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Surety bonds: a watertight guarantee?

Given the complexity and cost involved in large-scale infrastructure projects, surety bonds promise a new level of protection for all parties involved. Atradius Bonding director Pietro Lanzillotta guides us through the benefits

“OUR GOAL IS TO SECURE THE PERFORMANCE OF OUR CUSTOMERS AND SUPPORT THEIR BUSINESS DEVELOPMENT”

Director, Atradius Bonding
Pietro Lanzillotta

Europe’s construction industry may not attract the same level of attention as China or the Gulf Co-operation Council, but the sector is made up of mega infrastructure projects worth hundreds of billions of euros. High-speed railways, tunnels, airport extensions, new roads and power stations are being built right now.

Among these projects is the 21km Stockholm bypass. Set to be completed in 2025, the €3.1bn project will be the largest tunnel near a city. It will connect the southern and northern parts of the Stockholm county, aiming to significantly reduce traffic in the city.

Elsewhere, France’s Grand Paris Express is set to optimise transportation in the capital. Estimated to cost €25bn, the new transport system will comprise 200km of metro lines and 68 stations, which will reduce travel time and carry about two million passengers a day.

Norway’s plans to build the first underwater floating tunnel is also worth a mention. Predicted to cost $25bn (about €21bn), the tunnel will lie beneath the Sognefjord, the largest and deepest fjord in Norway, and link two disparate regions. It will be the first of its kind in the world.

These construction projects are no mean feat and demonstrate the scale and sheer complexity of today’s infrastructure market. They comprise several moving parts – tender, contract and budget agreements; supply chain and material overviews; and quality assurance.

There will be a huge team of stakeholders and service providers, including contractors, sub-contractors and project managers.

In each of these areas will be significant risks – labour difficulties, material shortages, equipment problems, contract breaches, failures from service providers – all of which could bring projects to a standstill. And, in extreme cases, contractor insolvency could cause severe financial loss.

Indeed, the demise of UK-based construction services company Carillion served as a stern reminder of the financial consequences of contractor bankruptcy – the company owes approximately £1bn (about €1.1bn) to some 30,000 subcontractors and suppliers.

So, with such huge sums of money at stake, how can project owners ensure the quality, commitment and solvency of a contractor?

Surety bonds offer a watertight guarantee, according to Atradius Bonding. While a number of insurance policies protect against some of the risks, there are key differences between bonds and insurance.

Surety bonds protect against disruptions or financial loss resulting from a contractor’s or service provider’s failure to complete the project or fulfil contractual obligations. They are a tripartite agreement between the surety bond provider, the principal and the third-party recipient of a contractual obligation, known as the obligee.

The bond guarantees that the principal (the contractor) will complete projects as per the contracts agreed with the obligee (the project owner). If contracts are in breach, the obligee will be able to recover losses from the surety provider.

Also from the perspective of the contractor (the surety’s customer) a bond provides protection. With a clear reference to his obligation under the underlying contract, it enables defence against an unjustified call in payment by the beneficiary. Here, sureties typically assist customers by evaluating any call in payment on the basis of the commitment in the individual bond.

Insurance, on the other hand, will compensate insureds in the event of a covered loss only – for example, if policies have been purchased to cover losses arising from delays in projects or damage to equipment. Insurance is a two-party contract between the insured and the insurance company.

As with insurance, there are several varieties of bonds. Below, Atradius Bonding director Pietro Lanzillotta helps us uncover the benefits of surety bonds by answering readers’ frequently asked questions.

WHAT BONDS DO I NEED TO CONSIDER?

There are number of bonds, including:

- **Bid bonds:** If you are a construction contractor and want to participate in a government project to build or refurbish a bridge, for example, you will first need a bid bond in order to enter the tender process. A bid bond insures the original bid, guaranteeing the project owner that you are able to enter the contract at the bid price stated and to provide the required performance and payment bonds if you are awarded the contract.
- **Performance bonds:** Upon winning the tender, you need a performance bond to secure the contractual obligations of your performance as it relates to agreed conditions – for example, price, timeline and quality.
- **Payment bonds:** These assure the subcontractors, labourers and suppliers of the project will be paid.
- **Advance payment bonds:** In addition, you might need to request some funds in advance to meet your start-up or procurement costs. An advance payment bond guarantees a refund to the project owner if delivery or performance does not take place.
- **Maintenance bonds:** This ensures project quality and protects against problems with defective materials or workmanship.
- **Tax duties bonds:** This covers the failure to pay excise taxes or custom duties on materials to the government and local authorities.

Bid, performance and advance payment bonds are mandatory for all publicly owned construction projects and often required by private owners.

WHY SHOULD I BUY BONDS FROM AN INSURANCE COMPANY RATHER THAN A BANK?

Surety bonds from an insurance company are a valuable alternative to bank guarantees and cash retention and can ensure the performance of a contractor or service provider. Insurers are well placed to understand the financial risks arising from a large-scale and complex construction project. For this reason, they typically offer the value-added service in assessing and reviewing contracts. In other words, they provide an independent second eye on contracts, with the view of identifying risks that may be embedded in the agreement. And, where necessary, insurers can offer advice on other risk-transfer options.

It is also wise for risk managers to diversify their risk transfer and not place all their risks with one provider, whether that is a bank or an insurer.

IN A COMPETITIVE MARKET, HOW DOES ATRADIUS STAND OUT?

Atradius Bonding strives to be a bond underwriter and not a capacity underwriter. What I mean by this is that we issue bonds willingly based on our assessments of contracts. Our goal is to help our customers secure their performance and support their business development.

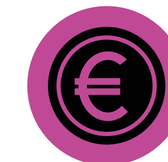
But we can help our customers do more than just manage risks and protect against worst-case scenarios. We provide tailor-made products and solutions that fit their needs and strategy. **SR**

THE BENEFITS OF BONDS

Bonds are a valuable alternative to bank guarantees and cash retention, as well as an effective way to increase your capital base.

They secure your performance without requiring you to provide tangible collaterals, thus enhancing your liquidity.

They raise your credibility and improve your relationship with your partners.



Surety bonding increases your liquidity and flexibility – there is no impact on your bank limits.

Typically there is no need to provide tangible security. This can free up your working capital and allow you to undertake new projects.

ATRADIUS BONDING IN NUMBERS

More than **50 years of experience** in the surety market
Support more than **55,000 customers**
Issue more than **400 types of bonds**
Issue more than **140,000 new bonds per year**