Surety Bonds

When an employer goes self-insured for workers comp a certain amount of collateral needs to be placed with the State to guarantee payment to injured workers should the self-insured employer go belly up. It is important to understand the nature of a workers comp claim. They can be small or they can be large. A large claim will require periodic payments that may stretch into decades. Yep, decades. The State is most concerned with large claims that may very well outlast the financial capabilities of the self-insured employer. The principals of Loveland & Smart underwrote these bonds for years in many States; however we would not underwrite them all. Many self-insured employers were stymied by a lack of a market to underwrite these bonds and petitioned States to accept letters of credit in lieu of a bond to secure the necessary collateral.

All States will accept a bond or cash, most states will now accept a letter of credit. Today a bond written will likely require collateral from the bond underwriter in the form of a letter of credit. The bond premium is usually $15 per $1,000 of penal amount or bond amount and the cost of a LOC is usually 1.5% of the letter of credit. It is cheaper to put up an LOC than it is to buy a bond and collateralize the bond with same LOC the State will take directly. Bonds are rarely underwritten in States where a letter of credit is accepted as security.

There are a number of reasons why there are few insurance carriers willing to write this kind of bond. There are basically two types of bonds. Each State has their own wording which is non-negotiable. One type of bond is referred to as 'losses occurring'. The 'losses occurring' type bond form guarantees payment for all claims that occur during the bond term. If this bond is replaced by another carrier then the prior bond carrier is not relieve their liability for the term of their bond. That is a liability for the bond underwriter that may last for decades. Yep, decades.

The second kind of a Self-Insured Retention (SIR) bond is a 'claims made' form. When SIR bond underwriters realized a lingering exposure for unknown years ahead, they petitioned States to change the wording and remove their exposure or continuing liability once the bond term ended. The 'claims made' bond form was created to address the long tail of the losses occurring form. The claims made bond form obligates the bond carrier to be responsible for all claims made during the bond period and all past claims since the day the employer became self-insured. If a bond carrier is replaced with another, the new bond carrier assumes all prior claim liabilities. You do not want to be the last bond underwriter on this type of bond. You would be holding the bag for all claims forever.

There are States which still require a bond or cash option and will not accept a LOC. However , those States are now the exception. A good advisor will check on cost and availability before recommending a bond or a LOC to satisfy the State mandated security amount.