

Matinée Gestion des Risques: Risques de construction Risk Management Morning: Construction Risks



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AGENDA

- Introductions
- ERM & Compliance of a global engineering firm:
 the insights of the Chief Risk Officer / Louis-Martin Richer -WSP Global
- From Conventional projects to PPPs: the risk management approach
- Construction projects related insurance policies: What you need to know Anis Safraoui - SNC-Lavalin
- Développements récents en assurances construction: Robert Emblem Clyde & Co.
- Break
- Surety bonds: what you need to know. Michael Fay AIG
- Case Study
- Q&A



WE ARE WSP: **TURNING INSIGHT** INTO ACTION

Louis-Martin Richer, Chief Risk and Ethics Officer WSP February 18th, 2016





AGENDA

- 1. Enterprise Risk Management Program
- 2. Compliance Program
- 3. Reporting Process

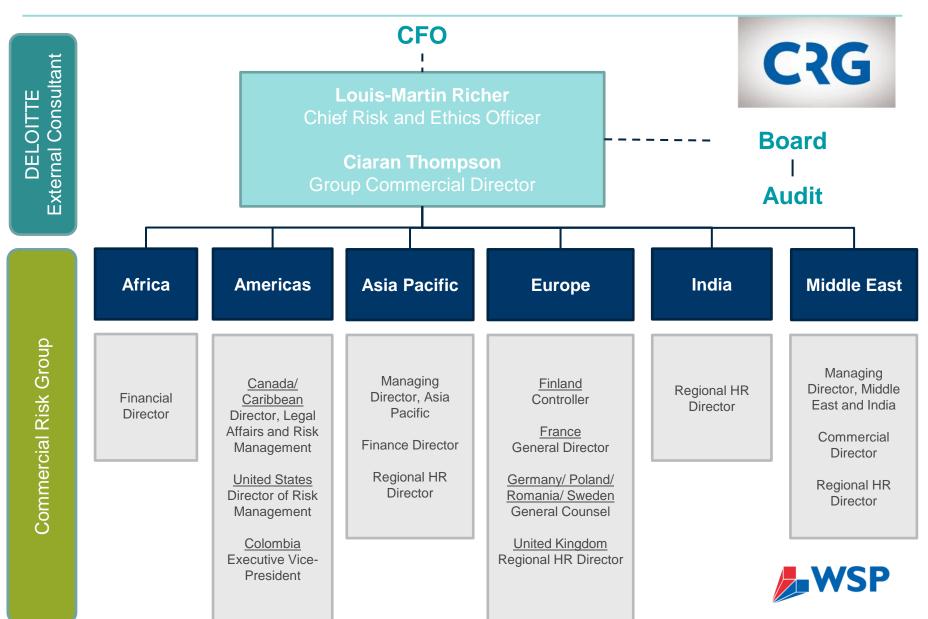




1. ENTERPRISE RISK MANAGEMENT



ENTERPRISE RISK MANAGEMENT – OUR TEAM



ERM – GOALS AND DELIVERABLES

Goals

- Improve performance through effective mitigation of risk, by:
 - Improving culture and consistency in approach to risk
 - Identifying and managing risk early



- Enabling focus on key risks and mitigation strategies
- Improving communication and reporting of risk to key stakeholders





ERM – GOALS AND DELIVERABLES (cont'd)

Deliverables

- Risks and mitigation measures owned by regions reviewed regularly
- Guidance and support for risks outside operational norm
- ✓ Simple, non-bureaucratic, risk escalation and decision process
- Commercial network focused on early pro-active intervention
- Definition and implementation of relevant training needs

The ultimate aim is to create tools which will be deemed indispensable to the business leaders, both on operational and strategic levels.



ERM – RISK & OPPORTUNITY REVIEW

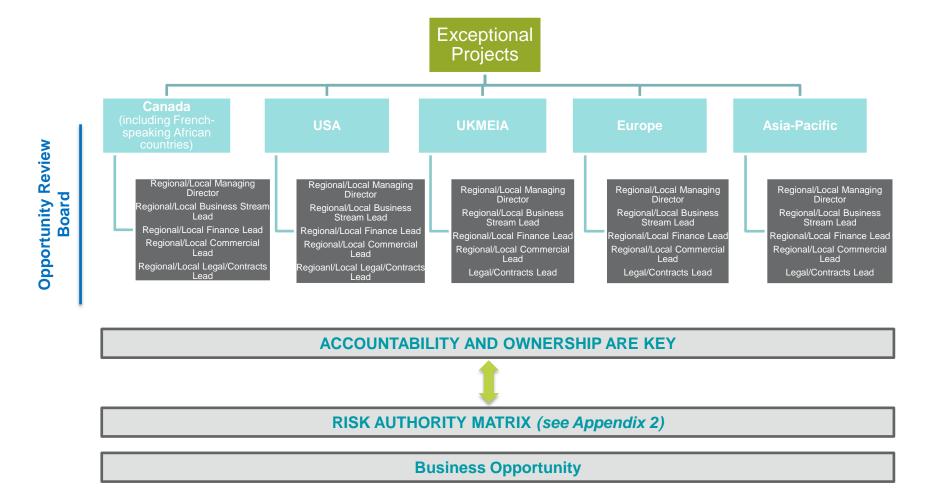
PROCESS Group MD NETWORK TO BE CONFIRMED & DEVELOPED Delegated Nominated individuals with responsibilities for specific risks, i.e. Prospect / bid oversight, Group commercial, legal, ethics, insurances, etc. authorities Exceptional regional matters via group governance Region MD Delegated Region authorities Exceptional local matters via region governance Operating business MD **Key issues** Confirm network and engage early



· Review and reinforce group governance



ERM – OPERATIONAL STRUCTURE





ERM – REPORTING PROCESS OVERVIEW

regular overview of the business key risks.

▼ Scope: To assess the overall performance of the business on a regular.

basis.

Methodology: To ultimately provide hard KPIs to assess business risks and effectiveness of mitigation strategies.





ERM – RISK OVERSIGHT/OWNERSHIP SNAPSHOT

Risk ownership at the Business Unit level and the responsibility to aggregate all risk information and report it to the Top management. Ideally, every decision taken in the organization needs to be a risk-weighted one.

Line Management

BU heads/ Risk owners To lead the risk management effort and report the results to the Board. The CREO champions the risk management effort and report directly to the Board.

Top Management

Separate ERM function

Setting the risk appetite and aligning strategic goals of the organization with the risk management effort, Also, to perform their fiduciary duties and fall in line with laws and regulations, stock exchange listing requirements, etc.

Board of Directors

Standing Committees of the Board



GENERIC RISK ITEMS AND PROPOSED KPI MEASURES

Risk heading	Risk description - Is the business?	Measure	Green	Amber	Red
External reputation	Effectively managing its external reputation with key stakeholders in a positive manner?	To be agreed	To be agreed	To be agreed	To be agreed
Governance structure / effectiveness	Effectively established in terms of appropriate governance structures which effectively manage the risks that the	To be agreed	To be agreed	To be agreed	To be agreed
Acquisition selection and integration	Selecting and securing apppropriate targets aligned to the group strategy and integrating them effectiveley	To be agreed	To be agreed	To be agreed	To be agreed
Ethics, corporate wrongdoing, etc	Training its staff regularly with regard to codes of conduct? Reviewing potential	Training delivered v training planned	Senior management & on line training delivered	Senior management or on line training delivered	No senior management or on line training delivered
Health & safety	Actively promoting Health & safety awareness and management?	Near miss reporting levels	To be agreed	To be agreed	To be agreed
Foreign exchange movements	Operating in countries where the exchange rates are aligned wth plan or are significant movements being experienced which could impact on consolidated results?	Negative variance to budget exchange rate	< 10%	10 - 20%	> 20%
Market conditions / economies	Facing market conditions which are effectively understood and supportive of the strategy being implemented?	View of economic conditions	Conditions are generally supportive of plan	Conditions are difficult and may impact the plan	Conditions have deteriorated and will impact the plan
Operating in new geographies	Effectively establishing businesses and managing staff in geographies outside core	Adequacy of risk management	Well considered & managed	Subject to review	Poorly considered and managed
Sectors	Achieving sector penetration / market share as planned?	Sector net sales \$ (actual v budget)	> 80% (all sectors) YTD	< 80% (any one sector) YTD	< 50% (any one sector) YTD
Key clients	Achieving key client penetration / share as planned?	Key client net sales \$ (actual v budget)	>80% YTD	> 70% YTD	< 70% YTD
Product development / innovation	Investing in staff & technology to retain/ improve its market position?	Training costs (actual v budget YTD) (hrs and /or \$)	> 90%	75 - 90%	< 75%
Business structure / leadership	Structure appropriate to implement the strategy? key leadership positions	Appropriateness & completeness	Sound & filled	Sound, gaps being addressed	Not sound, gaps > 6 months

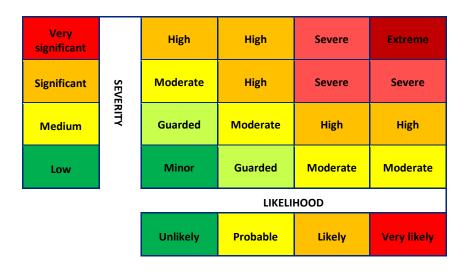


GENERIC RISK ITEMS AND PROPOSED KPI MEASURES (cont'd)

S. I.				- 1	
	Measure	Green	Amber	Red	
3 ,	Voluntary turnover rate YTD	< 10%	10 - 20%	> 20%	
• • • • • • • • • • • • • • • • • • • •		1-201		1 20,0	
0 11 1		Well considered plan for senior	Plan developed for senior	Inadequate / no plan in place for	
development? Actively planning and driving	Adequacy of current succession plan	· ·	management - however gaps	senior management	
succession?		management being actively managed	identified which require externals	sellioi ilialiagellielit	
Ensuring effectiveness of key risk	Effectiveness & disciplined use	Effective & well followed	Effective & reasonably followed	Ineffective and/or not followed	
Ensuring IT system recovery plans and		Updated & tested < 12 mths	Updated & tested < 24 mths		
business continuity plans are in place and	Plans in place & tested			Updated & tested > 24 mths	
tested to agreed business requirements.					
Securing enough sales at the right margins	Net sales \$ (actual v budget YTD)	> 90%	80 - 90%	< 80%	
to achieve the plan?	Backlog multiplier v budget multiplier	> 95%	90 - 95%	< 90%	
Securing acceptable written terms through	% of material (\$2M?) projects without contracts	To be agreed		To be agreed	
an appropriate governance structure?			To be agreed		
Ensuring right resources (people and				To be agreed	
systems) to provide effective management	Quality of PM systems & PM training	To be agreed	To be agreed		
Achieving the volume of net revenue					
anticipated under the plan	Net income \$ (actual v budget YTD)	> 95%	90 - 95%	< 90%	
Achieving the project profits (volume and			05 07 50/		
	Multiplier (actual v budget YTD)	> 97.5%	95 - 97.5%	< 95%	
	Utilisation % (actual v budget YTD)	> 97.5%	95 - 97.5%	< 95%	
costs anticipated to achieve planned	Operating margin % (actual v budget YTD)	> 95%	90 - 95%	< 90%	
	Corporate costs \$ (actual v budget YTD)	< 110%	110 - 120%	> 120%	
	EBITDA \$ (actual v budget YTD)	> 95%	85 - 95%	< 85%	
Working capital in line with the plan? Are	Combined WIP & debtor days (actual v budget)	< 110%			
			110 - 120%	> 120%	
	Impact of claims on excess erosion		Concern that current claims may lead	One or more claims causing breach of	
		No current claims likely to breach		aggregate excess (ie: insurer's funds	
effectively?		aggregate excess arrangements	arrangements	being called)	
	succession? Ensuring effectiveness of key risk Ensuring IT system recovery plans and business continuity plans are in place and tested to agreed business requirements. Securing enough sales at the right margins to achieve the plan? Securing acceptable written terms through an appropriate governance structure? Ensuring right resources (people and systems) to provide effective management Achieving the volume of net revenue anticipated under the plan Achieving the project profits (volume and percentage) anticipated under the plan? Achieving the utilisations and overhead costs anticipated to achieve planned	Retaining its key staff? Are the levels of staff turnover at an appropriate level? Providing appropriate training to enable development? Actively planning and driving succession? Ensuring effectiveness of key risk Ensuring if T system recovery plans and business continuity plans are in place and tested to agreed business requirements. Securing enough sales at the right margins to achieve the plan? Securing acceptable written terms through an appropriate governance structure? Ensuring right resources (people and systems) to provide effective management Achieving the volume of net revenue anticipated under the plan Achieving the project profits (volume and percentage) anticipated under the plan? Achieving the utilisations and overhead costs anticipated to achieve planned profitability levels? Working capital in line with the plan? Are provisions adequate for potential risk? Managing claims made against it Voluntary turnover rate YTD Adequacy of current succession plan succession; plan succession plan succession; plan succession plan succession; plan succession plan succ	Retaining its key staff? Are the levels of staff turnover at an appropriate level? Providing appropriate training to enable development? Actively planning and driving succession? 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Managing claims made against it Woluntary turnover rate YTD Voluntary turnover rate YTD Woluntary turnover rate YTD Woll Considered plan for senior management being actively managed Effective well followed Updated & tested < 12 mths Updated & tested < 12 mths Vecuring acceptable will followed Updated & tested < 12 mths Voluntary turnover rate YTD Well considered plan for senior management being actively managed Well considered plan for senior management being actively managed Well considered plan for senior management being actively managed Well considered plan for senior management being actively managed Well considered plan for senior management being actively managed Well considered plan for senior management being actively managed Wollowed Well followed Well followed<	Retaining its key staff? Are the levels of staff turnover at an appropriate level? Providing appropriate training to enable development? Actively planning and driving succession? 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CURRENT ASSESSMENT RISKS AND RATING 15 **SCALES**



Rating	Category	Definition		
4	Extremely likely	The risk will materialize under the majority of circumstances (more than 80% chance of occurrence in the next year and/or the next three years)		
3	Likely	The risk will probably materialize under most circumstances (50 - 80% chance of occurrence in the next year and/or the next three years)		
2	Probable	The risk may materialize under certain circumstances (20 – 50 % chance of occurrence in the next year and/or the next three years)		
1	Unlikely	The risk is unlikely to materialize (less than 20% chance of occurrence in the next year and/or the next three years)		

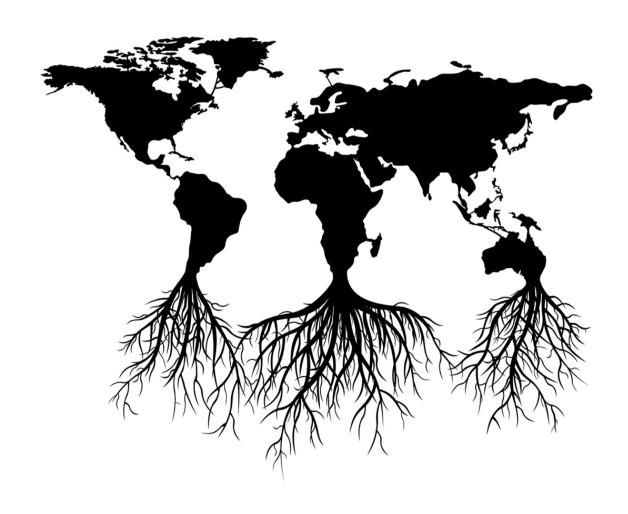




2. COMPLIANCE



ETHICS – STRONG ROOTS REQUIRED





OUR VIEW

- Preventing bribery by the company or its employees requires a combination of clear policies and training and risk-based financial or commercial procedures and controls.
- Preventing bribery by agents, sponsors or other third parties requires, in addition, a combination of clear business justifications and approval procedures, and appropriate risk-based due diligence.
- The higher the risks of corruption associated with a country, client, project or third party, the more closely we should scrutinize the corruption risks and the more steps we must take.





ETHICS - OUR TEAM



ETHICS – OUR ACTION PLAN: 10 COMPLIANCE WORKSTREAMS





ETHICS - BUILDING A FRAMEWORK FOR SUCCESS

1. UNDERSTANDING REGULATORY REQUIREMENTS AND RISKS

- → Identify specific requirements of the CFPOA, FCPA and UK Bribery Act
- → Understand country-specific requirements and enforcement climates in all countries in which the Company operates

4. TRAIN AND ENGAGE THE WORKFORCE

- Develop and provide anticorruption training on key regulatory requirements
- Develop tools to enable employee compliance

2. PLAN THE ANTI-CORRUPTION PROGRAM

- Secure Senior Management buy-in for anti-corruption initiatives
- Conduct an anti-corruption assessment

5. ASSESS THIRD PARTY RISK AND PERFORM DUE DILIGENCE

- Communicate anti-corruption policy to high-risk third parties
- Establish due diligence protocols employees must follow when initiating third party relationships

3. DRAFT AN ANTI-CORRUPTION POLICY

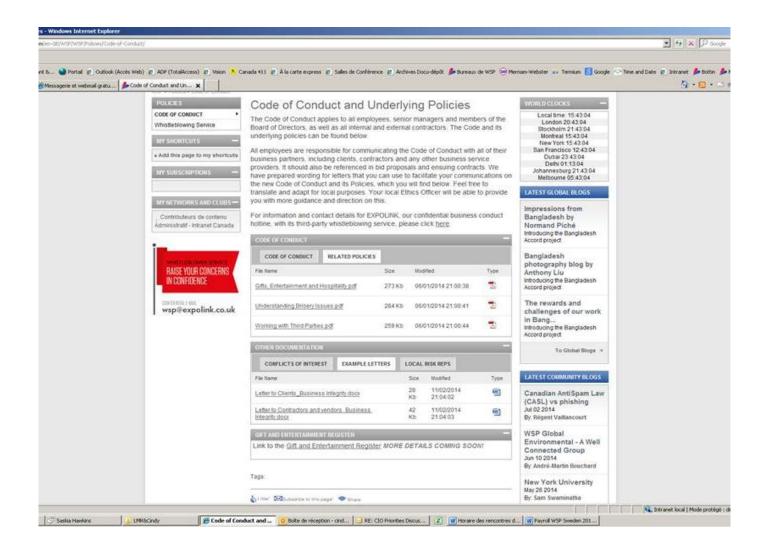
- Draft or revise an overarching anti-corruption policy
- Address the Company's stancenamely on facilitation payments and on gifts, entertainment and hospitality

6. MONITOR THE ANTI-CORRUPTION PROGRAM

- Collaborate with Internal Audit to assess the anti-corruption programs
- Ensure effective anti-corruption investigations



WSP ETHICS AND COMPLIANCE INTRANET SITE





ETHICS - ANTI-CORRUPTION SHORT-TERM KEY MILESTONES

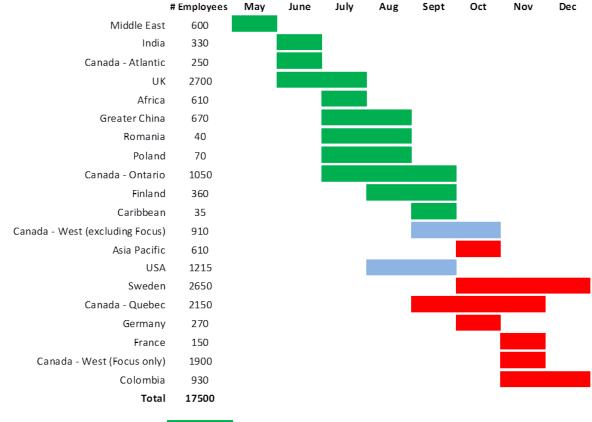
- Creation of the Ethics & Compliance committee
- Creation of the International Senior Management peer group
- Implementation of new policies (Code of Conduct; Working with Third Parties; Gifts, Entertainment and Hospitality; Disclosure; Understanding Bribery)
- Critical path mapping for whistleblowing reports
- Development of an Ethics training program and roll-out of the implementation schedule
 - Live training
 - E-learning go-live
- Our business partner:





ETHICS – ANTI-CORRUPTION SHORT-TERM KEY MILESTONES: 2014 E-LEARNING MODULE

Outline Deployment Plan









Our business partner:

TRAINING PROGRAM

Campaign	Audience	Frequency	Delivery Method
Working with Third Parties	All employees	Every two years	Online
Gift, Hospitality and Entertainment	All employees Board	Every two years	Online / In person
Whistleblowing	All employees Board	Every two years	Online / Workshops

Course	Course Length	Audience	Frequency	Delivery Method
Code of Conduct and underlying policies	45 minutes	All employees Board	Annual	Online
	2 hours	Business Leaders worldwide	Every two years	In person
Third party due diligence	30-45 minutes	All employees	Annual	Online
Anti Trust Competition	30-45 minutes	All employees	Every two years	Online



ETHICS & COMPLIANCE COMMITTEE

Members*:

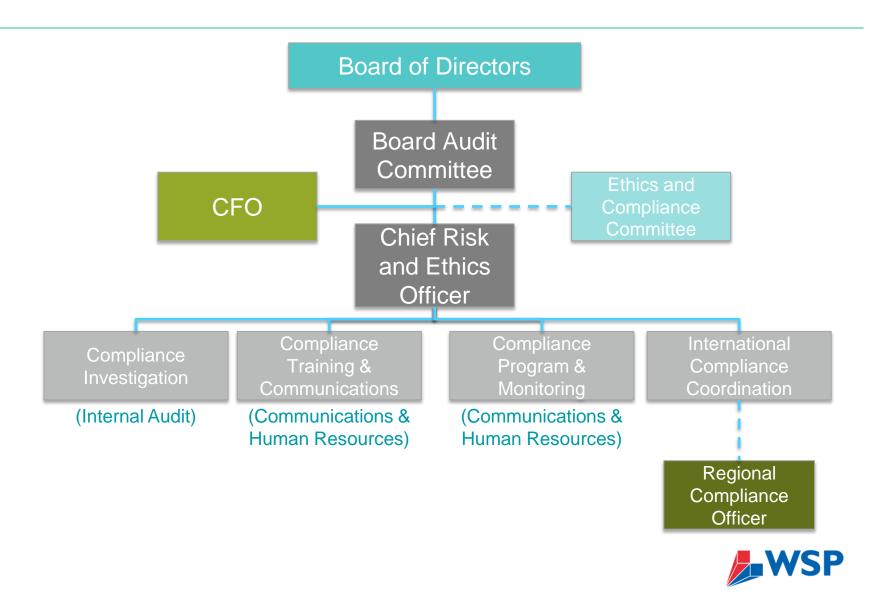
- Alexandre L'Heureux, Chief Financial Officer
- Tom Smith, Director
- James Nevada, Executive Vice President
- Ciaran Thompson, Commercial Director
- Louis-Martin Richer, Chief Risk and Ethics Officer
- Valéry Zamuner, Vice President Legal Affairs and Corporate Secretary

Duties:

- Review WSP Global's compliance policies annually recommend adjustments
- Provide oversight to the CREO as needed, to ensure that the Compliance program effectively prevents and/or detects violations
- Provide feedback to recommendations made by the CREO
- Review the disposition of whistleblower hotline
- Review resources assigned to the compliance program to assess their adequacy
- * Paul Dollin, Chief Operating Officer, is the newly appointed COO. He will be joining the Committee.



PREVENT - DETECT - RESPOND: STRUCTURE



OUR COMPLIANCE GOAL IS TO MAINTAIN A CULTURE WHERE THE INSTINCT TO DO THE RIGHT THING, TO COMPLY WITH THE LAW AND POLICIES IS TRULY EMBEDDED ACROSS OUR ORGANIZATION.





3. REPORTING PROCESS



OUR GOALS

- All members of staff should know where they can access policies, for example on an intranet site or in a staff handbook, and manager must be trained to apply these policies correctly.
- All members of the staff must feel free to disclose information "in the public interest," such as illegal or corrupt practices or health and safety concerns.
- The public must be in a position to peer into the company to understand its mission and values and that it is committed to doing business in a transparent and ethical manner with absolutely no tolerance for misconduct.







OUR END-GAME OBJECTIVES

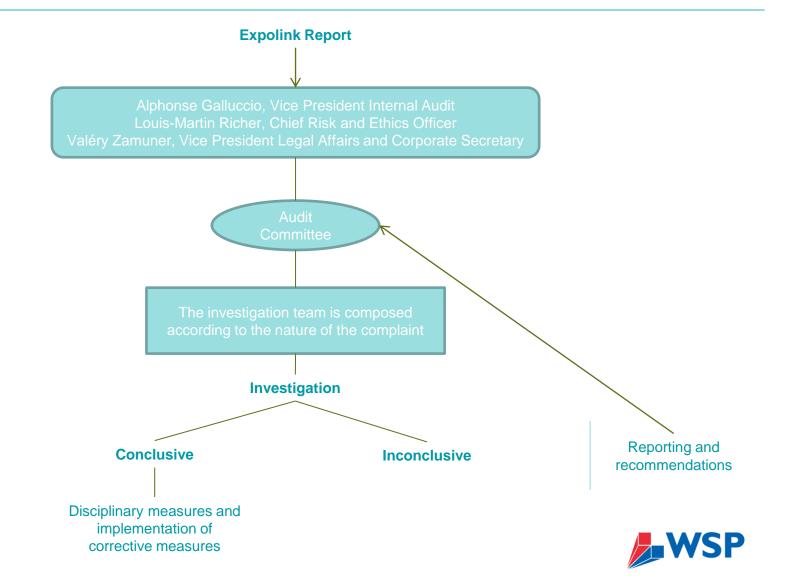
- Employees can speak up without fear of retaliation.
- The policy is communicated effectively and throughout the business, and responsibilities and training are assigned appropriately.
- Employees have convenient, free 24-hour access to the hotline, including translation services.
- All reported matters are diligently addressed, and levels of disciplinary action exists for wrongdoing.





OUR STRUCTURE

Initial Review



The Risk
Management
approach:
from conventional
projects to PPPs

PPP

According to the Canadian Council for Public-Private Partnerships:

"A cooperative venture between the public and private sectors, built on the expertise of each partner, that best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards."



Types of Asset Procurement Models

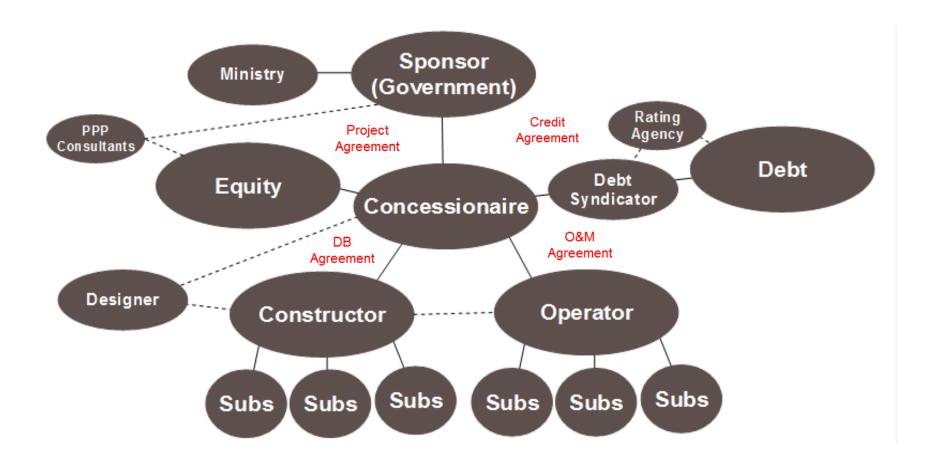
Traditional

- Bid-Build ("BB")
- Design-Bid-Build ("DBB")

PPP

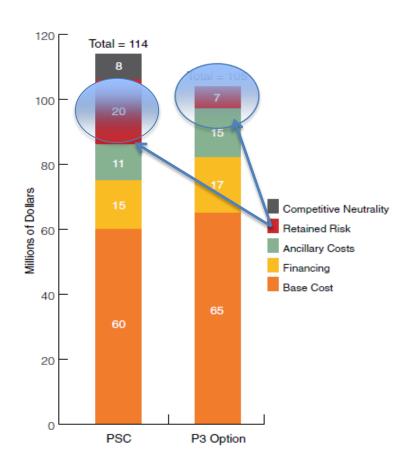
- Operate / Maintain Contract ("O&M")
- Build-Finance ("BF")
- Design-Build-Finance ("DBF")
- Design-Build-Finance-Maintain ("DBFM")
- Design-Build-Finance-Operate-Maintain ("DBFOM")

DBF(O)M Organizational and Contractual Structure



PPPs – Key Underlying Risk Concepts

- PPP a delivery model that creates cost efficiency and durability over the lifecycle of the asset
- One of the core principles of the PPP model is the creation of value for money (VfM)
- VfM the measure of cost savings achieved over the asset's lifecycle when delivering it through PPP v. traditional procurement
- VfM is achieved through the optimal allocation of risk to the party best able to manage and price it
- Optimal risk allocation strikes the balance between risk transfer and reward
- Risk allocation is at the heart of building the risk matrix



DBF(O)M Risk Allocation Matrix

Substantially fewer risks retained by the Sponsor: Traditional procurement: 76.5%; PPP procurement: 16.2%*

Risks	Traditional Procurement		PPP	
	Government	Developer	Government	Developer
Construction Risks				
Design				
Construction				
Site Safety				
Construction Costs				
Unforseen Site Conditions			Shared	
Labour and Material Issues				
Design Errors				
Scheduling Issues	Shared			
Construction Quality				
Scope Changes				
Delayed Site Access				
Increased Costs during Construction	Sha	red		
Weather Conditions	Shared			
Labour Disputes				
Fire/Vandalism/Theft				
Damages to Third Parties				
Subcontractor Insolvency				
General Risks				
Land Acquisition				
Life Cycle Management				
Stakeholders Management				
Coordination and Approvals through Users				
Utilities Hook-Up				
Concept Approval-Environmental				
Approval Risk				
Development Permits			Shared	
Building Permits				
Occupancy Permits				
Environmental Permits				
Building Code Compliance				
Land Use Approvals				

^{*}Source: Altus Group Limited, Design, Build and Maintain Risk Analysis (2007)

DBF(O)M Risk Allocation Matrix (con't)

Utilities Approvals	
Municipal Requirements ■	■
Environmental Risks – Known	—
Environmental Risks – Unknown	
Financial Risks	
Construction Financing	
Long-Term Financing ■	
Cash Flow Management	
Base interest rate before Project Agreement is signed ■	
Interest Rate Risk post-Closing ■	■
Inflation during Construction	—
Inflation on O&M ■	Shared
Insurance	
Change Orders	
Demand Risk (Volume) ■	
O&M Risks	
Change in Legislation ■	Shared
Damage to Property	Shared
Increased Maintenance Costs	
Performance Issues	
Change in Performance Standards	
Labour Issues	
Material Issues	
Non-Availability of Facility ■	
Vandalism ■	Shared
Fire Damage	
Acts of God ■	
Pollution	
Unplanned major replacements	■
Damages due to Contractor non performance	
Facility Condition risk at 20/25/30 years ■	
Liability Insurance ■	Shared
Business Risks	
Developer Bankruptcy ■	Shared
Subcontractor Default	

Building the Risk Matrix

The risk matrix is:

- An analytical tool
 - Identification, allocation, quantification, treatment, insurability
- A communication tool
 - Risk discussion with internal and external stakeholders
- A due diligence tool
 - Recording and reporting, due diligence

Methodology

- Identification
- Quantification
- Allocation
- Treatment
- Insurability

Managing Project Risks – A Public Sector Perspective

- Starts with PPP model itself (stats on risk reallocation)
- Retained risks
 - Policy approvals, change in law, change in policy, funding
 - Force majeure war, terrorism, nuclear, biological and chemical contamination
 - Pre-existing unknown conditions (geotechnical and environmental)
 - User risk ridership, tolls, user fees
 - Change in usage/occupancy/reconfiguration of the asset



Managing Project Risks – A Public Sector Perspective

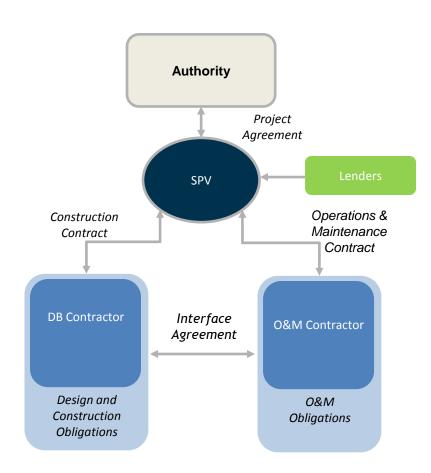
- Up-front due diligence (longer and more expensive)
 - Geotechnical, environmental, archeological, specifications
 - Assessing retained risk and insuring that private sector partner can accept and price the risk appropriately
- Project planning (longer)
 - Political, development approvals, funding
 - Asset usage planning for today's and tomorrow's needs
- Understanding user risk
 - To what degree is the funding of availability payments predicated on tolls/fees?
- Knowing the market which risks are bankable or can be competitively priced and incentivized for the private sector partner to take



Managing Project Risks – A Private Sector Partner Perspective

Risk management and mitigation measures:

- ☐ Substantial and rigorous due diligence process conducted by developers and lenders' advisors (legal, technical, insurance, tax, model audit)
- ☐ Integrated approach to design, construction, operation and maintenance under a cooperative approach starting from bid phase
- ☐ Special Purpose Vehicule is created by investors to enter into the project agreement and risks are typically flowed down to competent subcontractors backed by appropriate execution guarantees



Managing Project Risks – A Private Sector Partner Perspective

The Private Sector will favor contracts featuring:

- Quantifiable outputs: P3s require clearly quantifiable and measurable output metrics.
- Well defined risk allocation: Risk should transferred to entity best capable of managing that risk, well defined and manageable by the private sector
- **Transaction size**: considering the significant upfront costs incurred by both the public and private sector, P3s are not usually suitable for projects under <\$100M

Typical risks which are difficult to manage for the private sector include:

- land acquisition and access,
- volume risk (toll),
- soil contamination,
- legacy structures in poor or uncertain conditions,
- permits,
- force majeure, strikes, change in law,
- archeological and geotechnical when ground conditions are difficult to assess,
- utility relocation



Projects Risk Management

The contract is the first line of defense



Contractual Review: the insurance perspective of the contractor

- Scope & type of contract
- Stakeholders: client, partners, subs, lenders...
- Force Majeure & Relief Events
- Limitation of liability:
 - in proportion of the value of the contract,
 - limited to the re-performance of services
 - No liability for indirect or consequential damages: no liability for business interruption
- Limits of insurance shall not be related to LoL.
- Limits of insurance must not increase overall LoL towards the client.





Contractual Review: the insurance perspective

- Insurance & Financial security package: which insurance policies are applicable (OCIP vs CCIP) / which surety bonds are applicable (mainly in North America).
- Applicable laws and local specificities: the country/jurisdiction of the contract determines the insurance structure applicable to it.
- Local admitted policies mandatory under certain jurisdictions.





Major Risk Types & Insurance Coverage: Damages to the project

Risk Types

- Physical Damages to Project Works
- Damages to temporary Works (scaffolds, any temporary structure)
- Physical damages during Inland Transit
- Physical damages at Off-Site locations (storage)

Builders' All Risks Policy

- What's covered?
- Physical damages to the works caused by site activities or natural perils
- Where is it covered?
- On construction site and at specified offsite locations and inland transit
- When is it covered?
- From site mobilization to provisional acceptance/ substantial completion
- Including Testing, commissioning and dry runs when applicable
- Main extensions:
- Debris removal
- Expediting and extra expense
- Off-site storage / Transit
- Indirect and soft costs
- Main exclusions:
- LEG 2 / LEG 3
- Construction equipment*
- War, Terrorism



Damages to third parties

Risk Types

- Damage to third parties
- Damage to surrounding exposures
- Damage caused by a contractor to another contractor

Wrap-Up Liability Policy

- What is covered?
- Property damages and bodily injuries to third parties resulting from project works
- Where is it covered?
- On and around construction site and offsite for project related activities
- When is it covered?
- Site mobilization to provisional acceptance / substantial completion
- Products and Completed operations for up to 36 months
- Extensions / special provisions:
- Sudden and accidental pollution*
- Waiver of subrogation against insureds
- Cross liability (insured against insured)
- Main exclusions:
- Damages to the Project Works*
- Fines and penalties
- Damages to third parties due to E&O*



Professional Errors & Omissions

Risk Types

- Errors in design
- Omission in rendering professional services

Professional Liability / Errors & Omissions / Professional indemnity

- What is covered?
- Claims against the insured for property damages and bodily injuries to third parties resulting from errors or omissions in rendering professional services
- Coverage for consequential damages to third parties resulting from E&O
- Where is it covered?
- On project site
- When is it covered?
- Date of first design or professional services to provisional acceptance
- Coverage during extended reporting period, up to 60 months
- Exclusion:
- Failure to meet project schedule
- Cost of making good in the absence of damages



Pollution & damages to the environment

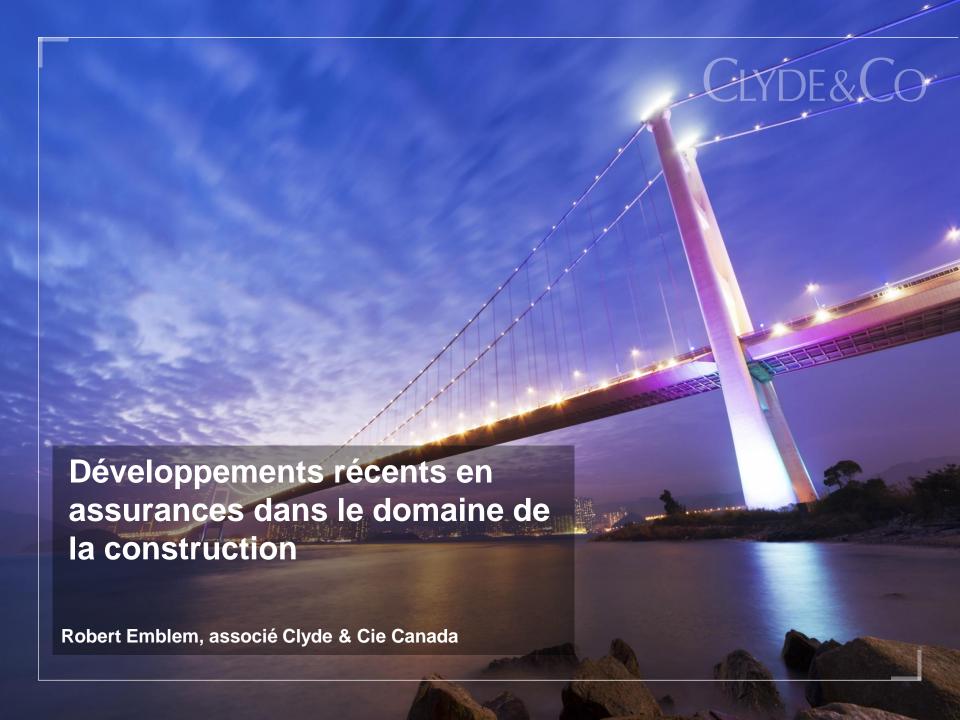
Risk Types

- Pollution
- Damage to the environment

Contractors Pollution Liability

- What is covered?
- Property damages and bodily injuries resulting from pollution caused or exacerbated by the works
- Where is it covered?
- On and around project site
- Off-site coverage during transportation and non-owned disposal sites
- When is it covered?
- Site mobilization to provisional acceptance
- Coverage for Extended Reporting Period
- Exclusions:
- Pre-existing known conditions





Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Company, 2015 BCCA 347 (demande d'autorisation de pourvoi à la CSC déposée le 1^{er} oct. 2015)

Faits

- Durant la construction d'une aile d'hôpital, on découvre des déviations et des fissures dans les planchers en dalles de béton.
- L'entrepreneur cherche à être indemnisé par l'assureur de chantier pour les coûts de réparation de 15 millions \$.
- L'assureur refuse de l'indemniser invoquant, entre autre, l'absence de dommages physique couvert, l'exclusion pour vices de construction et conception, et l'absence de cas fortuit.

Acciona Infrastructure Canada Inc. v. Allianz Global Risks US

Décision

• La Cour d'appel rejette l'argument voulant que les planchers n'ont pas subi de dommages physiques. Tel qu'expliqué par le juge de première instance:

"While some degree of deflection and cracking is expected in concrete slabs, the extent of what occurred in this case and its permanent nature support the conclusion that the slabs were left in an altered physical state, which some courts have again held to be the touchstone for a finding of damage. This conclusion finds further support in the uncontradicted evidence that the supporting rebar in the slabs had been stretched beyond its flexural point resulting in permanent deformity."

- Le sinistre a de plus été considéré par la Cour comme un cas fortuit en ce que les dommages n'étaient ni prévus, ni voulus par l'entrepreneur.
- La Cour interprète ensuite le libellé de l'exclusion LEG 2/96 (exclusion pour vices de construction et conception, etc.) développée par le London Engineering Group.

Cette clause exclut :

All costs rendered necessary by defects of material workmanship, design, plan or specification, and should any damage occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.

For the purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship, design, plan or specification.

• La Cour mentionne l'existence des clauses d'exclusion LEG 1/96 et 3/96 : la première étant une exclusion plus large (excluant "all damage caused but those actions under the control of the insured") et la deuxième plus limitée (excluant "the costs incurred to improve the original material workmanship design plan or specification").

- LEG 2/96 se situe entre les deux et exclut "only those costs of repair that would have remedied the defect immediately prior to the occurrence of the damage".
- La Cour précise que l'exclusion LEG 2/96 ne s'étend pas au point d'exclure les coûts des travaux de réparation ou de remplacement des biens endommagés.
- Dans ce cas, la Cour a conclu que la conception des dalles n'était pas défectueuse. Au contraire, les dommages résultaient des procédures d'étayement défectueuses. En d'autres mots, les dalles elles-mêmes ne contenaient aucun défaut.
- Les coûts exclus sont seulement ceux qui auraient remédié ou rectifié les procédures d'étayement défectueuses avant tout dommage aux dalles. Bref, les coûts de la mise en œuvre de procédures d'étayage adéquates (coûts de fabrication adéquate). La Cour a expliqué que dans ce cas c'était une coïncidence qu'aucun coût supplémentaire n'aurait été nécessaire pour faire le travail correctement.
- Par conséquent, la Cour d'appel a confirmé le jugement de première instance selon lequel la police d'assurance de chantier couvre les coûts de réparation de 8,5 millions \$ des planchers en dalles de béton.

Assurance de responsabilité civile générale des entreprises (assurance « CGL »)

Progressive Homes Ltd. c. Cie canadienne d'assurances générales Lombard, 2010 SCC 33

Faits

- Le propriétaire poursuit l'entrepreneur, Progressive Homes à la suite de la détérioration de certains immeubles en raison d'infiltrations d'eau.
- Progressive Homes demande à son assureur CGL de la défendre et de l'indemniser.
- L'assureur nie couverture, invoquant l'absence de « dommages matériels » ou de « sinistre » ainsi que l'exclusion visant les travaux de l'assuré.
- L'assureur cite certaines décisions qui ont conclu que si les dommages n'affectent que l'immeuble construit par l'assuré il n'y a aucun « dommage matériel » au sens de la police CGL car ce terme vise les dommages aux biens d'autrui; ces mêmes décisions ont conclu que les vices de construction allégués contre l'assuré dans un tel contexte ne constituent pas un « sinistre ».

- Couverture B Responsabilité pour les « dommages matériels »
 - verser pour le compte de l'assuré toute somme qu'il est légalement tenu de verser à titre de dommages-intérêts pour tout dommage matériel causé par un accident.
- « Dommages matériels » :
 - dommages causés à des biens matériels, ou de la destruction de tels biens, au cours de la période d'assurance, y compris la perte de jouissance consécutive à tels dommages; ou de
 - la perte de jouissance d'un bien matériel qui n'a pas été endommagé ou détruit, dans la mesure où cette perte de jouissance découle d'un accident survenu au cours de la période d'assurance.

- « Accident »
 - « Est assimilé à un accident l'exposition continuelle ou répétée à des conditions qui entraînent des dommages matériels qui n'étaient ni prévus ni voulus par l'assuré ».
- L'interprétation d'« accident »
 - évènement qui cause des dommages ni prévus ni voulus par l'assuré, peut découler d'une exposition répétée ou continue.
 - les malfaçons peuvent constituer des accidents.

Progressive Homes Ltd. c. Cie canadienne d'assurances générales Lombard

Décision

- L'assureur est tenu de défendre son assuré si les actes de procédure énoncent des faits qui, s'ils se révélaient véridiques, exigeraient qu'il l'indemnise relativement à la demande. Ce qui compte c'est la nature véritable de la demande et non pas la terminologie employée par le demandeur.
- Les « dommages matériels » inclut les dommages causés à tout bien matériel et ne se limite pas aux dommages aux biens d'autrui. Ainsi, des dommages causés à une partie d'un immeuble par une autre partie de ce même immeuble pourraient constituer des « dommages matériels ».
- Un « accident » n'est pas nécessairement un événement soudain et il peut découler d'une exposition continue ou répétée à certaines conditions.
- La question de savoir si la malfaçon constitue un accident est propre aux faits de chaque dossier.

Progressive Homes Ltd. c. Cie canadienne d'assurances générales Lombard

- Des allégations de négligence laissent entendre que les dommages sontfortuits (en d'autres mots ni prévus ni voulus) et donc accidentels.
- Ensuite, les trois versions de l'exclusion « travaux exécutés » n'écartaient pas clairement une possibilité de protection et ainsi l'obligation de défendre était déclenchée.
- La première version excluait seulement les dommages causés par l'entrepreneur à ses propres travaux et non les dommages matériels causés par les travaux ou aux travaux de sous-traitants (les actes de procédures faisaient référence à la participation de sous-traitants).
- La deuxième version excluait seulement les vices et non les dommages en découlant (il y avait possibilité de dommages résultant des vices selon les allégations de la poursuite).
- La troisième version était une combinaison de la 1ère et la 2ième version.

Intact, compagnie d'assurances c. Constructions GSS Gauthier 200 inc., 2014 QCCA 991 (demande d'autorisation de pourvoi en CSC refusée)

Faits

- Propriétaires d'un chalet poursuivent l'entrepreneur et son assureur responsabilité pour :
 - Dommages à l'intérieur du chalet causés par des infiltrations d'eau (13 000 \$);
 - Les coûts de réfection du toit par un tiers (68 000 \$);
 - Les coûts de travaux supplémentaires (50 000 \$); et
 - Troubles et inconvénients (15 000 \$).
- L'assureur reconnait que les montants réclamés pour les dommages à l'intérieur et les troubles et inconvénients sont couverts mais nie que les autres montants sont indemnisables (coûts de reconstruction du toit et travaux supplémentaires).

Intact, compagnie d'assurances c. Constructions GSS Gauthier 200 inc.

Décision

- La portée de l'arrêt *Progressive Homes Ltd.* ne se limite pas à l'obligation de défendre et s'applique relativement à l'obligation d'indemniser.
- Un vice de construction et un bien défectueux ne peuvent être exclus de la définition de « dommage matériel », d'autant moins lorsque les dommages subis sont visibles ou apparents.
- La malfaçon peut constituer un « accident » ou un « sinistre » au sens d'une police CGL.
- La Cour d'Appel confirme le jugement de première instance et ne fait aucune distinction entre les travaux mal exécutés et les dommages résultants.
- Dans la mesure où les travaux mal exécutés causent des dommages à d'autres biens, il s'agit de « dommages matériels » résultant d'un « sinistre ».
- Même si le toit défectueux ne semble pas avoir subi de dommages physiques, l'assureur a été obligé de payer pour sa réfection.

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Exclusion pour pollution

Precision Plating Ltd. v. Axa Pacific Insurance Co., 2015 BCCA 277 (demande d'autorisation de pourvoi à la CSC refusée)

Faits

- Le déclenchement des gicleurs suite à un feu dans les locaux de Precision Plating, a causé la fuite de produits chimiques entreposés dans des cuves.
- Des poursuites ont été intentées contre Precision Plating pour les dommages causés par les produits chimiques aux locataires avoisinants.
- Axa Pacific Insurance refuse de défendre Precision Plating sur la base de l'exclusion pour pollution dans la police CGL en cause.
- Le juge de première instance conclut que la police est ambigüe et que selon les attentes raisonnables des parties l'exclusion pour pollution ne couvre pas la fuite de substances polluantes causé par le feu.

Exclusion pour pollution

Precision Plating Ltd. v. Axa Pacific Insurance Co.

Décision

- La Cour d'appel renverse cette décision statuant que le juge de première instance a commis une erreur en analysant la cause du dommage plutôt que la source de la responsabilité.
- La police d'assurance exclut la responsabilité associée au rejet de polluants, et ce, même si le rejet résulte de d'autres causes concourantes qui ne sont pas autrement exclues.
- En effet la clause d'exclusion indique que:
 - " 4. This insurance does not apply to:
 - (b) (i) Bodily injury, Personal Injury or Property Damage <u>caused by</u> <u>contributed to by or arising out of</u> the actual, alleged or threatened discharge, emission, dispersal, seepage, leakage, migration, release or escape at any time of Pollutants."

Exclusion pour pollution

Precision Plating Ltd. v. Axa Pacific Insurance Co.

- La Cour d'appel est aussi d'avis que le juge de première instance a mal appliqué la porté de l'arrêt *Zurich Insurance Co.* v. 686234 Ontario Ltd. (2002), 62 O.R. (3d) 447 selon lequel l'exclusion pour pollution n'excluait pas une fuite de monoxyde de carbone provenant d'une fournaise défectueuse car l'assuré n'était pas un « pollueur industriel actif ».
- En effet, la Cour dans l'arrêt *Zurich* devait déterminer si l'exclusion pour pollution s'appliquait à un certain type de pollution (monoxyde de carbone), ce qui n'était pas du tout le cas en espèce. Les produits chimiques dans le locaux de Precision Plating étaient clairement inclus dans la définition du terme « polluant ».
- Au surplus, une interprétation littérale de l'exclusion ainsi que les attentes raisonnables de Precision Plating amènent la Cour d'appel à la même conclusion: la police exclue couverture pour la responsabilité de l'assuré en raison de la fuite de produits chimiques de ses cuves.

CLYDE&CO

360+

Associés

1800+

Professionnels du droit à travers le monde

3000+

Total des effectifs

45

Bureaux répartis sur 6 continents

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AIG Surety

Surety Basics

INTRODUCTION TO SURETY BOND CHARACTERISTICS Bond Basics



Introduction – What is Surety?

Surety Bond Characteristics

Surety is a Contract of Guarantee

- Surety is not Insurance
- Surety is a specialty contract that does not need consideration
- Surety has none of the usual insurance defenses

Tripartite Relationship

- Surety Guarantees Principal's performance
- Principal/Contractor Undertakes obligation
- Beneficiary a/k/a Obligee Receives benefit of bond

Underwritten to a Zero Loss Philosophy

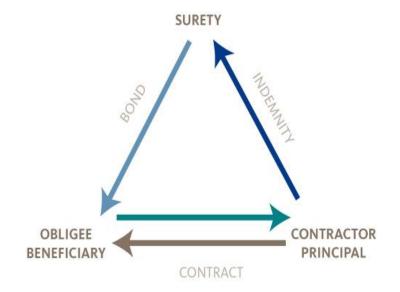
Emphasis must be on the credit quality of the client

Generally Cancellation For Non-Payment of Premium

= Not an Option

Historical Significance

- 2,750 BC: The earliest known suretyship contract was written on a Mesopotamian tablet.
- 1792-1750 BC: Surteyship was first addressed in a written legal code the Code of Hammurabi.





Who Asks For Surety Bonds and Why?

Who wants Surety Bonds?

- Public Sector Government, Local Authorities / Municipalities
- Private Sector Private Owners, Lenders / Financial Institutions, General Contractors
- South of the border, surety bonds are required by law under various

Benefits of Surety Bonds

- Ensures that contracts are completed and that subs and suppliers are paid in the event of default
- Sureties are more comfortable with completion exposure. Banks and other financial institutions less so.
- Transfer of Risk Transfers Principal's risk of default to the Surety
- Viable Alternative to Bank Guarantees and Letters of Credit Surety Bonds are conditional rather than on-demand
- Improves Liquidity Frees up bank lines for working capital needs and possible acquisition financing

Source of Enquiry

- Broker (most common)
- Direct from prospective client
- Internal Referral



Surety Bonds

Size of Surety Bonds?

- Most Canadian surety bonds are 50% bonds.
- Most Canadian surety bonds are conditional.
- P3 projects Don't always require surety bonds.
- South of the border, surety bonds are required by law under various statutes, regulations and requirements. Think
 of the Miller Act or the "little Miller Acts" that require bonds on public works projects.

Pricing -

- Usually based upon the contract price.
- Contract change orders usually trigger an additional premium.
- Depends on the credit worthiness of the company.
- Rates are not required to be filed in Canada
- Other jurisdictions may have rate filings.
- Surety is very credit driven better credit usually get better pricing.



Surety Bond Types - Contract

Purpose & Types

- Purpose provide financial security and construction assurance on building and construction projects by assuring the Obligee(Beneficiary) that the contractor (principal) will perform the work and pay certain subcontractors, laborers, and material suppliers.
- Bond Duration/Tenor Tenor follows the contract terms which can range from as little as 30 days to over 7 years and in some cases 10 years. If the project is extended the bond is also extended.
 Some bond types have more uncertain tenor risk than others.
 - Remember The bond follows the contract!

Typical sub-types include:

- <u>Performance</u> protects the owner from financial loss should the contractor fail to perform the contract in accordance with its terms and conditions
- Advance Payment guarantees the repayment of a cash advance by the Obligee ahead of scheduled project
 milestones or scheduled product deliveries. Protects the Obligee and ensures that the advanced funds are used
 toward their intended purpose and in conjunction with the terms and conditions in the underlying construction or
 supply contract.
- <u>Labor & Material Payment</u> assures that the contractor will pay specified subcontractors, laborers, and material suppliers on the project.
- Supply Guarantee that the supplier will provide all the contractually obligated supplies and materials.
- Warranty/Maintenance Guarantees against defective workmanship or materials for a fixed period of time.
- Bid assures that the bid has been submitted in good faith and that the contractor will enter into the contract at the
 price bid and provide the required performance and payment bonds.



Contract Bonds – Underwriting Philosophy

- Surety is designed to prevent loss. The surety prequalifies the contractor based on financial strength and construction expertise. The bond is underwritten with little expectation of loss.
- Construction is a risky business. Of 1,424,124 US contractors in business in 2007 only 969,937 were still in business in 2009 a 31.9% failure rate. Surety bonds offer assurance that the contractor is capable of completing the contract on time, within budget, and according to specifications. The bond shifts the burden of construction risk from the owner to the surety company.
- The surety underwriter's rigorous prequalification of the contractor protects the project owner and offers assurance to the lender that the contractor is able to translate the project's plans into a finished project. Their expertise, experience, and objectivity in prequalifying contractors is one of a bond's most valuable attributes.
- Before issuing a bond, the surety company must be fully satisfied that the contractor has, among other criteria:
 - good references and reputation;
 - the ability to meet current and future obligations;
 - experience matching the contract requirements;
 - the necessary equipment to do the work or the ability to obtain it;
 - the financial strength to support the desired work program;
 - an excellent credit history; and
 - an established bank relationship and line of credit.



Surety Bond Types - Commercial

Purpose & Types

- Purpose guarantee performance by the principal of the obligation or undertaking described in the bond.
- Bond Duration/Tenor Typically 1 year in duration and are annually renewable. Nonrenewal can
 result in a default or claim- in effect providing an evergreen policy that always has to renew unless
 another firm replaces us (which may be unlikely in the worst of times)

Typical sub-types Include:

- Court/Judicial Required in judicial proceeding. Ensures that the party to a lawsuit will post the bond to indemnify a particular obligation from the litigation (e.g. Appeal, probate, Executor/Executrix).
- <u>License & Permit</u> Required of a person or an entity as a prerequisite to obtain a license for various professions or a permit in any city, county or state (e.g. licenses required to driving motor vehicles, selling real estate and contracting services).
- Customs/Duty Deferment/Tax Guarantee that a company which has been deferring duties and/or tariffs, taxes, surcharges or fees will pay in due course.
- Immigration Bond is a class of federal bonds permitting aliens to legally enter and reside temporally in a given country (e.g. delivery, voluntary departure and public charge bonds).

Other sub-types that are selectively bonded include:

- Financial Guarantees
- Reclamation Bonds
- Workers Compensation Bonds



Surety Bond Types - Commercial

Other Selectively Written Sub-types

Financial Guarantees

- indemnifies the beneficiary for the Obligor's nonpayment of money when due watch for regulatory issues
- We avoid financial guarantees due to regulatory reasons, preventing multi-lines from participating.

Reclamation

- Heavily dependent on statutory and regulatory requirements
- Basic Industries: Coal Mining; Landfill; Hardrock Mining; Sand and Gravel Extraction
- Long-tail in duration upwards of 20 years or more
- Worker's Compensation Worker's Comp laws are designed to insure employees who are injured or disabled on the job are provided with fixed benefits
 - Employers that are subject to the worker's comp laws are liable for benefits for personal injury or death of its employees caused by accidents or occupational disease arising out of and in the course of the employee's employment
 - We have not been very active here due to tenor uncertainty Annually renewable long-tail exposure with bond penal sum usually determined based on estimated future liability
 - Liability Cumulative or Stacking
 - Bond formats
 - Occurrence Surety is liable for obligations occurring during the time the bond was in force. If the bond is cancelled the Surety remains liable for claims incurred prior to the cancellation/termination date.
 - Last Surety On Surety assumes all past, present and future liability. The Surety is released from liability only if the bond is cancelled
 and a suitable replacement surety or alternate security is posted
 - Careful attention needs to be paid to bond language, applicable statutes and regulations and effect on tenor



Contractor Failure

Work with Claims

- In the event of contractor failure, the owner must formally declare the contractor in default. The surety conducts an impartial investigation prior to settling any claim. This protects the contractor's legal recourse in the event that the owner improperly declares the contractor in default.
- When there is a proper default, the Surety's options are usually spelled out in the bond. These options may include:
 - Providing financial or technical assistance
 - Re-bidding the job for completion
 - Bringing in a replacement contractor
 - Paying the penal sum of the bond
- Why Do They Fail?
 - Unrealistic Growth i.e. Over-expansion
 - Performance Issues i.e. Poor job management
 - Character Issues i.e. No comprehensive business plan
 - Accounting Issues i.e. Poor estimating and job cost reporting
 - Management Issues i.e. Poor financial management & communication with customers, vendors and employees
 - Other Factors i.e. Factors beyond the contractor's control



Reasons to Claim on Contract Surety Bond

- Non-Payment Principal fails to pay suppliers of labor and/or material
- Breach of Contract Principal fails to perform per contract
- On bid bonds Surety refuses to issue final bond due to excessive bid spread questionable bid results
- On renewals or extensions, adverse change in underwriting criteria Underwriting requirements change or principal's financial condition changes which results in Surety not issuing new bond (are extensions, renewals expected?)
- Failure to execute a contract or provide required replacement surety
- Bid Mistakes Principal incorrectly bids and subsequently fails to provide final bond

<u>Current Trends</u> – Including a Ratings Trigger on the Surety. Most Sureties tend to want this stricken under the contract as an event of default.



Contract Bonds – Contractor Failure

Performance Bond and Labor & Material Payment Bond Default

- In the event of contractor failure, the owner must formally declare the contractor in default.
- Surety should be made aware of any perceived project problems including allegations of unpaid sub-contractors.
- Claimants limited to subcontractors or suppliers of the bonded principal or sub-subcontractors or suppliers to a subcontractor of the principal.
- Most bonds require that a claimant that does not have a contract with the principal give the principal/surety written notice of a claim within a short period of time after furnishing the labor or material.
- Time period is from the date of the claimant's last work or from date of each delivery.
- The surety conducts an impartial investigation prior to settling any claim. This protects the contractor's legal recourse in the event that the owner improperly declares the contractor in default.
- Claimant facilitates the claim process by providing notice in writing, explaining the claim, submitting
 full and complete documentation for the amounts owed and asking for any forms/affidavits that are
 required to evaluate the claim.



Claims Process

Initial Claim & Investigation

- Claims Handling
 - Notification
 - Surety's Initial Response
 - Contact Principal
 - Principal's Response
 - Surety's Subsequent Response
 - Notify Indemnitors
- Claims Investigation
 - Bond Form
 - Contract
 - Additional Documentation
 - Scope & Nature of the Problem
 - Merits of the Claim
 - Cost of the Claim
 - Remedies



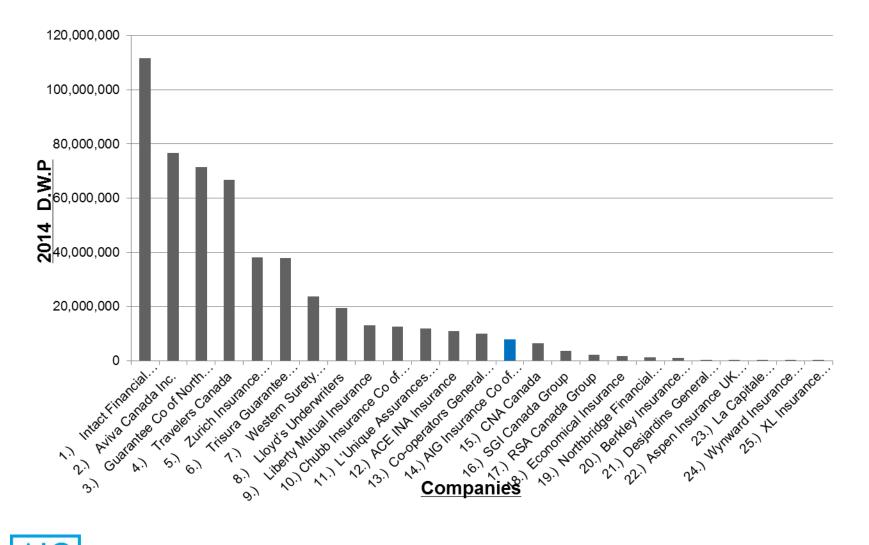
Claims Process

Remedies & Recovery

- Claims Remedies When there is a proper Performance Default, the surety's options may be spelled out in the bond. These options may include:
 - Tender Surety and Obligee agree on a replacement contractor to complete the work
 - <u>Takeover</u> Surety assumes or "takes-over" responsibility for completing the remaining work, i.e. hire construction professionals to manage and perform the completion. Takeover Agreement would be executed spelling out each party's rights and obligations in connection with the completion work.
 - Allow Obligee to Complete Surety elects to not be involved in the completion but remains liable for the costs to complete in excess of the remaining contract balances up to the penal sum of the bond.
 - <u>Deny Claim</u> after completion of its investigation the Surety determines that it has no liability. This may result in litigation.
 - <u>Finance Contractor's Completion</u> Providing financial and/or technical assistance to the existing contractor;
 - Pay Bond Penal Sum up front cash settlement
- Recovery Reimburse the Surety for losses incurred, including expenses and costs.
 - Identify any opportunity that would allow recovery of all or part of the loss and expense payments via Salvage,
 Subrogation and Contribution.
 - Pursuing indemnitors, drawing down on collateral held and pursuing third –parties to recover salvage

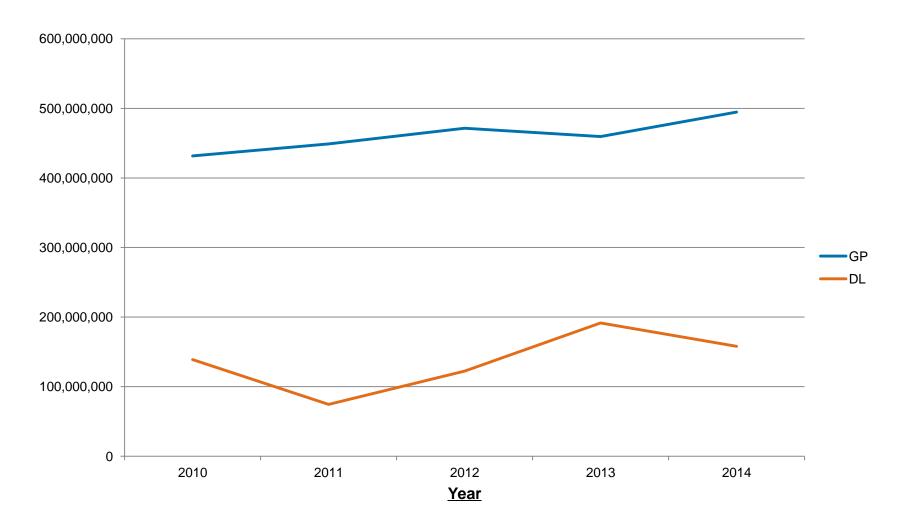


Canadian Surety Market – Direct Written – 2014 Leading Companies



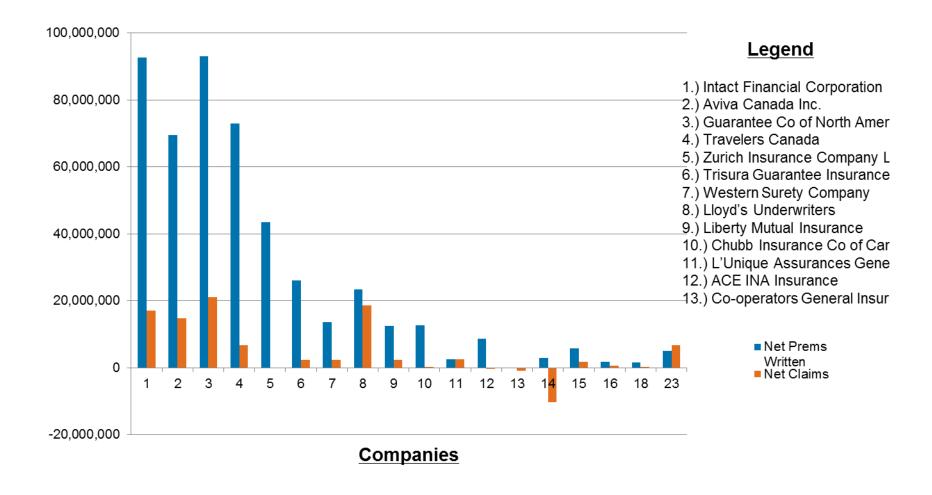


Canadian Surety – Five Year – Gross Premium – Direct Losses



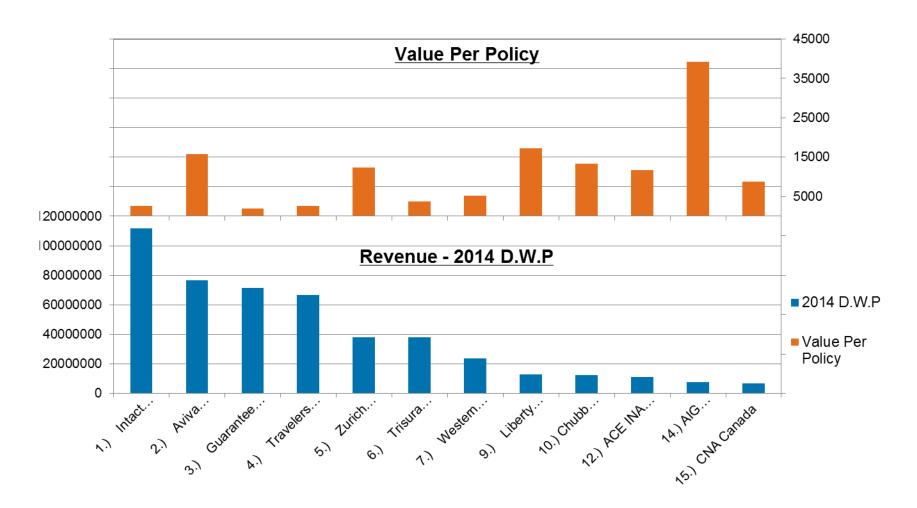


Canadian Surety Companies – NWP & Net Claims





Canadian Surety – Revenue vs. Policy





INDEMNITY & COLLATERAL



Indemnity

What Is It? Why Do We Need It?

- Indemnity An agreement that establishes the legal relationship and contractual terms between the Principal and the Surety.
- Primary Purpose Principal promises to indemnify and reimburse the Surety up to the face amount
 of the bond plus any related costs and expenses incurred by the Surety due to the Principal's
 default.
- Default Principal fails to perform its obligations under the contract or commercial bond.
- Secondary Purpose Protects the Surety during the course of the bond and provides account relationship tools such as:
 - Account oversight and monitoring of financial condition (Credit Oriented clauses)
 - Protect the Surety in relation to other unsecured creditors (Security Oriented clauses)
 - Provides ability to Step-in and Take-over a project (Loss mitigation clauses)
 - Specifies choice of law and dispute resolution venue in a manner that is more responsive to the exigencies of the cross-border or local transactions (Legal & Administrative clauses)

Indemnity agreements Quebec:

- Hypotheques should have a dollar amount.
- Allows the surety to secure rights on a project & equipment under the indemnity faster.
- Quebec Sureties have no issue with this.
- Larger companies have bank agreements with negative pledge clauses that need to be considered.



Collateral

What Is It? Why Do We Need It?

- Collateral may be required if the risk or the tenor is challenging in terms of scope or number of years.
- Collateral is typically cash or letters of credit.
 - Cash is more problematic as this carries an additional fiduciary responsibility
- Collateral is used to help mitigate risk; risk related to an obligor and/or a project
- Collateral can be 100% of the bond amount or less, depending on risk/tenor
- Collateral needs to meet the surety's requirements.



UNDERWRITING & CREDIT FUNDAMENTALS



Underwriting Process Summarized

Typical Steps For The Underwriter

Account Submission and Approval Process

- New enquiry received
- Initial review to assess fit with underwriting and credit criteria
- Review latest financials
- Discuss bonding needs
- Meet with prospective client to complete due diligence
- Negotiate Indemnity, agree on provisions, final wording and execute

Bond Submission and Approval – Things to Consider?

- Bond Size
- Project Scope
- Contract Terms & Conditions
- Tenor i.e. length of obligation, explicit or implicit renewals or extensions
- Geographic location, both obligor and project location
- Obligee
- Bond Type
- Bond Conditionality, i.e. Conditional vs. Unconditional/Pay-on-demand



Ownership & Management Profile

Ownership Changes Matter

- What is the overall competency of the Management team?
- Does the Management need or have specialized knowledge or expertise?
 - i.e. Gov't Projects, Projects outside their normal geographic territory
- Is there a continuity plan and succession plan in place? Not as big a deal with public companies but more critical with smaller companies.
- Changes in Ownership & Management
 - Why did the Ownership change?
 - Who are the new Owners?
- Background of new Owners & Management
 - Prior experience?
 - Industry knowledge?
 - Industry reputation?
- Do the new Owners and Management understand the existing company structure and business?
- What are the motivations of the new Owners and Management?
 - i.e. Private Equity firms generally drain cash, increase leverage, aggressive growth to achieve IPO in 3-5 years
- Is there "key-man" risk?



Scope of Operations and Business Strategy

Who are they? Do they have a plan in place?

- Scope of Operations : What does the company do?
- Management &/or Ownership change resulting in a change in the business strategy?
- Consistency -Has the business strategy remained consistent? Changed?
- What are the changes to the business strategy?
 - Projects outside normal geographic territory? Project concentration geographic shift?
 - Project type shift? Project complexity shift
 - What is the impact? Are/Were they foreseeable?
- Do we understand who the major affiliates are, especially if there are intercompany transactions
- Is the construction contractor also a concession operator? Do they have controls to be sure one side isn't a loss leader (take a thinner margin (higher risk)) on the concession business in order to enjoy higher construction profits in the near term.
- Life Cycle of the Business Need to Ramp-up or Mature?



Growth Rate Things To Watch

- Slow & Steady vs. Rapid growth over a short period of time
- Past growth rate vs. current growth rate year-over-year growth?
 - Is the growth rate accelerating or stabilizing?
- What is motivating the growth?
- Is the growth tied to new markets and territories?
- Are there risk management controls in place to manage and keep growth in check?



Project Risks

Project Risk

- Complexity of project and contractor's experience with similar projects
- Geographic and political risk experience counts
- Size of project Are large projects structured to minimize risk?
- Risk mitigants can include:
 - Joint Venture partner
 - Larger advance payments
 - % of self performed work vs. work subcontracted se
 - Fixed vs. variable cost contracts
 - Bonding subcontractors

Bid Analysis

- Are the company's bids within reasonably acceptable range?
- Does the company consistently underbid by a significant margin?

Work in Progress ("WIP")

- Frequency monthly, quarterly, every 6 months, yearly?
- Are the WIPs consistent or is there large variability?
- Does the WIP tie to Financial Statements?

Under/Over Billings

- What is the status?
- What is the level of variability?
- Can Management explain the levels and/or changes?



Underwriting/Credit Analysis - Balance Sheet Focal Points

Typical Balance Sheet With Components and Starting Questions

Assets

Cash

- · Restricted/Unrestricted
- Amount in relation to budget, number and size of projects
- · Is the amount stable or volatile?
- Is it derived from cash from operations or debt?

Receivables

- Current status older than 90 days? Increases?
- Concentration by customer or country?
- · Are there problematic government payers?

Under/Over Billings

- What is the status?
- What is the level of variability?
- Can Management explain the levels and/or changes?

Non-core/earning assets

- Any assets or companies not related to the construction business? (concessions?)
- · Is there debt associated with these assets?

Intangibles

Goodwill from acquisitions – may reflect poor capital quality



Liabilities & Equity

Payables

- Is it paying on a timely basis?
- Are increases commensurate with business levels?

Bank Lines of Credit

- What is the size of the bank line relative to the size of the projects in progress?
- Is the bank line regularly utilized
- What is the current availability under the bank line?
- Is there heavy reliance on borrowing for working capital?
- Is Bank Credit used to supplement cash flow?

Debt

- Is the debt secured by assets?
- Maturity schedule?
- Financial covenants (compliance?)
- · Multiple banks or sole bank?
- Access to bond market?
- Is it heavily weighted to short-term debt (producing refinancing risk)? Commercial paper?
- · Off balance sheet liabilities

Capital Availability

- What is the equity base? (Increasing or decreasing?)
- Does the company have an aggressive dividend/distribution policy?

Financial Statement Overview

Transparency

- Are financial statements audited, notes adequately detailed?
- What is the level of reporting on subsidiaries and related affiliates?
- Is the reporting comparable to what is provided to the banks?
- Detail behind debt
- Detail in intercompany transactions
- Financial covenants spelled out?
- Asset pledges specified?

Big Picture Analysis

- Audit from a known firm and clean?
- Balance Sheet Leverage; Liquidity; Working capital and component analysis
- Income Statement- Revenue ; Profitability
- Cash Flow- Gross Funds Flow, Cash Flow from Operations; Free Cash Flow
- Ratio Analysis Solvency Analysis
- Tends Analysis
- Common Size Analysis
- Notes Must read! Off balance sheet items, timing of debt repayments, litigation, debt description and more

Leverage Analysis

- Amount of Debt
 - Funded debt
 - Total liabilities
- Interest Rate Risk Fixed vs Variable
- Bank funded or capital markets funded reliability of the source (s)
 - Better to have multiple capital sources
- Repayment schedule
 - Escalating debt service or bullet maturities in excess of income and cash flow presenting refinancing risk?
 - How much is due this year, within 5 years or much longer? Collateral
 - Audited financial statements should contain footnotes summarizing long-term debt, repayment terms, interest rate
 and expense, collateral and guarantors and next five years' annual debt repayment
- Collateral What is posted, what remains unsecured watch when working capital items are used as collateral
- Covenants -Are they specified, calculations defined and calculations presented to prove compliance?
- Bank Lines of Credit
 - What is the size of the bank line relative to the size of the projects in progress?
 - Is the bank line regularly utilized?
 - What is the current availability under the bank line?



Off Balance Sheet Risks

Not In The Balance Sheet, But Should Be In The Notes

Guarantees Warranties & Endorsements

- Contingent liability Warranties can be expressed or implied look in the footnotes!
- What are the conditions/covenants that could trigger enforcement? Can enforcement impair loan repayment?

Pensions, Bonuses & Compensation

- Defined Benefit Plans present a liability, some may be recognized on the balance sheet, some not.
- May compete with debt repayment obligations; May require funding beyond company's internal funding ability

Union Contracts

- Reduce ability to hire, fire, promote and demote. Hamstrung management
- Public Works contracts in the US mandate employing union workforce at prevailing rate under Bacon-Davis Act and other federal regulations

Rental & Lease Agreements

- Operating Leases run through the income statement as rent expense but are not booked as asset and leverage
 on the balance sheet.
- Capital/Financing leases booked on the balance sheet and run through the income statement as depreciation and interest expense Commitments

Lawsuits

- Status of existing lawsuits
- What is the contractor's legal record of liens, judgments, convictions, penalties, fines, punishments, etc....?
- What is the extent of legal expenses? How are they managed?





Bring on tomorrow

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