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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: Final Rule.

SUMMARY: The Small Business Administration (SBA) is issuing this final rule 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 Surety Bond Programs, this rule clarifies that a Surety must directly employ underwriting and claims staffs sufficient to perform and manage these functions, and that final settlement authority for claims and recovery is vested only in salaried employees of the Surety. Second, this rule provides that all costs incurred by the Surety's salaried claims staff are ineligible for reimbursement by SBA, except the amounts actually paid for reasonable and necessary travel expenses. In addition, 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 modifies the criteria for determining when a Principal that caused a Loss to SBA is ineligible for a bond guaranteed by SBA. Fourth, the rule modifies the criteria for admitting Sureties to the Preferred Surety Bond 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: This rule is effective [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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

SUPPLEMENTARY INFORMATION:

I. Background Information

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.

On April 14, 2015, SBA published a notice of proposed rulemaking with a request for comments in the Federal Register (80 FR 19886). The rule proposed to change the regulations governing SBA's Surety Bond Guarantee Program (SBG Program) in the following four areas that had prompted questions from participating Sureties:

(1) The rule proposed to clarify that to participate in the Prior Approval and Preferred Surety Bond (PSB) Programs, a Surety must directly employ underwriting and claims staffs sufficient to perform and manage these functions, and that final settlement authority for claims and recoveries must be vested only in the Surety's salaried claims staff.

(2) The rule proposed to specify that the costs that the Surety incurs for its salaried claims staff are ineligible for reimbursement by SBA and that 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.

(3) The rule proposed 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. The rule provided that a Principal, or any of its Affiliates, would lose eligibility for further SBA bond guarantees if the Principal, or any of its Affiliates, had defaulted on an SBA guaranteed bond resulting in a Loss (as defined in 13 CFR 115.16) that had not been fully reimbursed to SBA, or if SBA had not been fully reimbursed for any Imminent Breach payments. It also provided that the Principal, or any of its Affiliates, may be reinstated only if SBA had been fully repaid for the Loss or for the Imminent Breach payment, unless SBA's Office of Surety Guarantees (OSG) found good cause for reinstating the Principal. In addition, the discharge of the indebtedness in bankruptcy would no longer be specifically included as a condition for reinstatement, but the circumstances of such discharge could be considered as part of OSG's good cause analysis for reinstatement. The Proposed Rule also clarified that the same standards regarding the loss of eligibility and the conditions for reinstatement would apply to both the Prior Approval Program and the PSB Program.

(4) The rule proposed to modify the criteria for admitting a Surety to participate in the PSB 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.

The comment period was open until June 15, 2015, and SBA received comments from one trade association and one surety company. One other comment was received from an individual, but this comment did not relate to the Proposed Rule or the SBG Program.

One of the commenters indicated its support for the proposed changes that modify the conditions under which a Principal, and its Affiliates, would be deemed ineligible for a bond guaranteed by SBA and that modify the requirements for reinstatement. The commenter also expressed support for SBA's effort to address the failure of some participating Sureties to maintain adequate in-house claims personnel, and to ensure that participating Sureties handle their SBA-guaranteed bond claims in the same manner as their other bond claims.

However, both commenters expressed concern that the proposed changes to 13 CFR 115.11 and 115.16(e)(1) would not create clear standards with respect to when SBA would reimburse Sureties for the costs of using outside consultants in connection with bond claims. Under the proposed 13 CFR 115.16(e)(1), a Surety may seek reimbursement for "[a]mounts 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." The commenters were concerned that this standard is too limiting, and instead suggested that SBA amend 13 CFR 115.16(e)(2) to allow Sureties to seek reimbursement for the "reasonable" costs of any outside consultants. The commenters indicated that this standard would cover a broader range of consultants, such as construction, accounting or other professionals, that assist Sureties in investigating and settling claims. They argued that the services of these outside consultants may become necessary to avoid delay and to mitigate expenses and that these expenses would be

recoverable from the Principal under the General Indemnity Agreement obtained under 13 CFR 115.17(a).

SBA has considered the suggestion but has concluded that the reasonable cost standard proposed by the commenters does not adequately reflect the requirement that Sureties employ sufficient in-house staff to handle all customary claims and recovery functions. SBA expects participating Sureties to employ adequate in-house staff to perform these functions and to bear the full cost of performing such functions. The Proposed Rule does recognize that there may be circumstances where an outside consultant with a particular expertise beyond the capabilities of the Surety's salaried claims staff is needed in connection with a claim, and would allow Sureties to seek reimbursement for the costs of such expertise. As described in the preamble to the Proposed Rule, an example of such "specialized services...beyond the capability of the Surety's salaried claims staff" would be the services of a structural engineer that are needed to evaluate the Principal's compliance with engineering specifications, and a commenter agreed with this example. SBA believes that its proposed language is sufficiently broad to cover the various situations that may arise.

In addition, a commenter suggested that the proposed requirement in 13 CFR 115.11 that the Surety must have a salaried staff "to perform all claims and recovery functions" be revised by removing the term "all" to account for those instances where outside consultants are retained to assist in claim and recovery functions. Instead of removing the term "all", SBA is revising this section to recognize that the Surety may seek reimbursement for specialized services provided by outside consultants under 13 CFR 115.16(e)(1). Again, SBA expects that these consultants will be needed to provide a specialized service that is beyond the expertise of the Surety's salaried claims staff.

Finally, both commenters stated that travel by in-house claims staff is often necessary and expressed concern that the proposed language in 13 CFR 115.16(f)(1) excludes travel costs as a reimbursable expense. SBA agrees that Sureties may seek reimbursement for reasonable and necessary travel expenses by their in-house claims staff, and has amended the language in 13 CFR 115.16(e)(1) and 115.16(f)(1) accordingly.

II. Section-by-Section Analysis

Section 115.11. As proposed, this provision required 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. For clarity, SBA is revising this section to recognize that, with respect to claims functions, a Surety may contract with an outside consultant for a specialized service the costs of which may be reimbursable under 13 CFR 115.16(e)(1). SBA expects Sureties to employ salaried claims staff capable of handling the routine processing and administration of claims and recovery, and to not seek reimbursement for the costs of these functions under 115.16(e)(1), except, as revised by this final rule, Sureties may seek reimbursement for the reasonable and necessary travel expenses of its salaried claims staff. This section also provides that final settlement authority for claims and recovery actions must be vested only in the applicant's "claims staff" and, for clarity and consistency, SBA is revising this phrase to read "salaried claims staff". There are no other changes to this section as proposed.

Section 115.13(a). As proposed, this provision added 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. There are no changes to this provision as proposed.

Section 115.14. SBA is modifying 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 will have the authority to waive this requirement for good cause.

In addition, as proposed, the same criteria on ineligibility and conditions for reinstatement would apply to both the Prior Approval Program and the PSB Program. As the same conditions for reinstatement will 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) will be moved in their entirety to 13 CFR 115.14(b) and (c), and the heading of this section will be changed to "Loss of Principal's eligibility for future assistance and reinstatement of Principal."

There are no changes to this provision as proposed.

Section 115.16(e)(1). As proposed, this provision provided that SBA would reimburse amounts actually paid by a Surety for specialized services 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. Based on comments, SBA is revising this provision to allow the Surety to seek reimbursement for travel expenses incurred by the Surety's claims staff, and to provide that the cost of the consultant's services and the travel expenses of the Surety's claims staff must be reasonable and necessary, and must specifically concern the investigation, adjustment, negotiation, compromise, settlement of, or resistance to a claim for Loss resulting from the breach of the terms of the bonded Contract. These changes, coupled with the changes made to 115.11, clarify 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 Surety will perform the claims function at no cost to the Agency (other than the reasonable and necessary travel costs of claims staff).

Section 115.16(f)(1). As proposed, this provision clarified 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. Based on the comments, and for consistency with section 115.16(e)(1), an exception for the reasonable and necessary travel expenses of the Surety's salaried claims staff is being added to this provision.

Section 115.18(a)(2). As proposed, SBA is revising this paragraph to provide that the Surety's failure to continue to comply with the requirements set forth in section 13 CFR 115.11 are sufficient grounds for refusal to issue further guarantees, or in the case of a PSB Surety, termination of preferred status. There are no changes to this provision as proposed.

Section 115.36. By including the conditions for reinstatement and the standard for underwriting after reinstatement in 13 CFR § 115.14(b) and (c), the rule, as proposed, renamed the heading of this section to "§ 115.36 Indemnity settlements", deleted the paragraph heading "(a) Indemnity settlements.", removed paragraphs (b) and (c), and renumbered paragraphs "(1)", "(2)", and "(3)", as "(a)", "(b)", and "(c)", respectively. There are no changes to this provision as proposed.

Section 115.60(a)(1). As proposed, SBA conformed 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. There are no changes to this provision as proposed.

Section 115.60(a)(5). By including in 13 CFR 115.11 the requirement that all Sureties vest final settlement authority for claims and recovery only in their salaried claims staff, this rule removes 13 CFR 115.60(a)(5) and renumbers the existing paragraph 13 CFR 115.60(a)(6) accordingly. There are no changes to this provision as proposed.

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 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 SBG Program regulations. In particular, SBA discussed the underwriting and claims staffing requirements that Sureties must meet in order to participate in SBA’s SBG 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 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 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 rule will not impose any new reporting or recordkeeping requirements.

Final 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 rule would impose any significant additional cost or burden on them. Consequently, this 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 stated in the preamble, SBA amends 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 perform all claims and recovery functions other than specialized services the costs of which may be reimbursable under 13 CFR 115.16(e)(1). Final settlement authority for claims and recovery must be vested only in the applicant's salaried 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.

(a) * * *

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

* * * * *

4. Amend § 115.14 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.

(a) * * *

(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 paragraph (a) of this section:

(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 (a)(1), (2), (3), (5) or (6) of this section.

(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) Reinstatement 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 paragraph (a)(1), (2), (3), (5) or (6) of this section.

(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, provided that such services are beyond the capability of the Surety's salaried claims staff, and amounts actually paid by the Surety for travel expenses of the Surety's claims staff. The cost of the consultant's services and the travel expenses of the Surety's claims staff must be reasonable and necessary and must specifically concern the investigation, adjustment, negotiation, compromise, settlement of, or resistance to a claim for Loss resulting from the breach of the terms of the bonded Contract. The cost allocation method must be reasonable and must comply with generally accepted accounting principles; and

* * * * *

(f) * * *

(1) Any unallocated expenses, all direct and indirect costs incurred by the Surety's salaried claims staff (except for reasonable and necessary travel expenses of such staff), or any clear mark-up on expenses or any overhead of the Surety, its attorney, or any other consultant 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.

(a) * * *

(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 (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 as follows:

- a. Revise the section heading;
- b. Remove the paragraph designation and 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 [Amended]

8. Amend § 115.60 as follows:

a. Amend paragraph (a)(1) by removing “\$2,000,000” and adding “\$6,500,000” in its place; and

b. Remove paragraph (a)(5) and redesignate paragraph (a)(6) as new paragraph (a)(5).

Maria Contreras-Sweet,
Administrator.

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