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Product Information Statement

What is a Surety Bond?

A surety bond insurance is a mechanism to transfer risk for a business entity. It is a written agreement to guarantee payment. It assures project owner (typically a government entity) that the assigned contractor will perform tasks as per the contract. The surety company pays the project owner the promised amount (as per the contract) in the event of a default. The company charges a fee to the contractor to write the surety bond and agrees to indemnify as per the contractual terms in case of default by the contractor.

Surety bond is provided by the insurance company on behalf of the contractor to the entity that is awarding the project.

Surety Bond Insurance involves three parties:

1. The First party is the **Entity** who is entering into the contract also termed as **Beneficiary**. The Surety Bond is executed by this party in case of non-performance by the contractor.
2. Second Party is the **Contractor**
3. The Third party is the **Surety Provider** i.e. **Insurance Company**.

Staff/Recruiting Agent Surety Bond

A Staff/Recruiting Agent Surety Bond is a type of surety bond insurance that staffing or recruiting agencies may need to obtain as part of their licensing requirements. This bond serves as a guarantee that the agency will comply with all relevant laws and regulations governing their industry. If the agency fails to fulfill its obligations, such as properly compensating employees or adhering to ethical recruiting practices, the bond can provide financial compensation to affected parties.

Who benefits from this product:

Staff/Recruiting Agents qualified by MEA under The Pravasi Bharatiya Bima Yojana (PBBY), a compulsory insurance initiative designed to protect the welfare of Indian emigrant workers subject to Emigration Check Required (ECR) regulations, destined for overseas employment in ECR countries.

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What is the benefit to a contractor, infra player?

By issuing the surety bond, the contractor does not have to furnish a hefty bank guarantee. The bank guarantee blocks a huge amount. Surety bonds create a level playing field, empowers the small and medium contractors to bid for a project at par with a large contractor with financial muscle.

Definition:

Contract Bond: It provides assurance to the public entity, developers, subcontractors and suppliers that the contractor will fulfill its contractual obligation when undertaking the project. Contract bonds may include: Bid Bonds, Performance Bonds, Advance Payment Bonds and Retention Money.

Customs and Court Bond: This is a type of guarantee where the obligee is a public office such as tax office, customs administration or the court, and it guarantees the payment of a public receivable incurred from opening a court case, clearing goods from customs or losses due to incorrect customs procedures.

1. **2 major challenges:** Lack of product clarity and market acceptance

   Surety bonds are different from bank guarantees in the sense that they are not unconditional and are subject to terms and conditions. When there is a claim on a performance bond, the insurer will seek to investigate the matter as to why there is a claim and whether any remediation was done and if so, the details thereof.

   This is not as if surety bonds have to be perforce conditional. There are unconditional bonds as well, but they are expensive than conditional ones.

   The central government notification says "Insurance Surety Bonds" shall also be accepted along with other instruments like FD, DD, BG etc. It does not specify what these surety bonds are and whether Surety Bonds have to be conditional or unconditional.

   It therefore follows that the Principals should get used to the concept of a conditional bond which is not the same as a guarantee. In the absence of such a market acceptance, the product would find it difficult to be an effective substitute for bank guarantees.

In this context, it would be instructive to look at the experience of the Indian market with Title Insurance. The product was supposed to be used by the bankers and housing finance companies to obviate their need for doing title searches. It did not happen and it has failed spectacularly to take off.

2. Inadequate local expertise and data

The insurers have to rely on foreign insurers and reinsurers for technical support in terms of underwriting and pricing. However, there is a problem with this approach. The international experience on the new product is not readily transportable and applicable to India.

The most important ingredient in product success is to develop local underwriting expertise and data.. For instance, credit rating can be used as one of the benchmarks for financial stability of a proposer who wants to buy a surety bond.

Further, the surety underwriting is more about underwriting the softer aspects such as the character and reputation of the proposer rather than the harder aspects of financial strength. This is one advantage the local underwriters would have as they are closer to the proposers than their reinsurers.

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Government of India
Ministry of Finance
Department of Expenditure
Procurement Policy Division

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OFFICE MEMORANDUM

Subject: Amendment to General Financial Rules (GFR), 2017 to include Insurance Surety Bonds as Security Instrument.

It has been decided to partially amend Rule 170(i) and Rule 171(i) of General Financial Rules (GFR), 2017 regarding 'Bid Security and Performance Security respectively' as under:

Rule/ Para	Existing provision	Amended Rule
170(i)	The bid security may be accepted in the form of Account Payee Demand Draft, Fixed Deposit Receipt, Banker's Cheque or Bank Guarantee from any of the Commercial Banks or payment online in an acceptable form, safeguarding the purchaser's interest in all respects.	The bid security may be accepted in the form of **Insurance Surety Bonds,** Account Payee Demand Draft, Fixed Deposit Receipt, Banker's Cheque or Bank Guarantee from any of the Commercial Banks or payment online in an acceptable form, safeguarding the purchaser's interest in all respects.
171(i)	Performance Security may be furnished in the form of an Account Payee Demand Draft, Fixed Deposit Receipt from a Commercial bank, Bank Guarantee from a Commercial bank or online payment in an acceptable form safeguarding the purchaser's interest in all respects	Performance Security may be furnished in the form of **Insurance Surety Bonds,** Account Payee Demand Draft, Fixed Deposit Receipt from a Commercial bank, Bank Guarantee from a Commercial bank or online payment in an acceptable form safeguarding the purchaser's interest in all respects

2. This OM is also available on website of Department of Expenditure; www.doe.gov.in -> Notification -> Circular --> Procurement Policy OM. Hindi version of this OM will follow.

2/2/22
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To
Secretaries to All Central Government Ministries/ Departments