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SMALL BUSINESS ADMINISTRATION

13 CFR Part 115

RIN: 3245-AG70

Surety Bond Guarantee Program; Miscellaneous Amendments

AGENCY: U.S. Small Business Administration

ACTION: Proposed Rule.

SUMMARY: This rule proposes to change the regulations for SBA's Surety Bond Guarantee Program in four areas. First, as a condition for participating in the Prior Approval and Preferred Programs, the proposal would clarify that a Surety must directly employ underwriting and claims staffs sufficient to perform and manage these functions, and final settlement authority for claims and recovery is vested only in salaried employees of the Surety. Second, the proposal would provide that all costs incurred by the Surety's salaried claims staff are ineligible for reimbursement by SBA, but the Surety may seek reimbursement for amounts paid for specialized services that are provided by outside consultants in connection with the processing of a claim. Third, the rule proposes to modify the criteria for determining when a Principal that caused a Loss to SBA is ineligible for a bond guaranteed by SBA. Fourth, the rule proposes to modify the criteria for admitting Sureties to the Preferred Surety Bond Guarantee Program by increasing the Surety's underwriting limitation, as certified by the U.S. Treasury Department on its list of acceptable sureties, from at least \$2 million to at least \$6.5 million.

DATES: SBA must receive comments to this proposed rule on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by RIN 3245-AG70, by any of the following methods: (1) Federal eRulemaking Portal: <http://www.regulations.gov>, following the instructions for submitting comments; or (2) Mail/Hand Delivery/Courier: Barbara J. Brannan, Office of Surety Guarantees, 409 Third Street, SW, Suite 8600, Washington, DC 20416.

SBA will post all comments on www.regulations.gov. If you wish to submit confidential business information (CBI) as defined in the User Notice at www.regulations.gov, you must submit such information to U.S. Small Business Administration, Barbara J. Brannan, Office of Surety Guarantees, 409 Third Street, SW, Washington, DC 20416 or send an email to Barbara.brannan@sba.gov. Highlight the information that you consider to be CBI and explain why you believe SBA should hold this information as confidential. SBA will review your information and determine whether it will make the information public.

FOR FURTHER INFORMATION CONTACT: Barbara J. Brannan, Office of Surety Guarantees, (202) 205-6545 or email: Barbara.brannan@sba.gov.

SUPPLEMENTARY INFORMATION:

I. Discussion of Proposed Changes

The U.S. Small Business Administration (SBA) guarantees bid, payment and performance bonds for small and emerging contractors who cannot obtain surety bonds through regular commercial channels. SBA's guarantee gives Sureties an incentive to provide bonding for small businesses and, thereby, assists small businesses in obtaining greater access to contracting opportunities. SBA's guarantee is an agreement between a Surety and SBA that

SBA will assume a certain percentage of the Surety's loss should a contractor default on the underlying contract.

This rule proposes to change the regulations governing SBA's Surety Bond Guarantee Program (SBG Program) in four areas that have prompted questions from participating Sureties over the past year. First, the rule proposes to clarify that, to participate in the Prior Approval and Preferred Programs, a Surety must directly employ underwriting and claims staffs sufficient to perform and manage these functions. Final settlement authority for claims and recoveries is vested only in the surety's claims staff. The current rules require PSB Sureties to vest final settlement authority for claims and recovery in their salaried employees, see 13 CFR § 115.60(a)(5), and this proposed rule would extend this requirement to Prior Approval Sureties. Some Prior Approval Sureties retain the final underwriting authority to approve a particular bond and some Prior Approval Sureties grant their agents this authority. For the latter arrangement, the proposed rule would clarify that Prior Approval Sureties must have salaried employees responsible for managing and overseeing the underwriting operations. In conducting such oversight, SBA would expect Prior Approval Sureties to periodically conduct reviews of the underwriting operations of their agents to ensure that the agent is underwriting SBA-guaranteed bonds in accordance with the standards set forth in 13 CFR 115.15(a). SBA is not aware that any Prior Approval Surety currently participating in the SBG Program is unable to satisfy this requirement, but is making this requirement explicit in the regulations for clarity and to avoid misunderstanding. PSB Sureties are currently required to vest underwriting authority in their salaried employees, see 13 CFR 115.60(a)(4), and the proposed rule would not affect this requirement. Accordingly, while PSB Sureties may allow their agents to perform the initial

underwriting on a bond, the current rule requires that only the PSB Surety may execute the bond guarantee agreement (SBA Form 990 or 990A).

Second, the rule proposes to specify that the costs that the Surety incurs for its salaried claims staff are ineligible for reimbursement by SBA. SBA considers such costs to be integral to the Surety's overhead, which is not eligible for reimbursement by SBA. See 13 CFR § 115.16(f)(1). Under the proposed rule, however, the Surety may seek reimbursement for amounts actually paid by the Surety for specialized services that are provided by an outside consultant, which is not an Affiliate of the Surety, in connection with the processing of a claim, provided that such services are beyond the capability of the Surety's salaried claims staff. For example, to evaluate a claim, the Surety may need the opinion of a structural engineer to determine the Principal's compliance with engineering specifications. SBA would not expect the Surety to directly employ a structural engineer, and SBA would approve reasonable costs to contract for this specialized service as part of the Surety's Loss.

Third, the rule proposes to modify the conditions under which a Principal, and its Affiliates, would be deemed ineligible for a bond guaranteed by SBA in the circumstance where the Principal has previously defaulted on an SBA guaranteed surety bond. Under the current rules, a Principal and its Affiliates are ineligible for further SBA bond guarantees if the Surety has requested reimbursement for Losses incurred under an SBA guaranteed bond issued on behalf of the Principal. See 13 CFR 115.14(a)(4). However, in the Prior Approval Program, the current rules provide that SBA's Office of Surety Guarantees (OSG) may agree, upon the Surety's recommendation, to reinstate the Principal, and its Affiliates, if the Surety has settled its claim with the Principal for an amount and on terms accepted by OSG (13 CFR 115.36(b)(2)), or

the Principal's indebtedness to the Surety is discharged by operation of law (e.g., bankruptcy discharge) (13 CFR 115.36(b)(4)), or OSG and the Surety determine that further bond guarantees are appropriate (13 CFR 115.36(b)(5)). In addition, in the PSB Program, the current rules provide that the PSB Surety may reinstate a Principal's eligibility upon the Surety's determination that reinstatement is appropriate (13 CFR 115.14(b)).

SBA is proposing to modify these rules in two ways. First, the proposed rule would prohibit the reinstatement of a Principal if the Principal, or any of its Affiliates, had previously defaulted on an SBA guaranteed bond that resulted in a Loss (as defined in 13 CFR 115.16) that has not been fully reimbursed to SBA or if SBA has not been fully reimbursed for any Imminent Breach payments. The proposed rule would provide that the Principal, or any of its Affiliates, may be reinstated only if SBA has been fully repaid for the Loss or for the Imminent Breach payment. In addition, the discharge of the indebtedness in bankruptcy would no longer qualify the Principal for reinstatement. These changes would conform the SBG Program more closely to SBA's other financial assistance programs under which an applicant is ineligible for financial assistance if it has caused a prior loss to the Agency. See 13 CFR 120.111(q). SBA believes that a Principal that has previously caused a Loss to SBA presents a higher risk to the Agency and should not receive the benefit of further SBA financial assistance. Under the proposed rule, SBA would have the authority to waive this prohibition for good cause. For example, if the Principal is able to show that the Loss was attributed to the acts or omissions of a co-owner who is no longer a part of the business, SBA could find good cause to reinstate the eligibility of the Principal. PSB Sureties would not be delegated the authority to make this "good cause" determination, but would continue to have the authority to reinstate the eligibility of a Principal

when the Surety determines that further bond guarantees are appropriate for those Principals deemed ineligible under paragraphs (1), (2), (3), (5) or (6) of section 115.14.

Second, the proposed rule would apply the same standards regarding the loss of eligibility and the conditions for reinstatement to both the Prior Approval Program and the PSB Program. SBA believes that the conditions for reinstatement of a Principal's eligibility for SBA guaranteed bonds should not depend upon whether the Surety is a Prior Approval Surety or a PSB Surety, but that the reinstatement conditions should be uniform and apply equally to both Programs.

Fourth, the rule proposes to modify the criteria for admitting a Surety to participate in the Preferred Surety Bond Guarantee Program by increasing the Surety's underwriting limitation, as certified by the U.S. Treasury Department on its list of acceptable sureties on Federal bonds, from at least \$2 million to at least \$6.5 million. This change would conform the underwriting limitation to the statutory increase made by P.L. 112-239 in the maximum amount of any Contract or Order for which SBA may guarantee a bond. All PSB Sureties currently participating in the PSB Program would satisfy this new requirement.

II. Section-by-Section Analysis

Section 115.11. SBA is proposing to revise this Section by including the requirement that an applicant have a salaried staff that is employed directly (not an agent or other individual or entity under contract with the applicant) to oversee its underwriting functions and to perform all claims and recovery functions. This section would also be revised to provide that final settlement authority for claims and recovery actions must be vested only in the applicant's salaried staff. In addition, this section would be revised to clarify that the applicant must continue to comply with SBA's standards and procedures for underwriting, administration,

claims, recovery, and staffing requirements while participating in SBA's Surety Bond Guarantee Program.

Section 115.13(a). SBA is proposing to revise this section by adding a new paragraph (7) to provide that, to be eligible for an SBA guaranteed bond, neither the Principal nor any of its Affiliates may be ineligible for an SBA guaranteed bond under the grounds set forth in 13 CFR 115.14.

Section 115.14. SBA is proposing to modify the criteria regarding the loss of the Principal's eligibility for future assistance and the conditions for reinstatement by providing that a Principal loses eligibility for further SBA bond guarantees if the Principal, or any of its Affiliates, has defaulted on an SBA guaranteed bond that resulted in a Loss (as defined in 13 CFR 115.16) that has not been fully reimbursed to SBA, or if SBA has not been fully reimbursed for any Imminent Breach payments. OSG would have the authority to waive this requirement for good cause. In addition, the discharge in bankruptcy of the Principal's indebtedness to the Surety would no longer qualify the Principal for reinstatement.

SBA is also proposing to apply the same criterion on ineligibility and conditions for reinstatement to both the Prior Approval Program and the PSB Program. As the same conditions for reinstatement would apply to both the Prior Approval Program and the PSB Program, the conditions for reinstatement set forth in 13 CFR 115.36(b) and (c) would be moved in their entirety to 13 CFR 115.14(b) and (c), and the heading of this section would be changed to "Loss of Principal's eligibility for future assistance and reinstatement of Principal".

Section 115.16(e)(1). SBA is proposing to revise this provision to provide that SBA will reimburse amounts actually paid by a Surety for specialized services that are provided under contract by outside consultants in connection with the processing of a claim, provided that such

services are beyond the capability of the Surety's salaried claims staff. The change, coupled with the other changes in this Proposed Rule, clarifies that a Surety cannot outsource routine claims functions and responsibilities or include such costs in its reimbursement requests submitted to SBA under the bond guarantee agreement. With the exception of specialized work that falls outside the scope of the routine processing and administration of claims, the expectation is that the Surety will be able to perform the claims function at no cost to the Agency.

Section 115.16(f)(1). SBA is proposing to revise this provision to clarify that all costs incurred by the Surety's salaried claims staff, whether or not specifically allocable to an SBA guaranteed bond, are excluded from the definition of Loss. Costs incurred by the Surety's salaried claims staff, like all other overhead of the Surety, are the responsibility of the Surety.

Section 115.18(a)(2). SBA is proposing to revise this paragraph to provide that the Surety's failure to continue to comply with the requirements set forth in section 115.11 are sufficient grounds for refusal to issue further guarantees, or in the case of a PSB Surety, termination of preferred status.

Section 115.36. By including the conditions for reinstatement and the standard for underwriting after reinstatement in § 115.14(b) and (c), this rule proposes to rename the heading of this section to “§ 115.36 Indemnity settlements”, delete “(a) Indemnity settlements.”, renumber paragraphs “(1)”, “(2)”, and “(3)”, as “(a)”, “(b)”, and “(c)”, respectively, and remove paragraphs (b) and (c).

Section 115.60(a)(1). SBA is proposing to conform this provision to the statutory increase in the maximum contract amount for which a bond may be guaranteed by removing “\$2,000,000” and inserting “\$6,500,000” in its place.

Section 115.60(a)(5). By including in § 115.11 the requirement that all Sureties vest final settlement authority for claims and recovery only in their salaried claims staff, this rule proposes to remove 115.60(a)(5) and renumber the existing paragraph 115.60(a)(6) accordingly.

Compliance with Executive Orders 12866, 13563, 12988, and 13132, the Paperwork Reduction Act (44 U.S.C. Ch. 35) and the Regulatory Flexibility Act (5 U.S.C. 601-612).

Executive Order 12866

The Office of Management and Budget (OMB) has determined that this proposed rule does not constitute a significant regulatory action under Executive Order 12866. This rule is also not a major rule under the Congressional Review Act (5 U.S.C. § 800).

Executive Order 13563

In accordance with Executive Order 13563, SBA discussed with several surety companies issues regarding the SGB Program regulations. In particular, SBA discussed the underwriting and claims staffing requirements that sureties must meet in order to participate in SBA's SGB Program. SBA also discussed with these companies the conditions for reimbursement of the costs incurred by their claims staffs. Generally, the sureties responded favorably to SBA's position that changes were necessary to clarify or amend the regulations on these issues.

Executive Order 12988

This action meets applicable standards set forth in Sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. The action does not have retroactive or preemptive effect.

Executive Order 13132

SBA has determined that this proposed rule will not have substantial, direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, for purposes of Executive Order 13132, SBA has determined that this proposed rule has no federalism implications warranting preparation of a federalism assessment.

Paperwork Reduction Act, 44 U.S.C. Ch. 35

For the purpose of the Paperwork Reduction Act, 44 U.S.C., Chapter 35, SBA has determined that this proposed rule will not impose any new reporting or recordkeeping requirements.

Initial Regulatory Flexibility Analysis

The Regulatory Flexibility Act (RFA) 5 U.S.C. 601, requires administrative agencies to consider the effect of their actions on small entities, small non-profit enterprises, and small local governments. Pursuant to the RFA, when an agency issues a rulemaking, the agency must prepare a regulatory flexibility analysis which describes the impact of the rule on small entities. However, section 605 of the RFA allows an agency to certify a rule, in lieu of preparing an analysis, if the rulemaking is not expected to have a significant economic impact on a substantial number of small entities. There are 23 Sureties that participate in the SBA program, and no part of this proposed rule would impose any significant additional cost or burden on them. Consequently, this proposed rule does not meet the significant economic impact on a substantial number of small businesses criterion anticipated by the Regulatory Flexibility Act.

List of Subjects in 13 CFR Part 115

Claims, Reporting and recordkeeping requirements, Small businesses, Surety bonds.

For the reasons cited above, SBA proposes to amend 13 CFR Part 115 as follows:

PART 115 – SURETY BOND GUARANTEE

1. The authority citation for Part 115 continues to read as follows:

Authority: 5 U.S.C. app 3; 15 U.S.C. 687b, 687c, 694a, 694b note; and Pub. L. 110-246, Sec. 12079, 122 Stat. 1651.

2. Amend § 115.11 by adding three sentences at the end to read as follows:

§ 115.11 Applying to participate in the Surety Bond Guarantee Program.

* * * At a minimum, each applicant must have salaried staff that is employed directly (not an agent or other individual or entity under contract with the applicant) to oversee its underwriting function and to perform all claims and recovery functions. Final settlement authority for claims and recovery must be vested only in the applicant's claims staff. The applicant must continue to comply with SBA's standards and procedures for underwriting, administration, claims, recovery, and staffing requirements while participating in SBA's Surety Bond Guarantee Programs.

3. Amend § 115.13 by adding paragraph (a)(7) to read as follows:

§ 115.13 Eligibility of Principal.

* * * * *

(7) *No loss of eligibility.* Neither the Principal nor any of its Affiliates is ineligible for an SBA-guaranteed bond under section 115.14.

4. Amend § 115.14 to read as follows:

- a. Revise the section heading, and paragraphs (a)(4) and (b)
- b. Add paragraph (c).

§ 115.14 Loss of Principal's eligibility for future assistance and reinstatement of Principal.

* * * * *

(4) The Principal, or any of its Affiliates, has defaulted on an SBA-guaranteed bond resulting in a Loss that has not been fully reimbursed to SBA, or SBA has not been fully reimbursed for any Imminent Breach payments.

* * * * *

(b) *Reinstatement of Principal's eligibility.* At any time after a Principal becomes ineligible for further bond guarantees under § 115.14(a):

- (1) A Prior Approval Surety may recommend that such Principal's eligibility be reinstated, and OSG may agree to reinstate the Principal if:
 - (i) The Surety has settled its claim with the Principal, or any of its Affiliates, for an amount that results in no Loss to SBA or in no amount owed for Imminent Breach payments, or OSG finds good cause for reinstating the Principal notwithstanding the Loss to SBA or amount owed for Imminent Breach payments; or
 - (ii) OSG and the Surety determine that further bond guarantees are appropriate after the Principal was deemed ineligible for further SBA bond guarantees under paragraph (1), (2), (3), (5) or (6) of section 115.14(a).
- (2) A PSB Surety may:
 - (i) Recommend that such Principal's eligibility be reinstated, and OSG may agree to reinstate the Principal, if the Surety has settled its claim with the Principal, or any of its Affiliates, for an amount that results in no Loss to SBA or in no amount owed for Imminent Breach payments, or OSG finds good cause for reinstating the Principal notwithstanding the Loss to SBA or amount owed for Imminent Breach payments; or

(ii) Reinstate a Principal's eligibility upon the Surety's determination that further bond guarantees are appropriate after the Principal was deemed ineligible for further SBA bond guarantees under § 115.14(a) (1), (2), (3), (5) or (6)..

(c) *Underwriting after reinstatement.* A guarantee application submitted after reinstatement of the Principal's eligibility is subject to a very stringent underwriting review.

5. Amend § 115.16 by revising paragraphs (e)(1) and (f)(1) to read as follows:

§ 115.16 Determination of Surety's Loss.

* * * * *

(e) * * *

(1) Amounts actually paid by the Surety for specialized services that are provided under contract by an outside consultant, which is not an Affiliate of the Surety, in connection with the processing of a claim, provided that such services are beyond the capability of the Surety's salaried claims staff; and

* * * * *

(f) * * *

(1) Any unallocated expenses, all direct and indirect costs incurred by the Surety's salaried claims staff, or any clear mark-up on expenses or any overhead of the Surety, its attorney, or any other party hired by the Surety or the attorney;

* * * * *

6. Amend § 115.18 by revising paragraph (a)(2) to read as follows:

§ 115.18 Refusal to issue further guarantees; suspension and termination of PSB status.

* * * * *

(2) *Regulatory violations, fraud.* Acts of wrongdoing such as fraud, material misrepresentation, breach of the Prior Approval or PSB Agreement, the Surety's failure to continue to comply with the requirements set forth in § 115.11, or regulatory violations (as defined in §§115.19(d) and 115.19(h)) also constitute sufficient grounds for refusal to issue further guarantees, or in the case of a PSB Surety, termination of preferred status.

* * * * *

7. Amend § 115.36 to read as follows:

- a. Revise the section heading;
- b. Remove the paragraph heading “(a) Indemnity settlements.”;
- c. Remove paragraphs (b) and (c); and
- d. Redesignate paragraphs “(1)”, “(2)”, and “(3)”, as “(a)”, “(b)”, and “(c)”.

§ 115.36 Indemnity settlements.

* * * * *

§ 115.60 Selection and admission of PSB Sureties. [Amended]

8. Amend § 115.60 to read as follows:

- a. Amend § 115.60(a)(1) by removing “\$2,000,000” and inserting “\$6,500,000” in its place; and
- b. Remove paragraph (a)(5) and redesignate paragraph (a)(6) as paragraph (a)(5)

Dated: April 6, 2015.

Maria Contreras-Sweet,
Administrator.

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