



[HOME](#) :: [Insurance](#) 

Q - What Insurance Company Product is Not Insurance? A - Surety Bonds - Learn Why

By [Steven Golia](#) ★

Article Word Count: 527 [[View Summary](#)] [Comments \(0\)](#)

Insurance is widely understood by the general public and the business community. You apply for insurance and if approved, you pay the premium. If a covered event occurs (such as a fire), you make a claim against the insurer and if they pay it, they send you (the insured) a check.

In that example, you transferred risk to the insurer. For the premium paid, they agreed to assume the risk of financial loss associated with a fire at the covered property. For most people, this scenario is what they know about insurance companies, and so it may result in some assumptions about surety bonds - most of which would be incorrect because: Surety Bonds are Not Insurance.

In the insurance example, there are two parties, you and the insurer. You made the application, paid the premium, filed the claim and received the claim payment. The insurer accepted the transfer of risk (contractually, through the policy they issued), they held the premium, processed the claim, and paid the loss out of all the premiums they gathered from everyone insured.

Surety bonds are a three party arrangement. The applicant is called the Principal. The bond concerns (guarantees in some manner) the actions of the principal for the benefit of another party called the Obligee. This is the party who benefits from the bond. The third party is the insurance company, which in this case is called the Surety. So the three parties in a surety relationship are the Principal, Obligee "Ob-luh-zhee" and the Surety. In insurance there was only the Insured and the Insurer.

In bonds, the Principal applies for the bond and pays the premium. If a claim is made, it is by the obligee. If the Surety finds the claim valid, they pay to the Obligee.

One example of a Surety Bond is a Performance Bond. These are routinely required when a construction company performs a contract for a governmental body such as a city or state. If the contractor (Principal) fails to perform the contract guaranteed by the Performance Bond, the city (Obligee) can make a claim against the Surety. The surety must then step in and complete the contract, thus protecting the Obligee from financial loss or delay.

So one difference between bonds and insurance is that a bond is three-party and insurance is two-party.

Another important difference is that insurers have assumed risk and expect a certain number

of claims and losses (such as fires). Sureties operate the same as banks. The bank only approves your loan if they are confident you will pay it back (protect them from any financial loss) and you sign a promissory note stating so. Surety companies also operate with no expectation of loss. They routinely require such a hold harmless, called "Indemnity" which is the Principal's promise to pay back the Surety if their failure to perform causes a claim, loss or expense to the Surety.

In summary, Surety Bonds are not insurance. They are similar to a credit relationship with a bank. In a bond, the Surety guarantees the Principal's actions for the benefit of the Obligee, but with no transfer of risk or expectation of loss.

A 40 year veteran of the surety industry, Steve has worked in a variety of roles and is now Executive Vice-President of The IBCS Group. IBCS is Risk Manager for the Scarborough Bond & Guarantee Program <http://www.IBCS.com> which is a major writer of Bid and Performance bonds for contractors.

Article Source: http://EzineArticles.com/?expert=Steven_Golia

This article has been viewed 28 time(s).
Article Submitted On: November 30, 2008