Insurance Institute
Canada

CIP PROGRAM
EXAMINATION
December 2003

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: Ⓐ Ⓑ ● Ⓓ

DO **NOT** MARK THE ANSWERS ON THESE PAGES.
USE THE **FIRST PAGE** OF YOUR ANSWER BOOK.

1. Suretyship

(A) is a four party agreement involving the principal, obligee, the architect, and the surety.
(B) operates on the contingent basis, whereby the guarantor will be called upon only if the principal fails in its obligation.
(C) indemnifies the principal to the full extent of his losses regardless of the amount.
(D) is subject to federal laws that have been established to ensure that the obligee will be protected regardless of the province in which the indebtedness is established.

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2. Insurance that will make good the loss to an employer from whom an employee has stolen is known as

   (A) personal guarantee.
   (B) fidelity bonding.
   (C) employer's liability.
   (D) corporate suretyship.

3. A fiduciary bond guarantees

   (A) obligations imposed by consumer protection acts and regulations.
   (B) to pay for damages should a specified peril occur.
   (C) the fulfillment of the primary construction contract between contractor and owner.
   (D) that a person entrusted with a task will perform it faithfully and honestly.

4. The essence of surety bond underwriting is to

   (A) compute, using statistics on past losses, the probability of an acceptable loss ratio being maintained in the future.
   (B) assume only a degree of risk that falls within the acceptable guidelines of the company.
   (C) assess a risk and refuse to issue a bond if there is a chance of loss.
   (D) carefully establish a fee to cover expected losses and earn a profit for the company.

5. Contractors, wishing to take advantage of the skills and experience of others, pool their financial resources and spread the risk, could enter into a

   (A) cross-corporate contract.
   (B) buy-sell agreement.
   (C) joint venture.
   (D) joint and several obligation.

6. In the tendering process, a bid bond may be substituted for

   (A) a signed copy of the tender documents.
   (B) a certified cheque for a percentage of the job cost.
   (C) a personal cheque from the contractor.
   (D) an unspecified down payment from the contractor.

7. A cost-plus contract

   (A) does not specify a cost amount but uses a formula to establish how much will be paid.
   (B) guarantees that the contract price offered to the owner is a specified set amount of money.
   (C) is used on ordinary, routine projects.
   (D) pays a contractor a set fee to supervise and manage a project.

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8. Holdbacks are

(A) progress payments made for the percentage of work that has been completed when only a portion of the contract price is paid up front.
(B) payments for completed work that have been retained pending the architect's approval of workmanship.
(C) deposits held by sureties who enter into fronting agreements for clients doing business outside the country.
(D) a percentage of the contract price used to pay construction liens.

9. An agreement to bond is

(A) issued by the surety as a promise to furnish the necessary bonds on a particular job for a bidder.
(B) issued by a surety to a contractor when they have completed their investigation and agree to provide a surety market for the contractor.
(C) a two-party contract between the surety and the contractor guaranteeing bonds for a particular job will be furnished on request.
(D) a guarantee made by a contractor when submitting the bid that proper bonds will be arranged should the contractor's bid be successful.

10. Which of the following statements is true of Labour and Material Payment Bonds?

(A) The obligee directly benefits from any payment made.
(B) A broad form payment replaces the need for a performance bond.
(C) The surety acts as a trustee for the claimants under this bond.
(D) All monies are used to reimburse those who supplied labour and material.

11. The type of surety bond issued to guarantee that the work done is free from defective materials and workmanship for a specified period beyond the coverage period of the performance bond is a

(A) bid bond.
(B) labour and material bond.
(C) broad form payment bond.
(D) maintenance bond.

12. The surety's obligations under a bid bond are to

(A) pay the difference or obtain another bidder.
(B) complete the contract or obtain other bids.
(C) take over the principal's obligation to make payments.
(D) remedy the default by paying for any defects.

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13. The bond underwriting process requires that the underwriter review the obligations between the contracting parties and, when not issuing the surety's own bond form,

(A) write a manuscript wording that is appropriate for the obligee to sign.
(B) carefully review the bond wording to determine how it differs from a standard form.
(C) assume that bond forms imposed by the architect or engineer will not expand the sureties responsibility.
(D) refuse to issue a bond that does not conform with the forms sponsored by the Canadian Contractor's Document Committee (CCDC).

14. The one significant difference between surety credit underwriting and the process a bank loan officer uses to extend credit is that the bank's

(A) position is enhanced by collateral.
(B) primary concern is the contractor's ability to pay back borrowed funds.
(C) name and reputation is given in support of the client's financial responsibility.
(D) acceptance signifies a thorough credit analysis has been conducted and the finances of the client are adequate.

15. Contractors doing business outside the country, in addition to the usual underwriting steps, must

(A) prove a record of successful operations similar in Canada.
(B) form a separate corporation to ensure the Canadian arm of the operation remains unaffected by any adverse incidents in the foreign country.
(C) demonstrate that the working environment in the foreign country is well understood and can be managed.
(D) agree to transact all business in Canadian funds.

16. In joint venture agreements, **joint and several** obligations mean that

(A) several contractors will co-operate to complete a project.
(B) although more than one contractor participates to complete a project each is responsible only for its portion of the project.
(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. Preparing an Accountant's Review Engagement Report, involves a process of

(A) assessing the accounting principles used and expressing an opinion.
(B) compiling statements from information supplied by the client.
(C) reviewing a company's financial statements to determine how fairly they represent the company's financial position.
(D) reviewing the statements prepared by a company's management to determine if they are plausible in the given circumstances.

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18. The financial document that provides a summary of the major cash sources and dispositions, flow of funds, and how the company has generated and used its cash resources over a defined period of time is the

    (A) notes to financial statements.
    (B) statement of changes.
    (C) work-in-progress schedule.
    (D) retained earning statement.

19. The formula used to determine the amount of cash available and the speed by which it can be obtained if a company finds itself in financial trouble is known as the

    (A) working capital.
    (B) acid test.
    (C) work-in progress analysis.
    (D) reserved earnings ratio.

20. An underwriter will complete a work-in-progress analysis to assess

    (A) whether gross profit margins are reasonable with respect to the contractor's overhead structure.
    (B) how quickly cash can be found if a company gets into trouble.
    (C) whether the business is displaying profitable growth and growth potential.
    (D) how well the contractor is doing this year compared to the last five years and whether there are any operating cycles.

21. The three contracts of particular importance to a surety specialist are the bond, the construction contract, and the

    (A) maintenance contact.
    (B) insurance contract.
    (C) subcontractor's agreement.
    (D) indemnity agreement.

22. A loss that falls within the contract bond will be paid with reasonable speed if

    (A) the principal is in default and liable for the loss.
    (B) the construction contract cannot be upheld.
    (C) the construction contract is impossible to perform.
    (D) a dispute arises between the principal and the obligee.

23. When liens have been attached to a job, priority of payment is given to the

    (A) subcontractors.
    (B) workers.
    (C) contractor.
    (D) suppliers.

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24. **Public law** deals with

(A) contracts including construction contracts.
(B) torts.
(C) property and property rights.
(D) the regulatory control of sureties.

25. A Certificate of Independent Legal Advice should be secured when an indemnity agreement is requested

(A) from subsidiaries, associated and affiliated companies.
(B) and proof is required to show that it has been approved by the board of directors.
(C) from spouses.
(D) from a corporation.

26. **Cross-corporate indemnities** refer to agreements obtained from the company's

(A) major shareholders, under seal.
(B) principal, principal's spouse, and principal's family members.
(C) subsidiaries, associated and affiliated companies.
(D) members of the Board of Directors.

27. Usually an indemnity agreement includes an item or clause that

(A) prohibits the surety from refusing to write a bond for the principal.
(B) makes the agreement void where there are several signatories and one signature is not valid.
(C) prohibits a surety from obtaining personal information on the individual indemnitors.
(D) declares funds due to pay subtrades on a bonded contract as trust funds.

28. Often the surety holds collateral and has the right to liquidate the collateral if the principal defaults on a(n)

(A) immigration bond.
(B) maintenance bond.
(C) fidelity bond.
(D) bid bond.

29. Bonds categorized as financial guarantee bonds are required

(A) by corporations asked to replace securities or certificates in the event that the original documents are presented for payment later.
(B) as security for court costs, to release liens and to comply with probate and bankruptcy laws.
(C) to guarantee obligations imposed by consumer protection acts and regulations.
(D) to guarantee the repayment of a loan, payment of rent or other similar commitments.

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30. A forfeiture commitment on a miscellaneous bond

(A) increases the indemnification to 110% of the loss to encourage performance.
(B) often requires the surety to pay the full bond penalty regardless of the amount of loss.
(C) allows indemnification for damages suffered up to the bond penalty.
(D) makes the amount of the bond or bond penalty cumulative year after year.

31. The type of litigation bond that guarantees that the clerk of the court and the sheriff will be paid is known as a

(A) Replevin Bond.
(B) Security for Costs Bond.
(C) Appeal Bond.
(D) Trustee in Bankruptcy Bond.

32. In miscellaneous bonds, the **bond of indemnity** provides

(A) that the issuer of a replacement security will not suffer economic loss should the lost document turn up later.
(B) a guarantee of repayment of a loan or payment of rent.
(C) a guarantee that costs incurred in litigation will be paid.
(D) the security that must be posted when vacant land is sub-divided to assure installation of such services as water mains, sanitary sewers, sidewalks and roads.

33. The first step in the claims sequence for a bond adjuster when a default occurs is

(A) confirming the financial collapse of the principal.
(B) investigating the contracted obligations.
(C) resolving the contracted obligations in accordance with the bond.
(D) understanding the contracted obligations.

34. A bidder may be permitted to withdraw from a bid by the obligee if the

(A) principal ceases doing business between the submission of the bid and the obligee awarding the contract.
(B) obligee reasonably delays in the awarding of the contract.
(C) principal's estimator obtained a quote for the incorrect materials.
(D) the bidder made a genuine mistake of fact in preparing the bid, such as an addition error.

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) rebidding the contract to obtain another contractor to complete the work.

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36. A surety may have a right of subrogation

(A) against an indemnitor if the contractor acted in bad faith.
(B) against the obligee if the general contractor was working under his or her direction.
(C) against the principal for defective workmanship.
(D) for work performed by the obligee or agents of the obligee not necessarily contracted to the principal.

37. Where two or more sureties enter a system of risk allocation that resembles the method used in subscription fire insurance policies, the relationship is called

(A) treaty reinsurance.
(B) facultative reinsurance.
(C) co-suretyship.
(D) non-proportional suretyship.

38. In Canada, co-suretyship has NOT evolved to

(A) allow sureties to gain experience in writing larger projects.
(B) ensure that sureties can become involved on a project when the exposure would otherwise have been too large.
(C) resolve the capacity needs of the market.
(D) create a market that can accommodate risky, substandard projects.

39. In a surplus treaty reinsurance arrangement,

(A) the surety arranges excess coverage for large risks on an individual bond basis.
(B) the surety agrees to a minimum retention amount and amounts in excess are shared on a percentage basis varied by bond size.
(C) the risk is shared on a fixed percentage that remains constant.
(D) the risk is shared on a percentage from first dollar.

40. A reinsurance arrangement where the retention level is set by the surety based on the assumption that only a few claims may reach or exceed it and only at that point will the reinsurer's obligation attach, is known as

(A) excess of loss.
(B) quota share treaty.
(C) proportional treaty.
(D) facultative reinsurance.

(2 marks each = 80 marks)

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Section B: Narrative Questions

Question 2. (a) What is the purpose of suretyship? (4 marks)

(b) Explain the importance of surety bonds to the construction industry. (8 marks)

(c) Describe the role of the producer in the construction bonding business. What background knowledge is expected of the producer? (8 marks)

Question 3. (a) Detail the information that you would expect to see for each project in a contractor's work-in-progress schedule. What is the goal of the underwriter in assessing this information? (10 marks)

(b) Explain, under general headings, FIVE (5) types of information found in a contractor's balance sheet and what that information conveys to the underwriter. (10 marks)

Question 4. (a) In the context of surety business, what is an **indemnity agreement** and what is its importance in the underwriting process? (6 marks)

(b) Identify indemnitors, who in addition to the principal indemnitor, might be asked to provide indemnity agreements. What precautionary steps should a surety take to ensure the enforceability of such indemnities? (10 marks)

(c) Briefly discuss the proper execution, timing, and distribution of copies of indemnity agreements. (4 marks)

Question 5. (a) Briefly describe the nature of the obligation entered into by a surety under the following classes of miscellaneous bond:

(i) Canada Customs bond (2 marks)
(ii) Replevin bond (2 marks)
(iii) Administration bond (2 marks)
(iv) Lost instrument bond (2 marks)
(v) Completion bond (2 marks)

(b) Briefly explain miscellaneous bond wordings in general terms under the following headings:

(i) Term (4 marks)
(ii) Guarantee clause (4 marks)
(iii) Discovery period (2 marks)

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Question 6. (a) Briefly describe **treaty reinsurance,** including its various types and the common elements to each treaty contract. (10 marks)

(b) When is **facultative reinsurance** used and through what process might a facultative relationship between the surety and reinsurer lead to treaty agreement? (5 marks)

(c) How are claims handled when a bond is reinsured? (5 marks)

Section C: Application Question

Question 7. (a) 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)

(b) You are a senior surety bond underwriter who has been asked to assist a junior underwriter in issuing a lost document bond for an insured. The insured is an elderly man who has misplaced his stocks in a company that has recently seen an increase in its share value. The registrar of the corporation has asked that the surety provide coverage using that company's bond form. Explain the type of bond being requested by the company with the underwriter and discuss the underwriting process that should be followed. (10 marks)

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