What is Suretyship?

Suretyship is a very specialized line of insurance that is created whenever one party guarantees performance of an obligation by another party. There are three parties to the agreement:

- The principal is the party that undertakes the obligation.
- The surety guarantees the obligation will be performed.
- The obligee is the party who receives the benefit of the bond.

What is a Surety Bond?

A surety bond is a written agreement that usually provides for monetary compensation in case the principal fails to perform the acts as promised. There are many different types of surety bonds, but the two general categories are contract and commercial surety bonds.

What characteristics of suretyship are like more common forms of insurance?

- They are both risk transfer mechanisms.
- State insurance commissioners regulate them both.
- They both provide for financial loss.

How is suretyship different from more common lines of insurance?

In traditional insurance, the risk is transferred to the insurance company. In suretyship, the risk remains with the principal. The protection of the bond is for the obligee.

In traditional insurance, the insurance company takes into consideration that a certain amount of the premium for the policy will be paid out in losses. In true suretyship, the premiums paid are "service fees" charged for the use of the surety company's financial backing and guarantee.

In underwriting traditional insurance products the goal is "spread of risk." In suretyship, surety professionals view their underwriting as a form of credit so the emphasis is on prequalification and selection.

How does a surety underwrite?

Each surety company has its own guidelines and underwriting criteria. However, the following basic factors will be taken into consideration in some format.

- **Character**: Does the applicant's record show him to be of good character and likely to perform the obligation he or she assumes?
- **Capacity**: Does the applicant have the skill and ability to perform the obligation?
- **Capital**: Does the financial condition of the applicant justify approval of the particular risk?

What is Personal Indemnity?

It is common for a surety to request the indemnity of the owners of a closely held corporation. Typically, the spouse's indemnity also is required because personal assets are jointly owned. The two main reasons for this requirement are that the surety requires all personal assets to be available to back the guarantee and that there is less chance a principal will avoid its responsibilities if its personal assets are at stake.

How does collateral security relate to a surety bond?
If an underwriter is unable to approve a bond request based on the qualifications given by the principal, the company may suggest depositing some form of collateral as an inducement to write the bond. In practice, many bonds are written on this basis, particularly ones that are considered financial guarantees.

What is a financial guarantee bond?
A financial guarantee bond obligates the surety to pay a certain amount of money if the principal does not perform its obligation. Examples include tax bonds and Medicare and Medicaid bonds. These bonds are extremely hazardous and very carefully underwritten.

Fidelity

A fidelity bond is a bond which indemnifies the insured for loss caused by the dishonest and fraudulent acts of its covered employees. In addition, a fidelity bond typically covers the insured against the following:

- Forgery or Alteration;
- Loss inside the premises caused by theft, disappearance and destruction, and robbery and safe burglary;
- Loss outside the premises caused by the robbery of a messenger.

These coverages sometimes are referred to as Crime Coverage. Annually writers of Fidelity and Crime Coverage incur over $300 million in losses by protecting organizations from risks that are present each day they are open for business: employee dishonesty, robbery and burglary.

Fidelity bonds are divided into two primary categories: financial institutions (for example, banks, stock brokers, insurance companies and finance companies) and mercantile and governmental entities (non-financial institutions). The coverage needs of these categories differ and SFAA has developed standard forms that meet the particular coverage needs of each group.