01 – 10 – 2023

News: Surety Bonds

- Recently, some of the leading general insurers like New India Assurance, SBI General Insurance etc. have announced their plans to issue Surety Bonds, but nobody has been able to do so due to lack of supporting elements.

Surety Bond

- A surety bond is a legally binding contract entered into by three parties—the principal, the obligee, and the surety.
- The obligee, usually a government entity, requires the principal, typically a business owner or contractor, to obtain a surety bond as a guarantee against future work performance.
- Surety bonds are mainly aimed at infrastructure development, mainly to reduce indirect cost for suppliers and work-contractors thereby diversifying their options and acting as a substitute for bank guarantee.
- Surety bond is provided by the insurance company on behalf of the contractor to the entity which is awarding the project.
- Surety bonds protect the beneficiary against acts or events that impair the underlying obligations of the principal. They guarantee the performance of a variety of obligations, from construction or service contracts to licensing and commercial undertakings.

- In the Budget 2022-23, the government has allowed the use of surety insurance bonds as a substitute for bank guarantees in case of government procurement and also for gold imports.
- Insurance Regulatory and Development Authority of India (IRDAI) has also released final guidelines to ensure orderly development of surety insurance business in India.
- The IRDAI (Surety Insurance Contracts) Guidelines, 2022 will come into effect from 1st April, 2022.

Issues with Surety Bonds

- Surety bonds, a new concept, are risky and insurance companies in India are yet to achieve expertise in risk assessment in such business.
- Also, there's no clarity on pricing, the recourse available against defaulting contractors and reinsurance options.

Significance

- The move to frame rules for surety contracts will help address the large liquidity and funding requirements of the infrastructure sector.
- It will create a level-playing field for large, mid and small contractors.
- The Surety insurance business will assist in developing an alternative to bank guarantees for construction projects. This shall enable the efficient use

of working capital and reduce the requirement of collateral to be provided by construction companies.

- Insurers shall work together with financial institutions to share risk information. Hence, this shall assist in releasing liquidity in infrastructure space without compromising on risk aspects.