AFFILIATED
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PROVIDING PEACE OF MIND SINCE 1962

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Bonding VS. Insurance

Important: A bond is not an insurance policy, but more like banking.

Bond = 3 Parties

Contractor (principal) + Bond Co. (surety) + Owner of Project (obligee)

A bond is a three party agreement whereby the surety guarantees the faithful performance of the principal to the obligee.

Premium – Judgment Rating

A bond premium is more of a service charge to cover expenses for weeding out unqualified risks and for handling the transaction.

Losses Are Not Expected

The surety takes only risks that are qualified and safe risks.

Losses Are Recoverable

The surety is lending its name which it wants returned untarnished after the obligation is performed. In case of a claim, the surety expects to collect from the principal.

Sureties – Selective Risk Takers

Cannot afford to write every risk, must be selective.

Insurance = 2 Parties

Insured + Insurer

Insurance is a two-party agreement. The insurance company pays the insured directly for losses incurred

Premium – Actuarial Rating

Insurance premium covers losses and expenses.

Losses Are Expected

Insurance losses are expected, therefore, the rates are adjusted to cover the losses and expenses.

Losses Are Not Recoverable

An insurance company doesn’t expect to be repaid by the insured.

Insurance – Writes Most Risks

Insurer tries to write most everything, thus letting the volume cover the risk.

Fundamentals

- Understanding the basic concept of bonding is helpful in communicating the underwriting requirements/process to the principal.
- New and less experienced contractors may not realize that applying for a line of bonding credit is similar to applying for a bank loan.
- There are forms to complete, credit and reference checks conducted, banking history reviewed, suppliers contacted, job completions confirmed, etc.

Bonding VS. Banking

Bonding

A surety lends its name for a service fee and expects the name returned untarnished when the obligation is completed.

Banking

A bank lends money for a much higher service fee. Collateral is required in most cases, and they expect the money back with interest.

Bid Bond

Definition – A bond given by a bidder to guarantee that the bidder, if awarded the contract, within the time stipulated will enter into the contract and furnish the prescribed Performance and/or Payment Bond. Default will ordinarily result in liability payable to the obligee for the difference between the amount of the principal's bid and the bid of the next low bidder who can qualify for the contract. In any event, however, the liability of the surety is limited to the bid bond penalty.

The BID BOND comes BEFORE the PERFORMANCE and PAYMENT Bond

- Are used by the obligee to pre-qualify contractors.
- Help eliminate those who do not qualify for bonding
- Are written for 5% or 10% of the total contract price.

Important: The time factor can be a critical issue.

The Surety **will not** issue the Bid Bond unless the contractor qualifies for the Performance and Payment Bond. Therefore, the underwriting is done on the total contract price, which is the amount that the Performance Bond is written for.

Even though most obligees will allow the posting of a cashier or certified check in lieu of a Bid Bond, it would be wise for the producer to educate the contractor about applying for a line of bonding credit with a surety company first. If the contractor bids with a cashier's check and is awarded the job, then he has approximately 10 to 14 days to provide the Performance/Payment Bond. Failure to do so, in accordance with the terms of the bid, may result in forfeiture of the cashiers or certified check.

Pre-qualify a contractor for a line of bonding credit. Write contractor clients who might need bonding some day and send them the necessary underwriting paperwork.

Performance Bond

Definition – A bond which guarantees performance of the terms of a written contract. Performance bond frequently incorporate payment bond (labor and materials) and maintenance bond liability.

Obligation – The contractor will perform the job in accordance with the terms of the contract, plans, specifications, all of which are part of the contract. Basically, the bond covers whatever is in the contract. That is the reason why the surety needs a copy of the contract to determine what their liability is.

Important – Know who the obligee is, whether it is an individual owner, a bank lender in the project, third party, or dual obligee. Each one takes a different approach in the underwriting process.

Payment Bond

Definition – A bond given by a contractor to guarantee payment to certain laborers and suppliers for the labor and material used in the work performed under the contract. This liability may be contained in the performance bond, in which case a separate labor and material bond (payment bond) is not given.

The bond form may be separate or there may not be one because the language is contained in the performance bond.

If a payment bond is issued separately from the performance bond, then the amount is usually for 100% of the contract price. If the payment bond is combined with the performance bond, then the amount may be 100% of the contract price, unless specifically stated otherwise.

Laborers and materialmen are prohibited from filing liens against federal projects. The Miller Act statue mandates that on contracts above a specific dollar amount, the contractor will provide performance and payment bonds, within the form specified by the Miller Act.

Basically, the payment bond states that those people supplying labor and materials on the project will be paid subject to restrictions and limitations imposed by statue or the contract.

Other Types of Bonds

- Notary
- Receivership
- Subcontract
- Maintenance
- Subdivision
- Completion
- Supply