Contents

1) Surety Bonds Timeline(The following timeline information is not needed for the prelicensing Surety exam, but is supplied to you as personal miscellaneous information only).

2,750 BC: Earliest known suretyship contract written on a Mesopotamian tablet. According to the contract, a farmer could not take care of his fields because he was drafted into the king's army, so another farmer offered to work the fields. The two agreed to split the profit evenly. A local merchant served as the world's first known surety by guaranteeing that the second farmer would keep his word.

1792-1750 BC: Suretyship first addressed in a written legal code–the Code of Hammurabi.

670 BC: Age of the oldest surviving written surety contract.

150 AD: Roman Empire developed first laws about surety.

1837: William L Haskins proposed the first surety company in America–the New York Guarantee Company. (Tasker, Murphy & Schwartzkopf)

1840: The first successful corporate surety, Guaranty Society of London, founded. (Tasker, Murphy & Schwartzkopf)

1853: New York enacted first law allowing establishment of corporate surety firms.

1865: Fidelity Insurance Company became first U.S. corporate surety company. (NYT)

1884: American Surety Company incorporated in New York and becomes first U.S. company committed to surety underwriting.

1894: Congress passed the Heard Act, requiring surety bonds on all federally funded projects.

1898: U.S. Supreme Court heard American Surety Co. v. Pauly, its first surety case.

1908: Fourteen corporate sureties formed the Surety Association of America. (surety.org)

1917: The victorious defendants of the Venner v. New York Central Railroad Company et al. Supreme Court case collected a $50,000 surety bond in legal fees from the plaintiff. (NYT)

1930: First known surety bond against suicide written.

1931: Handbook of the Law of Suretyship and Guaranty written to clarify fulfillment of sureties.

1935: Miller Act passed requiring public work contracts exceeding $100,000 to obtain performance bonds. It also mandated payment protection for contracts exceeding $25,000.

1938: American Surety Company and New York Casualty Company develop a new “Discovery Bond,” which protects businesses against old acts of employee dishonesty yet to be discovered. (NYT)

1942: National Association of Surety Bond Producers founded to represent the needs and interests of surety agents and brokers. http://www.nasbp.org

1971: Federal Trade Commission entered the insurance field for the first time by challenging the 1969 merger between the American General Insurance Company and Fidelity and Deposit Company of Baltimore. The merger had made American General the leading surety bond underwriter and the largest fidelity writer in the United States.

1991: Municipal Bond Investors Assurance Corporation began offering new surety bonds that covered deposits local governments put into banks. The First National Bank of Chicago was the first bank to use the bond. (NYT)

1993: Westpac Derivative Products, Ltd., became the first specialist in its music to use a surety bond. The bond was issued for $100 million and allowed the company to earn the highest triple-A ratings. (NYT)

2003: Surety insurance companies, including AIG and Travelers, pay an unheard of $900 million settlement to Enron customers following the crash. (NYT

2) Introduction to Suretyship

Suretyship is a term meaning one person or entity (the surety) guarantees another entity (the obligee) that the third entity (the principal) will or will not do something. In other words, contract surety bonds guarantee the performance or financial obligations of others.

Suretyship (bonds) is one of the oldest forms of financial service. In ancient times a person might leave a family member as "surety" to another until an obligation or debt was discharged. Suretyship today is usually conducted by insurance companies and is evidenced by a written contract called a surety bond. Surety bonds are used to provide a wide range of guarantees. One type of surety bond may guarantee that a contractor will comply with all of the obligations set forth in a construction contract and another may guarantee that an importer or exporter will pay duties as required by the United States statutes.

Most large property and casualty insurance companies have surety departments. In addition, there are some insurance companies for which surety bonds make up all or most of their business. In either case, in order for a company to write a surety bond in the United States, it must be licensed by the insurance department of one or more states in which the surety conducts business. ***A surety that wants to write bonds for federal government construction projects must have a certificate of authority issued by the U.S. Department of the Treasury.***

A Surety Bond is a type of bond that guarantees that a principal will carry out the obligation for which the principal is bonded. A surety bond is most often issued to a contractor, a person seeking a license or permit, or a person involved in a court case. **If the principal fails to fulfill its obligation, the surety will must fulfill the obligation or pay damages to the obligee**.

A Fidelity Bond is a type of bond that will reimburse an employer (the insured) for the **dishonest acts of employees**. Losses generally fall into one of the following categories of dishonest acts: Employee Dishonesty, Forgery, Burglary, Robbery and Theft.

License required to sell bonds:

- *Property and Casualty Producers license* allows the licensee to sell bonds.
- ***Limited-Line License*** means the **producer** can sell ***only one type of product***. **Limited Line Surety License** allows the licensee to sell bonds.
- No pre-license education or continuing education is required, however, **an initial state Surety insurance exam is still required. A Surety License is a limited lines license.**

What is the Surety's Job? To protect public and private interests against financial loss resulting from a company or individual's bankruptcy or failure to perform a contracted service. **If the principal fails to fulfill its obligation, the surety must either fulfill the obligation to the obligee or pay damages to the obligee**.

- ***For example***: A contractor is awarded a building contract for a school. The principal (the contractor) will usually be required to provide a performance bond (or contract bond). The performance bond guarantees the obligee (the school) that the work will be completed in accordance with the contract. If the contractor (the principal) defaults, the surety will be responsible for completing the work or paying damages to the obligee (the school).

Period of Coverage**:** Surety bonds ordinarily do not terminate until the principal has fulfilled its obligation, which may take only a few days or as long as many years. Consequently, ***surety bonds are not issued as a year-to-year contracts and they normally do not allow either the surety or the principal to cancel them.***

Fiduciary Bonds **(usually required by Court Order or by Statute)** guarantee that a fiduciary will faithfully perform duties and act in the best interests of the person being represented. ***A fiduciary is someone who has a legal right to handle the affairs of others. Fiduciary bonds are available for administrators and executors of estates.*** Fiduciary bonds are also issued to receivers in bankruptcy cases and to various trustees.

Fiduciary: person or company holding assets in trust for a beneficiary. The fiduciary is charged with the responsibility of managing the money wisely for the beneficiary's benefit. Some examples of fiduciaries are executors of wills and estates, receivers in bankruptcy, trustees, and those who administer the assets of underage or incompetent beneficiaries.

- A broker is a *fiduciary* for the seller.
- A banker is a *fiduciary* for the bank's depositors.
- An attorney may be a *fiduciary* for the client.
- A guardian or trustee is a *fiduciary* for the beneficiaries. ***Guardians or trustees*** may need to be bonded because they are often ***appointed by courts*** to handle the affairs of people who are incapable of doing so for themselves.
- A qualified producer (or Surety) who receives collateral or security for a bond is a ***fiduciary*** of the property.

Most U.S. States have laws about what a fiduciary may or may not do with a beneficiary's assets. For instance, it is illegal for fiduciaries to invest or misappropriate the money for their personal gain.

Prudent Person Rule: standard adopted by some U.S. states to guide those with responsibility for the money of others. Such fiduciaries (executors of wills, trustees, bank trust departments, and administrators of estates) must act as a prudent man or woman would be expected to act, with discretion and intelligence, to seek reasonable income, preserve capital, and, in general, ***avoid speculative investments***.

General Contract Principles (2 items)

1) **Essential elements of a contract** , Insurance policies are legal contracts and are enforceable by law. The ***Entire Contract Provision*** states the contract consists of the application, the policy and any riders or endorsements. All statements on an application are deemed to be representations, not warranties.

A **contract** is defined as an agreement enforceable by law.It is entered into by two or more persons under which one agrees, for a consideration, to do or to refrain from doing an act in accordance with the wishes of the other party(s).

Insurance is a two party contract between a company and an insured, where an insurer agrees, for a consideration, to provide benefits, reimbursement or provide services for an insured. **Suretyship is a three party contract which will be discussed in detail**.

In order for the contract to be considered a legal and binding contract the following elements must be in place:

**** CCOAL: Consideration, Competent Parties, Offer, Acceptance, Legal Object**

a) **Offer…** The applicant makes the ***offer*** to the insurance company. Remember, the legal contract is between two parties, the insurer and the insured. One must make the offer, and the other accepts it. Insurance, even though advertised by a company, must be initiated by the client.

b) **Acceptance…** The insurance company ***accepts*** the ***offer*** by issuing the policy. A ***counter-offer*** is made by the insurance company if it issues the policy other than how it was requested. The applicant ***accepts*** the ***counter-offer*** when the additional premium is paid, and the counter-sheet is signed by the owner/applicant (insured).

   Note: Offer and Acceptance together constitute an **agreement.** The agreement is meant to create a legal relationship.

c) **Consideration…** Means that something of value must be exchanged by all parties for the contract to be legal. It is the signed and completed application, plus the premium from the insured. If there is no application, the company does not know what policy you need. The insurance company issues a contract (policy) that represents a promise to pay.

d) **Legal Object…** In order for a contract to be legal, it must be for legal purposes only. This is why *insurance contracts do not cover intentional or criminal acts of the insured,* why there must be insurable interest and why stolen property cannot be insured. A contract to commit a crime is not legal and cannot be upheld in a court of law.

e) **Competent Parties…** The insured must be of legal age, not be under the influence of intoxicants and not be mentally handicapped. Any person 18 years of age or older will be considered of full legal age and may contract for or with respect to insurance. A person under 18 years old will be considered a minor.

- Consent must be freely given in order to enter into the contract.
- The meaning of the contract must be certain
- The contract must be possible. If the act is impossible or illegal, the contract is void.

2) Characteristics of an Insurance Contract:

1) **Contract of Adhesion** means that since ***the insurer prepares the provisions of the contract,*** and the policyholder simply **adheres** (or agrees) to them, a court will rule in favor of the **insured** if there is any ambiguity in the contract terms. The contract is issued as a take it or leave it proposition. The insured must accept it as is.

2) **Unilateral Contract** means that one party is required to perform under the contract. The insurer cannot demand that the **insured** make the premium payments, but if the premiums are paid, the **insurer** is obligated to pay.

3) **Conditional Contract** refers to the fact that insurance contracts are conditional. That is, the insurance company is obligated to pay a claim based on the condition that premiums were paid and a proof of loss was submitted to the insurance company.

4) **Aleatory Contracts** are agreements that have an *unequal exchange* of values. The insured will pay premium but may never file a claim due to a loss, the consumer is paying more than the insurer. If there is a claim, the insurer pays out to cover the loss and will pay out more than the premium it has received from that claimant.

3) Parties to a contract

The parties in a contract are the ones bound by the contract. An insurance policy usually has 2 parties, the insurer and the owner. The insured may be a different individual and if this happens the owner is called a third-party owner. In reality, the contract is still between the owner and the insurer. When we move into bonds, there are actually 3 parties to the contract. The insurer or guarantor, the principal and the obligee. The owner's rights are many. They may include canceling the policy, renewing the coverage, paying and determining the mode of payment.

Special Note: Surety bonds are contracts and are subject to the statute of frauds and other common laws calling for certain types of agreements to be in writing. **Therefore, a surety bond is not enforceable unless it is in writing.**

The principal (obligor) – the party who has agreed to perform a contractual obligation.

The surety – the company providing the bond and agreeing to pay damages if the principal defaults. An individual could also act as a surety or indemnitor. If a bail bond has two or more indemnitors (guarantors) they would be listed as co-sureties or dual-sureties.

The obligee (**the one protected**) - is the recipient of the obligation. The party for whose benefit the bond is written, and to whom payment is made if the principal defaults.

1) Surety Contracts (15 items)

1) WA State Surety laws

RCW 48.28

a) Requirements deemed met by surety insurer.

Whenever by law or by rule of any court, public official, or public body, any surety bond, recognizance, obligation, stipulation or undertaking is required or is permitted to be given, any such bond, recognizance, obligation, stipulation, or undertaking which is otherwise proper and the conditions of which are guaranteed by an authorized surety insurer, or by an unauthorized surety insurer as a surplus line pursuant to chapter **48.15** RCW of this code, shall be approved and accepted and shall be deemed to fulfill all requirements as to number of sureties, residence or status of sureties, and other similar requirements, and no justification by such surety shall be necessary.

b) Fiduciary bonds—Premium as lawful expense.

Any fiduciary required by law to give bonds, may include as part of his or her lawful expense to be allowed by the court or official by whom he or she was appointed, the reasonable amount paid as premium for such bonds to the authorized surety insurer or to the surplus line surety insurer which issued or guaranteed such bonds.

c) Judicial bonds—Premium as part of recoverable costs.

In any proceeding the party entitled to recover costs may include therein such reasonable sum as was paid to such surety insurer as premium for any bond or undertaking required therein, and as may be allowed by the court having jurisdiction of such proceeding.

d) Official bonds—Payment of premiums.

The premium for bonds given by such surety insurers for appointive or elective public officers and for such of their deputies or employees as are required to give bond shall be paid by the state, political subdivision, or public body so served.

e) Release from liability.

A surety insurer may be released from its liability on the same terms and conditions as are provided by law for the release of individuals as sureties.

f) Binders—Duration—Premium.

(1) A "binder" is used to bind insurance temporarily pending the issuance of the policy. No binder shall be valid beyond the issuance of the policy as to which it was given, or beyond ninety days from its effective date, whichever period is the shorter.

(2) If the policy has not been issued a binder may be extended or renewed beyond such ninety days upon the commissioner's written approval, or in accordance with such rules and regulations relative thereto as the commissioner may promulgate.

(3) Where the premium used in the binder differs from the actual policy premium by less than ten dollars, the insurer shall not be required to notify the insured and may use the actual policy premium.

2) Definition of a Surety

A surety is a contract whereby one party (the Surety company or guarantor) promises another party (the obligee) that a third party (the obligor) will, or will not, do something.

There are 2 main types of bonds. A surety bond promises something is sure to happen, i.e. the contractor will finish the roof. If the job is not complete, it is up to the surety to make sure it is done. The surety, then, is a 'person' who accepts legal responsibility for another person's debt or behavior.

'Person' as defined by law is an individual, company, insurer, association, organization, reciprocal exchange, partnership, business trust, or corporation.

A fidelity bond guarantees something will not happen; i.e., no money will be missing …

Surety guarantees activity, fidelity deals with money.

3) Differences between Surety and Insurance :

An insurance policy has 2 parties, the owner and the insurance company, a surety has 3 parties.

Insurance companies plan on insurance claims. They collect premium from a large group of people in order to have money to pay claims.

Surety companies do not want to pay claims. If and when they do pay, they will go back to the responsible party to collect back what they paid out.

Insurance is defined by law as follows:

"***Insurance is a contract whereby one undertakes to indemnify another or pay a specified amount upon determinable contingencies."***

i. Indemnity is:

- The obligation resting on a person to make good a loss
- The right which the person suffering the loss or damage is entitled to claim
- Restoration to a victim of a loss by payment, repair, or replacement

***If I have collision coverage on my auto and the is a collision, the insurer will pay for the repairs as well as a rental vehicle while the car is being repaired. I am indemnified when the repair is completed and I have paid my deductible. If a $10,000 ring is lost and it is scheduled as a floater on my homeowners' policy, I will be paid $10,000. There will be no subrogation to me. In other words, the insurer pays and continues to collect my premium but that's it.*

ii. How losses are paid

Loss Payments: Differences between surety and insurance fields can be found with respect to indemnification and subrogation rights. Principals must indemnify the surety company for any losses and the ***surety has subrogation rights*** against the principal who purchased the bond. With insurance the insurer agrees to indemnify the insured or another party on behalf of the insured, and has ***no subrogation rights*** for paid losses against the insurer.

A surety bond is designed to protect the bonding company while an insurance policy is designed to protect the insured. ***Losses are NOT expected in the surety field*** so ***premiums are not collected to pay losses but*** **are actually paid for service fees.**

Insurance companies are expected to have losses and charge premiums for paying those losses.

As an additional departure from Insurance contracts, Suretyship involves a continuous review process in order to determine that there is no negative change in the 3 Cs of a contractor and that the contractor's work program is progressing successfully.

Regarding insurance, policies may be a valued policy or an indemnification contract. A valued policy is where the company pays the face value of the policy. Life insurance, scheduled items on a property policy like rings or artwork. Indemnification contracts are intended to make a person whole, back to the original position with no loss or gain. Most property and casualty as well as disability contracts are indemnification contracts. An individual may have 3 life policies and upon death, each policy pays the face amount. If an individual were to purchase 3 auto policies and their car was stolen, each company would pay 1/3 of the loss.

When there is a claim on a surety, the company investigates and if there is a valid claim they refer it to the principal to take care of. If this doesn't work, the surety will do what is necessary according to the type of bond to fulfill the contract. They surety will then approach the principal for reimbursement for all moneys spent including claim defense costs. (a.k.a. subrogation)

iii. Two party agreement

An insurance contract is a legal contract between 2 parties, the owner and the insurance company. A bond is a 3 party contract.

iv. Cancellation

The owner of an insurance policy may cancel the contract at any time in writing to the insurer or by returning the policy. An insurance company may cancel for non-payment of premium always, but depending on the line of insurance must have a reason to cancel. Getting sick will not cancel a person's life or disability policy.

Canceling a bond may be done by the obligee in writing or by returning the bond, the bond may expire, or the surety may cancel as the underlying terms have been met, i.e., in a bond to replace a roof, the work is done and the bond is no longer needed.

Most bonds are continuous as long as premiums are paid. ***However, with Fidelity Bonds, coverage for an employee is cancelled immediately upon discovery by the obligee of any dishonest act committed by that employee (the principal)***.

v. **Binders**: A binder is temporary guaranteed coverage and is in effect until the policy issues. A binder may only be given by an agent as a representative of a company. Binders may be in writing or may be verbal. When a premium receipt is issued that also binds coverage a premium receipt must:

- Be given or mailed no later than the next working day.
- clarify this is a binder, not the policy
- have the date, amount paid, full name of the carrier and the location of the home or principle office, name of the insured, effective date of coverage if not today's date, reason for coverage

4) Obligation of the surety

: A **Surety Bond** is a type of bond that guarantees that a principal will carry out the obligation for which the principal is bonded. A surety bond is most often issued to a contractor, a person seeking a license or permit, or a person involved in a court case. ***If the principal fails to fulfill its obligation, the surety will must fulfill the obligation or pay damages to the obligee.***

5) Parties to the Surety Bond

-A surety bond is a contract between 3 individuals:

a) The obligee: The party protected

b) The principal: The party who is to perform the contractual obligation for the obligee.

The party who purchases the bond

The party who stands between the bonding company and the loss

c) The surety: The person who assumes the risk and guarantees the contract will be complete

***The obligee is me, the person who needs a new roof. I hire a contractor, make sure they are licensed and bonded, and they start the job. If they stop with a portion done and I cannot get in touch with them to finish the work, I contact the insurer. They, acting as the party who guarantees the work (the guarantor or surety), will refer back to the principal first, then find another company to complete the work according to the original specifications and pay them to complete it. The surety will then subrogate to the principal to be reimbursed the amount they paid out.*

6) Suretyship: Surety, whether personal or corporate, is a guarantee that you will do something!

Promise of Surety… If the principal fails to fulfill its obligation, the surety must either fulfill the obligation to the obligee or pay damages to the obligee. But then the surety has the right to recover its losses from the principal. This right of recovery is called subrogation and part of common law.

- In the event of a claim, the surety will investigate it. If it turns out to be a valid claim, the ***surety will pay it and then turn to the principal for reimbursement*** of the amount paid on the claim and any legal fees incurred. If the principal defaults and the surety turns out to be insolvent, the purpose of the bond is rendered void. Thus, the surety on a bond is usually an insurance company whose solvency is verified by private audit, governmental regulation, or both.

- ***A key term in nearly every surety bond is the penal sum***. This is a specified amount of money which is the maximum amount that the surety will be required to pay in the event of the principal's default. This allows the surety to assess the risk involved in giving the bond; the premium charged is determined accordingly.

Promise of Insurance **is to assume, for a specified time, the losses suffered by the insured**. Insurance is a risk sharing device that expects losses based upon calculated probabilities. Though losses occur, bonds are structured and written with the expectation that few losses will occur and those that do occur are recoverable. A bond closely resembles a **bank letter of credit**. The **surety** is lending its credit to a person or organization to back their service or performance of an obligation.

Fidelity vs. Surety

Surety is a person (or entity), who is legally responsible for the contracts, debt, delinquency, or liability of another. If there is more than one surety, it could be called ***Co-sureties or Dual-sureties***. **Two or more individuals may act to guarantee that the principal will return for court**.

Fidelity means faithfulness to obligations, duties, or observances. It means adherence to right, careful and exact observance of duty, or discharge of obligations.

Fidelity Bonds are bonds that can protect business owners and employers from monetary or property loss at the hands of employees. Some businesses, including insurance companies, are required to utilize fidelity bonds. **Fidelity Bonds** are bonds issued to **protect an employer from financial or property losses due to the dishonesty of employees.**

Cancellation of a Bond: Most bonds are continuous as long as premiums are paid. ***However, with Fidelity Bonds, coverage for an employee is cancelled immediately upon discovery by the obligee of any dishonest act committed by that employee (the principal)***.

7) PURPOSE AND TYPES OF FIDELITY BONDS

A Fidelity Bond is a type of bond that will reimburse an employer (the insured) for the **dishonest acts of employees**. Losses generally fall into one of the following categories of dishonest acts: Employee Dishonesty, Forgery, Burglary, Robbery and Theft.

Coverage for dishonesty and forgery is available for businesses under two different types of contracts. **One is to obtain the coverage through an insurance policy and the second is to obtain the protection through a fidelity bond.**

- ***Fidelity bond coverage for an employee is cancelled immediately upon discovery by the obligee of any dishonest act committed by that employee (the principal).***

a) **Individual Bonds** are bonds written in the ***name of a single employee*** for a specific limit of liability. If an employer has only one employee, or one employee with access to funds or the business's property, an individual bond could be used.

b) **Schedule Bonds** are bonds that schedule the coverage for acts of a ***specific named employee or by the employee's position or job title.***

- A ***name scheduled bond*** covers several specific individuals who are named on the bond, and allows the insured to list a ***separate limit of liability for each employee*** on the schedule.

- A ***position scheduled bond*** is similar to a name scheduled bond, except that it covers ***listed positions*** and does not mention the employees by name.

c) **Blanket Bonds** are bonds which protect an employer from loss due to dishonest acts of all employees.

- **Blanket Position Bonds** are bonds which protect an employer from loss due to dishonest acts of employees, including embezzlement. The bond is issued for a fixed amount and each position (rather than individual) is covered for this amount.

- **Blanket Position Public Official Bonds** are bonds which protect from loss due to dishonest acts of public employees. The bond is issued for a fixed amount and each position is covered for this amount.

- **Blanket Public Official Bonds** are bonds which protect from loss due to the dishonest acts of all public employees.

Indemnification and General Indemnity Agreement

If the principal defaults, the surety pays the obligee. **The surety has the common law right to recover its losses from the principal under the rights of subrogation**. Under subrogation only the bond penal amount (penalty amount) can be recovered by the surety and not any additional expenses or costs of the surety.

- **(General) Indemnity Agreement**— Is a contract provision which allows the surety to go after the principal for the recovery of expenses, costs and losses incurred by the surety over and above the bond amount. It in effect expands the subrogation rights.

The surety may not issue bonds unless it has received agreements from the principal and other indemnitors with sufficient assets to secure the surety from any claims that may be made against the bonds. This is done by an ***indemnity agreement to be signed by the principal and the individuals who will serve as indemnitors.***

The indemnity agreement sets forth and expands upon the separate common law obligations (subrogation rights) between the principal and the surety. A separate indemnity agreement may be issued for each bond or the parties enter into a **general indemnity agreement covering any bonds that the surety may issue to that contractor.**

The indemnitors (the contractor and individuals who have pledged their assets to support the bonds) agree that they will indemnify (completely reimburse) the surety for any liabilities, attorney's fees, expenses, or damages the surety may incur as a result of its issuance of a bond to the principal.

d) **A Personal Bond** (sometimes referred to as a **signature bond**) *is where you merely put up a promise to appear, or guarantee the bail with personal assets*. Fail to appear in court and you will owe the money for the bond. A Personal bond is just a signature for specific amount. The court wants a guarantee that you, as an individual, will properly administer the estate. A personal bond will need to be procured.

e) **Corporate Suretyship** was first formed in the 1800s. Prior to that time, individual arrangements were risky and there were no guarantees that the assets of a backer would satisfy the obligation. Once organizations began to specialize in issuing surety bonds, formal contracts backed up by corporate assets became available to meet individual and business needs. Bonds are usually issued by insurance companies.

A corporate surety is a company that charges for the guarantee; and

A personal surety is a person(s) who the court would accept as a guarantor (like a co-signor).

8) Role of U.S. Treasury

Most large property and casualty insurance companies have surety departments. In addition, there are some insurance companies for which surety bonds make up all or most of their business. In either case, in order for a company to write a surety bond in the United States, it must be licensed by the insurance department of one or more states in which the surety conducts business. ***A surety that wants to write bonds for federal government construction projects must have a certificate of authority issued by the U.S. Department of the Treasury.***

Treasury Department Circular No. 570 is published in the **Federal Register** yearly as of the first workday of July. As they occur, interim revisions of the circular are published in the Federal Register. **Surety companies issued a Certificate of Authority from the U.S. Treasury Department are published in the Federal Register.**

Financial Institutions (a.k.a. Banker's Bonds) have special exposures because they receive and distribute funds and handle transactions for clients. ***Various bonds are available to cover bankers, credit unions, finance companies, insurance companies, and savings and loan institutions***.

- Bonds for financial institutions provide broad coverage for multiple exposures and are similar to that provided by a commercial crime policy. ***One bond might be used to cover employee dishonesty, robbery, larceny, theft or hold-up on or off the premises***.

- For example: a **Banker's Blanket Bond** is a Fidelity bond that covers banks in the event of a loss due to the *dishonest act of one of its employees*. If a teller steals money from the bank they are employed by, the bank would be indemnified from the Banker's bond. Then the bonding company would go after the ex-employee for recovery of the money.

- The Banker's bond would also protect a bank against losses from a variety of criminal acts: ***employee fraud, robbery, burglary and forgery***.

- **It does NOT cover errors made by employees, losses on inventory computation or a profit and loss computation.**
- ***Fidelity coverage for an employee (the principal) is cancelled immediately upon discovery by the obligee of any dishonest act committed by that employee.***

9) Notary Bonds

- Notaries are individuals empowered by a state to perform certain legal functions. Primarily, those are limited to administering oaths and affirming signatures. To protect those who use notaries, most states have a bonding requirement as part of the notary public registration process. The notary surety bond, underwritten by a private company, does not transfer liability away from the notary, but ensures that her clients will receive swift compensation for damages.

The required value of a notary surety bond varies by state. They typically range from $5,000 to $15,000, though the amounts are subject to change. The cost of obtaining the bond is a tiny fraction of the bond amount, as little as $35 to $50 depending on the surety company. ***The precise requirements for each state are set forth in statutes and codes.***

Notaries are licensed through the states. A claim against the notary in her professional capacity is filed against the state. The surety company collects a fee to write the notary bond. If a claim is made, the surety pays out to the state, as obligee, in the amount of a claim, up to the maximum limit of the bond. The payment is used to settle the claim for damages by the notary's client. The principal, which is the notary, is then liable to the surety company, who can collect the full amount of the payment from the notary directly. The notary surety bond does not protect a notary; it protects her clients.

Key concepts to remember about Notary Bonds:

- They protect the public - not the Notary - from liability or dishonest acts by a Notary.
- They cover monetary damages for claims made against a Notary.
- They must be repaid by the Notary in the event of a claim.
- Because Notary Bonds only protect the public, Notaries will have to repay any judgments in addition to reimbursing their bonding company. Errors & Omissions Insurance can protect Notaries from personal financial liability.
- Washington State requires a Notary Bond to protect the public from negligent mistakes or dishonest acts made by a Notary.

10) Underwriting considerations a.k.a. Underwriting (Prequalification) Standard…

The principal (or contractor in a contract bond) must qualify for a bond. **This process is very much like qualifying for a loan, line of credit or mortgage, or an insurance policy.** Underwriting is a risk selection process and requires information on an application regarding the principal. What is this for? Do you have any experience? What is your financial condition? Credit score?

Unlike with insurance, there is little expectation of loss with surety bonds. Because of that, the bond premium is typically meant to cover ***prequalification services***.

The primary service of the surety is prequalification. Therefore, the surety bond fee that a contractor pays (for example) is primarily for service and granting of surety credit. A surety offers financial backing for the contractor. It does not lend the contractor money, but rather commits its financial resources to back the commitment of the principal/contractor.

For example, with a Contract Bond, the surety company's process for prequalification analyzes the contractor's (principal's) entire business operation. The surety is backing the promise of that contractor to perform the contract. The company investigates and evaluates the contractor's capacity to perform a particular contract, determines his or her financial strength (capital), reviews his or her character and may ask for personal or corporate indemnity.

- The surety bond producer (agent) assists the contractor with prequalification in the area referred to ***the 3 C's of underwriting a surety bond:***

  Capacity to perform;

  Capital or financial strength; and

  Character of the individual (personal information).

a) Capacity to Perform – typically includes analysis of:

- Resumes of the contractor and key personnel
- Contractor’s track record of successfully completed work
- **Adequacy of the contractor’s equipment and tools required to perform the contract**
- Rationale for why the contractor is undertaking the project
- Continuity plan that illustrates how the company will continue performing its obligations in the event of the demise or departure of key personnel
- Contractor’s future plans, goals, objectives, and growth strategies

b) Capital (Financial Strength) – typically includes analysis of:

- Detailed financial statements for the past 3-5 years. Accounting methods should comply with Generally Accepted Accounting Principles (GAAP). Financial statements should include: Balance Sheet, Statement of Earnings, Statement of Changes in Owner's Equity, Statement of Cash Flow and Contract Schedules.
- *The surety may ask for interim financial statements. Requirements for interim statements vary, but a six-month statement usually is the minimum.*
- Contract schedules that typically include a summary of completed contracts and contracts in progress. ***Sureties also will require a schedule of work in progress (usually quarterly).***
- Cost records that account for the financial status of the contractor's jobs.
- Credit reports demonstrating how the contractor handles payment of debts; and
- A bank line of credit showing unsecured credit that can be used as short-term working capital.

c) Character – Surety companies may review trade references from owners, architects, subcontractors, general contractors, material suppliers, etc., with whom the firm has worked to get a sense of the contractor's reputation for fair, businesslike dealings.

Indemnity Agreement - Surety companies may require the personal indemnity of the owners, their spouses, or major stockholder(s) of the construction firm to assure that they are going to put forth their best efforts to meet contract obligations. For a proper evaluation of what loss paying power the personal indemnity does provide, the surety may request the contractor to provide personal financial statements.

- The indemnity agreement sets forth and expands upon the separate common law obligations (subrogation rights) between the principal and the surety. A separate indemnity agreement may be issued for each bond or the parties enter into a **general indemnity agreement covering any bonds that the surety may issue to that contractor.**

- **As an additional departure from insurance contracts, Suretyship involves a continuous review process in order to determine that there is no negative change in the 3 Cs of a contractor and that the contractor's work program is progressing successfully.**

11) Obligations under a surety bond

a) Contractual

Contract Bond… a guarantee of the performance of a contractor. In general, ***contract bonds are used to guarantee that the contractor will perform according to the specifications of the construction contract.*** If the contractor fails to perform according to contract, the insurance company is responsible to the insured for payment, up to the limit of the bond, which is usually for an amount equal to the cost of the construction project. The insurance company then has recourse against the contractor for reimbursement.

Many performance bonds give the surety three choices:

1) Completing the contract or project itself through a completion contractor

2) Selecting a new contractor to contract directly with the owner

3) Allowing the owner to complete the work with the surety paying the costs

b) Statutory

Statutory Bonds are bonds required by law or statutes, usually with the intention of protecting the public. Some of the same bonds are required by statute and by the courts, such as Appeal Bonds.

Statutory Bonds are bonds required by law or statutes, usually with the intention of protecting the public. Some of the same bonds are required by statute and by the courts, such as Appeal Bonds. Types of bonds that might be ***required by statute or law*** include:

Federal Officials Bond… coverage for the federal government in the event of loss due to dishonest acts of federal government employees.

Permit Bond… guarantees that a person licensed by a city or state agency will perform activities for which the bond was granted, according to the regulations governing the license.

Securities Bond… protects the issuer of securities (stocks and bonds) against forgery of the securities.

Appeal Bond… guarantees payment of the original judgment of a court. When a judgment is appealed, ***a bond is required by the court*** to guarantee that if the appeal is unsuccessful, funds would be available to pay the original judgment as well as costs of the appeal. This serves to discourage an individual from appealing merely to stall for time or for frivolous reasons.

Bid Bond… bond required of a contractor submitting the lowest bid on a project. ***If the contractor then refuses to undertake the project, the bid bond assures that the developer will be paid the difference between the lowest bid and next lowest bid.*** The bid bond encourages contractors to make serious bids and live up to their obligations.

Notary Bond… Notaries are licensed through the states. A claim against the notary in his/her professional capacity is filed ***against the state***. **The surety company collects a fee to write the notary bond. If a claim is made, the surety pays out to the state, as the obligee.**

c) Court order

Certain bonds are required by the courts. For example:

A ***court bond*** is a dollar amount set by a judge, which must be paid by the defendant charged with a crime, to ensure that the defendant returns for trial. A court bond can also be non-monetary -- or "on your own recognizance" -- meaning the judge believes the defendant will return to court on his/her own, without any disincentive from the courts. Bond can also be denied, and in the case of a homicide, usually is.

- The purpose of a court bond is to ensure a defendant returns to court. If the bond amount is paid, the accused may go home until the court date. If it is not paid, the defendant will be held at the local jail until the court case comes up.
- Bond, in many cases, ***is a set amount determined by the criminal statute*** that the defendant is accused of violating. Different classes of felonies and misdemeanors have different bond amounts. Sometimes, it is up to the judge's discretion; in others, it is not.
- Defendants usually don't have to pay the full amount of the bond. Most states have the ***10 percent rule which states*** the defendant only has to pay 10 percent of the total bond set. That is the bail amount.
- There are typically four different types of court bonds that can be issued after a person is arrested. There is the *signature bond*; the *cash bond*, in which the arrestee must pay the bail amount upfront before he is released; *the 10-percent bond*, in which the arrestee must pay 10 percent of the bail amount upfront before he is released; and *a **surety bond***, in which a bail bondsman, who is approved by the court, promises the court that the arrestee will appear on his court date, and that if he does not, the bail bondsmen will pay the bail amount in full.

12) Power of attorney-A legal instrument (contract) in writing by which one person (a surety company for example) appoints another (bondsman or surety agent for example) as his agent and confers upon him the authority to perform certain **specific acts** (as in writing bonds for a surety company) ***on behalf of that person***. The purpose of a power of attorney is to evidence the authority of the agent to third parties with whom the agent deals.

- ***Because the bond agent has the "power of attorney" from a surety company the bonding agent can write bonds and sign on the surety's behalf.***
- ***Bond principals give their power of attorney to the bonding agent to act on the principals' behalf.***
- **Authority Agreement… An agreement (or contract) between the agent and the surety governing the use of the Power of Attorney.**