The Surety & Fidelity Association of America
And
American Insurance Association

Statement in Opposition to AB 345

The Surety & Fidelity Association of America is a non-profit corporation whose member companies collectively write the majority of surety and fidelity bonds in the US. SFAA is a licensed rating or advisory organization in all states and is designated by state insurance departments as a statistical agent for the reporting of fidelity and surety experience.

The American Insurance Association (AIA) is the leading property-casualty insurance trade organization, representing approximately 325 insurers that write more than $127 billion in premiums each year. AIA member companies offer all types of property - casualty insurance, including surety and fidelity bonds, personal and commercial auto insurance, commercial property and liability coverage for small businesses, workers' compensation, homeowners' insurance, medical malpractice coverage, and product liability insurance.

SFAA and AIA urge members of the Committee on Government Affairs to consider the recent experience with the use of individual sureties. In Maryland. In a study of the individual surety law for the legislature the Maryland Insurance Administration concluded that the alternative individual surety market did not achieve its intended purpose of helping small contractors. Rather, there was a robust corporate surety market in the state, ample programs in place to help small contractors and fraud in the individual surety market. Maryland concluded that the individual surety market was not needed and we believe that Nevada should reach the same conclusion.

We believe that the intent of AB 345 is to assist small, emerging and minority contractors to obtain bonding and increase their participation in public works contracts as was the intent of the former Maryland individual surety law. Rather than focus on a solution that has proven not to work, SFAA and AIA urges the Committee to focus on an approach of bonding education that has a proven track record of success.
What Works to Help Small, Emerging and Minority Contractors to Obtain Bonding

The Model Contractor Development Program (MCDP)®, which SFAA developed and introduced at its Annual Meeting in 2000, is a surety industry-sponsored program aimed at increasing access to bonding for small and emerging contractors. Since its beginnings as a modest program of bonding information and assistance adapted from the best practices of various local surety associations (LSAs), the MCDP® has evolved into a comprehensive program of bonding awareness, education, and support that continues to be implemented in locales around the country. To date, thousands of contractors have been impacted, and the level of bonding offered and underwritten exceeds $617 million ($241 million through the MCDP® and $376 from SFAA’s partnership with the U.S. DOT on the Bonding Education Program). It should also be noted that bonds obtained through the MCDP® are for small amounts, which means that the overall total indicates that the MCDP® has helped numerous small and emerging contractors.

The current MCDP® is comprised of two distinct components: education and bond readiness. The educational component offers eight comprehensive workshops on topics ranging from construction accounting to bonding and insurance to estimating and bidding. These workshops are designed to assist contractors in improving their company’s operations, thereby making it easier to obtain surety bonds. Most of the classes are taught by volunteers from LSAs and other surety professionals. The surety industry has an incentive to participate in these programs, as every company and agent want to write more bonds. They look for ways to develop relationships with contractors that are able to qualify for bonds and will grow and move on to bigger projects. The Construction Financial Management Association (CFMA), the Associated Builders and Contractors (ABC), the Associated General Contractors (AGC), and the National Association of Surety Bond Producers (NASBP) also provide local instructors.

Initially, SFAA implemented the MCDP® on a local basis wherever it was needed. Early on, SFAA participated actively in the meetings and programs of the National Association of Minority Contractors, National Conference of Black Mayors, and the National Black Caucus of State Legislators to promote our MCDP®. The relationships built through those organizations have created a network that has assisted in the implementation of our MCDP®.

In 2007, SFAA first implemented the MCDP® on a statewide basis in Mississippi, in which MCDP® programs were conducted in multiple locations throughout the state as part of an overall plan to help small and emerging contractors. Since its inception, the Mississippi Program has been implemented in several locations around the state and has graduated more than 400 small, minority, and women contractors. More importantly, over $12 million in bonding can be attributed directly to this program.

In 2008, SFAA implemented the MCDP® on a statewide basis in New York. We conducted MCDPs® around the state for the next three years. Based on a white paper that SFAA wrote after three years, a program based on our MCDP® has been institutionalized within the New York state government, and SFAA no longer is directly involved. Bonding that has been offered
or underwritten by surety companies on behalf of contractors participating in the New York State Bonding Initiative has grown to more than $100 million, including more than $18 million in bonding that has been obtained by female contractor participants, thanks to SFAA’s additional efforts with the Women Builders Council in New York City.

In 2010, SFAA entered into an agreement with the U.S. Department of Transportation (DOT) to assist DOT in designing, developing, and implementing the DOT Bonding Education Program (BEP). This was SFAA’s first opportunity to implement our MCDP® nationally. SFAA worked with DOT to develop a bonding education program based on our MCDP®. SFAA and DOT implemented the BEP in 12 locales in 2011, with programs conducted through the DOT’s network of Small Business Transportation Resource Centers. Since the BEP’s inception in 2010, 66 programs have been implemented, and nearly 250 contractors across the country have achieved bonding totaling $376 million. BEPs continue to be held in multiple locales each year.

SFAA and the USDOT did a BEP in March-April 2013 in Las Vegas. This program was planned to jump start to the Project NEON P3 in terms of small and emerging contractor participation. The project was cancelled. Project NEON would have been a great opportunity and would have provided for long term work for local contractors because of the operations and management component project. As it stands today, 19 contractors were originally in the BEP. Sixteen contractors finished the program. Ten of the contractors were engaged in one-on-ones with a surety professional and two have received bonding totaling $800,000 for other local projects.

The reason why the MCDP® works so well is that it is more than just a series of workshops. For one thing, the MCDP® demonstrates the commitment of the surety industry to making bonding available to all sectors of the construction community. The MCDP® introduces these small and emerging contractors to professional bond producers and regulated surety companies that offer an increasing array of surety products aimed at the smaller contractor. The MCDP® provides both information and access to other resources—such as construction CPAs and lenders—that small and emerging contractors need to better manage their companies and improve their bondability. The MCDP® results in successful bonding outcomes and relationships that allow the contractors to manage growth and increase their chances for long-term viability.

**Why Individual Surety Legislation Does Not Work**

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*Many Small and Emerging Subcontractors Are Left with Far Less Protection;* Mechanics liens cannot be asserted against public property. Most small and emerging contractors start out as subcontractors. These subcontractors, along with laborers and suppliers on public projects, must rely on the general contractor's payment bond for protection. With individual sureties, these parties could be left with no practical means to collect for their services and supplies if the contractor is unable or unwilling to pay them. The only protection the workers and suppliers will have is the ability of the State and local governments to seize and liquidate the collateral pledged by the individual surety and use the proceeds to pay the individual surety's obligations. This problem could be exacerbated with state legislation, such as AB 345, which does not even require individual sureties to put the assets pledged in the hands of the State or in a federally insured financial institution.
--Individual Sureties Put Taxpayer Dollars at Risk; The history of fraud in the use of individual sureties at the state and federal levels cannot be ignored. Nevada has had problems in the past with individual sureties. One individual surety, Robert Joe Hanson, operated out of Nevada. The Nevada Insurance Department issued cease and desist order against him. Several other states did the same under various aliases and company names that he operated under. Similarly, various states currently have cease and desist orders in place against other individual sureties. Under AB 345, individual sureties would be authorized to write bonds in unlimited amounts and they could be the surety on multiple large state and local contracts. The exposure of the state and local government budgets could increase rapidly. If the assets pledged to support the bonds are uncollectible, and any or all of the bonded contractors defaulted, the public owners would be left to complete the construction projects and pay subcontractors, suppliers and laborers. Most state and local budgets may have a hard time absorbing the extra costs to complete projects abandoned by the individual sureties. These additional costs ultimately fall on the taxpayers.

--Individual Sureties Place New Burdens on State Contracting Officers; Use of individual sureties places a tremendous burden on state contracting officers, who focus on the already complex tasks of efficiently procuring and administering the state's construction projects, and who otherwise have been able to rely on the state insurance departments to license and regulate sureties conducting business in the State. If individual sureties are permitted to write surety bonds on state and local public construction projects, contracting officers at all levels of government will be required to determine the authenticity of the documentation of the assets pledged to support the individual surety's bond obligations and to verify that the pledged assets actually exist, are sufficient and are available to the State or local government. Few, if any, contracting officers state procurement officers have been trained or are prepared to perform these tasks. They will have to know that a particular financial document is what it purports to be and to understand and to assess the different types of collateral, such as stocks and real estate located anywhere in the United States. Most states also do not have the necessary infrastructure, budget and precedents in place to assist state procurement officers with performing these critical tasks.

--Individual Sureties Do Not Have Claim Handling or Underwriting Prequalification Expertise; Corporate sureties bring to the table their prequalification expertise to determine if a contractor has the capacity, capital, and character to complete the project. If the individual surety does not have sufficient technical and underwriting experience to determine if a contractor is qualified to complete a project, the contractor may default. The State also must consider the individual surety’s claims handling experience and reputation. If the individual surety does not have personnel with experience to handle claims for a project on which the contractor has been terminated, it likely will take much longer to correctly remobilize, and subcontractors’ claims will take longer to resolve. The importance of the ability of the individual surety to step in and complete the project by paying the claim or finishing the work can’t be discounted when considered in the context of a main bridge in need of immediate repair or a school that needs to be completed before the next school year.

--Individual Surety Legislation Does Not Necessarily Help Small and Emerging Contractors; Permitting individual sureties to issue bonds does not mean that such sureties will focus their
efforts on small and emerging contractors. AB 345 would authorize individual sureties to issue bonds for any state contracting officer that will accept their bonds—which could be any job and any contractor.

The Maryland Experience Shows Why AB 345 Should Not Be Enacted

In 2013 the Maryland Insurance Administration (MIA) was charged to review the individual surety market. MIA survey all 50 states regarding their experience with individual sureties. There were three key finding in the MIA report:

--A Robust Corporate Surety Market Exists; Since the individual surety law went into effect in 2006, MIA reported that only six individual surety bonds have been submitted (less than one per year). Two bid submissions were accepted and the contracts were awarded to the contractors, and two bid submissions were rejected based on the individual surety’s failure to meet regulatory criteria. The contractor voluntarily withdrew one bid submission and the sixth was withdrawn due to re-bidding of the entire project. The MIA also found a robust market for bonds in Maryland, with 145 licensed surety companies to write bonds in the State. The MIA report concluded that there was no need for the individual surety market in Maryland.

--Programs are in Place to Assist Small Contractors; The primary program for assisting small and emerging contractors has been SFAA’s own Model Contractors Development Program (MCDP)® – a combination of educational workshops and hands-on assistance from the surety industry in achieving positive bonding results. SFAA conducts programs. For over a decade, SFAA has conducted its programs to assist small and emerging contractors obtain bonding in many states as needed. In the past five years alone, more than $367 million in bonding has been offered or underwritten by Treasury-listed surety companies, all of whom also are licensed by the insurance departments in the states in which they do business, through implementation of our MCDP. The MIA report also details the MSBDFSA Surety Bond Program, the SBA Bond Guarantee and Lending Program and the Maryland DOT Bonding Education Program.

Several sureties have “rapid response” programs in operation in Maryland and other under which a small and emerging contractor can obtain a bond within 24 to 48 hours with minimal requirements. The surety company programs vary but contractors in most programs can obtain bonds up to $250,000 in these rapid response programs, and up to $500,000 in others. In one year in Maryland alone, Liberty Surety First, a part of Liberty Mutual, wrote 75 bonds for 43 small contractors, for a total bond amount of $56.5 million. Of the 43 accounts, 22 never needed a bond over $500,000. ACE similarly wrote over $80 million in bonds for smaller contractors, specifically including minority contractors. CNA Surety wrote 737 bonds of $1 million or less during that period. Penn National, a smaller surety company, wrote $7.8 million in bonds for 37 contractors. Travelers, a leader in the industry, is extremely active in small contractor programs and writes bonds for 65 small contractors in Maryland, and for 3000 small and emerging contractors nationwide. This is just a sample of the efforts of the corporate surety market to address the needs of small and emerging contractors in Maryland and throughout the country.
Through such programs as the MCDP®, small and emerging contractors are obtaining early entry into the bonding arena, with quality, regulated surety companies underwriting their bonds and guaranteeing the performance of such contractors to both public and private owners. Bonds from these companies also are ensuring that small and emerging subcontractors, suppliers and laborers will be paid should a prime contractor default on a project. SFAA and AIA believe that more efforts such as these are needed, and less uncertainty on the part of these small owners and contractors, who have no way of knowing whether the individual sureties to whom they have paid their money have the means to back up any subsequent bond claims. While AB 345 intends to make bonding even more accessible by opening up another market from which bonds can be obtained, SFAA and AIA urge the Committee not to permit unregulated bond placements in which the contractors and the small owners who sought the bonding protection are left in worse shape than they began.

--- **Fraud Exists in the Individual Surety Market** ---

During the time that the individual surety was in place, MIA reported that Maryland and at least 14 other states took 26 administrative actions against 12 individual sureties, according to the information that the other state insurance departments provided to the MIA. The MIA report notes that a number of the sanctions against individual sureties were for failure to return premiums when individual surety bonds were not accepted and for failure to pay claims. Individual sureties also were sanctioned for misrepresenting that they were authorized insurers or that their products were approved by the state or that they were exempt from state licensure requirements.

There also was testimony in the Maryland House and Senate regarding the Korean Seventh-Day Adventist Church in Howard County, Maryland. According to church officials, they lost millions of dollars when their contractor on a remodeling project had obtained bonds from an individual surety. When the contractor defaulted, the individual surety did not complete the job or pay claims. Despite the fact that individual sureties only have authority to write bonds on state public works projects in Maryland, these bonds were written to secure private construction contracts in violation of the law.

SFAA and AIA urge the Committee to focus on who the Maryland individual law harmed. In addition to owners like the church, people working on these projects are harmed. Laborers, subcontractors, and suppliers on public projects must rely on the general contractor’s payment bond for protection, because they cannot assert mechanics liens against public property. Laborers, subcontractors and suppliers have a right to have a licensed and well capitalized surety behind the bond. The claimant has no real protection when the individual surety is fraudulent.

The MIA report recommended, and the legislature agreed, that “in order to better safeguard the public against the issuance of fraudulent surety bonds or contracts of surety insurance, all sureties doing business in the State should be required to obtain a certificate of authority issued by the Commissioner and should be subject to the same level of regulatory oversight required for corporate sureties under Maryland law.” For the same reason, we believe that the alternative market of individual sureties under AB 345 will not help and may well hurt the very small businesses that AB 345 intends to help.