JRO Surety Insider

J.R. Olsen Surety Bonds & Insurance 2007 - 4th Quarter - Volume 1, Issue 3 Today's Topic: ***Irrevocable Letter of Credit***

Irrevocable Letter of Credit

By George Jimenez

What exactly is an Irrevocable Letter of Credit (ILOC)? If you have had an application turned down at any time in your career then you have heard these words; ***"Your client does not qualify due to his present credit, personal financial statements and or business financial statements. We can proceed with the bond if we can get collateral in the form of an ILOC".***

And many times the response is ***"What is an ILOC?"*** An ILOC is an irrevocable letter of credit issued by banks as a financial guarantee; this is an irrevocable commitment by the issuing bank to a third party beneficiary (Insurance Company) on behalf of a bank customer (principal) to meet demands for Payment. When a Surety requires this guarantee, the Surety is essentially stating that the contractor does not quite meet the financial requirements and would like additional guarantee and this would be through the ILOC. With it the contractor guarantees the Surety that the project will be completed and that in the event there is a claim the ILOC is there as back up for the Surety. Needless to say the contractor, in good faith, will do everything in its power to fix the problem without a claim on the bond. With the ILOC in place the banks are stating that money is available as payment in the event that the fulfillment of the agreement from the contractor is not follow thru. The word Irrevocable in front protects the Surety, since it can NOT be taken back or cancel hence the word IRREVOCABLE. There are two instances that the Surety would draw on an ILOC. *First*: in the event of a claim that the contractor will not fix or take care of, *Second:* if the contractor elects not to renew the letter prior to the completion of the work.

If an ILOC is acceptable with the OBLIGEE, why not get one instead of a Surety Bond? This is a very good question and one that should be answered, the best way and cost effective is to get approved for a Surety Bond without the requirement of an ILOC. Most Surety Bonds start at 3% and it scales down as the size of the bond increases. An ILOC will cost you anywhere between 1 to 2 percent per year and could be lower if you have posted cash funds as back up for the ILOC (*for a more accurate rate on the ILOC your client should check with their local Bank since they are the one's to inform them on the rates, these are only estimates*) for a multiple year contracts the ILOC can be renewed and the fee is charged every year, the Surety Bond is based on the contract. Another excellent reason to go with Surety Bond rather than an ILOC is because unlike the ILOC the Surety will NOT immediately pay on claim, therefore in many instances, the Surety will act as the middle man between the Obligee and Principal and will try to resolve any disputes that may cause a claim on the bond. The ILOC is there for this purpose and it can be cashed at the first glimpse of trouble since the Banks sole commitment is to honor the draft. The Surety will try to resolve the problem prior to paying out any claim, think of a bond as a check that is NEVER supposed to be cashed. While there are not many options when it comes to bonding one thing is for sure, an ILOC should not be your first option but your last or nothing more than a helping hand to make your financial state stronger. *Mark Twain once said, "A banker is a fellow who lends you his umbrella when the sun is shining and wants it back the minute it begins to rain."* If you have any questions regarding the above please feel free to call us and we will try to give you the best options available to you and your client. Thanks for the opportunity to be of service to you and your client, I know you have many options and you continue to come to us.

If you have any questions, call me toll free at 800-452-7121 ext 120, or email me at gjimenez@jrolsenbonds.com.

New Laws for Oregon Contractors

By Bryant Spiegler, Senior Underwriter

The Oregon legislature enacted two laws to further regulate commercial and residential contractors in the state. The bonding requirements are changed and increased in both new laws.

Since 1999, the Construction Contractors Board (CCB) has issued licenses to general contractors and licensed developers, special contractors, and inspectors. Under HB 2654, each of these license bonds have increased by $5,000.00 as follows:

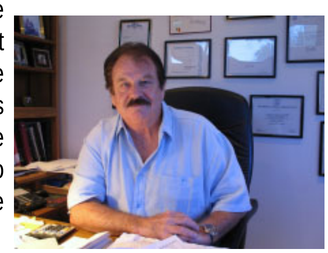
- general contractors and licensed developer from $5,000.00 to $10,000.00
- specialty contractor from $10,000 to $15,000
- inspector from $5,000.00 to $10,000

Under the new law, the board cannot reduce the bond bond to less than $10,000. These increases will be applicable to applications for initial license received by CCB on or after January 1, 2008. For renewals, these increases become effective to applications that the CCB receives on or after July 1, 2009.

If you have any questions, call me toll free at 800-452-7121 ext 115, or email me at bspiegler@jrolsenbonds.com.

Owner's Corner *by James R. Olsen*

Have you ever been asked? **What is the difference between a Surety Bond and Insurance Policy?** Here is one answer you can share with others. An Insurance Policy is between two parties, Insurance Company and Principal; in the event of any losses your Insurance Policy will protect YOU (principal). Essentially your monthly premium on an Insurance Policy covers you in case of any claims. A Surety Bond is between three parties, Principal, Obligee (Owner) and Insurance Company, in a Bond the risk of any an all losses are the responsibility of the Principal in essence a Surety Bond will shift the liability back to the principal. The premium is a fee from the Surety Company and not funds to pay for losses, the premiums basically cover the use of the Surety's name to guarantee the performance of the contract. No matter how anyone explains it to you at the end is all about the liability, Insurance Policy protects the Principal and Surety Bond protects the Obligee (project owner).



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