



# **Designing Electronic Pathways Together**

## **A Blueprint for Electronic Bonding**

### **Contract Bid Bonds**

**October 2008**

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#### **The Challenge**

The Blueprint for E-Bonding is an ambitious, collaborative undertaking to define electronic pathways for efficient surety transactions. The Blueprint represents a common set of principles, values, standards and some design specifications among the surety players across Canada. The content will lay a foundation for the design of electronic applications and engage stakeholders to effect a transition to technology. A few opportunities for value added applications are captured.

Surety bonds play a major role in the development of the economy. Their main purpose is to provide a security guarantee to performance of a contract or compliance to legislation. Depending on the nature of the business, one may be required to obtain bonding before bidding or starting to work on a job. As such, a key value element of the surety industry is the pre-qualification of principals.

In recent years, there has been a growing awareness of the potential for transactions to be conducted electronically. The presence of bidding and tendering technologies has created the need for bonding to complete the electronic tender submission process. For the surety profession and for the value of bonding - to respond to this expansion demand, a strategic approach is required to better meet the needs of its clients on both sides of the bond.

The Blueprint will identify several priorities and standards within six areas: mainstream processes; enforceability; accountabilities of stakeholders; general principles; business requirements; and financial viability. The Blueprint speaks to any stakeholder, whether within the surety industry, construction industry, public or private sector, with an interest to build, develop or purchase a electronic bonding solution for their business purposes.

## **The Vision**

The vision for the future of electronic pathways enabling surety transactions can be described as:

- Collaborative planning of electronic pathways to enhance surety transactions and education.
- Value added for all surety stakeholders, including ease of use, undoubted authentication, high efficiency, quality improvements and informative applications.
- Highly regarded and respected electronic standards adopted by all surety stakeholders.
- Open market to encourage technology designers and providers to build and operate applications to support surety business needs.
- Financially viable for all surety stakeholders and technology developer/providers.
- Continuous improvement and long term viability of electronic pathways.

## **The Benefits of the Vision**

The vision will allow each stakeholder to focus on their core business purposes and to conduct their business in a more efficient manner. The avoidance of multiple systems with varying standards and workflows will save an undue burden being placed upon all parties.

## **Making the Vision a Reality**

A shared vision by all stakeholders of surety security along with a commitment of all stakeholders to the vision and the contents herein will set the stage for the benefits to be realized.

## **Scope**

The content herein is applicable for all contract bid bonds, for project specific contracts as well as for service contracts. Further, the content applies to public and private contracts and combinations thereof, for example, private public partnerships. All industries, construction, corporate, retail and all other industry users of bonds represent the targeted audience.

Although the prime focus is bid bonds as the initial movement toward electronic applications, some information is provided that references other bond products as well as workflows beyond the bidding process.

## **Purpose and Value**

The purpose of an electronic bond system represents a transition from paper to digital. The fundamental workflows are representative of three primary parties – the owner of a contract; the principal party agreeing to carry out the work per the terms of the contract; and the surety agreeing to guarantee to the owner that the principal will carry out the work per the terms of the contract. The surety's guarantee is the duly executed surety bond form which is considered legally to be a deed or document under seal in all Canadian provinces other than Quebec (where surety bonds are governed by specific provisions of the civil code). These legal relationships remain intact, as they do in the pre-digital environment.

Primary expected benefits of electronic bonds versus paper bonds are: the automation opportunities for quality assurance; and significant efficiencies provided to all parties of the bond, saving valuable resources.

The Surety Association of Canada recommends that a stakeholder seeking a solution to address electronic bonding should ensure it clearly identifies and defines the purpose of such a solution before considering decisions for design, build or purchase of a solution. As well, if such a solution is required to fit current business needs – such as electronic delivery – the industry recommends that consideration be made for longer term needs and its impact – such as storage and retrieval of electronic bonds.

## **Mainstream Processes**

Electronic procurement technologies will not be complete until surety bonds are received and digitally matched to the tender submissions. Where electronic bidding and tendering applications are already adopted, the natural next step to complete e-procurement (particularly for construction buying) is the electronic delivery of bonds and the ability to match with the remainder of the contract documents that have been delivered electronically.

Getting a bond delivered electronically and ensuring its authenticity are the two primary considerations. There will be no sense investing into processes and technologies that cast doubt on the very mechanism that helps protect taxpayer and private investment dollars, no matter how convenient.

The Surety Association of Canada recommends that information technology strategies for e-procurement incorporate checks to ensure digital bonds are in fact real and valid. Much of this, however, falls into the reliability of the process of how the bond was electronically created in the first place.

The more obvious mainstream processes and the various applications that might be considered to achieve these objectives are noted as follows:

<b>Electronic Bonding : Mainstream Processes</b>	<b>Various Potential System Applications</b>	<b>Gets it there</b>	<b>Ensures it's real</b>
Obligee's receipt of valid bond; matched with tender packages	Submission	X	
	Retrieval	X	
Creation of bond	Execution		X
	On-line management of power of attorney privileges		X
	Creation of bond	X	
	Bond library or template	X	
Access and storage	Pre-approved authorization rights to read; upload; download and edit		X
	Repository for retention	X	

Several differing applications are and will continue to appear in the marketplace to respond to the need for e-bonding solutions. Opportunities to contribute to the validity of a bond might potentially exist in several of these applications, however, particular attention for the cognizance of business rules and processes surrounding the signatory execution of the bond and collaborating applications leading up to its execution should be at the top of assessment criteria for e-bonding solutions.

The development of collaborated business rules for each potential system application (and other complementary applications that exist, such as applying for a bond on-line) presents an opportunity for overall 'big picture efficiencies'. One of the biggest challenges facing e-procurement relative to bonding, is the development of excessive system solutions presenting a varied combination of

applications and services. Should the pendulum swing beyond simple solution competitiveness in the marketplace, operational challenges will quickly arise from the need to accommodate various passwords, procedures, system interfaces and varying forms of end products.

## **Enforceability of Electronic Bonds**

**Disclaimer:** This commentary on the legal enforceability of electronic bonds is for informational purposes only. It is not intended as a comprehensive or detailed statement of the law concerning the matters addressed, and it does not constitute legal or any other kind of advice. No person should act or refrain from acting in reliance on any information found in this commentary, or elsewhere in this Blueprint, without first obtaining appropriate, qualified professional advice. *The Surety Association of Canada will not in any circumstances be liable for use of this information by members or any other person for any loss or damage of any kind arising from, connected with, or relating to the use of this information.*

**Legal effect of surety bonds:** In the common law jurisdictions of Canada, a surety bond is interpreted as a deed, or document under seal, which therefore has specific legal requirements as to its form. These legal requirements for valid bonds are rather technically complex and this commentary is intended only to discuss some of them that are relevant to whether bonds can be issued electronically. The requirements addressed here are that a deed must be "signed and sealed", and that a bond must be in writing and (historically) on paper.

Overall, the Surety Association of Canada is optimistic that electronic bonds can be considered enforceable under the current electronic legislation regime throughout Canada, although there is some variation because of differing legislation in the different jurisdictions.

**Signed:** To comply with the requirement that an electronic bond be signed, it should adhere to the electronic signature requirements of the applicable electronic documents legislation.

**Sealed:** To meet the requirement that an electronic bond be sealed, the person executing the bond to undertake a specific and unequivocal act, in addition to signing the bond, indicating that the person doing so intends the electronic bond to take effect under seal.

The act indicating an intent to issue a bond under seal should be made during the electronic bond creation process. Just for illustration, such an act could be answering a dialog box, independent of other steps in generating the electronic bond, asking whether the person executing the electronic bond intends the

document to be executed under seal. To add further evidence of an intention to seal the bond, upon clicking “yes” to the question in the dialog box, the image of the bond as represented on the computer screen might thereafter appear to bear a seal in the traditional form. This is simply an example: any specific act of the person authorizing the bond would probably qualify, so long as the act clearly shows that the person doing so had an intention to be bound by a document under seal.

On the other hand, simply using wording in the bond saying that the person signing it intends to be bound under seal might not provide the same likelihood of enforceability for the bond. It would be preferable to have a separate, clear act by the persons executing the bond on behalf of the surety and the principal as discussed above.

**On paper:** Common law traditionally required a deed not only to be executed in writing, but also specifically on paper. Canada’s new electronic commerce laws are intended to allow what previously was required to be on paper to be effective when expressed electronically.

**In writing:** Legislation enabling electronic documents differs across the country and in some cases gives slight variation to the enforceability risk. All Canadian jurisdictions (except the Northwest Territories) have in place electronic document legislation. Legislation in Prince Edward Island, the Yukon Territory and at the federal level permit electronic instruments to satisfy the writing requirements imposed by legislation or regulation and this might raise a question about whether a surety bond falls into that category. In those provinces, a notation on the bond form indicating the writing requirement for the bond is satisfied via electronic instruments may be appropriate.

## Players and their Roles:

This section identifies the players involved in surety transactions and their roles and responsibilities to the process.

	<b>Player</b>	<b>Role and responsibilities relative to surety</b>
Surety	Surety Broker	<ul style="list-style-type: none"> <li>- provides consultative support and liaison services to principals and/or owners for bond requirements and solutions</li> <li>- in cases where powers of attorney have been provided from the surety company to the broker, the broker is able to commit the surety company into a bond agreement; and further executes and delivers the bond document to the principal</li> </ul>

<ul style="list-style-type: none"> <li>- Surety Company</li> <li>- (various roles within the surety company are involved to carry out the surety's responsibilities; typically a surety underwriter and authorizing management)</li> <li>-</li> </ul>	<ul style="list-style-type: none"> <li>- prequalification assessment to establish and make approval decision</li> <li>- establishes bond form and/or wording to be used (sometimes bond form is pre-determined by owner)</li> <li>- establishes premium</li> <li>- guarantees to the obligee that the principal will perform as per conditions of contract</li> <li>- completes contract or pays compensation for the loss if principal defaults on performance or compliance</li> </ul>
<ul style="list-style-type: none"> <li>- Attorney in fact</li> <li>- (an identifiable authorized signing authority on behalf of the surety)</li> </ul>	<ul style="list-style-type: none"> <li>- signs the bond on behalf of the surety company</li> <li>- If this role is delegated to the broker, the surety must provide a duly executed power of attorney from surety company to the authorized broker</li> </ul>
Witness	<ul style="list-style-type: none"> <li>- Signs the bond guaranteeing their witness to the signature by the Attorney in Fact</li> </ul>

Owner	Owner or Obligee	<ul style="list-style-type: none"> <li>- establishes terms &amp; conditions for performance of contract</li> <li>- identifies and calls for need of security bond</li> <li>- liaise with principal &amp; surety re performance matters</li> <li>- provides remuneration to principal for performance as per contract</li> </ul>
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Principal	Principal	<ul style="list-style-type: none"> <li>- seeks and identifies a broker partner &amp; establish relationship</li> <li>- applies for surety security through application process</li> <li>- carries out performance or compliance as per bond agreement</li> </ul>
	- Authorized signatory	<ul style="list-style-type: none"> <li>- signs the bond on behalf of the principal organization</li> </ul>
	- Witness to Principal	<ul style="list-style-type: none"> <li>- signs the bond guaranteeing their witness to the signature of the individual with authorized signing authority</li> </ul>

Product	The Surety Bond	The Bond itself should name the parties on the bond and explain the role and responsibility of the parties involved. The Bond further outlines terms and conditions for the surety security.
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The Surety Association of Canada recommends that a solution not force shifts away from the current accountabilities that are standard in the marketplace as noted per the above.

## **General Principles**

The integrity of the bond authentication is of primary importance. The Owner must have complete confidence that any digital bond submission is undeniably valid.

Surety companies named on the bond must be licensed by established Canadian or Provincial regulatory bodies to provide surety guarantee services for the geographical scope covered by the bond.

Electronic bonding does not change the traditional relationships, roles and obligations of the bond parties.

Digital signatures executing for each party should be identifiable to an individual, a title, their company, their full contact information. This information must be made available to all parties of the bond for each digital signature on the bond.

Digital signatures allowable to execute electronic bonds on behalf of their organizations are expected to go through a rigid internal process with established business rules ensuring legally binding authorization has been granted. Evidence of power of attorney for signing authorities should be required prior to approval of digital signatories of parties external to the authorizing organization on the bond. These business rules and commitment of its practice should be made readily available to bond Owners.

Once a digital surety bond has been duly executed, the document cannot be altered and assurance that the document cannot be altered should be provided.

Responsibility for safekeeping of executed electronic bonds belongs to the Owner of the bond. The bond should be kept for the duration of the contracted performance and for the time period equal to a discovery period following the completion of the contracted performance.

Other parties to the bond are free to store the executed electronic bonds as they wish for their ease of retrieval and review as required.

For the construction industry, the Surety Association of Canada endorses the Canadian Construction Association Guidelines for Electronic Procurement and the contents herein complement those guidelines.



Adoption and implementation of electronic bond systems should be phased in over a reasonable period of time, allowing other parties process time to adjust. This transitional period should include the ability to provide bonds by traditional paper form.

Policies should be adopted by the recipient of the bid bond to contend with computer and/or network problems with respect to its impact to time sensitive workflows. These policies should be communicated in advance and made accessible to all stakeholder parties of the bond as they would for the remainder of the bid package. Various construction associations have in place such policies and standards for electronic submission of construction tenders.

The practice of identifying any language requirements for the bond should be included in the bond issuance requirements.

Assurances should be in place for the acceptance of large file sizes, i.e. files with digital seals and signatures and logos from the signing authority organizations to ensure digital files are not rejected.

The Surety Association of Canada recommends that all stakeholders should adopt a protocol where their own standards can integrate with a variety of systems that meet the standards noted herein.

## **Business Requirements to Consider**

Legal	Accepted and enforceable in the eyes of the court Audit trails for all transactions – for full contractual obligation + 7 years
Security	Confidence that solid controls are in place, and kept up to date with electronic standards on an ongoing basis Assurance that the bond is from an authorized surety company Protection from forged bonds and signatures Protection from hacking & other electronic mischief
Valid authority	Proper authorization on bond certificate Ability to positively identify signing authorities Business rules in place for digital signatures
Quick and easy to adopt	Quick turnaround required for contractors to obtain a digital signature  Low charge required for contractors to obtain a digital signature Supported by promotions to encourage use Supported by friendly, learning tools and support lines Acknowledges use by various obligees, i.e. provinces, regions, municipalities, academic and school environments, and hospitals, etc.

## Business Requirements Continued

Easy to use after learned	System ID process for bond certificate, project #, contractor ID, surety company ID, etc. to be effective and not onerous Bond library, both pdf and text format
Work with other software	Most easily collaborate and work with various electronic tendering and bidding systems across Canada – and preferably outside of Canada as well.
Easy to maintain	Advanced communication for auto upgrades Service level agreements in tact Contacts for technical and business support for system
Communication network	Communication ease for Contract Status Reports (value added)  Where possible, contribute to the foundational triangular relationship behind security bonds
Procurement efficiency	Do not allow non-valid bonds nor incomplete bonds to get through the process Must be reliable for all stakeholders Automatic rejects with reasons why back to surety for completion and ability to resubmit Offer innovation where financially feasible and possible
Business Value	Process must run smoothly Process must take into consideration future operating relationships and anticipated trends

## Applications

### Contract surety bonds within bidding environment:

Initial applications for electronic bid bonds should incorporate workflows #2, #3 and #4 (conceptually depicted below) with integration into the electronic bidding applications or with easily connecting applications to match bond to tender bids for #4.

## Contract Surety Bonds: Basic Process (Bidding Environment)



Bid bonds ensures to Party A: the owner or the obligee; that Party B: the contractor or the principal of the bond whom has been awarded the contract is capable and willing to enter into contract at the tendered price. If the Party B fails to fulfill its obligation as per the bid bond, the surety must compensate Party A for the difference between the principal's bid and that of the next lowest bidder.

### Contract surety bonds outside of the bidding environment:

Surety security outside of the bidding environment are still subject to similar workflows as noted above, with exception or subject to variation for the initial transaction, #1, where the contract is promoted to attract a vendor.

### Other Applications for Value-Added Considerations:

A bond library of frequently used and industry endorsed bond language and wordings will add value to the workflows between the surety and the broker.

Informative risk management and process information regarding how and when to use and call for surety security in contract bids will add additional value to the workflows within the owner's environment, as will on-line Q&A help applications.

## **Financial Viability**

The service costs to provide electronic pathways for users of surety bonding should be reasonable in that it will not discourage nor prohibit any party from using the applications; and also, to ensure long term viability (proper maintenance, upgrades, service standards) of technology applications.

The Surety Association of Canada recommends that a solution seeker consider goals to ensure additional expenses are not incurred to the attainment of security bonds are incorporated into their planning. Further, that the solution does not incur any additional financial risks nor operating risks than those which already exist in the current paper environment.

## **Legislation**

Bonds differ from contracts in the eyes of the law. Considered to be 'deeds', other than the provinces of Ontario and Nunavut, legislation does not exist to recognize their legal validity when in digital form.

Owners should be familiar with their legislative positions pertaining to bonds and actively pursue changes to the legislation to allow for the acceptance.

Recommendations for legislative and regulatory changes are available from the Surety Association of Canada.

## **Closing**

This Blueprint has been prepared by the Surety Association Canada with the intent to support, encourage and guide the development of electronic bonding solutions for the Canadian marketplace.

Questions and comments can be directed to the Surety Association of Canada, 905-677-1353. More information can be found at [www.suretycanada.com](http://www.suretycanada.com).