

The surety market in Canada

Angus H. Ross

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Article abstract

Notre collaborateur présente ici une étude du marché de l'assurance cautionnement au Canada. Celle-ci est orientée vers les résultats obtenus par les assureurs depuis quelques années. Le lecteur a ainsi une vue d'ensemble sur une assurance qui a ses problèmes, mais qui, dans l'ensemble, a bien fonctionné durant les derniers exercices, malgré la crise. Après avoir apporté quelques précisions sur le sens que l'on doit donner à ce genre d'assurance, M. Ross mentionne certains chiffres ayant trait à la répartition du revenu-primes entre les assureurs intéressés. De cette manière, l'auteur permet au lecteur d'avoir une excellente idée du marché, de ses risques et de ses responsabilités.

The surety market in Canada

by

Angus H. Ross⁽¹⁾

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Surety has been a traditionally profitable line of business in Canada, particularly for the specialist surety companies. It is written on a basis somewhat different from that seen in Europe (at least on contract bonds – which is the major area).

Contract bonds are subdivided into three main sectors :

- *Bid bonds* : if contractor's bid is successful, he will enter into a contract and provide the necessary performance and labour materials bonds ;
- *Performance* : guaranteeing he will fulfill all obligations of the contract ;
- *Labour and Materials* : guaranteeing the payment of supply, services and material work will be free of lien.

In Europe, underwriters are accustomed to seeing bond penalties of 10% of contract price whilst in Canada, the standard amount is at least 50%. In the event of a claim, the European bond is far more likely to reach the bond penalty than in Canada.

(1) Mr. Angus H. Ross is Senior Vice President of *Reinsurance Management Company of Canada Inc.* – member of the Sodarean group.

Another vital difference is that European reinsurance contracts almost invariably have an aggregate bond exposure limit per contractor. This is not so in Canada, although control is established at the original underwriting level by setting a per contractor workload schedule. This is made possible in Canada since contractors only deal with one surety company, unlike in Europe where a contractor can have several sureties.

22 It is also European practice for reinsurers to measure their cumulative exposure by adding the total penalty of all bonds outstanding whereas in Canada some consideration is given for the degree of completion of the reinsured jobs, since it is a major factor in assessing the financial risk on outstanding bonds.

The Canadian surety market has grown steadily over the past decade as Exhibit "A" (page 25) shows. (Unfortunately figures on a gross basis are not available over this period). Exhibit "B" shows the twelve major direct writers for 1981, 1980 and 1979 on a gross written basis with their net and reinsurance ceded. Exhibit "C" shows the top five reinsurers net writings over the same period.

There is little doubt that the bulk of Canadian surety reinsurance is placed in the licensed local market. This is done not solely for reporting purposes but also because the treaty reinsurer is normally the first avenue for large contract facultative placements. This requires an effective, speedy response made by someone familiar with the Canadian market.

Reinsurances of Canadian surety business have normally been effected on a proportional basis : Quota Share, Graded Quota Share, Surplus. Commissions run from about 37.5% to 45% inclusive of taxes. Whilst these commission rates appear high, it must be remembered that, in theory, surety is loss-free but has high expense factors.

A recent development that we have seen has been the advent of excess of loss protection – usually on the company's net retention – to protect against either an accumulation of contracts for a single bankrupt contractor or an accumulation of two or more contractors on the same jobs. These excess covers, usually led and rated by M & G London, have been in the market for about two years now without a loss. The rating has generally been a flat percent of premium although at least one contract is scale rated.

Despite the recession through which Canada has been passing in the past three years, surety results have been surprisingly good. Although a great many contractors have gone out of business, these have generally been the smaller contractors for whom bonds are not readily available (other than through one or two companies who have specialized in writing the smaller contractor). As Canada begins to move out of the recession – and particularly in view of the last budget – we can anticipate a recovery in the construction sector with an accompanying increase in surety writings within a more favourable economic climate.

Apart from contract bonds, there are a number of other miscellaneous surety classes (excluding fidelity) :

- Public official's bonds
- Fiduciary bonds (executors or administrators of an estate, guardian of a minor or incompetent)
- Licence and Permit bonds
- Customs and Excise bonds.

Generally these bonds are retained net by the company, since the required limits are often very low, or else ceded in conjunction with the regular contract surety.⁽²⁾

EXHIBIT "A"
SURETY RESULTS

	<i>Net Earned Prem.</i>	<i>Incurred Loss Ratio</i>
1972	\$25,360,000	18.31%
1973	\$27,883,000	26.60%
1974	\$33,723,000	29.88%
1975	\$38,838,000	24.01%
1976	\$43,819,000	34.16%
1977	\$44,116,000	36.77%
1978	\$50,854,000	19.11%
1979	\$56,913,000	26.38%
1980	\$60,845,000	32.20%
1981	\$69,322,000	22.90%

(2) Figures quoted in the exhibits "A", "B" and "C" are taken from *T.R.A.C. Report (Canada)* and *Canadian Insurance* (Statistics issue).

A S S U R A N C E S

EXHIBIT "B"

**THE TOP TWELVE MAJOR DIRECT SURETY WRITERS IN 1982
WITH THEIR 1981, 1980 AND 1979 WRITINGS⁽³⁾**

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COMPANY	YEAR	GROSS	NET	R/I CEDED	% CEDED
GCNA	1982	10925	7102	3823	34.99
	1981	11293	7206	4087	36.19
	1980	7908	5607	2301	29.10
	1979	6981	4036	2945	42.19
USF&G GROUP	1982	8342	6502	1840	22.06
	1981	7886	6336	1550	19.66
	1980	7023	5703	1320	18.80
	1979	7372	6011	1361	18.46
CANADIAN INDEMNITY	1982	8185	3465	4720	57.67
	1981	8801	3901	4900	55.68
	1980	6050	2895	3155	52.15
	1979	6167	1860	4307	69.84
CANADIAN SURETY	1982	4888	3657	1231	25.18
	1981	4576	3557	1019	22.27
	1980	3808	2962	846	22.22
	1979	3642	2785	857	23.53
FIREMAN'S FUND	1982	2528	1904	624	24.68
	1981	2406	1663	743	30.88
	1980	1342	724	618	46.05
	1979	1015	728	287	28.28
AETNA CASUALTY	1982	3115	2898	217	6.97
	1981	4440	1776	2664	60.00
	1980	1154	772	382	33.10
	1979	2797	1936	861	30.78

(3) Gross is direct written. Net also includes any assumed R/I.

A S S U R A N C E S

COMPANY	YEAR	GROSS	NET	R/I CEDED	% CEDED
GUARDIAN	1982	4512	1601	2911	64.52
	1981	3036	1788	1248	41.11
	1980	2362	1378	984	41.66
	1979	1919	1139	780	40.65
CHUBB INS. (FED. INS.)	1982	1932	1097	835	43.22
	1981	2018	1632	386	19.13
	1980	1417	1077	340	23.99
	1979	1029	786	243	23.62
WESTERN SURETY	1982	4104	2312	1792	43.66
	1981	4342	2306	2036	46.89
	1980	4072	2188	1884	46.27
	1979	4082	2260	1822	44.63
TRAVELLERS	1982	1993	1579	414	20.77
	1981	2219	2126	93	4.19
	1980	2696	2945	— 249	— 9.24
	1979	3077	3076	1	0.03
CONTINEN- TAL	1982	5048	1929	3119	61.79
	1981	3700	1875	1825	49.32
	1980	2667	1425	1242	46.57
	1979	1644	1090	554	33.70
GROUPE COMMERCE	1982	1963	1458	505	25.73
	1981	2533	1933	600	23.69
	1980	2446	1913	533	21.79
	1979	2082	1528	554	26.61
TOTAL	1982	57535	35504	22031	38.29
	1981	57250	36099	21151	36.94
	1980	42945	29589	13356	31.10
	1979	41807	27235	14572	34.86

A S S U R A N C E S

EXHIBIT "C"
THE TOP 5 REINSURERS

		<i>Net</i>	<i>Net Loss Ratio</i>
Canadian Re	1981	3,986	14.27
	1980	2,868	27.01
	1979	2,874	1.14
Employers Re	1981	3,317	7.82
	1980	2,408	31.94
	1979	2,776	6.00
M & G	1981	2,910	16.16
	1980	2,305	57.42
	1979	1,636	33.90
Munich Re	1981	2,712	52.53
	1980	1,367	46.15
	1979	1,440	41.06
Skandia	1981	1,447	5.99
	1980	734	23.58
	1979	446	15.87
Total	1981	14,372	15.5923
	1980	9,682	15.5923
	1979	9,172	15.0807

(Gross writings not available)