BONDS…
SHAKEN OR STIRRED ?

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BACKGROUND AND HISTORY OF SURETY

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A BRIEF HISTORY

- Addressed in the Bible
- 150AD Roman Empire developed its first laws around surety
- 1865 Fidelity Insurance Company became the first corporate surety in the US
- 1894 Heard Act passes – requires bonding of federal projects

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- 1898 US Supreme Court heard its first surety case
- Surety Assn. of America formed by 14 companies in the US
- 1935 Miller Act – performance bonds required for public works contracts in excess of $100,000
- 2003 – over $900m paid by companies to Enron customers following the crash

A BRIEF HISTORY

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WHAT IS A SURETY BOND ?

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- IRMI

- A surety bond is a contract under which one party (the surety) guarantees the performance of certain obligations of a second party (the principal) to a third party (the obligee).

DEFINED

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- 1. A contract between three parties
-
- a. The principal (you)
- b. The surety (the insurer)
- c. The obligee (the party requiring the bond)

DEFINED

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- B. A specialized line of insurance

- 1. One party guarantees the performance of another
- 2. The principal is the party that undertakes the obligation
- 3. The surety guarantees that the obligation will be performed

DEFINED

COMPARING BONDS VS. INSURANCE

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- 1. The 3 parties involved
- 2. **What** is guaranteed – commitment by the principal
- 3. **Who** is protected – the party the principal is doing business with
- 4. **Who** is responsible for claims – the principal

A SURETY BOND

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- 1. Two parties involved
  - a. The buyer of the contract/policy
  - b. The insurance company
- 2. What's guaranteed – payment of Covered Losses
- 3. Who's protected – the party buying the contract
- 4. Who is responsible for claims – the insurer

INSURANCE

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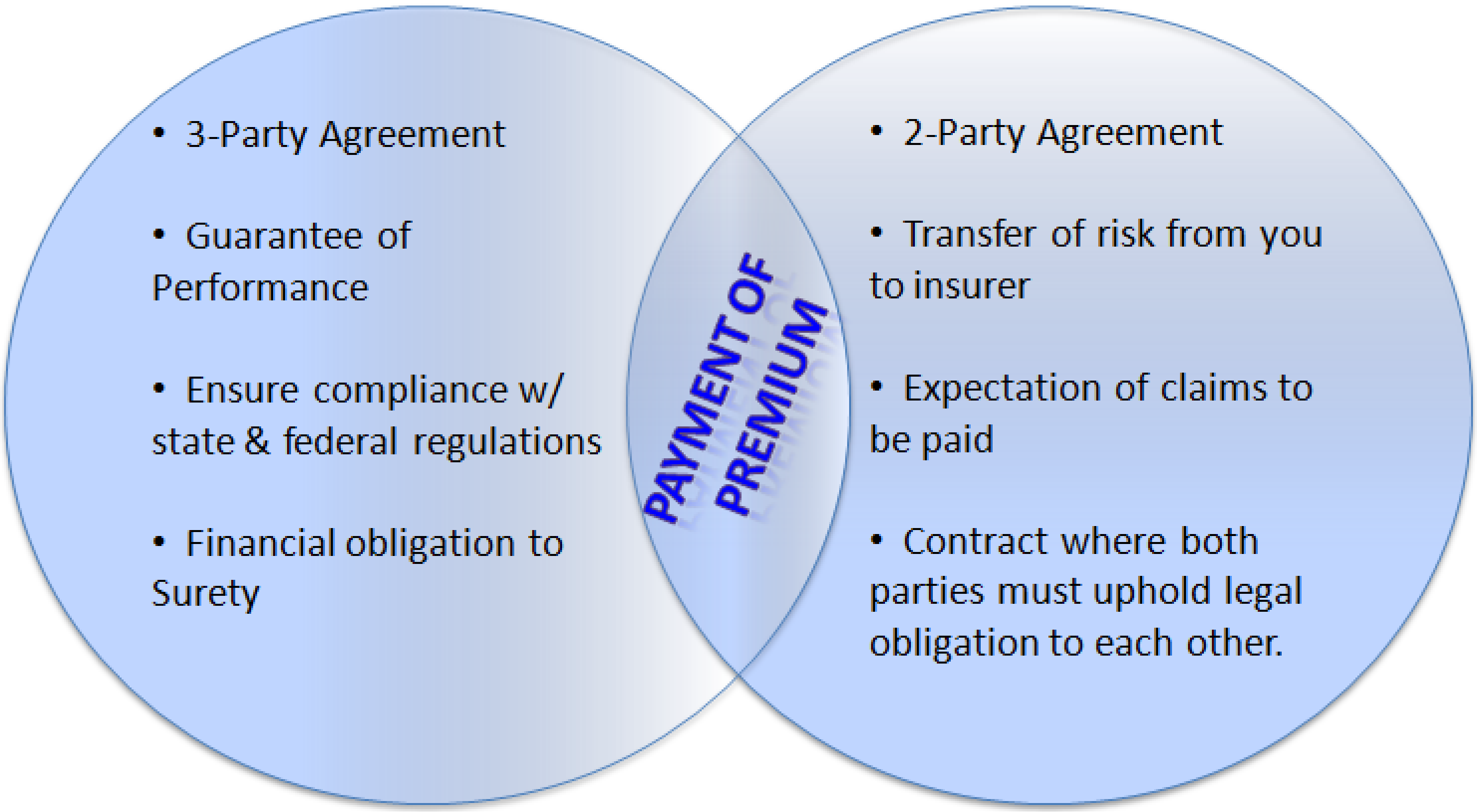
Surety Bonds | Insurance



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CHARACTERISTICS OF SURETY BONDS

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- A. The principal is primarily liable to the obligee
- B. The surety expects no losses
- C. Why is that? – the C's of suretyship
  - Character
  - Capacity
  - Capital
  - Collateral

CHARACTERISTICS

- Considerations may include:
  - a. Personal credit
  - b. Principal's spouse's credit
  - c. Business credit
  - d. Bill payment history
  - e. Management experience
  - f. Past judgments or liens
  - g. Standing in the community

CHARACTER

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- Capacity to complete the work – may include:
  - a. Company staff
  - b. Estimating team
  - c. Supervisory skills
  - d. Project management
  - e. Internal controls
  - f. Overall company management

CAPACITY

CAPITAL

- Capital – money & financial resources
  - a. Profitability
  - b. Working capital
  - c. Cash
  - d. Credit lines
  - e. Debt to equity ratios
  - f. Equity
  - g. Personal financial strength
  - h. Cash is KING

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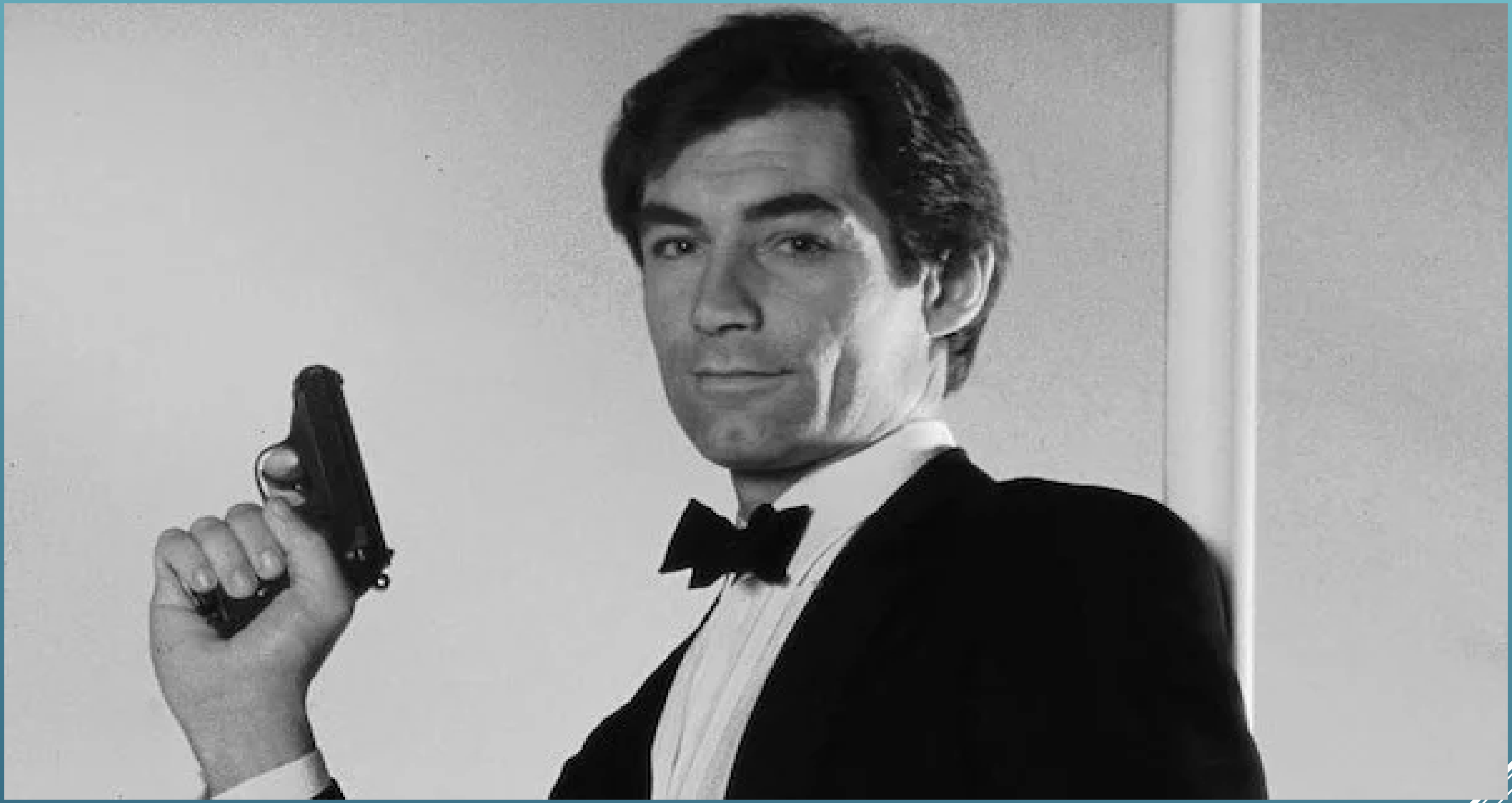
- Collateral – commonly composed of
  - 1. Irrevocable letters of credit
  - 2. Certificates of deposit
  - 3. Fixed assets

COLLATERAL



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- Joint Control

- Salvage

TWO OTHER CONSIDERATIONS

- 1. Funds put into joint accounts
- 2. Dispensed only with the agreement of both the
  - a. Surety
  - b. Fiduciary

JOINT CONTROL

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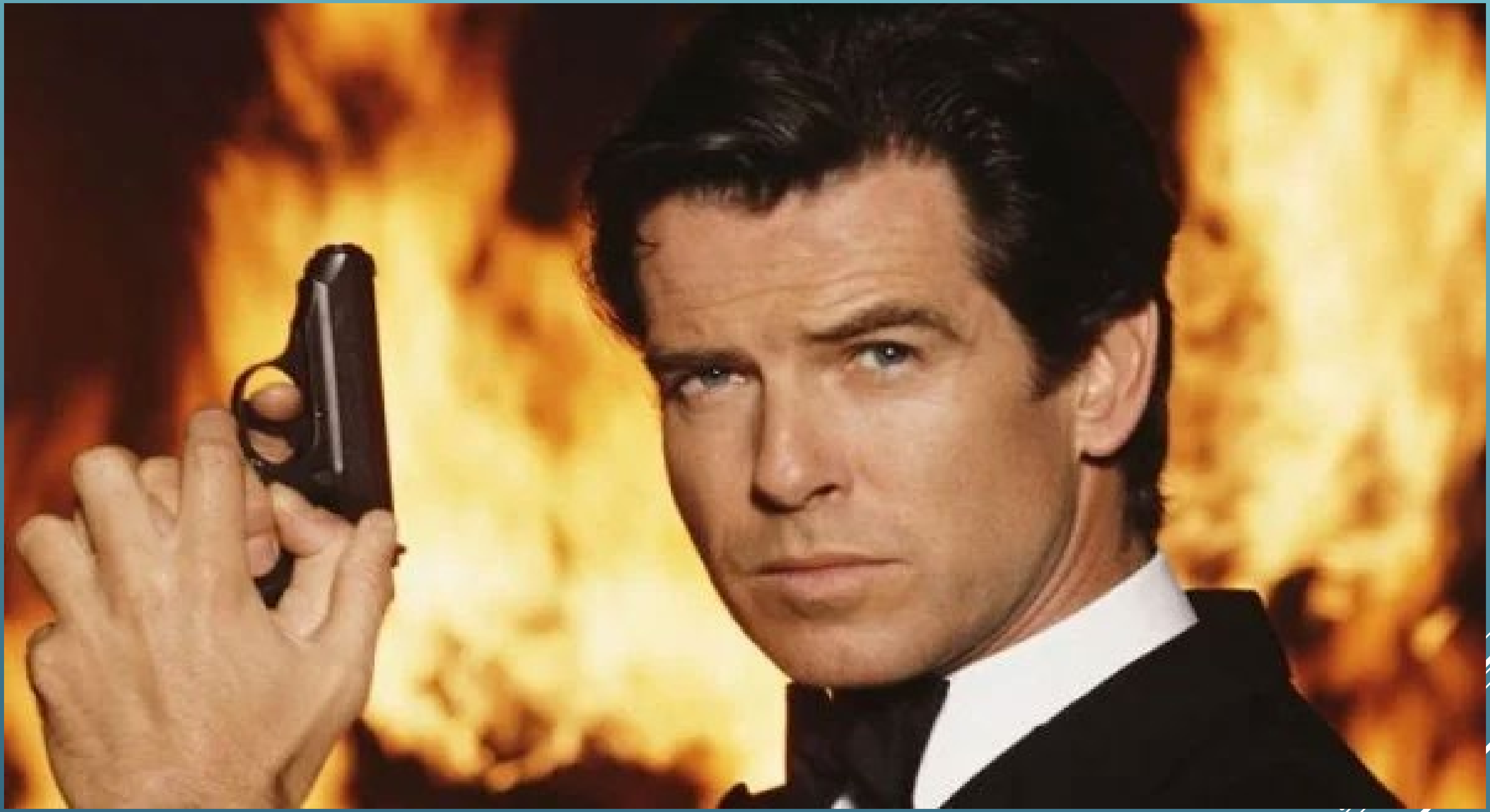
- 1. Reimbursement of a surety's losses
- 2. From the assets of its principal
- 3. From the assets of its indemnitor

SALVAGE



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COMMON BONDS IN USE TODAY

- Contract surety bonds
- Commercial surety bonds
- Fidelity surety bonds
- Court surety bonds

COMMON SURETY BONDS

CONTRACT SURETY BONDS

- 1. Purpose
  - a. Ensure the obligations of a construction contract
- 2. Who uses it
  - a. General contractors
  - b. Construction companies
  - c. Subcontractors of the Federal government
- 3. When is it required
  - a. Commercial projects of a certain size
  - b. Federally funded real estate projects

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- Bid
- Performance
- Payment
- Maintenance
- Subdivision

NORMALLY

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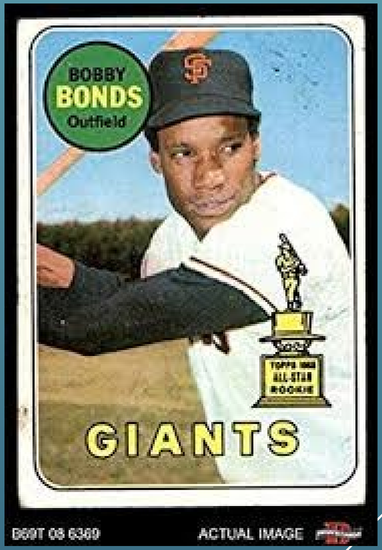
- 1. Ensures licensed companies will comply with all codes
- 2. Required of those who are operating with a specific license
- 3. Typically used by licensed professionals

COMMERCIAL SURETY BONDS

- Required by Federal, State or local government agencies to protect public interests
- They ensure that businesses that operate with a license adhere to all required codes, regulations and conduct
- Types of:
  - License
  - Permit
  - Mortgage
  - Liquor, Utility, warehouse, Auctioneer, fuel tax, etc.

NORMALLY



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- 1. Protects companies & their customers from employee theft
- 2. Often used by companies with assets they want to protect
- 3. Typically not required – it is a peace of mind and protection decision

FIDELITY SURETY BONDS

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- Business Services Bond
- Employee Dishonesty
- ERISA

NORMALLY

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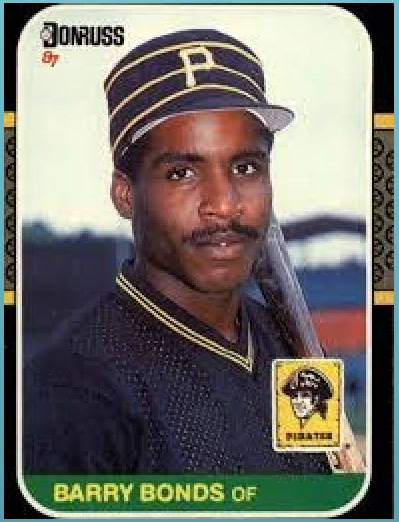
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AVG: .298
RBI: 1996
SLG: .607
HITS: 2935
HR: 762

COURT SURETY BONDS

- 1. Ensures protection from loss in a case of a court proceeding
- 2. Used by
  - a. Companies in a court proceeding
  - b. Individuals or companies with a fiduciary duty
- 3. Typically required from plaintiffs, but not defendants

- Cost Bond
- Administrator Bond
- Guardianship Bond

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- 1. Bonded amount typically between 10% to 15% of the value of a business' equity
- 2. Most require 10% of the total bonded amount in working capital
- 3. This then limits the amount available to be bonded due to the person's capital abilities
- 4. Bond premiums often run from 1% to 15% - based on the four Cs
- 5. Length of a bond is often one (1) to four (4) years
  - a. Principal can then renew
  - b. Some are written "continuous until cancelled"

COMMONALITIES OF EACH

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- Insurance forms and endorsements vary based on insurance company; changes in edition dates; regulations; court decisions; and state jurisdiction.
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