

**MANUAL OF FIDELITY INSURANCE AND
CORPORATE SURETYSHIP: DESCRIPTIVE OF
SURETY AND FIDELITY BONDS
WITH THEIR PRACTICAL USES, AND THE
CONDITIONS UNDER WHICH THEY SHOULD
BE WRITTEN WITH HINTS TO AGENTS**

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Manual of Fidelity Insurance and Corporate Suretyship: Descriptive of Surety and Fidelity Bonds with Their Practical Uses, and the Conditions Under Which They Should Be Written with Hints to Agents by Henry G. Penniman

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HENRY G. PENNIMAN

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PREFACE.

The need for a concise, accurate, and at the same time, simple treatise on Fidelity and Surety Bonds has frequently been brought to the attention of the writer, both by his friends among the soliciting fraternity and also as a result of his own experience in the surety business. To meet this lack of accessible information this manual has been prepared. In it, as far as possible, legal and technical phrases have been avoided, the effort being to make it comprehensive and useful to the agent and solicitor in their particular fields.

Most of the literature upon the subject has been either the work of lawyers for their brothers of the profession—the matter being treated from a purely legal point of view—or the compilations of specialists, whose articles have been constructed on a purely technical foundation. The writer has been compelled to familiarize himself with the legal and technical literature on the subject, which is widely scattered, and not generally accessible to the agent or solicitor. The logical relation between this information, which usually treats of matters of interest to the general office or its legal department, and the basic principles of the surety business is not always clear.

Although this work is primarily for the agent and solicitor, the basic principles on which the business is founded are explained; while the manner in which any individual proposition must be regarded by the home office is so discussed, that it is hoped the business man may overcome any uncertainty of mind in regard to the general subject existing on his part by reference to the following pages.

The surety business is now so extensive and far reaching that there is scarcely any business or profession with which

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it does not come into contact, and on which its influence is not felt. This book, therefore, should be of interest not only to the agent or solicitor whose livelihood may depend upon his knowledge of suretyship, but also to many others who use corporate suretyship to a sufficient extent to be interested in its principles and workings.

W. W. W. W. W.
O. L. L. L. L.
Y. A. A. A. A.

INTRODUCTION.

HISTORICAL.

The exact origin of suretyship is unknown, but we know that it is of ancient practice having been referred to in the Old Testament.* Many hundreds of years later, it was made the basis of one of Shakespeare's greatest plays, "The Merchant of Venice."

The first recorded attempt to establish a society having for its purpose acts at all akin to the present form of fidelity insurance was made in London in the year 1720. The object of this society, however, extended no further than what might be termed the guarantee of hired servants, and did not embrace the numerous uses to which Fidelity Bonds are now put.

About the year 1840, recognition was given to the application of the laws of average, which govern insurance, to the principles of fidelity insurance, and several years later the pioneer fidelity company was organized in England by a special act of Parliament. This was the first public or official recognition of the usage of fidelity insurance, for the act granted power to certain government officials to accept the company's bonds or policies in lieu of personal surety or securities formerly authorized to be taken by law.

The first legislative recognition of this business in the United States was given by an act of Legislature of the State of New York in 1853. This enactment empowered insurance

*Genesis, 43: 9--I will be surety for him; of my hand shalt thou require him; if I bring him not unto thee, and set him before thee, then let me bear the blame forever.

Proverbs, 11: 16--He that is surety for a stranger shall smart for it: and he that hateth suretyship is sure.

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companies organized under its provisions to guarantee, among other things, the fidelity of persons in positions of public and private trust. However, it was not until the year 1876 that a company was organized under this act, and not until 1880 did it commence the transaction of fidelity insurance. In June, 1881, the Legislature of New York extended the powers of companies, authorized under its authority, to such an extent that the guarantee of the companies could be taken in lieu of the usual security given on bonds and undertakings required by law, while judges and other officials were authorized to approve bonds and undertakings when so guaranteed. Prior to this time, corporate suretyship was limited to that class of bonds which are now known as straight Fidelity Bonds, or those which guarantee only against dishonesty. Subsequently, by operation of the laws referred to, and by numerous others enacted since, corporate suretyship has branched out until it now covers a much wider scope of transaction than any other form of insurance, including not only the guaranteeing of honesty, but also the faithful performance of duty, the carrying out of an agreement or contract, and indemnity against loss in a great number and variety of other cases.

By the growth of legislation on the subject, as well as the change in custom, the practice of personal guarantees has been almost superseded by that of corporate suretyship.

This widespread use, and the necessary compilation by the companies of the results of risks which they have taken, has caused the greatest caution and most careful scrutiny to be given to every proposition. Indeed, this is necessary for the safety of companies on account of the enormous variety of obligations which a corporation issuing Surety Bonds is called upon to assume. One of the chief causes of this exercise of care is the fact that the transaction of this line of business differs from other insurance lines in that there are three instead of two persons involved:—the surety, the assured, and the so-called third party or principal from whom as a rule the Fidelity or Surety Bond has been exacted. The fact that

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the bond is required of the principal rather than given voluntarily by him is an important element in considering the moral hazard of the risk, and it is due chiefly to this that much that affects a corporate bond may remain unknown to, or at best only surmised by the underwriter. This underlying principle in the writing of Fidelity and Surety Bonds makes the business differ greatly from other lines of insurance, and causes considerable confusion among field men.

ANALYSIS OF RISKS.

A simple, but necessary, analysis of all risks may be outlined as follows:

1—Those risks which are underwritten on a straight insurance or average basis, such as the usual Fidelity Bond or those bonds which may be termed honesty risks.

2—Those risks which are underwritten on a credit or banking basis and which may be termed pecuniary risks.

3—Those, in which both of the above principles are involved, and which guarantee not only the honesty of the principal, but also that he will faithfully perform his duties or carry out any contract or agreement under which he is working.

Misconception of these different classes of risks often gives rise to the erroneous idea which exists in the minds of a large part of the public that, inasmuch as corporate suretyship is classed as insurance, it can be and is written on the general insurance plan of an average basis; whereas, from a consideration of the above, it is evident that only a portion of it can be written in this manner. A further treatment of the subject will be given in subsequent chapters, which will show its application to the various kinds of bonds.

DIVISION BY STATE INSURANCE DEPARTMENTS.

The insurance departments of the various states have divided the business of corporate suretyship into the two divisions; i. e., fidelity and surety. Broadly speaking, the