Surety Bonds: Frequently Asked Questions

What is a surety bond?

A surety bond is a three party agreement between an obligee, principal, and surety. This agreement ensures monetary compensation should there be a failure to perform a specific act in a stated period.

What is a bid bond?

A bid bond is a form of a bid security provided by the principal to the obligee. The bond guarantees that the principal's bid is in good faith and they will enter into the contract should the principal be awarded the contract.

What is an obligee?

The obligee is the entity that is obligated, or protected, by the surety bond. In contract bonds the obligee is typically the owner of the project and the principal is the contractor doing the work.

How much does a bid bond cost?

In most cases bid bonds are provided free of charge. Markets do not charge a premium on bid bonds and therefore most surety producers do not either. Some markets charge a small premium in rare cases where only a bid security, no performance and payment bond, is required and there needs to be an extensive underwriting requirement to provide that bid bond.

How is a bid bond underwritten?

Because a bid bond guarantees the principal will enter into a contract with the obligee, the bid bond also guarantees a performance and payment bond by the surety. Therefore a bid bond is underwritten essentially in the same manner a performance bond is underwritten.

How much does a performance and payment bond cost?

Performance and payment bond premiums vary in range. Oftentimes it is the qualifications of the contractor that determine the premium. A well qualified contractor with many years of experience, excellent financial statements, excellent credit and surety experience may receive rates as low as 1% or better on a performance and payment bond. Standard bond rates, what most contractors qualify for, are in the ballpark of 3%. Contractors who may not have the experience, credit or financials would look at rates starting at 3.5% and above. Collateral or funds control may be required according to the level of risk determined by the market.

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What is a bid security?

A bid security usually comes in the form of a bid bond or a cashier's check. Bid securities guarantee that a principal, or bidder, has provided a bid in good faith and will enter into the contract should they be awarded the project. If the principal is awarded the project and they cannot or are unwilling to enter into the contract, the penalty is the bid security amount. Most often the penalty is 5% or 10% of the contract amount.

Is a surety bond insurance?

No, a surety bond is not an insurance product. Though both insurance and a surety bond act in a manner that transfers risk from one party to another, they behave very differently. Insurance is a two party agreement between the insured and the insurance company. The premiums paid go into a large pool that is used to pay out claims as well as the administrative expenses of the insurance company. A surety bond on the other hand is a three party agreement between an obligee, principal, and surety who's premium only covers the administrative expenses for that company. If a surety company pays out any claims, the funds are expected to be paid back by the principal.