THE SURETY & FIDELITY ASSOCIATION OF AMERICA

Surety & Fidelity 101

Surety and fidelity bonds protect taxpayers, empower businesses and enable innovation

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Surety and fidelity bonding *provides critical financial protections*

Surety and fidelity bonds are an essential risk management tool and public policy function. While the types of bonds are different, the overarching purpose remains the same — **to provide financial protection to businesses, families, and consumers by guaranteeing contractual obligations are met through the securement of a bond**.

With these protections in place, businesses are able to grow and flourish, critical infrastructure developments are successfully carried through to completion, and companies are protected from wrongful acts of their employees — all of which positively support the economy.

What is a **Surety Bond***?*

Surety bonds are an essential risk management tool.

In its simplest form, a surety bond is a written agreement, often required by law, to guarantee performance or payment of another company's obligation under a separate contract or compliance with a law or regulation. It's a unique type of insurance because it involves a three-party agreement between a principal (general contractor, business, or individual), the surety company (insurance company), and the obligee (government agency, private developer, or other parties).

Surety Bonds

A surety bond is a three-party written agreement by which one party (the surety) guarantees another party (the obligee) that a third party (the principal) will perform according to the bond, statute, contract or other obligation. The surety bond protects the obligee by guaranteeing performance to the obligee if the principal does not fulfill their obligation.

SURETY

The Insurance Company

Obligated to be liable for the performance of a contract, debt or failure of a duty of another party.

OBLIGEE

Government Agency, Private Developer/Owner or Other Party

Protected by the bond. The one to whom the principal, and subsequently the surety, has become obligated.

PRINCIPAL

General Contractor or Business

Bound by construction contract, other contract, statutes, or other obligations to perform or pay a debt.

Categories *of Surety Bonds*

Contract and Commercial

The two general categories of surety bonds are: contract and commercial. Bonds are purchased by a wide variety of businesses and individuals including construction companies, mortgage brokers, insurance adjusters and more. A business will demonstrate its commitment to financial responsibility and ethical business practices by purchasing a surety bond.

CONSTRUCTION/CONTRACT SURETY BONDS

Contract surety bonds are primarily used in the construction industry and may be required by the government or private developer of a construction project to ensure the contractor is qualified and able to complete a project in a timely manner. The contract surety bond also ensures the contractor will pay all subcontractors, suppliers and other workers to complete the project. The three types of contract surety bonds are — a bid bond, a performance bond and a payment bond. Federal and state construction projects generally require a contract surety bond.

COMMERCIAL SURETY BONDS

Commercial surety bonds protect the public (consumers) against fraud, misrepresentation and financial risk and are typically required by federal courts, government bodies, financial institutions and private corporations as part of a company's licensing processes. Examples include license and permit bonds, court bonds, fiduciary bonds, and more.

No other risk management product provides the comprehensive protection that surety bonds provide. Bonds serve as a critical risk management and public policy function, protecting small businesses, workers and taxpayers, creating economic growth, and enabling innovation.

Examples *of Surety Bonds*

- **CONSTRUCTION BONDS** Includes bid or proposal bonds, performance bonds, payment or labor and material bonds, maintenance bonds and supply bonds. These bonds are required by state or federal law for most public construction projects or by a private developer.

- **COURT BONDS – FIDUCIARY** This type of bond is given by a Court Fiduciary to secure the faithful performance of fiduciaries' duties and compliance with the orders of the court having jurisdiction. Typical bonds within this category include bonds for Administrators, Executors, Guardians, Trustees Under Will, Liquidators, Receivers and Masters.

- **COURT BONDS – JUDICIAL** This type of bond is required when litigants seek to avail themselves of privileges or remedies that are allowed by law only upon condition that a bond with surety be furnished for the protection of the opposing litigant or other interested party. Typical bonds within this category include bonds for Injunction, Appeal, Indemnity to Sheriff, Mechanic's Lien, Attachment, Replevin and Admiralty.

- **LICENSE AND PERMIT** This category consists of any bond required by state law, municipal ordinance, regulation, and in some instances, the federal government or its agencies, to obtain a license to engage in a particular business or a permit to exercise a particular privilege. In general, the terms "License" and "Permit" are used interchangeably. Typical bonds within this category include Contractors' License Bonds, Motor Vehicle Dealer Bonds, Securities Dealers' Blue Sky Bonds, Employment Agency Bonds, Health Spa Bonds, Grain Warehouse Bonds, Liquor Bonds, Cigarette Tax Bonds, and Sales Tax Bonds.

- **PUBLIC OFFICIAL BONDS** This type of bond guarantees the faithful performance of duty by a public official in a position of trust. These bonds are required to secure compliance with federal or state statutes and, therefore, guarantee whatever liability the statute imposes. Typical bonds within this category include bonds for Gubernatorial Appointees, Treasurers, Tax Collectors, Sheriffs, Constables, Judges, Court Clerks, and Notaries.

- **BONDS PROTECTING THE U.S. GOVERNMENT** Various agencies of the federal government require or accept surety bonds for a number of different obligations, such as Medicare and Medicaid Provider Bonds, Immigrant Bonds, Excise Bonds, Customs Bonds and Alcoholic Beverage Bonds.

- **MISCELLANEOUS BONDS** This category includes other types of bonds that do not fall into the categories outlined above, such as Lost Securities Bonds, Lease Bonds, Bonds to Guarantee Payment of Utility Bills or Return of Borrowed Property, Bonds to Guarantee Employer Contributions for Union Fringe Benefits and Workers' Compensation Bonds for Self-Insurers.

Benefits *of Surety Bonding*

A Construction Industry Example

The construction industry can be a risky business; however, a contract surety bond provides the essential protections and services necessary to support our country's immediate and future infrastructure needs. There are multiple benefits of using a contract surety bond:

- **Ensures Project Completion by Prequalification**

  Surety companies conduct an extensive underwriting process to prequalify a contractor for a construction contract surety bond. This thorough vetting helps government agencies and private owners/developers make the right decisions when hiring a contractor for a project.

- **Provides Contingency Planning in the Event of a Contractor Default**

  A contract surety bond gives the government agencies or private owners/developers a contingency plan should the contractor default on the project. This can include the surety company giving the contractor technical or financial support, hiring a replacement contractor, re-bidding of the contract, or paying the full amount of the bond to the oblige.

- **Protects Tax Dollars While Promoting Economic Growth**

  Bankruptcy filings have serious implications for government agencies and taxpayers, however if a contractor failure does happen, the surety company is responsible for the solution – not the government or taxpayer.

- **Ensures Payment to Workers**

  A contract construction surety bond guarantees that covered subcontractors, suppliers and laborers on the job will get paid.

- **Increases Innovation**

  Bonding allows states and localities to consider innovative project procurement methods, such as public-private partnerships (P3s), because the surety company provides critical security if something goes wrong.

- **Supports Contractors by Providing Critical Resources**

  A good contract surety bond insurance company r and producer can be two of a contractor's greatest assets. The producer and insurance company possess or have access to a wide variety of resources to assist contractors.

How to Get a **SURETY BOND**

The first step to get a bond is to contact a professional insurance agent or broker, also known as a surety bond producer. The **National Association of Surety Bond Producers** offers an **online search platform to access surety bond producers** across the country and internationally.

What is a **Fidelity Bond***?*

Protecting business owners from employee dishonesty.

Employee Dishonesty Insurance, often broadly referred to as a "fidelity bond," is a type of business insurance that offers an employer protection against financial losses that are caused by its employees' dishonest misconduct.

Although fidelity bonds were originally written as three-party surety bonds guaranteeing the honesty of an employee, today's fidelity bonds are two party insurance policies. In addition to being referred to as a fidelity bond, Employee Dishonesty Insurance is sometimes also referred to as:

- Financial Institution Bond
- Commercial Crime Policy
- Employee Dishonesty Bond
- Crime Insurance Coverage

Why Do You Need *Fidelity Bond?*

Each year, businesses lose millions of dollars to employee theft, with some cases resulting in bankruptcy. Every business with employees, regardless of size or industry, should purchase a fidelity bond to protect it from fraud. According to the U.S. Chamber of Commerce:

- Three out of four employees admit to stealing from their employers at least once.
- One of every three business failures is the direct result of employee theft.
- Employee dishonesty losses incurred by American business total more than $50 billion annually.

What Can Businesses Do to Protect Themselves?

First and foremost, all businesses should put into place policies and procedures designed to help protect the company from financial loss caused by dishonest employees. Examples of these preventive measures include:

- Pre-hiring background checks of prospective employees
- Countersignature requirements for checks
- Reconciliation of bank accounts by someone other than the employee that handles deposits and withdrawals.
- Internal audits/review of all financial records and inventory
- Annual audits using an independent accountant
- Employee Dishonesty Insurance (Fidelity Bond)

Despite a business's best efforts at prevention, losses can still occur. Incorporating Employee Dishonesty Insurance (Fidelity Bonds) into the company's risk management practices offers a substantial hedge against financial losses caused by employee theft. These policies are especially important for small businesses, which can be financially devastated by the actions of a single dishonest employee.

Examples of **FIDELITY BONDS**

Generally speaking, within the marketplace, there are two general types of fidelity insurance available today:

- **FINANCIAL INSTITUTION BONDS**
  (offered to financial institutions such as banks, stockbrokers, insurance companies etc.)
- **COMMERCIAL CRIME INSURANCE POLICIES**
  (offered to non-financial commercial entities)

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The Surety & Fidelity Association of America (SFAA) is a District of Columbia non-profit corporation licensed as a rating or advisory organization in all states and has been designated by state insurance departments as a statistical agent for the reporting of fidelity and surety experience.

SFAA member companies collectively write the vast majority of surety and fidelity bonds in the United States. To learn more, visit: **www.surety.org**