

C45 SURETY BONDS

IMPORTANT

The time allowed for this exam is 3 hours.

Total marks: 200

You must hand in this paper and any paper used for rough work to the supervisor when you leave the examination room. Failure to do so may result in disqualification.

Section A: Multiple-Choice Questions

Question 1. For the following multiple-choice questions, fill in the circle of the letter that identifies the most correct answer.

Example: (A) (B) ● (D)

<p>DO NOT MARK THE ANSWERS ON THESE PAGES. USE THE FIRST PAGE OF YOUR ANSWER BOOK.</p>
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1. The amount a surety will pay on a bond is called the
 - (A) policy limit.
 - (B) penalty.
 - (C) limit of insurance.
 - (D) collateral.

2. The surety is the party
 - (A) whose obligation or debt is guaranteed.
 - (B) who is the beneficiary of the bond.
 - (C) who guarantees the fulfillment of the principal's obligation.
 - (D) who guarantees the obligee's debt.

3. Which of the following is NOT a surety bond?
- (A) Estate bond
 - (B) Performance bond
 - (C) Bid bond
 - (D) Labour and material payment bond
4. What is the most important role of surety?
- (A) It promises economic relief to those who make jobs and create wealth.
 - (B) It limits the amount of money the guarantor must promise under legislation.
 - (C) It provides money to principals who default on their obligations.
 - (D) It provides a source of financing for surety companies.
5. Which category of contractor may be involved in the construction of any type of project?
- (A) Architect
 - (B) General contractor
 - (C) Engineering contractor
 - (D) Specialty contractor
6. Tenders usually require a deposit as well as the bid document. Which of the following is NOT considered a form of deposit?
- (A) Certified cheque for a percentage of the job
 - (B) Certified cheque for a specific sum
 - (C) Bid bond
 - (D) Performance bond
7. A type of construction contract where the contract price is based on the contractor's estimates of the sub-trades, administration costs, profit, and unexpected contingencies is known as a
- (A) lump-sum contract.
 - (B) unit price contract.
 - (C) cost-plus contract.
 - (D) construction management contract.
8. A specified percentage used as a fund to release construction liens or as security for the owner should any deficiencies or defects need to be corrected describes what kind of payment term?
- (A) Progress payment
 - (B) Holdback
 - (C) Final payment
 - (D) Extra work

9. The function of the “*Now, therefore,...*” clause is to
- (A) identify the construction contract or tender and make it part of the bond contract.
 - (B) introduce the three parties to the bond by name and position.
 - (C) explain the conditions and obligations of the parties in the contract and outline the action to be taken in the event of a default.
 - (D) activate and formalize the bond into a legally enforceable document.
10. A surety undertaking, where the surety agrees to issue the final bonds if the tender is accepted and the principal enters into a contract, describes which of the following?
- (A) Performance bond
 - (B) Bid bond
 - (C) Labour and Material Payment bond
 - (D) Agreement to Bond
11. Standard construction bond wordings
- (A) are prescribed by government.
 - (B) have been developed by the Canadian Construction Documents Committee.
 - (C) do not exist.
 - (D) are developed by each company but must contain certain prescribed conditions.
12. When could a subcontract bond expose a surety to greater risk?
- (A) When the general contractor imposes reasonable penalties for delay
 - (B) When excessive burdens are not placed on the subcontractors
 - (C) When the obligations imposed by the general contractor upon the subcontractor extend beyond the portion of the work for which the subcontractor is responsible.
 - (D) When the bond covering the subcontractor is similar to the primary contract between the general contractor and the owner
13. Why must an underwriter review a construction contract before agreeing to issue a bond? Bond wordings
- (A) are rigid and may not adapt to the unique obligations between the parties.
 - (B) serve as a base to gauge whether the principal can abide by the contract and follow through successfully.
 - (C) might not conform to the standard contract wording.
 - (D) serve as the basis upon which an underwriter can write terms specific for the bond.
14. Character, as one of the elements of the fundamental rules of credit analysis,
- (A) represents the investigation into the contractor’s physical ability to complete the job.
 - (B) refers to conditions related to the environment in which the principal functions.
 - (C) is the amount of money required to operate the business.
 - (D) refers to the integrity or the honesty of the contractor.

15. A Canadian surety which enters into a fronting agreement when a client does business out of the country
- (A) assumes little or no loss exposure by making such financial arrangements.
 - (B) is usually paid a fee for providing current underwriting information to the fronting surety.
 - (C) shares the underwriting responsibilities and loss exposures with the fronting surety.
 - (D) pays the fronting surety a percentage of the premium for providing the facility and ensuring the legal requirements of the country are met.
16. Joint venture agreements are usually joint and several obligations meaning that
- (A) several contractors will cooperate to complete a project.
 - (B) although more than one contractor participates to complete a project each is responsible only for that portion it has agreed to finish.
 - (C) each contractor's financial contribution to the project is based on the division of responsibility for loss.
 - (D) if one party fails, the remaining parties must assume the total liability and complete the entire project.
17. A qualified opinion in an auditor's report signifies that
- (A) the audit has been conducted in accordance with generally accepted accounting principles.
 - (B) the financial statements are represented fairly, except for the matter in question.
 - (C) anyone reviewing the financial statement can rely on the information contained therein.
 - (D) the statements are not presented fairly because of the matter in question.
18. The balance sheet represents the financial position and resources of an organization
- (A) for the period under review.
 - (B) including its operating activities for the whole year.
 - (C) as it stands at a particular point in time.
 - (D) measuring the progress to produce satisfactory income on capital investment.
19. Owners' equity is the
- (A) capital invested by the owner in the organization.
 - (B) net worth of the company's profit.
 - (C) company's profit.
 - (D) owner's earnings.
20. A profit and loss statement
- (A) shows the financial position of a company at a given time.
 - (B) calculates the contributed capital over a twelve month basis.
 - (C) calculates the net result between the income and expenses of the company for a given period of time.
 - (D) shows the cumulative total of all earnings held and reinvested in the company.

21. Which of the following equations is known as the quick ratio?
- (A) $\frac{\text{long term assets}}{\text{long term liabilities}} = x$
- (B) $\frac{\text{cash} + \text{marketable securities} + \text{current receivables}}{\text{current liabilities}} = x$
- (C) $\frac{\text{total liabilities}}{\text{net worth}} = x$
- (D) $\text{sales} - \text{cost of services/products} - \text{selling expenses} - \text{administrative and general expenses} = x$
22. For a surety to exercise its right of indemnification under a bond
- (A) it must have paid a sum because of a default by the principal on an obligation covered by the bond.
- (B) the principal or the obligee must have a right of remedy against a third party.
- (C) it must indemnify the principal and then take action against the negligent party.
- (D) it must have an assignment in the form of an express agreement.
23. Any ambiguities existing in a contract that will be construed against the person who composed the contract, is known as the
- (A) Civil Code.
- (B) principle of contra proferentem.
- (C) Statute of Frauds.
- (D) principle of uberrimae fidei.
24. Select the statement that is true regarding delays in work.
- (A) Contracts do not stipulate when work must be done, but rather they provide for a reasonable completion time.
- (B) Where a contract expressly excludes the right to damages, the owner is barred from claiming even if the delay has been caused wrongfully.
- (C) Some contracts stipulate the payment of liquidated damages, a sum of money anticipated to reasonably cover the harm caused the owner by delays.
- (D) Where contracts do not stipulate a time within which the work must be completed, either the owner or the contractor may claim for damages.
25. Lien legislation
- (A) prevents an owner from benefiting from labour without paying for it.
- (B) does not protect parties who do not have a contract with the owner.
- (C) excludes protection for material ordered for a project and delivered elsewhere.
- (D) protects a party who finances the sale of tools and machinery being used by a contractor on a project.

26. An indemnity agreement
- (A) must be negotiated separately for each bond a surety issues for a principal.
 - (B) outlines the duties and obligations for each party to a surety bond.
 - (C) is rarely needed because the surety can rely on the common law principle that a surety has the right to be indemnified against loss by the principal.
 - (D) binds the principal to repay the surety in the case of a loss.
27. Which of the following statements is true of cross-corporate indemnities?
- (A) The surety requires the signature of the Chief Executive Officer at the Head Office only on the indemnification agreement.
 - (B) The surety requires the corporate indemnity of each company acting on its own behalf and the cross-corporate guarantees of the associated companies involved.
 - (C) The surety requires the corporation to deposit a certified cheque in an amount equal to the potential loss with the surety.
 - (D) The surety requires the personal guarantee of all shareholders and their spouses.
28. An indemnitor under an indemnity agreement
- (A) has the right to insist a surety write all bond requests.
 - (B) is given the right to participate in the negotiation and settlement of a claim.
 - (C) is required to supply information about finances and marital status.
 - (D) can assign his or her obligations to another by a separate agreement.
29. Collateral may be required and held by the surety in a safety deposit box and released only when the obligation is completed for which of the following bonds?
- (A) Administration bond
 - (B) Bid bond
 - (C) Government bond
 - (D) Labour and Material Payment bond
30. Bonds that guarantee obligations imposed by consumer protection acts and regulations are categorized as
- (A) License and permit bonds.
 - (B) Customs and excise bonds.
 - (C) Court and fiduciary bonds.
 - (D) Financial guarantee bonds.
31. The clause in a miscellaneous bond wording that describes how much will be paid upon default of the duty or obligations is the
- (A) bond penalty clause.
 - (B) guarantee clause.
 - (C) release clause.
 - (D) fixed term clause.

32. Governments often regulate businesses and activities that involve some risk to the public welfare. Occupations generally considered to be a higher risk than others include
- (A) door-to-door sales people and employment agencies.
 - (B) used car dealers, travel agents and security agents.
 - (C) private detectives, bailiffs, and collection agents.
 - (D) claims adjusters and contractors.
33. A substituted surety on a miscellaneous bond is
- (A) a cash collateral.
 - (B) a warranty guaranteeing joint control of the cash or property to be administered.
 - (C) an individual who acts as a personal surety.
 - (D) a surety that agrees to bind a fiduciary previously operating under another's bond.
34. Indemnity agreements
- (A) can usually be amended if a defect is discovered after a claim has occurred provided it does not prejudice the rights of the indemnitor.
 - (B) Generally assign the principal's interest in certain assets to the surety.
 - (C) are registered instruments and have priority with the registered interests of secured parties.
 - (D) allow the rights of indemnitors to be prejudiced by the actions of the surety without recourse provided the surety has acted responsibly.
35. When a principal is in default, action to remedy the default usually involves the surety
- (A) financing the contractor to complete the contract.
 - (B) buying the bond back.
 - (C) hiring its own contractors to complete the project.
 - (D) re-bidding the contract to obtain another contractor to complete the work.
36. Second tier claimants may exist on a
- (A) Labour and Material Payment Bond claim.
 - (B) Miscellaneous Bond claim.
 - (C) Performance Bond claim.
 - (D) Bid Bond claim.
37. Salvage, as it applies to surety bonds, includes
- (A) materials paid for by the principal but not yet used in the project.
 - (B) the portion of the project that has been completed when the default occurs.
 - (C) the surety's right to contractual indemnity as well as subrogation.
 - (D) property taken over by the surety after indemnifying the obligee.

38. When facultative reinsurance is arranged,
- (A) a percentage of each bond written is automatically ceded to the reinsurer.
 - (B) each bond in excess of a fixed amount is automatically ceded to the reinsurer.
 - (C) the reinsurer has assessed the surety's philosophy, underwriting and skill and determined it is a good match.
 - (D) the surety completes an underwriting submission and negotiates each bond individually.
39. A surety negotiated reinsurance on a performance bond with a bond penalty of \$5,000,000. The insurer retained the first \$2,000,000 and the reinsurer accepted the remaining \$3,000,000 of limit. This is an example of which type of reinsurance?
- (A) Treaty
 - (B) Quota share
 - (C) Surplus treaty
 - (D) Excess of loss
40. A cut-through clause added to a reinsurance contract
- (A) amends the accepted practice of placing the primary responsibility for handling bond losses with the ceding company.
 - (B) allows the principal to negotiate directly with the reinsurer when the surety has not negotiated a treaty agreement.
 - (C) gives the surety the authority to negotiate and authorize settlement on behalf of the reinsurer when the loss involves them.
 - (D) allows an obligee to sue the reinsurer directly for payment of a bond default should the surety become insolvent.

(2 marks each = 80 marks)

Section B: Narrative Questions

- Question 2. (a) Define the following terms commonly used in Surety Bonds.
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|-------------------|-----------|
| (i) Bond | (2 marks) |
| (ii) Bond Penalty | (2 marks) |
| (iii) Guarantees | (2 marks) |
| (iv) In default | (2 marks) |
| (v) Obligee | (2 marks) |
- (b) Briefly explain FIVE (5) differences between surety and insurance. (10 marks)

- Question 3. (a) Outline the tendering process including the role of sureties for a construction project. (10 marks)
- (b) Identify the purpose of the following clauses common in all construction bonds.
- (i) The *Know all...* clause (2 marks)
 - (ii) The *Whereas ...* clause (2 marks)
 - (iii) The administration clause (4 marks)
 - (iv) The *Signed and Sealed...* clause (2 marks)
- Question 4. (a) Identify and explain the 3-C's of credit used in the credit analysis process. (12 marks)
- (b) Identify SIX (6) items of information required to complete a work-in-progress schedule. (6 marks)
- (c) How does the doctrine of contra proferentem operate with respect to construction contracts? (2 marks)
- Question 5. (a) Discuss the legal aspects in the following as they apply to construction contracts and surety bonds:
- (i) Delays in work (5 marks)
 - (ii) When loss will be paid according to the bond (5 marks)
- (b) State the purpose and use of each of the following bonds:
- (i) Appeal Bond (2 marks)
 - (ii) Replevin Bond (2 marks)
 - (iii) Fiduciary Bond (2 marks)
 - (iv) Committee Bond (2 marks)
 - (v) Land Sub-dividers Bond (2 marks)
- Question 6. (a) Discuss the effect of a mistake on a Bid Bond. (10 marks)
- (b) Briefly explain the operation of each of the following treaty arrangements:
- (i) Quota share (4 marks)
 - (ii) Surplus (3 marks)
 - (iii) Excess of loss (3 marks)

Section C: Application Question

- Question 7. (a) You are a surety bond underwriter. A Performance Bond and a Labour and Material Payment Bond have been issued for a project to construct a senior citizens' residence sponsored by a charitable organization. The building is well in progress when the project sponsors receive a call from an excavation contractor complaining that he has not yet been paid for the site preparation work he performed. The obligee knows that it has made progress payments to the general contractor as authorized by the architect, and decides to ask you what to do about the complaint.

What is your position? Outline the considerations that led to your position.

(10 marks)

- (b) You are a surety bond underwriter. A large, well-respected, and supporting broker calls asking for special consideration for one of her valued clients, a local building contractor. The contractor is bidding on a contract to build a new school in town. He has not previously undertaken a contract this size, nor one that required a Performance Bond. The bids must be submitted by noon the following day and the outcome will be announced one week later. The broker is not asking you to commit to bonding the contractor at this time. However, the owner is requesting that either an agreement to bond or a bid bond accompany the bid.

What do you decide to do? Outline the considerations that led to your decision.

(10 marks)

