Brown & Brown INSURANCE®

Surety Bonds: An Alternative to Letters of Credit

Be Efficient with Your Capital Utilizing Surety Bonds

Utilizing Surety Bonds can enable your organization to take cash-collateralized Letters of Credit debt off your balance sheet. Replacing Letters of Credit with Surety Bonds allows them to be treated as off-balance sheet items and not debt. By taking the debt off the balance sheet, capital can be utilized more efficiently and more economically than with Letters of Credit.

TYPES OF LETTERS OF CREDIT

There are two main types of Letters of Credit (L/C):

- **Commercial L/C** is utilized to pay sellers for goods purchased; this type of L/C is drawn upon as expected.
- **Standby L/C** is not anticipated to be drawn upon because it is used to support financial and/or performance obligations.

WHEN CAN A BOND BE USED IN PLACE OF A LETTER OF CREDIT?

Whenever a standby L/C is provided by a bank, there may be an opportunity to provide a Surety Bond in place of the L/C. These include:

- Collateral obligations to insurance carriers such as high deductible or paid loss retrospective rated programs
- Performance obligations such as leases, environmental financial guarantees, or decommissioning plans
- Workers' compensation self insurers' obligations
- Captive obligations
- Compliance obligations to meet governmental or regulatory requirements

WHAT ARE THE ADVANTAGES OF USING A BOND VS. A LETTER OF CREDIT?

- **Credit Availability:** An L/C ties up the company's credit capacity. Surety Bonds are not credited against a company's bank line but do require an indemnification.
- **Default Instrument:** A bank L/C is a demand instrument whereas a Surety Bond is not. An L/C may be drawn down at any time, without proof of default or reason. In the case of a Surety demand, the Surety requests proof of a company's default from the beneficiary. This protects the company from the beneficiary collecting on the Surety Bond without substantiation.
- **Rates:** L/C rates will fluctuate based on interest rates and other marketplace factors. They may also have issuance, utilization, or commitment fees. Surety rates are based on credit strength of the company and do not fluctuate based on financial marketplace conditions. In addition, Surety Bonds have no additional fees outside of the direct cost of the bond.
- **Security/Collateral:** Banks often take a security interest in the company's assets. This security is generally perfected through a UCC filing, which acts as a lien to protect the bank's financial interest. A Surety is an unsecured creditor and does not obtain a UCC filing but rather obtains a general agreement of indemnity.
- **Covenants:** Banks may have restrictive covenants as part of the bank line of credit or L/C credit program. Surety agreements do not encompass covenants.