



NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS

1828 L Street, NW, Suite 720

Washington, DC 20036-5104

Tel: 202.686.3700

Fax: 202.686.3656

www.nasbp.org

August 21, 2009

Mr. Russell Orban
General Counsel
House Committee on Small Business
Washington, DC 20515

Dear Russ,

Thank you for taking the time to discuss issues of concern with the National Association of Surety Bond Producers (NASBP). We are delighted to learn that the Committee on Small Business intends to introduce a legislative solution sometime this Fall that will ensure that procurements for construction will be scrutinized for improper contract bundling, enabling many more small construction businesses to compete for award of construction contracts as prime contractors. Should Chairwoman Velazquez decide to conduct a hearing investigating the impact of improper contract bundling on small construction businesses, NASBP would appreciate an invitation to provide an NASBP member to testify about how improper contract bundling is impacting the ability of small construction firms to compete for federal contract awards.

As we discussed during our meeting, NASBP's legislative agenda seeks and supports legislation, regulations and policies that would assist small construction businesses to participate in public construction markets as prime contractors. To that end, NASBP supported the reforms made to the Small Business Administration (SBA) Surety Bond Guarantee Program that were included in the Economic Stimulus Package. Although we believe that these reforms were significant steps forward for the Program to assist more small businesses, additional reforms, both in the near term and in the future, are necessary so that the Bond Guarantee Program can function to the fullest extent possible for the benefit of small businesses needing bonding assistance.

We note that the SBA is exploring reforms to its Bond Guarantee Program and has commissioned a study, to which NASBP furnished information. Although the study has not been released, it is our understanding that the study will examine the possibility of restructuring the Program so it functions similarly to a "reinsurance model." Such a model more accurately reflects the current business practices and operations of surety companies, which seek to insure a portion of their surety credit risk through the purchase of reinsurance. If the Bond Guarantee Program assumed a role similar to that of a reinsurer to a surety company, the SBA would enter into a treaty with each surety company which would frame and define the expectations and obligations placed on that surety company to participate in the Program. This model would be much more efficient in terms of time and resources than the present operation of the Program, which actually comprises two programs. In one of the present programs, the SBA effectively "re-underwrites" each guarantee application, slowing down approvals and second-guessing the judgments of surety companies that are in the regular business of writing surety bonds. Such a significant restructuring to a reinsurance model likely will attract more surety companies to participate in the Program.

We strongly support efforts to restructure the Bond Guarantee Program, so it functions similar to a reinsurance model, but recognize that it may take some time to accomplish such a restructuring. In the near term, we believe that the Bond Guarantee Program could be further improved to make it more attractive to sureties, bond producers, and small construction businesses needing surety credit to pursue private and public construction contracts. We note a decided disparity between certain characteristics of the SBA loan programs and those of the Bond Guarantee Program. We believe that Bond Program should be on equal par with the Loan Programs. Our suggestions for immediate improvements address this disparity as well as address aspects of the program that are out of keeping with prevailing surety practices and, thus, function as substantial disincentives for surety company participation. Needed short-term enhancements include the following:

- Reduce/waive fees paid by contractors and sureties in the Bond Guarantee Program, much like the SBA 504 and 7(a) programs are currently doing;
- Ensure that SBA does not require equivalent working capital levels as found in standard market underwriting in order to obtain a bond guarantee—if SBA insists on such underwriting requirements as found in the standard market, how is the Bond Guarantee Program serving contractors who can not qualify for bonding credit in the standard market?
- Establish better internal coordination and communications between the SBA Bond Guarantee Program and other SBA Small Business programs, such as those relating to loan guarantees and business assistance;
- Adopt electronic signature technology to expedite the Bond Guarantee application process by eliminating the “wet signature” requirements;
- Increase the guarantee to surety companies writing in the Program to 90% (this increases the guarantee to levels approximate to that provided to lenders in the SBA loan program)
- Revise SBA Bond Guarantee Program regulations to comport with prevailing practices used by construction and surety industry—for example, current regulations require notice to the SBA of change orders exceeding a certain amount but most construction contracts and bonds require the surety to waive notice of such changes;
- Characterize the circumstances under which discretion will be exercised by the SBA Administrator in waiving regulatory non-compliance (this discretion was provided as part of the American Recovery and Reinvestment Act but remains undefined);
- Create a hearing and appeals process for sureties denied their bond guarantee (there is a process on the loan guarantee side but this is absent on the Bond Guarantee Program);
- Make permanent that the Bond Guarantee Program can provide guarantees on contracts up to \$5 million (this is a temporary increase in the American Recovery and Reinvestment Act).

During our meeting we also raised the issue of federal contracting officers waving or reducing payment bond protections for subcontractors and suppliers. While the Federal Miller Act appropriately allows contracting officers the discretion to reduce the payment bond when supported by “specific findings” that the amount of the payment bond is “impractical” or waving the payment bond for overseas projects when it is determined that the payment bond is “impracticable for the contractor,” NASBP believes that there needs to be better disclosure to subcontractors and suppliers when contracting officers make such decisions, since these decisions impact the level of payment protection for subcontractors and suppliers, who often are small businesses. I have enclosed a copy of a recent case that illustrates the impact on domestic subcontractors and suppliers of failing to require a payment bond on an overseas federal construction project. NASBP currently is speaking with its industry partners on practical approaches to address this issue.

We also note that we are hearing more frequent reports of fraudulent surety bond activity engaged in by individuals acting as sureties on federal construction projects. Worthless bonds often victimize small businesses that either have procured surety bonds that turn out to be unacceptable to the government or that have gone unpaid after making claim against such payment bonds. Under the FAR, individuals are permitted to furnish bid, performance and payment bonds on federal public works projects. Such individuals solely are vetted by the procuring contracting officer, not by the US Department of the Treasury (as are corporate sureties). This places a significant administrative burden on contracting officers, who may not have familiarity with surety bonds or the assets pledged to back surety bonds issued by individuals. We believe that any surety, corporate or individual, should be reviewed and certified by the US Department of the Treasury in order to write surety bonds on federal construction projects, and urge that Congress require such scrutiny of individuals issuing surety bonds on federal projects to avoid acceptance of worthless bonds.

Thank you for your time and your consideration of these matters. We would be glad to go into further detail with you on any of these points.

Please feel free to contact me with any questions. NASBP looks forward to working with you on these issues and others in the future.

Yours sincerely,

A handwritten signature in black ink, reading "Mark H. McCallum". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Mark H. McCallum
General Counsel & Director of Government Relations