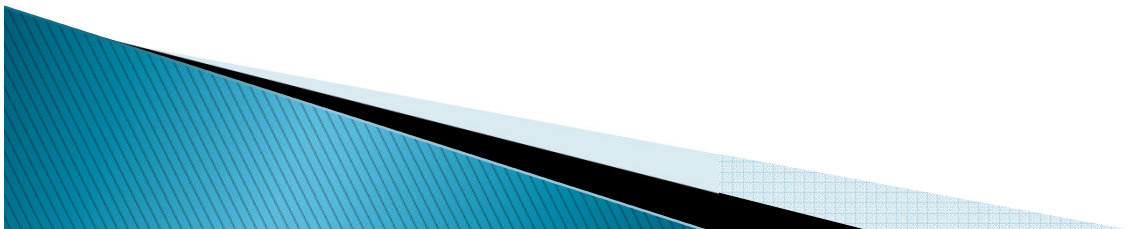
- Protects the Insured.
- Is a form of risk management for the insured.
- Provides coverage for covered losses (i.e., specific causes of loss).
- Losses *are* expected.
- The Insured is *not* expected to repay a claim.

▶ Surety Bonds

- Protects the Obligee.
- Is (generally) related to specific obligation.
- Provides coverage if the obligation is not satisfactorily completed.
- Losses are *not* expected.
- The Principal *is* expected to repay a claim.
 - A surety bond is a form of credit, much like a loan.

Examples of Surety Bonds

- ▶ Contract Bonds
- ▶ License and Permit Bonds
- ▶ Court Bonds
- ▶ Bail Bonds
- ▶ Large Commercial Bonds
- ▶ Plugging and Abandonment Bonds

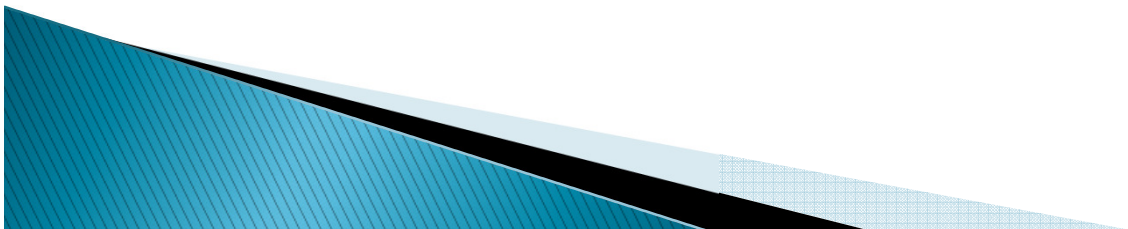


Contract Bonds

- ▶ Guarantees that a construction job will be completed in accordance with the conditions set forth in the contract.
 - In the US, the Miller Act requires a surety bond on federal government construction projects the exceed a certain amount.
 - On non-government projects, if the Principal obtains a surety bond it's because the Obligee made it a requirement in order to get the contract.
- ▶ Main Types of Contract Bonds:
 - Performance Bonds
 - Payment Bonds
 - Maintenance Bonds

Performance Bond

- ▶ Guarantees the project will be completed according to the contract's terms and specifications.
- ▶ In the event the contractor defaults, there are options to finish the performance bond:
 - Finance the contractor
 - Undertake completion of the project
 - Tender a new contractor to the owner (Oligeo)
 - Pay the bond penalty



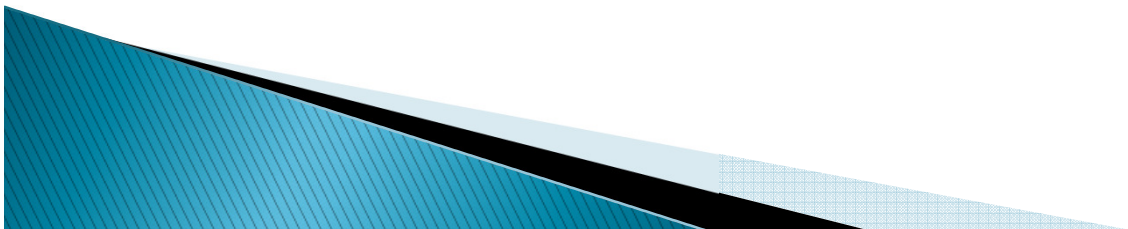
Payment Bond and Maintenance Bond

▶ Payment Bond

- Also called Labor and Materials Bond.
- Ensures that all of a contractor's obligations to suppliers, laborers and subcontractors will be fulfilled in the event that the contractor defaults.

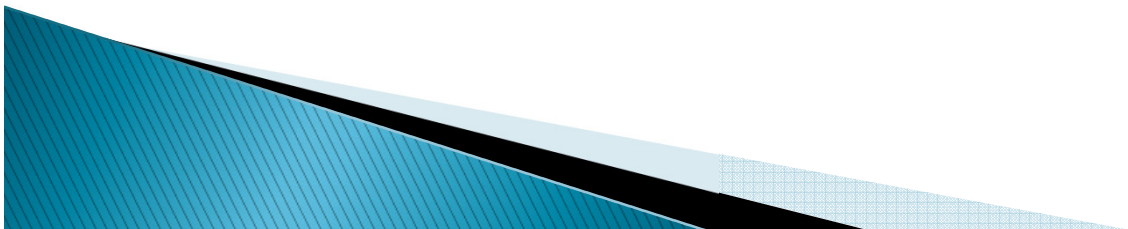
▶ Maintenance Bond

- Sometimes called Warranty Bond.
- Ensures that a project will remain free of defects in workmanship or materials for a specified period of time.



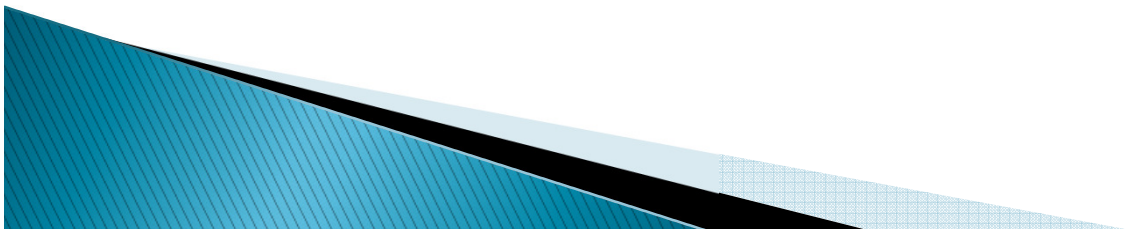
Contract Bonds Additional

- ▶ Usually Performance Bonds and Payment Bonds are issued together.
 - Sometimes the Obligee may request only one of the two.
- ▶ Payment bonds are only in the US.
- ▶ Bid Bonds
 - Assures that the winning contractor will fulfill the contract at the given bid price.



License & Permit Bonds

- ▶ Government agencies require business owners in certain industries to purchase these bonds before they can be legally licensed.
 - They protect consumers by guaranteeing businesses adhere to laws and other regulations enforced by government agencies.
- ▶ Unlike most of the other bond classes that are tied to a specific obligation and are exonerated when that obligation ends, L&P bonds tend to be ongoing.

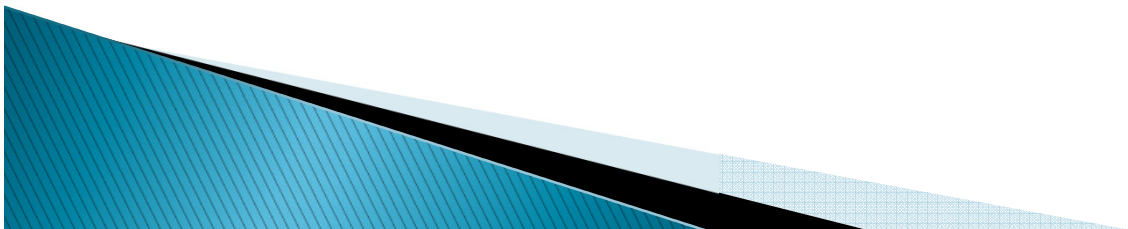


Examples of License & Permit Bonds

- ▶ Although there are many L&P Bonds here are a few of the more common ones:
 - Auctioneer Bond
 - Auto Dealer Bond
 - Contractor License Bond
 - These are not the same as a Contract Bond.
 - Insurance Broker Bond
 - Janitorial Services Bond
 - Mortgage Broker Bond
 - Notary Bond
 - Sports Promoter Bond (e.g., Boxing and MMA)
 - Surplus Lines Broker Bond
 - Title Agency Bond
 - Travel Agency Bond

Errors and Omissions Insurance vs License and Permit Bonds

- ▶ E&O policies protect the *insured* from damages resulting from malpractice.
 - Generally exclude Contractual Liability.
 - Appears to cover Statutory/Legal Liability.
- ▶ License and permit bonds protect the *customer* from losses resulting from the Principal's failure to operate according to laws and regulations.
 - Sometimes a license and permit bond can subrogate against an E&O policy.



Court Bonds

- ▶ Court proceedings often require certain parties to obtain bonds to verify their personal credibility and financial integrity.
- ▶ A bond might be required to:
 - Ensure fulfillment of a court-appointed task.
 - Reduce the risk of financial loss following a court ruling.
- ▶ Types of Court Bonds:
 - Fiduciary/Probate Bonds
 - Judicial/Civil Bonds

Fiduciary/Probate Bonds

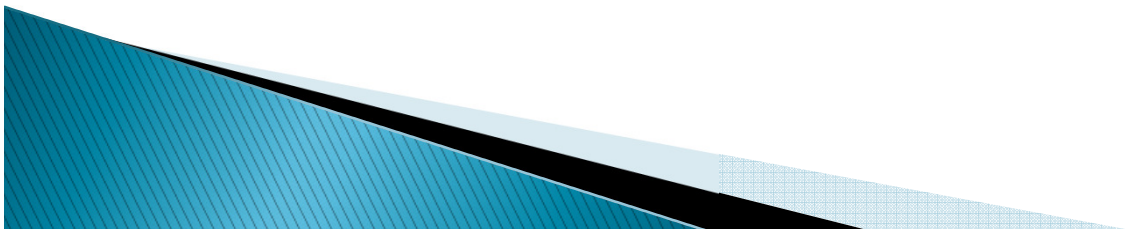
- ▶ Required of individuals appointed by the court to care for others or manage their assets.
- ▶ These ensure that these caretakers fulfill their court-appointed duties, especially those related to funds management, according to the court's expectations.
- ▶ Types include:
 - Estate/Executor Bond
 - Guardianship/Custodian Bond
- ▶ Fiduciary losses are not dischargeable through bankruptcy.

Judicial/Civil Bonds

- ▶ Provides security to preserve interests of opposing parties in litigation when court has granted one party relief.
 - These bonds stop something from happening or allow something to happen.
- ▶ Appeal Bonds
 - These are the most common type.
 - In order to appeal a judgment the plaintiff is required to post an appeal bond.
 - Designed to discourage frivolous appeals.
 - The bond amount is usually 100% of the judgment but may also include interest.
 - The collateral is usually 100% of the bond.
 - The success rate of appeals is not very good.

Other Judicial/Civil Bonds

- ▶ Injunction Bond (Restraining Order Bond)
 - Provides indemnity to the party restrained from certain activities, should the Court decide that an injunction should not have been granted.
- ▶ Court Cost Bond
- ▶ Attachment Bond
- ▶ Stop Notice Bond
- ▶ Release of Lien Bond



Bail Bonds

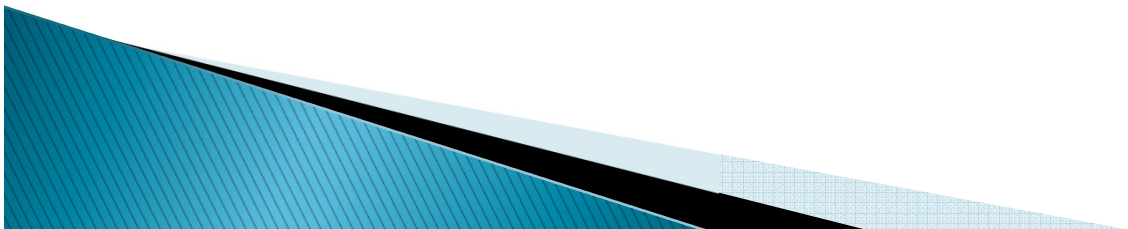
- ▶ This type of bond ensures that a person in jail will appear in court after being released back into the public.
 - The individual can post the bail themselves.
 - The cost of a bond is usually around 10%–15% of the bail amount and the cost is non refundable.
 - For the large bail amounts collateral would also be required.
- ▶ If the accused person fails to appear, the bail amount will be forfeited to the court.
- ▶ A warrant is issued for their arrest and the Bounty Hunter goes to work.

Bonds Related to Land Restoration

- ▶ Large Commercial Bonds
 - Reclamation Bond
 - Guarantees that the vegetation and contours of the land will be recreated after the mining operation is completed.
 - Closure/Post-Closure Bond
 - Guarantees that landfill will be closed after a solid waste management company (e.g., Republic Services) is finished with the landfill.
- ▶ Plugging and Abandonment Bond
 - Guarantees that an energy well will be properly plugged after drilling is concluded and the well is abandoned.
 - Both onshore and offshore drilling.

Collateral

- ▶ Collateral depends on:
 - The riskiness of the obligation
 - The riskiness of the Principal, i.e., credit worthiness
 - The size of the bond
- ▶ Collateral is usually:
 - Irrevocable Letter of Credit
 - Cashier's Check
 - Money Order
 - Real Estate, but rarely



Reserving

- ▶ Triangles
 - Select ultimate losses using standard reserving methods as applied to most other lines of business.
- ▶ Analyze recoveries separately from loss and LAE since the recoveries are substantial.
- ▶ Some surety types are susceptible to large losses and large recoveries that can distort the development.
 - For example there could be a large appeal bond loss with an equally large recovery. It would be best to remove both from their respective triangles.

