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Feature

What Surety Bonds Cost

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There is no surprise that the cost of surety bonds is going up, and this trend will likely continue for the foreseeable future. The same reinsurance companies that have sustained massive losses on the insurance side reinsure surety bonds. Whether the surety carriers for Enron ever pay a dime is immaterial. Primary carriers and reinsurers alike are reevaluating the premiums generated by surety as it relates to the potential liability.

Historical Pricing

Because surety is a credit-based product and not an actuarial one, surety traditionally has been priced about the same for everyone, 1 to 2 percent, if your financials and business credit were good enough. Since the early '90s, companies have enjoyed a soft surety market. Although there has always been the rare surety market charging 3 to 5 percent for troubling cases, most companies could get whatever bonds they needed at very reasonable rates.

However, problems can occur very quickly if sureties start to experience losses in a particular class of bond. On a $50,000 PEO license bond, the surety collects $1,000 at 2 percent. Not a bad premium if everything goes okay. But, even if there are just three PEOs that have a loss, the surety has to write 153 PEOs just to cover its losses, not to mention expenses, and an acceptable profit. Even at a 5 percent rate, a surety must write 30 good PEOs for every three bad ones. Many surety companies have recently gotten out of the surety business, either voluntarily or by reinsurer mandate. Many of the companies still writing it will be filing higher rates with the states they do business in or surcharging their existing rate filings.

What You Can Do

You can do several things to help assure your PEO will get bonding at reasonable rates.

CPA Prepared Statements

Whether it is a reviewed or audited statement, CPA participation is the first step in offering the surety company information it can rely on. This is especially true if your financial statements contain any questionable assets or any unusual account balances. An audit can be expensive. If it is not within your budget, it is important to present the surety with good internal financial statements. Present the financial statements in the same format as a CPA statement. If you are using internal statements, make sure you include multiple years. The first place a surety will look will be the stockholders equity section to determine if the current equity ties with prior year's profit or loss.

If a CPA statement is not possible for you right now, here are some other tips to help get the best bonding terms:

- Try to include as much "audit" information as you can. Bank statements and other liquid account verifications that tie to your internal statements are good.
- Accounts receivable aging report. Sureties always wonder how much of an A/R balance is old and probably uncollectable.
- Don't be vague on assets. Anything listed as "other assets" will usually be thrown out in a surety analysis. If it is a tangible asset, state what it is.
- Accounts payable aging report. This will not only help tie the liabilities side, but also show you are prompt in your bill paying.
- G&A schedule. Sureties like to see a G&A breakdown. Don't be ashamed of large officer salaries. Even though sureties like to see healthy bottom line profits, it is also helpful to see that there is some downward flexibility in officer salaries during lean years. Sureties are also interested in the amount paid in rent expense if the officers own the building.
- Provide a narrative. Nobody knows your company better than you do. A short narrative can be very effective in emphasizing the positive aspects of your performance and providing an explanation and plan to improve the trouble areas.
- There are other things to keep in mind that you may have some control over, in an effort to present the best possible financial picture to keep your bond cost down.
- Profits. Many companies manage their ownership withdrawals to limit profits shown for the company so that tax liability is mitigated. Sureties understand that but also expect to see income left in the company to help the financial base grow. If there are some expenses that can be pushed into the next year, this can also increase the current bottom line.
- Subordinated notes payable. Many companies carry notes payable to the officers of the company with no set due date. Even though this debt may automatically be subordinated to other creditors in the case of business failure, it would be good to offer to

formally subordinate it to the surety carrier. Although this does require their approval to pay back the debt, they will often add that amount back in to equity, which may mean a better rate.

Personal Indemnity
The best way to assure you are getting the best possible terms is to personally sign, indemnifying the surety against loss for writing bonds for your PEO. Certainly all business owners like to shield their personal assets from contingent business liability, but nothing makes a surety more suspicious than asking them to stand behind your PEO when you won't do the same. Personal indemnity is pretty much mandatory these days anyway unless you have a long-standing relationship with your surety. Generally speaking, anyone who owns 10 percent or more will be expected to sign, spouses too in most cases. If all your assets are held in a family trust, the trust will need to indemnify. Most sureties will want to see a personal financial statement, although CPA involvement is not usually necessary.

Conclusion
Although the rules have not changed, they have gotten stickier as far as surety bond qualification and pricing. A surety will look for a healthy equity position, annual net profits, positive working capital, CPA involvement if at all possible, and a willingness to personally hold the surety harmless for losses they may suffer as a result of bonding your PEO. Traditionally, if your PEO was weak, it would mean you were paying 2 to 3 percent for your bonds. Now, with no CPA involvement and a weak financial statement, you may be asked to pay 5 percent or more in some cases and may be asked to partially or fully collaterialize the bond amount in the form of cash collateral or a bank letter of credit. In some cases, a surety will let you post a CD so at least you are earning interest on your collateral. Always provide as much information as you can to avoid collateral and secure the best terms for your PEO.

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