Consider a bond as an alternative to a letter of credit

COMMERCIAL SURETY

For more than a century, we have met the surety needs of individuals and businesses through our steady, stable approach. Top rating agencies have consistently provided our primary underwriting company, Travelers Casualty and Surety Company of America, with high marks for financial strength.

Types of letters of credit

There are two broad types of letters of credit (L/C):

1. **Commercial L/C –** used as a means of paying sellers for goods purchased; both parties expect that the letter will be drawn upon.
2. **Standby L/C –** not expected to be drawn upon; used to support financial 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 letter of credit.

- paid loss retro programs
- performance obligations
- workers compensation self insurers' obligations
- security for appeals of a court decision
- international obligations

What are the advantages of using a bond vs. a letter of credit?

Credit capacity: An L/C ties up the company's credit capacity, thus reducing financial flexibility. Surety bonds are not credited against a company's bank line.

Covenants: Banks may place restrictive covenants on the client in return for extending a bank line of credit, or they may require extensive financial reporting. Surety companies typically offer more flexibility.

Security: Banks may choose to take a security interest in the client's assets. This security is required to be perfected through the filing of public documents (UCC filings) that publicize their secured lender status. A surety is generally an unsecured creditor. A UCC filing is rarely made.

Default defenses: A bank L/C is a demand instrument; a surety bond typically is not. An L/C may be drawn down at any time, without any reason; the company has no defenses. With a surety bond, the surety requests proof of a company's default from the obligee and works with the principal to identify defenses. This protects the principal from the obligee taking possession of the bond proceeds without merit.

Claim handling: Travelers has a professional, dedicated claims staff available to handle disputes and to assist in the claim resolution process. Banks do not have a claims staff, which requires a client to resolve disputes on its own.

Rates: L/C rates can be volatile. The L/C rate may include a commitment fee or utilization fee, as well as issuance fees, in addition to a stated rate. Surety rates tend to be stable and are directly tied to the credit quality of the principal and to the types of obligations bonded.

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