RISKS AND **BENEFITS**

BARRY
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The insurance industry, just as any other business sector – including surety bonding – is unquestionably a commercial enterprise designed to generate profits. Notwithstanding the quest for profit, insurance and surety bonding are services; their goal is to provide financial support to companies of every industry so they can weather the impact of financial losses and/or offer them the possibility of obtaining contracts.

In an ideal world, service providers would adapt quickly to their clients' needs and realities. Unfortunately, this is not always the case. The example of monopolies comes to mind, as well as that of markets which are more or less "captive" despite being serviced by several different providers. There are many such instances in public services: healthcare, hydroelectricity and banks, to name just a few.

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Even service providers with captive audiences will eventually evolve to keep up with their clients but the evolution will:

1. Likely be slow and, most probably, not in sync with the clients' changing needs and expectations. Think, for instance, of taxi drivers and Uber.
2. Possibly be imposed by the Government. Think, in this case, of banks or of credit card or telecommunication companies.
3. Possibly be imposed upon clients by the service provider. Think here of Hydro Quebec's next generation meters or of the many Provincial insurance regimes across Canada.
4. Be forced upon service providers by structural changes which affect their revenues/profits or by specific events. Think of flood coverage and the change brought about by the heavy floods in Alberta in 2014.

In commercial insurance, a client's ability to obtain custom-designed coverage and prices depends on the size of the premium and/or on the client's appeal (desirability). Accounts that generate a lower premium or are less desirable in the eyes of insurers (not a prestigious name, or simply a less than stellar loss experience) become a "captive" audience.

When it comes to surety bonding, financial strength is the name of the game, but within a "captive" setting. Nonetheless, globalization and the turn towards P3 projects have brought about change in the Canadian surety market.

This change is the topic of our feature article, written by Kelly Parker, Vice-President and Client Executive at our Toronto office. On the benefits side, Patrick Malloy, Benefits Consultant for BFL CANADA Consulting Services, discusses retirement age in light of legislative amendments passed in the past few years.

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WHO, US? CHANGE? WHY THE SURETY INDUSTRY HAD TO ACT

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The first recorded act of surety was carved into a Mesopotamian tablet in approximately 2750 B.C. In that instance, a farmer agreed to watch over the fields of another who had been conscripted into military service in return for a percentage of the crop that was harvested. A local merchant served as surety by guaranteeing that the substitute farmer would keep his promise. Undoubtedly, the merchant relied on what are still the basic underwriting principles of surety. These are referred to as the 3 C's – "character, capital and capacity" – and translate into "will they perform (uphold) their obligations?", "do they have the means to do it?", and "do they know how to do it?".

With such a long history, it should come as no surprise that change in the surety industry is slow to occur. However, the primary source of surety premiums today comes from the bonds provided on construction projects. Economic globalization and the increasing use of technology are driving changes in all businesses of which construction and surety are not exempt. In addition, competing products and timeliness of service are placing demands on all surety industry stakeholders, including construction owners (both government and private owners), contractors, surety companies, and brokers.

In Canada, our infrastructure deficit is the product of years of prioritized spending on social programs that we still need to maintain. In order to fund the repairs to our neglected hospitals, roads, water, waste and transportation systems, it has become increasingly popular to introduce private industry partners to provide the required up-front financing for the cost of public construction. This "Public Private Partnership" is referred to as a P3. Our country's stability and commitment by the Government to the re-development of our infrastructure make Canada an attractive place for investment by foreign construction companies and their accompanying financial partners. These new market entrants can more readily provide guarantees such as Letters of Credit that convert into cash on demand and are, therefore, favored by private P3 lenders. In a P3 model, the traditional "on default" Performance Bond product is no longer acceptable as the sole guarantee of a contractor's obligations, and hence the need for change in the industry.

During Canada's 2008-2010 Federal Government infrastructure stimulus programs, Export Development Canada (EDC) stepped in to provide assistance to Canadian firms so they could compete for P3 projects on an even playing field. In a nutshell, EDC provided Canadian financial institutions with assurances that their construction clients would perform their P3 contractual obligations and that EDC would act as surety to make them whole for the financial losses caused by delay or non-performance. This enhanced financial assurance greatly expanded the risk that a surety takes under a traditional "on default" Performance Bond. As a corporation created for Export purposes, EDC could only be a temporary solution to a problem that Canada's surety companies were uncertain they could solve.

With the exit of EDC from this type of assurance, and the need from Canada's largest construction firms still prevalent, a P3 Performance Bond solution was created by a surety company and accepted by the project's owner and financial partners. This new bond form now provides liquid security for a percentage of the bond amount so as to give the Obligee immediate necessary funds to protect the financing model. A few of the larger surety companies operating in Canada are now providing this liquid feature through an on-demand sub-limit as part of their Performance Bond. This allows Canadian companies to provide a new type of Performance Bond security for a P3 project that is the same (or near) as the ones offered by foreign multi-national competitors.

A project's completion and delivery date are also critical to the P3 financial model. In an industry known for delays, a default by a single subcontractor can play havoc with the entire construction schedule.

The traditional performance bond for “on default” claims process is problematic to the on-time delivery necessary for privately financed construction. It resulted in the creation of construction and subcontractor default insurance products, commonly referred to by the Zurich trademarked name of Subguard™. This solution has become a preferred method of dealing with defaulted subcontractors in a more timely fashion as it allows the General Contractor to replace or finish the work of a defaulted subcontractor and to be indemnified for the costs of doing so. It does not require that a third party (surety) investigate the default nor that there be an agreement on how the claim will be settled.

Realizing that this alternative was gaining popularity and that they were losing premiums from surety bonds formerly provided to their subcontractor clients, the surety industry has responded. In 2014, The Guarantee Company of North America introduced a Headstart™ Performance Bond. It is provided by subcontractors to general contractors and contains features that can be triggered prior to an actual notice of default, as well as timelines for the surety to respond.

Even more recently, revisions to the industry standard Surety “CCDC” Performance Bond were passed by the national construction and surety associations. Features of this new bond form include a pre-demand conference between all parties, post-demand timetables and an allowance for emergency remedial action. All of these provisions can address many of the delays in settling bond claims from both prime contractor and subcontractor defaults.

Lastly, technology is starting to eliminate the traditional need for hard copies of bonds in order to insure they are authentic. Because a bond is a three-party instrument, in lieu of applying a corporate seal, it is required that a secure verification of the surety’s electronic signature is performed to insure that the beneficiary (Obligee) of a bond has received a valid guarantee. Several private companies are providing this technology and Obligees in Quebec, British Columbia, Alberta and New Brunswick are already using a variety of these e-bonding systems. Defence Construction Canada has also started an e-procurement pilot that will call for e-bonding in its later phases.

Staying abreast of industry changes and the use of technology through active participation in surety, construction and financial associations is essential not only for brokers, but also for clients. The developments they learn about in the process could be of tremendous benefit to their competitiveness and their business in general.

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MANDATORY RETIREMENT AT 65: STILL LEGAL?

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Traditionally "65" was considered the "normal" retirement age, at which employers could force employees to leave employment. There never was such a thing as "mandatory retirement" in a legislative sense, but employers themselves could impose such a rule or policy. Most benefit and pension schemes were based on employment ending at 65 – and in many cases earlier – through "early retirement" provisions and incentives. While some provinces previously made amendments to their Employment Standards Act, on December 16, 2012, amendments to the Canadian Human Rights Act and Canada Labour Code were brought into force to prohibit federally regulated employers from setting a mandatory retirement age, unless there is a bona fide occupation requirement (e.g. fire suppression: fire-fighters mandatory retirement age is 60).

WHO IS AFFECTED?

The change to the Code was in no way intended to penalize anyone who chooses to retire at or prior to the age of 65. Rather, employees are now able to choose for themselves how long they wish to remain in the workforce based on their own lifestyles and financial circumstances, so long as they are capable of performing their jobs.

Employers wishing to dismiss employees aged 65 or over would have to provide termination notices or pay-in-lieu unless mandatory retirement policies could be justified on "bona fide occupational requirement" grounds. If an employee suspects that he was terminated only due to age – a prohibited ground for discrimination under the Code – a complaint could be filed with their Provincial/ Territorial Human Rights Commission.

The end to mandatory retirement has had an impact on a variety of employment-related topics. Three areas are listed below:

Collective Agreements

- Mandatory retirement provisions in collective agreements are no longer enforceable, as the Code takes precedence.
- Collective agreements can only include mandatory retirement in those cases in which being under a certain age is a "bona fide occupational requirement".
- Unions and employers are still able to negotiate voluntary retirement incentives (i.e. early retirement packages).

Benefits

- As an example, under the Ontario Employment Standards Act, employers are prohibited from discriminating on the basis of age in providing benefits to employees aged only between 18 and 64. Consequently, benefits such as extended health need not by law be provided to employees over the age of 65.
- An employer might opt to continue benefits for workers 65 and over depending on what various insurance carriers are willing to offer.

Performance management

If an employee failed to continue to be able to perform his or her duties, this could be addressed through an employer's performance management system. However, the employer would also have to consider the Code's requirement under the "Duty to Accommodate" if the employee's performance was suffering as a result of disability.

With a greater number of Canadians working beyond the age of 65, it is imperative that employers ensure they have a clear understanding of the aging demographic in the workforce and, most importantly, receive professional advice on how they can incorporate efficient and supportive benefits for these workers.

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