Property & Casualty Insurance

Surety Bonds are a contract among at least three parties: The obligee - the party who is the recipient of an obligation, the *principal* - the primary party who will be performing the contractual obligation, the surety - who assures the obligee that the principal can perform the task. Through a surety bond, the surety agrees to uphold — for the benefit of the obligee — the contractual promises (obligations) made by the principal if the principal fails to uphold its promises to the obligee. The contract is formed so as to induce the obligee to contract with the principal, i.e., to demonstrate the credibility of the principal and guarantee performance and completion per the terms of the agreement. The principal will pay a premium (usually annually) in exchange for the bonding company's financial strength to extend surety credit. 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 nugatory. 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. Surety bonds are also used in other situations, for example, to secure the proper performance of fiduciary duties by persons in positions of private or public trust. Annual US surety bond premiums are approximately $3.5 billion. State insurance commissioners are responsible for regulating corporate surety activities within their jurisdictions. The commissioners also license and regulate brokers or agents who sell the bonds.