Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515–6315

MEMORANDUM

TO:	Members, Small Business Committee
FROM:	Nydia M. Velázquez, Chairwoman
DATE:	July 27, 2022
RE:	Hybrid Hearing: "Leveraging the Infrastructure Investment and Jobs Act: The Role of the SBA's Bond Guarantee Program"

The Committee on Small Business will meet for a hybrid hearing titled "Leveraging the Infrastructure Investment and Jobs Act: The Role of the SBA's Bond Guarantee Program." The hearing is scheduled to begin at **10:00 A.M. on Wednesday, July 27, 2022, in person in 2360 Rayburn House Office Building and via the Zoom platform.**

The hearing will examine the SBA's Surety Bond Guarantee Program, which has been assisting small businesses in obtaining bonds and winning contracts for more than 50 years. Taking into account the heightened role it will play as part of rebuilding the nation's infrastructure, Members will have the opportunity to learn how it serves small businesses and explore potential ways to improve and modernize the Program.

Panel

- Mr. Peter Gibbs, President, Foundation Surety & Insurance Solutions, Bowie, MD - Testifying on behalf of the National Association of Surety Bond Producers
- Mr. Ralph Pulver, Regional Underwriting Officer, Travelers Bond & Specialty Insurance, Hartford, CT - Testifying on behalf of the Surety & Fidelity Association of America
- Mr. Alan Gravel, President, Willow Construction, Inc., Powder Springs, GA
- Mr. Joel Griffith, Research Fellow, The Heritage Foundation, Washington, DC

Background

The SBA's Surety Bond Guarantee Program (hereinafter the SBG Program) is designed to provide small businesses with greater access to federal, state, local, and private-sector contracts by guaranteeing surety bonds.[1] Surety bonds are required for many construction, service, and supply projects. While many small and emerging businesses have the skills necessary to perform these projects, they struggle to qualify and obtain surety bonds through commercial channels due to lack of credit or limited capital. To overcome this challenge, SBA guarantees bid, payment, performance, and ancillary bonds issued by participating surety companies. This government guarantee allows sureties to write bonds for contractors who otherwise would not meet their

[1] Robert Dilger, Cong. Rsch. Serv, R42037, *SBA Surety Bond Guarantee Program* (Updated. July 2022) [hereinafter Dilger R42037].

minimum standards and thereby allows small businesses to compete and secure contracting opportunities that otherwise would be out of their reach.

In FY 2021, the SBA guaranteed 9,633 bid, payment and performance bonds for a combined contract value of approximately $7 billion, which supported more than 34,000 jobs.[2]

<u>What are Surety Bonds?</u>

Surety bonds are three-party agreements through which one party (the surety) guarantees the performance of a second party (the contractor or principal) to a third party (the project owner or obligee). Basically, it constitutes a promise to be liable for the debt, default or failure of another.[3] If the contractor fails to successfully perform the contract, the surety assumes the contractor's responsibilities and ensures the project is completed.[4] Prime contractors can also request surety bonds from subcontractors. The surety guarantees to the prime contractor (in this case, the obligee) that the subcontractor (or principal) will perform its contractual obligations.[5]

Surety bonds reduce the risks associated with contracting, protecting the project owner, subcontractors and suppliers. At the federal level, all construction contracts with a value greater than $150,000 require surety bonds under the provisions of the Miller Act.[6] Most state and local governments have adopted similar provisions to the Miller Act and require surety bonds. An increasing number of private sector projects also require surety bonds.

Under the SBG Program, the SBA in turn guarantees surety bonds, thereby indemnifying the surety for a certain percentage of loss originating from a surety bond claim. However, SBA guarantees what are known as "contract bonds," as opposed to "commercial bonds."[7] Contract bonds ensure that the terms of a specific contract are fulfilled, while commercial bonds ensure that all applicable laws and regulations are followed.[8] As previously mentioned, the SBA covers 4 types of contract bonds:

- Bid Bonds, which ensure that the bidder will enter the contract and provide the corresponding performance and payment bonds if awarded the contract.
- Performance Bonds, which ensure that the contractor will complete the project in accordance with the contract terms and conditions.
- Payment Bonds, which ensure that subcontractors and suppliers receive full payment.

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[2] Small Bus. Admin., *FY 2023 Congressional Budget Justification and FY 2021 Annual Performance Report*, available at: https://www.sba.gov/sites/default/files/2022-04/FY%202023%20SBA%20Congressional%20Budget%20Justification-508-2022-0413%20updated.pdf [hereinafter, FY 23 SBA Budget Justification].

[3] National Association of Surety Bond Producers (NASBP), *Answers to 51 Questions Small Contractors Ask About Bonding*, available at: https://higherlogicdownload.s3.amazonaws.com/NASBP/175be0e0-5e37-43e7-8bc9-c67c5b8c85c8/UploadedImages/NASBP_ANS_PUB_8-18.pdf [hereinafter NASBP].

[4] FY 23 SBA Budget Justification, *supra*, note 2.

[5] NASBP, s*upra*, note 3.

[6] 40 U.S.C. §3131. See also FAR 28.102-1 for the increased threshold.

[7] Small Bus. Admin, Surety Bonds, available at: https://www.sba.gov/funding-programs/surety-bonds.

[8] *Id.*

- Ancillary Bonds, which ensure completion of requirements outside of payment and performance, such as maintenance.[9]

The Framework of the SBG Program

Origins, Bond Limits, and Requirements

Congress created the SBG Program through the Housing and Urban Development Act of 1970.[10] The Act amended Title IV of the Small Business Investment Act of 1958 to authorize the SBA to guarantee any surety against loss that resulted from the breach of the terms of a bid bond, payment bond, or performance bond by a principal on any contract up to $500,000.[11] Throughout the years, Congress has revised the bond limits for the SBG Program on a couple of occasions, most recently through the National Defense Authorization Act of 2013.[12] As a result, currently the SBG Program guarantees surety bonds for contracts up to $6.5 million and up to 10 million for federal contracts if the contracting officer certifies that such guarantee is necessary.[13]

According to the statute, SBA is able to guarantee bonds under the Program when: 1) the principal of the bond is a small business, (2) the bond is required as a condition of bidding on a contract or serving as a prime contractor or subcontractor thereon, (3) the small business is not able to obtain such bond on reasonable terms and conditions without the guarantee, and (4) there is reasonable expectation that the small business will perform the covenants and conditions of the contract and the terms and conditions of the bond are reasonable in light of the risks involved and the extent of the surety's participation.[14]

Programs and Guarantee Rates

Within the SBA, the Office of Surety Guarantees (OSG) administers the SBG Program as a public-private partnership between the federal government and the surety industry. The SBG Program consists of the Prior Approval Program (Plan A) and the Preferred Surety Bond (PSB or Plan B) Program. The difference between them is that in Plan A, the SBA must approve each guarantee before the issuance of the bond, whereas in the PSB Program, participating sureties are delegated the authority to issue, service, and monitor SBA-guaranteed bonds without prior approval.[15]

Originally, the SBG Program relied on large standard surety companies.[16] However, their participation soon began to decline allegedly because of the administrative burdens of submitting each bond for prior approval and the administrative costs associated with dealing with smaller loans.[17] To encourage more sureties to participate, Congress authorized the Preferred Surety Bond Program through the Small Business Administration Reauthorization and Amendment Act of 1988

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[9] *Id*.
[10] Pub. L. No. 91-609, 84 Stat. 1770 (1970).
[11] Pub. L. No. 91-609, §411, 84 Stat. 1770, 1813-14 (1970).
[12] Pub. L. No. 112-239, §1695, 126 Stat. 1632, 2089-90 (2013).
[13] 15 U.S.C. §694b(a)(1)
[14] 15 U.S.C. §694b(a)(4)
[15]Small Bus. Admin, *Become an SBA Surety Partner,* available at: https://www.sba.gov/partners/surety-bond-partners-agents/become-sba-surety-partner [hereinafter *SBA Surety Partner Information*].
[16] Dilger R42037, *supra*, note 1.
[17] Dilger R42037, *supra*, note 1.

on a three-year trial basis.[18] It was then made permanent through the Consolidations Appropriations Act of 2005.[19]

Plan B addressed the concerns of the non-SBA sureties by ensuring that if a surety met certain qualification standards, it would be deemed as a "preferred surety" and would be allowed to issue bonds backed by SBA without prior approval.[20] To participate in the Plan B Program, SBA essentially pre-approves the surety's standards, processes, and procedures for underwriting. In exchange, however, the sureties received only a 70 percent guaranty of loss on each bond rather than the 80 or 90 percent guaranty associated with the Plan A Program.[21]

Eventually, the PSB guarantee rate was increased from not to exceed 70 percent to not to exceed 90 percent of losses through the National Defense Authorization Act of 2016.[22] Thus, currently, SBA guarantees up to 90 percent of losses in both programs if the total amount of the contract does not surpass $100,000 or if the principal is a Veteran or Service-Disabled Veteran-Owned small business, a socially and economically disadvantaged small business, an 8(a) or a HUBZone small business. Otherwise, SBA guarantees 80 percent.[23]

There are multiple requirements with which a surety company must comply to participate in the SBG Program, including that they must be certified by the U.S. Treasury to issue bonds in connection with Federal procurement contracts.[24] Currently, the SBG Program counts with a total of 41 active sureties, 31 under Plan A and 10 under Plan B.[25] There are also approximately 450 active authorized agents.[26]

<u>SBG Revolving Fund and Program Fees</u>
The SBG Program counts with its own SBG Revolving Fund account, where appropriated amounts to carry out the Program and any additional fees collected are deposited.[27] Currently, the Revolving Fund counts with approximately $106 million.[28]

To help offset its costs, the SBA is called to administer the Program on "a prudent and economically justifiable basis and establish such fee or fees for small business concerns and premium or premiums for sureties as it deems reasonable and necessary."[29] SBA does not charge application fees. However, it does charge guarantee fees to both the sureties and the principals on each guaranteed bond, other than bid bonds. On October 1, 2018, the SBA began implementing a one-year initiative decreasing the surety fee from 26 percent of the bond premium to 20 percent

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[18] Pub. L. No.100-590, §§207, 102 Stat. 2989, 3009 (1988).
[19] Pub. L. No.108-447, Div. K §203, 118 Stat. 2809, 3466 (2004).
[20] Dilger R42037, *supra*, note 1.
[21] Dilger R42037, *supra*, note 1.
[22] Pub. L. No. 114-92, §874, 129 Stat. 726, 940-41 (2015).
[23] SBA Surety Partner Information, *supra*, note 15.
[24] 13 C.F.R. §115.11
[25] Small Bus. Admin, *List of Surety Bond Partners*, available at: https://www.sba.gov/partners/surety-bond-partners-agents/list-surety-bond-partners.
[26] FY 23 SBA Budget Justification, *supra*, note 2.
[27] 15 U.S.C. §694c
[28] Office of Management and Budget, *Budget of the U.S. Government, FY2023: Appendix, Small Business Administration*, p. 1196.
[29] 15 U.S.C. §694b(h)

and decreasing the principal fee from $7.29 per thousand dollars of the contract amount to $6.00.[30] This initiative was later extended until these lower fees were made permanent for all SBA surety bond guarantees approved on or after October 1, 2020.[31]

Potential Reforms

On November 15, 2021, President Bident signed into law the bipartisan $1.2 trillion Infrastructure Investment and Jobs Act.[32] In light of this once-in-a-lifetime investment, HR 5376, the Build Back Better Act would have expanded the SBA's SBG Program to guarantee bonds for larger projects.[33] Specifically, section 100102 would have raised the threshold on individual contracts from $6.5 million to $10 million. More importantly, it would have raised the threshold for Federal contracts from $10 million to $20 million without requiring certification from a contracting officer. This requirement has proven to be challenging as contracting officers often do not issue the certification.

This legislation would have provided $100 million to the SBG Revolving Fund to adequately support the potential increased demand.[34] It is important to note that historically, the Program's default rate has averaged about 3 percent to 5 percent and that, in general, the default rate on larger contracts tends to be lower than the default rate for smaller contracts.[35] Furthermore, this legislation would have authorized SBA to use up to 15 percent of the amount that is in the fund on the first day of each fiscal year for costs associated with the management and administration of the SBG Program.[36] This funding would have helped support areas in which the Program can improve such as information technology, staffing, and outreach activities to ensure businesses know about the Program and make use of it.

Additionally, it is worth considering whether the parameters of the SBG Program should be broadened to accept new bond products. As previously mentioned, the Program only guarantees contract bonds, expanding the Program to include commercial bonds could potentially help small businesses that are required such assurances. Finally, it is worth considering the Program's structure. For example, a decade ago, SBA introduced the "QuickApp," which is a streamlined underwriting and application process for Prior Approval Sureties for surety bonds up to $400,000. The Quick App is sometimes being referred to as the "Quick Bond Program." [37]Similarly, it is worth considering if it makes sense to merge the Plan A Program with the PSB Program, maintaining the characteristics of the PSB Program.[38]

Conclusion

The SBA's SBG Program supports small businesses by guaranteeing surety bonds that are necessary to win and perform construction, services, and supply contracts. The Program plays an important role in ensuring that small businesses can access both public and private contracts. With

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[30] Small Bus. Admin., Press Release No. 18-54, *SBA Announces Decrease in Surety Bond Guarantee Fees* (Sept. 4, 2018).
[31] Surety Bond Guarantee Program Fees, 85 Fed. Reg. 62362 (Oct. 2, 2020).
[32] Pub. L. No. 117-58, 135 Stat. 429 (2021).
[33] HR 5376, 117th Cong. (2021).
[34] HR 5376, 117th Cong. (2021).
[35] Dilger R42037, *supra*, note 1.
[36] HR 5376, 117th Cong. (2021).
[37] Dilger R42037, *supra*, note 1.
[38] Dilger R42037, *supra*, note 1.

the passage of the Infrastructure and Jobs Act, the importance of the SBG Program is underscored. Thus, it is crucial to thoroughly review it to ensure it is functioning properly, effectively and reaching those disadvantaged small businesses that need it the most.