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SBA Surety Bond Guarantee Program

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December 11, 2013

Congressional Research Service

7-5700

www.crs.gov

R42037

Summary

The Small Business Administration's (SBA's) Surety Bond Guarantee Program is designed to increase small businesses' access to federal, state, and local government contracting, as well as private-sector contracts, by guaranteeing bid, performance, and payment bonds for small businesses that cannot obtain surety bonds through regular commercial channels. The program guarantees individual contracts of up to \$6.5 million, and up to \$10 million if a federal contracting officer certifies that such a guarantee is necessary. The SBA's guarantee ranges from 70% to 90% of the surety's loss if a default occurs. In FY2013, the SBA guaranteed 12,866 bid and final surety bonds with a total contract value of about \$6.1 billion.

A surety bond is a three-party instrument between a surety (who agrees to be responsible for the debt or obligation of another), a contractor, and a project owner. The agreement binds the contractor to comply with the contract's terms and conditions. If the contractor is unable to successfully perform the contract, the surety assumes the contractor's responsibilities and ensures that the project is completed. Surety bonds are viewed as a means to encourage project owners to contract with small businesses that may not have the credit history or prior experience of larger businesses and are considered to be at greater risk of failing to comply with the contract's terms and conditions.

P.L. 112-239, the National Defense Authorization Act for Fiscal Year 2013, increased the program's bond limit, which had been \$2 million since 2000, and was temporarily increased, from February 17, 2009, through September 30, 2010, to \$5 million, and up to \$10 million if a federal contracting officer certified in writing that a guarantee in excess of \$5 million was necessary. Advocates of raising the program's bond limit argued that doing so would increase contracting opportunities for small businesses and bring the limit more in line with limits of other small business programs, such as the 8(a) Minority Small Business and Capital Ownership Development Program and the Historically Underutilized Business Zone (HUBZone) Program. Opponents argued that raising the limit could lead to higher amounts being guaranteed by the SBA and, as a result, increase the risk of program losses.

This report examines the program's origin and development, including the decision to (1) supplement the original Prior Approval Program with the Preferred Surety Bond Guarantee Program that provides a lower guarantee rate (70%) than the Prior Approval Program (80% or 90%) in exchange for allowing preferred sureties to issue SBA-guaranteed surety bonds without the SBA's prior approval; and (2) increase the program's bond limit. It also examines the program's eligibility standards and requirements, provides performance statistics, and concludes with a discussion of proposals to merge the Prior Approval Program and the Preferred Surety Bond Guarantee Program while retaining the Preferred Program's more flexible operating requirements.

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Congressional Interest in Surety Bonds

The Small Business Administration (SBA) administers several programs to support small businesses, including loan guaranty programs to enhance small business access to capital; contracting programs to increase small business opportunities in securing federal contracts; direct loan programs for businesses, homeowners, and renters to assist their recovery from natural disasters; and small business management and technical assistance training programs to assist business formation and expansion. Congressional interest in these programs has increased in recent years, primarily because assisting small business is viewed as a means to enhance economic growth.

The SBA's Surety Bond Guarantee Program has been operational since April 1971.¹ It is designed to increase small business's access to federal, state, and local government contracting, as well as private-sector contracting, by guaranteeing "bid, performance, and payment bonds on contracts ... for small and emerging contractors who cannot obtain bonding through regular commercial channels."² The program guarantees individual contracts of up to \$6.5 million, and up to \$10 million if a federal contracting officer certifies that such a guarantee is necessary. The SBA's guarantee ranges from 70% to 90% of the surety's loss if a default occurs.

In FY2013, the SBA guaranteed 12,866 bid and final surety bonds (a payment bond, performance bond, or both a payment and performance bond) with a total contract value of about \$12.9 billion.³ Although the surety industry does not report the total value of the bonds it issues each year, estimates based on the total amount of premiums collected by the private sector in recent years suggest that the SBA's Surety Bond Guarantee Program represents, by design, a relatively small percentage of the market for surety bonds (from about 1.0% to 4.1% of the value of surety bonds issued by the private sector).⁴

A surety bond is a three-party instrument between a surety (who agrees to be responsible for the debt or obligation of another), a contractor, and a project owner. The agreement binds the contractor to comply with the contract's terms and conditions. If the contractor is unable to successfully perform the contract, the surety assumes the contractor's responsibilities and ensures that the project is completed. The surety bond reduces the risk of contracting.⁵

¹ P.L. 91-609, the Housing and Urban Development Act of 1970; and U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Small Business Legislation - 1974*, hearing on S. 3137 and S. 3138, 93rd Cong., 2nd sess., March 13, 1974 (Washington: GPO, 1974), p. 19.

² U.S. Small Business Administration, "FY2014 Congressional Budget Justification and FY2012 Annual Performance Report," p. 37. An ancillary bond, which ensures that requirements integral to the contract, but not directly performance related, are performed, is also eligible if it is incidental and essential to a contract for which SBA has guaranteed a final bond. A reclamation bond is eligible if it is issued to reclaim an abandoned mine site and for a project undertaken for a specific period of time.

³ U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 5, 2013.

⁴ Surety bonds range in price from 0.5% to 2% of the contract price. By dividing the total amount of premiums issued each year by the private sector (about \$3.0 billion annually in recent years) by .005 and .02 provides a range for the value of those contracts (\$150 billion to \$600 billion). Premium data from Surety Information Office, "Contract Surety Bonds, Understanding Today's Market, 2013," Washington, DC, at http://suretyinfo.org/?page_id=70&wpfb_cat=3#wpfb-cat-3.

⁵ U.S. Small Business Administration, "Surety Bonds," at <http://www.sba.gov/category/navigation-structure/loans-grants/bonds/surety-bonds>.

Surety bonds are viewed as a means to encourage project owners to contract with small businesses that may not have the credit history or prior experience of larger businesses and are considered to be at greater risk of failing to comply with the contract's terms and conditions.⁶ The three general types of surety bonds are

- *bid bonds* guarantee that the bidder on a contract will enter into the contract and furnish the required payment and performance bonds if awarded the contract,
- *payment bonds* guarantee that suppliers and subcontractors will be paid for work performed under the contract, and
- *performance bonds* guarantee that the contractor will perform the contract in accordance with its terms and conditions.⁷

Surety bonds are important to small businesses interested in competing for a federal contract because the federal government requires prime contractors, prior to the award of a federal contract exceeding \$150,000 for the construction, alteration, or repair of any building or public work of the United States, to furnish a performance bond issued by a surety satisfactory to the officer awarding the contract, and in an amount the contracting officer considers adequate, to protect the government.⁸ Prime contractors are also required to post a payment bond with a surety satisfactory to the contracting officer for the protection of all persons supplying labor and material in carrying out the work provided for in the contract. Both bonds become legally binding upon award of the contract and their "penal amounts," or the maximum amount of the surety's obligation, must generally be 100% of the original contract price plus 100% of any price increases.⁹ Most state and local governments have adopted similar legislation, often called "Little Miller Acts," referencing the Miller Act of 1935 that established the federal requirement.¹⁰ Many private project owners also require contractors to furnish a surety bond before awarding them a contract.

This report opens with an examination of the SBA's Surety Bond Guarantee Program's legislative origin and provides a historical summary of the major issues that have influenced the program's development, including the decision to (1) supplement the original Prior Approval Program with a Preferred Surety Bond Guarantee Program that provides SBA-approved sureties a lower guarantee rate (70%) than those participating in the Prior Approval Program (80% or 90%) in exchange for allowing preferred sureties to issue SBA-guaranteed bonds to small businesses without the SBA's prior approval; and (2) increase the program's bond limit. It then examines the

⁶ Ibid.

⁷ U.S. Small Business Administration, "Surety Bonds: Explained," at <http://www.sba.gov/content/surety-bonds-explained>.

⁸ The threshold amount was originally set at \$2,000 in 1935 under P.L. 74-321, An Act Requiring Contracts for the Construction, Alteration, and Repair of Any Public Building or Public Work of the United States to be Accompanied by a Performance Bond Protecting the United States and an Additional Bond for the Protection of Persons Furnishing Material or Labor for the Construction, Alteration, or Repair of Said Public Buildings or Public Work [the Miller Act of 1935], 49 Stat. 793 (August 24, 1935) (codified at 40 U.S.C. §3133(b)(1)). For further information and analysis of federal requirements concerning surety bonds, see CRS Report R41230, Legal Protections for Subcontractors on Federal Prime Contracts, by Kate M. Manuel.

⁹ Performance bonds may be less than 100% provided that the contracting officer determines that a smaller amount will adequately protect the government. 40 U.S.C. §3133(b)(2).

¹⁰ U.S. Small Business Administration, "Standard Operating Procedure: Surety Bond Guarantee Program," SOP 50 45 2, effective March 8, 1999, p. 7, at <http://www.sba.gov/sites/default/files/sop5045.pdf>.

program's current eligibility standards and requirements, and provides performance statistics, including the number and amount of bond guarantees issued annually.

The report concludes by examining proposals to merge the Prior Approval Program and the Preferred Surety Bond Guarantee Program while retaining the Preferred Program's more flexible operating requirements. In addition, data concerning the number and amount, in both nominal and inflation-adjusted dollars, of final bonds guaranteed from FY1971 through FY2013 (see **Table A-1**) and for bid and final bonds combined from FY2000 through FY2013 (see **Table A-2**) are provided.

Legislative Origin

P.L. 91-609, the Housing and Urban Development Act of 1970, authorized the SBA's Surety Bond Guarantee Program.¹¹ The act amended Title IV of the Small Business Investment Act of 1958 (P.L. 85-699, as amended) to provide the SBA authority to guarantee any surety against loss as the result of a breach of the terms of a bid bond, payment bond, or performance bond by a principal on any contract up to \$500,000.¹² The act specified that (1) the principal of the bond is a small business, (2) the bond is required as a condition of bidding on the contract or serving as a prime contractor or subcontractor on the project, (3) the small business is not able to obtain such bond on reasonable terms and conditions without the guarantee, (4) the SBA determines that there is a reasonable expectation that the small business will perform the covenants and conditions of the contract, (5) the contact meets SBA requirements concerning the feasibility of the contract being completed successfully and at a reasonable cost, and (6) the bond's terms and conditions are reasonable in light of the risks involved and the extent of the surety's participation.¹³ The act also required that the SBA's guarantee not exceed 90% of the loss incurred by the surety in the event of a breach of the bond's terms and conditions by the small business.¹⁴

The SBA was authorized to finance the program through the Leasing Guarantee Revolving Loan Fund within the Department of the Treasury, which renamed that fund the Lease and Surety Bond Guarantee Revolving Fund. The act authorized the transfer of \$5 million from the SBA's Business Loan and Investment Revolving Fund to the Lease and Surety Bond Guarantee Revolving Fund, raising that fund's capital to \$10 million available without fiscal year limitation, to support both the lease guarantee program and the surety bond guarantee program.¹⁵ The act also recommended that the program be appropriated up to \$1.5 million each fiscal year for three fiscal years after its

¹¹ The SBA's Surety Bond Guarantee Program was authorized in this particular act because the program, as introduced in the House (H.R. 19436), would have been administered by the Department of Housing and Urban Development to provide or guarantee surety bonds for construction contractors and subcontractors. The program's administration was shifted to the SBA in the conference agreement accompanying the bill. See U.S. Congress, House Committee of Conference, *Housing and Urban Development Act of 1970*, report to accompany H.R. 19436, 91st Cong., 2nd sess., December 17, 1970, H.Rept. 91-1784 (Washington: GPO, 1970), p. 65.

¹² P.L. 91-609, the Housing and Urban Development Act of 1970, §411. Authority of the Administration.

¹³ Ibid. At that time, the SBA considered contractors small if the company's average annual receipts over three years did not exceed \$2 million, or \$1 million for most special trade contractors. See U.S. Congress, Senate Select Committee on Small Business, *Surety Bond Guarantee Program of the Small Business Administration*, 94th Cong., 1st sess., November 19, 1975 (Washington: GPO, 1975), p. 14.

¹⁴ P.L. 91-609, the Housing and Urban Development Act of 1970, §411. Authority of the Administration.

¹⁵ U.S. Office of Management and Budget, *Budget of the U.S. Government, FY1974: Appendix, Small Business Administration*, p. 944.

date of enactment (December 31, 1970) if additional funding were needed to offset the program's expenses.¹⁶

The SBA was directed to administer the program “on a prudent and economically justifiable basis.”¹⁷ It was authorized to offset the program's administrative costs by charging a uniform annual fee, subject to periodic review to ensure that the fee is the “lowest fee that experience under the program shows to be justified,” and uniform fees for the processing of applications for guarantees.¹⁸ The SBA also was authorized to “obligate the surety to pay the Administration such portions of the bond fee as the Administration determines to be reasonable in light of the relative risks and costs involved.”¹⁹

The program's sponsors argued in 1970 that “there is widespread evidence that a significant number of construction contracting organizations find varying degrees of difficulty in obtaining surety bonds” and that “the major share of these organizations are small businesses, and many of them are headed by minority groups.”²⁰ They argued that the Surety Bond Guarantee Program would “facilitate the entry and advancement of small and minority contractors in the construction business.”²¹ At that time, witnesses at congressional hearings testified that surety bonds were not necessarily required for most private sector construction contracts, but they were required for most public sector construction contracts.²²

Initial Demand and Costs Exceed Expectations

The SBA implemented the program on a pilot basis on April 5, 1971, in Kansas City. The program later was expanded to Los Angeles and became nationwide on September 2, 1971.²³ Initially, the SBA guaranteed 90% of the amount of all of the surety bonds in the program and charged sureties 10% of the bond premium paid to the surety company by the contractor.²⁴ It also charged small business applicants for payment and performance bonds 0.2% of the contract price upon their obtaining the contract. It did not charge for the processing of bid bonds, rejected applications, or applications that did not result in a contract award.²⁵ Contractors wishing to

¹⁶ P.L. 91-609, the Housing and Urban Development Act of 1970, §411. Authority of the Administration.

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ Ibid.

²⁰ U.S. Congress, House Banking and Currency, *Housing and Urban Development Legislation - 1970*, 91st Cong., 2nd sess., June 5, 1970 (Washington: GPO, 1970), p. 351.

²¹ Ibid.

²² U.S. Congress, House Committee on Small Business, Subcommittee on SBA Oversight and Minority Experience, *Selected Small Business Administration Programs and Activities*, 94th Cong., 2nd sess., February 24, 1976, H. Rept. 94-840 (Washington: GPO, 1976), p. 4.

²³ U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Oversight of SBA Set-Aside, Lease Guaranty, and Surety Bond Programs*, 94th Cong., 2nd sess., March 8, 1976 (Washington: GPO, 1976), pp. 26, 28.

²⁴ The SBA reported to the Government Accounting Office in 1975 that the surety bond industry initially insisted that the SBA guarantee “90% of any loss for no more than 10% of the premiums collected” as a condition of participating in the program. The SBA also reported that the industry indicated a willingness to “reassess the adequacy of SBA's 10% share after two years of experience.” See U.S. General Accounting Office, *Use Of Surety Bonds In Federal Construction Should be Improved*, LCD-74-319, January 17, 1975, p. 35, at <http://archive.gao.gov/d46t13/094722.pdf>.

²⁵ U.S. Congress, Senate Select Committee on Small Business, *Surety Bond Guarantee Program of the Small Business Administration*, 94th Cong., 1st sess., November 19, 1975 (Washington: GPO, 1975), p. 14.

participate in the program were required to have less than \$750,000 in gross annual receipts for the past fiscal year or to have averaged less than \$750,000 in gross annual receipts over the past three fiscal years. This size standard was more stringent than for other SBA programs, and it was designed “to reach that segment of small business which was obviously intended to benefit from the legislation as evidenced by the limit of \$500,000 on any one contract.”²⁶

Demand for the program exceeded the SBA’s expectations. In 1971, the SBA estimated that it would guarantee about 8,000 contracts amounting to about \$540 million from FY1972 through FY1974. Instead, it guaranteed 16,118 contracts amounting to nearly \$1.1 billion (see **Table A-1** in the Appendix).²⁷ Because the demand for the program exceeded expectations and the initial fees proved to be insufficient to recoup the program’s expenses, in 1974, the SBA requested an additional \$25 million for the program. The SBA argued that the additional funds were necessary to take into account the program’s projected growth and to establish a reserve fund “to protect against having to suspend [the] program in the fact of more rapid growth than is projected.”²⁸

In response to the SBA’s request for additional funding for the program, Congress held congressional hearings to reassess the need for the program and to explore options concerning how to finance the program’s proposed expansion. The financing discussions focused on the relative merits of relying primarily on higher fees to increase the program’s revenue, reductions in the guarantee percentage to reduce the program’s expenses, or additional appropriations to finance the program’s proposed expansion. Although the SBA has periodically increased the program’s fees and later instituted a tiered system of guarantee percentages, historically, the SBA has tried to keep the program’s fees as low as economically feasible and the guarantee percentage as high as economically feasible to encourage the program’s use. As an SBA official testified before Congress in 1975:

SBA’s loss exposure could be reduced by a decrease in the guarantee extended to sureties from 90% to 80%. Before proceeding with this recommendation, a thorough analysis will have to be made of the adverse effect on the willingness of sureties to participate in the program which would result from the increase from 10% to 20% of the sureties’ share of the loss potential.

An increase in contractor’s fees would obviously be beneficial to the operating income of the program, but would also increase the bids which small business-contractors would have to make, thus placing them at a competitive disadvantage with contractors with more ready access to bonding.²⁹

²⁶ U.S. Congress, Senate Select Committee on Small Business, *Review of Small Business Administration’s Programs and Policies - 1971*, 92nd Cong., 1st sess., October 5, 1971 (Washington: GPO, 1971), p. 46.

²⁷ U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Small Business Legislation - 1974*, hearing on S. 3137 and S. 3138, 93rd Cong., 2nd sess., March 13, 1974 (Washington: GPO, 1974), pp. 4, 19.

²⁸ U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Small Business Legislation - 1974*, hearing on S. 3137 and S. 3138, 93rd Cong., 2nd sess., March 13, 1974 (Washington: GPO, 1974), p. 20. As of 1974, the SBA reportedly took in \$3 million in surety bond premiums and paid out more than \$12 million in claims. See Representative William Cotter, “Providing for Consideration of H.R. 15578, Small Business Amendments of 1974,” House Debate, *Congressional Record*, vol. 120, part 20 (August 1, 1974), p. 26398.

²⁹ Testimony of John T. Wettach, SBA Associate Administrator for Finance and Investment, in U.S. Congress, Senate Select Committee on Small Business, *Surety Bond Guarantee Program of the Small Business Administration*, 94th Cong., 1st sess., November 19, 1975 (Washington: GPO, 1975), p. 3.

Moreover, as mentioned previously, the SBA is required by statute to ensure that the fees are the lowest “that experience under the program shows to be justified.”³⁰

Determining the program’s appropriate size became a recurring theme at congressional hearings, and continues to be of congressional interest today. For example, Congress has regularly requested testimony from representatives of the surety bond industry and various construction organizations concerning the extent to which the program is necessary to assist small businesses generally, and minority-owned small businesses in particular, in gaining access to surety bonds. Congress has also periodically asked the Government Accountability Office (GAO) to examine the need for the SBA’s surety bond guarantee program and to recommend ways to improve the program’s management.³¹ That testimony and GAO’s reports have supported a need for the program, but, as will be discussed, have had somewhat limited usefulness in helping Congress determine the program’s appropriate size.

In 1974, Congress responded to the SBA’s request for additional funding for the program by passing P.L. 93-386, the Small Business Amendments of 1974. It established a separate Surety Bond Guarantees Revolving Fund account within the Department of the Treasury to support the program. The act also recommended that the program be appropriated \$35 million in additional funding. It also increased the maximum dollar amount of the contract that could be provided a guarantee to \$1 million from \$500,000.³²

The Ford Administration objected to increasing the program’s funding through appropriations. Instead, it recommended transferring \$20 million from the SBA’s Business Loan and Investment Revolving Fund to the Surety Bond Guarantee Revolving Fund. The transfer would provide the program access to additional capital without affecting the federal budget deficit. Congress approved the Administration’s proposal.³³

As shown on **Table 1**, Congress subsequently approved additional appropriations amounting to \$130.5 million for FY1976 through FY1979 to support the program’s continued growth. Congress also provided the program additional appropriations during the 1980s and 1990s, and increased the program’s bond limit to \$1.25 million from \$1 million in 1986, but as will be discussed, the appropriations and increase in the bond limit were not sufficient to continue the program’s growth.³⁴ Instead, both in terms of the number of final surety bonds guaranteed by the

³⁰ P.L. 91-609, the Housing and Urban Development Act of 1970.

³¹ U.S. General Accounting Office, *Use Of Surety Bonds In Federal Construction Should be Improved*, LCD-74-319, January 17, 1975, at <http://archive.gao.gov/d46t13/094722.pdf>; U.S. General Accounting Office, *The Surety Bond Guarantee Program: Significant Changes Are Needed In Its Management*, CED-80-34, December 27, 1979, at <http://archive.gao.gov/f0202/111534.pdf>; U.S. General Accounting Office, *Surety Bond Guarantee Program: Small Business Administration’s Actions on Prior Program Recommendations*, GAO/RCED-86-183BR, September 18, 1986, at <http://archive.gao.gov/d4t4/131018.pdf>; U.S. General Accounting Office, *Small Business: Information on and Improvements Needed to Surety Bond Guarantee Programs*, GAO/RCED-91-99, April 23, 1991, at <http://archive.gao.gov/d20t9/143966.pdf>; U.S. General Accounting Office, *Small Business: Construction Firms’ Access to Surety Bonds*, GAO/RCED-95-173FS, June 26, 1995, at <http://www.gao.gov/archive/1995/rc95173f.pdf>; and U.S. General Accounting Office, *Minority-Owned Firms’ Access to Surety Bonds*, GAO/RCED-95244R, July 14, 1995, at <http://archive.gao.gov/paprpdf1/154722.pdf>.

³² P.L. 93-386, the Small Business Amendments of 1974, §411. Authority of the Administration.

³³ S.Doc. 93-116, Supplemental Appropriations for FY75 for Department of Commerce and Small Business Administration, Communication from the President, October 2, 1974; and P.L. 93-554, the Supplemental Appropriations Act, 1975.

³⁴ P.L. 99-272, the Consolidated Omnibus Budget Reconciliation Act of 1985.

SBA and the amount guaranteed by the SBA, the program began to slowly diminish. As will be discussed, this general trend continued until the maximum individual surety contract amount was increased, first on a temporary basis by P.L. 111-5, the American Recovery and Reinvestment Act of 2009, and later, on a permanent statutory basis, by P.L. 112-239, the National Defense Authorization Act for Fiscal Year 2013.³⁵

As shown on **Table 1**, Congress did not appropriate any funding for the program from FY2000 to FY2004, allowing the program to cover the cost of claim defaults through its reserve. Congress also increased the program's bond limit to \$2 million from \$1.25 million in 2000.³⁶

Congress appropriated \$2.9 million for the program in FY2005, \$2.86 million in FY2006, \$2.86 million in FY2007, and \$3.0 million in FY2008. During the 111th Congress, P.L. 111-5 provided the program a separate appropriation of \$15 million to support a temporary increase in the program's bond limit to \$5 million, and up to \$10 million if a federal contracting officer certified in writing that a guarantee in excess of \$5 million was necessary, from \$2 million. Those funds were in addition to the \$2 million that had already been appropriated for the program for FY2009.

Table 1. SBA Surety Bond Guarantee Program Appropriations, FY1976-FY2014

Fiscal Year	Appropriation	Fiscal Year	Appropriation	Fiscal Year	Appropriation
1976	\$12,500,000	1989	\$9,497,000	2002	\$0
1977	\$36,000,000	1990	\$11,000,000	2003	\$0
1978	\$47,000,000	1991	\$10,200,000	2004	\$0
1979	\$35,000,000	1992	\$14,600,000	2005	\$2,900,000
1980	\$0	1993	\$13,020,000	2006	\$2,861,000
1981	\$0	1994	\$7,000,000	2007	\$2,861,000
1982	\$19,000,000	1995	\$5,369,000	2008	\$3,000,000
1983	\$0	1996	\$2,530,000	2009	\$17,000,000
1984	\$8,910,000	1997	\$3,730,000	2010	\$1,000,000
1985	\$8,910,000	1998	\$3,500,000	2011	\$0
1986	\$7,000,000	1999	\$3,300,000	2012	\$0
1987	\$9,497,000	2000	\$0	2013	\$0
1988	\$9,497,000	2001	\$0	2014	\$0

Sources: P.L. 94-121, the Department of State, Justice, and Commerce, the Judiciary, and Related Agencies Appropriation Act, 1976; P.L. 94-362, the Departments of State, Justice, and Commerce, the Judiciary, and Related Agencies Appropriation Act, 1977; P.L. 95-86, the Departments of State, Justice, and Commerce, the Judiciary, and Related Agencies Appropriation Act, 1978; P.L. 95-431, the Departments of State, Justice, and Commerce, the Judiciary, and Related Agencies Appropriation Act, 1979; P.L. 97-92, A joint resolution making further continuing appropriations for the fiscal year 1982, and for other purposes; P.L. 98-166, the Departments

³⁵ U.S. Small Business Administration, "Much Higher Surety Bond Guarantee Ceilings Enable Small Businesses to Bid on Larger Contracts and Grow," February 6, 2013, at <http://www.sba.gov/community/blogs/much-higher-surety-bond-guarantee-ceilings-enable-small-businesses-bid-larger-contra>; and U.S. Small Business Administration, "Surety Bond Guarantee Program," 78 *Federal Register* 46528-46532, August 1, 2013.

³⁶ P.L. 106-554, the Consolidated Appropriations Act, 2001.

of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriation Act, 1984; P.L. 98-411, the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriation Act, 1985; P.L. 99-180, the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriation Act, 1986; P.L. 99-591, A joint resolution making continuing appropriations for the fiscal year 1987, and for other purposes; P.L. 100-202; A joint resolution making further continuing appropriations for the fiscal year 1988, and for other purposes; P.L. 100-459, the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 1989; P.L. 101-162, the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 1990; P.L. 101-515, the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 1991; P.L. 102-140, the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 1992; P.L. 102-395, the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 1993; P.L. 103-121, the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 1994; P.L. 103-317, the Departments of Commerce, Justice, and State, the Judiciary and Related Agencies Appropriations Act, 1995; P.L. 104-134, the Omnibus Consolidated Rescissions and Appropriations Act of 1996; P.L. 104-208, the Omnibus Consolidated Appropriations Act, 1997; P.L. 105-119, the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 1998; P.L. 105-277, the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999; P.L. 108-447, the Consolidated Appropriations Act, 2005; P.L. 109-108, the Science, State, Justice, Commerce, and Related Agencies Appropriations Act, 2006; P.L. 109-289, Making Appropriations for the Department of Defense for the fiscal year ending September 30, 2007, and for other purposes; P.L. 110-161, the Consolidated Appropriations Act, 2008; P.L. 111-5, the American Recovery and Reinvestment Act of 2009; P.L. 111-8, the Omnibus Appropriations Act, 2009; P.L. 111-117, the Consolidated Appropriations Act, 2010; P.L. 112-10, the Department of Defense and Full-Year Continuing Appropriations Act, 2011; P.L. 112-74, the Consolidated Appropriations Act, 2012; P.L. 112-175, the Continuing Appropriations Resolution, 2013; and P.L. 113-6, the Consolidated and Further Continuing Appropriations Act, 2013.

In FY2010, the program received \$1 million. In FY2011, FY2012, FY2013, and FY2014, Congress did not provide the program additional funding, noting that the Obama Administration had estimated that there were sufficient funds in the program's reserve to cover the cost of anticipated claim defaults.³⁷

As mentioned previously, the SBA relied primarily on increased appropriations to finance the program's expansion during the 1970s, but it also increased the program's fees charged to applicants and sureties. For example, in 1976, the SBA increased its fees to sureties to 20% from 10% of the bond premium, instituted a deductible clause on bond claims, and generally limited its approval for bid, participation, and performance bonds to \$250,000 unless specified circumstances were met.³⁸ In 1977, it increased the contractor applicant fee for payment and performance bonds to 0.5% from 0.2% of the contract price upon their obtaining the contract.³⁹ The program's current fee structure is discussed later in this report.

³⁷ U.S. Office of Management and Budget, *Budget of the U.S. Government, FY2012: Appendix, Small Business Administration*, p. 1163; U.S. Congress, House Committee on Small Business, *Views and Estimates of the Committee on Small Business on Matters to be set forth in the Concurrent Resolution on the Budget for Fiscal Year 2012*, 112th Cong., 1st sess., March 17, 2011 (Washington: GPO, 2011), pp. 5, 6, at http://smbiz.house.gov/UploadedFiles/March_17_Views_and_Estimates_Letter.pdf; and U.S. Office of Management and Budget, *Budget of the United States Government: FY2014: Appendix: Small Business Administration*, p. 1177.

³⁸ U.S. Small Business Administration, "Title 13 Business Credit and Assistance, Chapter 1 Small Business Administration, Part 115 - Surety Bond Guarantee Policy and Guarantee Fees," 41 *Federal Register* 16549-16550, April 20, 1976.

³⁹ U.S. Small Business Administration, "Guarantee Fees," 42 *Federal Register* 9397, February 16, 1977.

Rapid Growth Is Not Sustained

Both the number of final surety bonds guaranteed by the SBA each fiscal year and the amount guaranteed by the SBA increased relatively rapidly during the 1970s (see **Table A-1** in the Appendix). The number of final surety bonds guaranteed by the SBA increased from 1,339 in FY1972 to 20,095 in FY1979, and the amount guaranteed by the SBA increased from \$94.4 million in FY1972 to \$1.39 billion in FY1979.

During the 1980s and 1990s, both the number of final surety bonds guaranteed by the SBA each fiscal year and the amount guaranteed by the SBA generally declined, in both nominal and inflation-adjusted dollars. A review of congressional testimony during the 1980s and 1990s suggests that there was no single, discernible factor to account for the program's slow contraction over that time period. Because the demand for surety bonds tends to fluctuate with changes in the economy, the program might have been expected to contract somewhat during recessions, but the economy experienced periods of both economic growth and decline during the 1980s and 1990s. There also was no indication that the ability of small businesses to access surety bonds in the private marketplace without the SBA's assistance had materially improved, which, if that had been the case, might have contributed to the decline by reducing the number of small businesses applying for assistance.

One possible contributing factor to the decline in the number of final surety bonds guaranteed by the SBA during the 1980s and 1990s was the continuing reluctance of many surety companies to participate in the program, either because they did not view the program as particularly profitable or because they "had developed alternative methods to the program, such as requiring collateral or funds controls and underwriting programs based in part on credit scores, in order to write small and emerging contractors."⁴⁰ Another possible contributing factor was a change in the way the program was perceived by congressional leaders and in their willingness to provide additional resources necessary to continue the program's expansion.

During the 1970s, the program was uniformly praised by witnesses at congressional hearings as a great success in helping small businesses access surety bonds and compete for government contracts. During the 1980s and 1990s, congressional hearings focused less on the program's successes and more on its shortcomings. For example, in 1982, the chair of the Senate Committee on Small Business indicted that the program at that time was subject to "the most insidious types of fraud," including "evidence of involvement of organized crime figures."⁴¹ In addition, reports by both GAO and the SBA's inspector general had called into question the SBA's management of the program, arguing, among other things, that the SBA lacked useful underwriting guidelines for surety companies and adequate procedures for verifying information provided by applicants.⁴²

⁴⁰ U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Legislation Updating and Improving the SBA's Investment and Surety Bond Programs*, 110th Cong., 1st sess., September 6, 2007, Serial No. 110-44 (Washington: GPO, 2007), p. 64.

⁴¹ U.S. Congress, Senate Committee on Small Business, *Small Business Administration's Surety Bond Guarantee Program*, 97th Cong., 2nd sess., March 11, 1982 (Washington: GPO, 1982), pp. 1, 257, 258.

⁴² U.S. General Accounting Office, *The Surety Bond Guarantee Program: Significant Changes Are Needed In Its Management*, CED-80-34, December 27, 1979, at <http://archive.gao.gov/f0202/111534.pdf>; U.S. General Accounting Office, *Surety Bond Guarantee Program: Small Business Administration's Actions on Prior Program Recommendations*, GAO/RCED-86-183BR, September 18, 1986, at <http://archive.gao.gov/d4t4/131018.pdf>; U.S. General Accounting Office, *Small Business: Information on and Improvements Needed to Surety Bond Guarantee* (continued...)

During the 1980s, the SBA guaranteed, on average, 11,840 final surety bonds each fiscal year, with the SBA's share of those bonds' value averaging \$1.0 billion. During the 1990s, the SBA guaranteed, on average, 5,859 final surety bonds each fiscal year, with the SBA's share of those bonds' value averaging \$823 million. During the first decade of the 2000s, the SBA guaranteed, on average, about 1,802 final surety bonds each fiscal year, with the SBA's share of those bonds' value averaging about \$385 million.⁴³

Since then, the number and amount of final surety bonds guaranteed by the SBA has generally increased (see **Table 2** and **Table A-1**). For example, in FY2012, the SBA guaranteed 2,323 final surety bonds. The SBA's share of those bonds' value was \$625.3 million. In FY2013, the number and amount of final surety bonds guaranteed by the SBA increased, primarily because the SBA's maximum surety bond individual contract amount was increased from \$2.0 million to \$6.5 million, and up to \$10 million if a federal contracting officer certifies that such a guarantee is necessary. In FY2013, the SBA guaranteed 3,073 final surety bonds. The SBA's share of those bonds' value was just over \$1.0 billion.⁴⁴

The Preferred Surety Bond Guarantee Program

The surety bonding process begins when a contractor applies for a bond. As GAO has reported

Surety companies are generally corporations that are licensed under various insurance laws and, under their charters, have legal power to act as a surety (making themselves responsible for another's obligations) for others. Most surety companies accept business only through independent agents and brokers. In screening a bond applicant, a surety attempts to measure the contractor's ability to undertake and complete the job. When the surety's evaluation of the contractor's acceptability to perform the contract is favorable, the surety underwrites the bond. If the surety does not provide a bond to the bond applicant, the appropriate forms are forwarded to SBA for consideration of a surety bond guarantee.⁴⁵

(...continued)

Programs, GAO/RCED-91-99, April 23, 1991, at <http://archive.gao.gov/d20t9/143966.pdf>; U.S. Congress, House Committee on Small Business, Subcommittee on Procurement, Exports and Business Opportunities, *Small Business Administration's Surety Bond Guarantee Program*, 104th Cong., 1st sess., April 5, 1995, Serial No. 104-24 (Washington: GPO, 1995), pp. 252-307.

⁴³ U.S. Small Business Administration, "FY2003 Budget Request and Performance Plan," pp. 17, 19; U.S. Small Business Administration, "SBA Budget Request & Performance Plan, FY2004," pp. 3, 4; U.S. Small Business Administration, "Congressional Submission Fiscal Year 2005," p. 15; U.S. Small Business Administration, "Congressional Submission Fiscal Year 2006," pp. 19, 78; U.S. Small Business Administration, "FY2007 Congressional Budget Request and Performance Plan," pp. 25, 71; U.S. Small Business Administration, "FY2009 Congressional Budget Justification and FY207 Annual Performance Report," p. 65; U.S. Small Business Administration, "Fiscal Year 2010 Congressional Budget Justification," p. 46; U.S. Small Business Administration, "FY2011 Congressional Budget Justification and FY2009 Annual Performance Report," p. 46; U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, September 29, 2011; and U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 5, 2013.

⁴⁴ U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 11, 2012. In FY2011, the SBA guaranteed 1,863 final surety bonds. The SBA's share of those bonds' value was \$488.1 million. In FY2012, the SBA guaranteed 2,323 final surety bonds. The SBA's share of those bonds' value was \$625.3 million.

⁴⁵ U.S. General Accounting Office, *Small Business: Information on and Improvements Needed to Surety Bond Guarantee Programs*, GAO/RCED-91-99, April 23, 1991, p. 10, at <http://archive.gao.gov/d20t9/143966.pdf>.

Initially, the SBA surety guaranteed program's bonds were underwritten and issued by large, "standard" surety companies. However, the larger surety companies' participation in the program soon began to decline, reportedly because of the administrative burdens associated with the program, such as the SBA's requirement that sureties submit all bond applications to the SBA for its review and approval.⁴⁶ In addition, the administrative costs of dealing with relatively small bonds versus relatively large ones may have also played a role in the larger, standard surety companies leaving the program. As a congressional witness testified in 1976:

You have a professional underwriter, who ... is going to be asked to spend 3 or 4 days looking into a \$25,000 first-time application. There are many expenses involved. That same underwriter could very easily be writing four or five bonds for \$10 million for contractors that everyone knows can perform. And it becomes a matter of how much time and resources can the surety industry devote to this type of business.⁴⁷

Another contributing factor may have been the outbreak of the Israeli-Egyptian War in 1973, which was followed by a tripling of oil prices and double-digit inflation. This led to the failure of many smaller contracting companies. In response to the economic downturn, many surety companies enhanced their underwriting standards to protect themselves from rising defaults. As a result, many of the larger surety companies became increasingly reluctant to participate in a program in which the profit margins were relatively small given the required paperwork and the program's limitation on the bond amount, and when the risk of defaults was at a historically high level.⁴⁸

The void created by the departure of standard sureties from the program was filled by the expansion of "specialty" surety companies. Initially, specialty sureties devoted almost all their business exclusively to SBA-guaranteed surety bonds.⁴⁹ These companies later expanded their business into offering other high-risk bonds not normally handled by standard sureties. Specialty sureties typically required the contractor to provide collateral for the projects they bonded, and, in most cases, charged higher premiums than standard sureties.⁵⁰

In 1982, the SBA invited officials from the Surety Association of America, representing the standard surety companies, to suggest ways to encourage their participation in the program.⁵¹ As mentioned previously, at that time, some specialty surety companies had been accused of being associated with organized crime and GAO and the SBA's inspector general had reported the existence of fraud and mismanagement in the program. This may help to explain why the SBA was interested in encouraging the larger, more established surety companies to return to the

⁴⁶ Ibid., p. 11; U.S. Congress, Senate Select Committee on Small Business, *SBA Surety Bond Guarantee Program*, 96th Cong., 2nd sess., June 30, 1980 (Washington: GPO, 1980), p. 24; and S.Rept. 100-416, Small Business Administration Reauthorization and Amendments Act of 1988, p. 24.

⁴⁷ U.S. Congress, Senate Select Committee on Small Business, *Surety Bond and Lease Guarantee Programs of the Small Business Administration*, 94th Cong., 2nd sess., May 7, 1976 (Washington: GPO, 1976), pp. 15, 16.

⁴⁸ U.S. Congress, House Committee on Small Business, Subcommittee on SBA and SBIC Authority, Minority Enterprise, and General Small Business, *Surety Bond Guarantee Program*, 98th Cong., 1st sess., May 17, 1983 (Washington: GPO, 1983), p. 58.

⁴⁹ U.S. General Accounting Office, *Small Business: Information on and Improvements Needed to Surety Bond Guarantee Programs*, GAO/RCED-91-99, April 23, 1991, p. 10, at <http://archive.gao.gov/d20t9/143966.pdf>.

⁵⁰ Ibid., pp. 11, 12.

⁵¹ S.Rept. 100-416, Small Business Administration Reauthorization and Amendments Act of 1988, p. 24; and U.S. Congress, Senate Committee on Small Business, *S. 2259, The Preferred Surety Bond Guarantee Program Act of 1988*, 100th Cong., 2nd sess., April 12, 1988, S.Hrg. 100-692 (Washington: GPO, 1988), pp. 2, 101, 103, 125-127.

program. The SBA also hoped that greater participation by the larger sureties would lead to lower premiums for small business contractors.

During this outreach period, representatives of the standard surety companies indicated a willingness to increase their participation in the program if the SBA would create a second special program, similar to the Preferred Lenders Program already in place for the SBA's 7(a) loan guarantee program.⁵² Under the proposal, firms meeting specified qualification standards would be designed as a "preferred surety" and would not be required to seek the SBA's prior approval of each decision relating to the issuance and administration of a guaranteed bond. Instead, the SBA would only approve the firm's standards and procedures for bond underwriting and administration. The preferred surety's decisions would be subject to regular, annual audits and existing reporting and access to records requirements. As a measure of their confidence in their own underwriting standards and claims decisions, the standard surety firms indicated that they would accept a 70% guarantee against losses as opposed to the then allowed 80% or 90% guarantee against losses, as long as they would not be required to seek prior approval of their underwriting decisions, bond administration, and claims procedures from the SBA.⁵³

Congress subsequently authorized the proposed Preferred Surety Bond Guarantee Program in P.L. 100-590, the Small Business Administration Reauthorization and Amendment Act of 1988 (Title II, the Preferred Surety Bond Guarantee Program Act of 1988). The program was initially authorized on a three year trial basis. The program was provided permanent statutory authority by P.L. 108-447, the Consolidated Appropriations Act, 2005.

Small Business Eligibility Standards and Program Requirements

The SBA is authorized to guarantee surety bonds issued to contractors or subcontractors when

- the business, together with its affiliates, meets the SBA's size standard for the primary industry in which it is engaged;⁵⁴
- the bond is required;
- the applicant is not able to obtain such bond on reasonable terms and conditions without a guarantee; and
- there is a reasonable expectation that the applicant will perform the covenants and conditions of the contract, and the terms and conditions of the bond are

⁵² For information concerning the Preferred Lenders Program see CRS Report R41146, *Small Business Administration 7(a) Loan Guaranty Program*, by Robert Jay Dilger.

⁵³ U.S. General Accounting Office, *Small Business: Information on and Improvements Needed to Surety Bond Guarantee Programs*, GAO/RCED-91-99, April 23, 1991, p. 12, at <http://archive.gao.gov/d20t9/143966.pdf>, and S.Rept. 100-416, Small Business Administration Reauthorization and Amendments Act of 1988, pp. 24-25.

⁵⁴ U.S. Small Business Administration, "Surety Bond Guarantee Program; Size Standards," 76 Federal Register 48549, August 11, 2010. In addition, for any contract or subcontract, public or private, to be performed in the Presidentially-declared disaster areas resulting from the 2005 Hurricanes Katrina, Rita or Wilma, a construction (general or special trade) concern or concern performing a contract for services is small if it meets the size standard set forth in paragraph (d)(1) of this section, or the average annual receipts of the concern, together with its affiliates, do not exceed \$7.0 million, whichever is higher. 13 C.F.R. §121.301(d)(2).

reasonable in light of the risks involved and the extent of the surety's participation.⁵⁵

The applicant must also "possess good character and reputation," as demonstrated by (1) not being under indictment, being convicted of a felony, or having a final civil judgment stating that the applicant has committed a breach of trust or has violated a law or regulation protecting the integrity of business transactions or business relationships; (2) not having a regulatory authority revoke, cancel, or suspend a license held by the applicant which is necessary to perform the contract, and (3) never having obtained a bond guarantee by fraud or material misrepresentation or failing to keep the surety informed of unbonded contracts or of a contract bonded by another surety.⁵⁶

Applicants must also certify the percentage of work under the contract to be subcontracted. The SBA does not guarantee bonds for applicants that are primarily brokers or who have effectively transferred control over the project to one or more subcontractors.⁵⁷ The applicant must also certify that they are not presently debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from transactions with any federal department or agency.⁵⁸ Also, the SBA will not guarantee a bond issued by a particular surety if that surety, an affiliate of that surety, or a close relative or member of the household of that surety or affiliate owns, directly or indirectly, 10% or more of the business applying for the guarantee. This conflict of interest prohibition also applies to ownership interests in any of the applicant's affiliates.⁵⁹

As mentioned previously, the SBA guarantees contracts up to \$6.5 million, and up to \$10 million if a federal contracting officer certifies that such a guarantee is necessary.⁶⁰ There is no limit to the number of bonds that can be guaranteed for any one contractor.

The SBA may guarantee up to 70% of the loss incurred and paid by a surety issued under the Preferred Surety Bond Guarantee Program.⁶¹ Under the SBA's original Prior Approval Program, the SBA may guarantee up to 90% of the loss incurred if the contract is \$100,000 or less, or if the bond was issued on behalf of a small business owned and controlled by socially and economically disadvantaged individuals, a qualified HUBZone small business, a small business owned and controlled by veterans, or a small business owned and controlled by a service-disabled veteran.

⁵⁵ 15 U.S.C. §694b(a)(4).

⁵⁶ 13 C.F.R. §115.13(a)(2).

⁵⁷ 13 C.F.R. §115.13(a)(5).

⁵⁸ 13 C.F.R. §115.13(a)(6).

⁵⁹ 13 C.F.R. §115.13(a)(6)(b).

⁶⁰ Prior to enactment of P.L. 112-239, which increased the surety bond limit from \$2 million, P.L. 110-246, the Food, Conservation, and Energy Act of 2008, §12079. Small Business Bonding Threshold, had provided the SBA authority, provided that funding was appropriated for this purpose, to guarantee within specified time frames (typically within 12 months following a major disaster declaration) contracts up to \$5 million for non-federal contracts or orders if the product will be manufactured or the services will be performed in a major disaster area as identified in the Federal Emergency Management Administration's (FEMA's) website; and up to \$5 million for federal contracts or orders under those circumstances or if the products will be manufactured or the services will be provided outside the major disaster area and the products or services will directly assist in the recovery efforts in the major disaster area. The SBA was also authorized to issue a guarantee of up to \$10 million on a federal contract if the contract meets any of the conditions above and is requested by the head of the agency involved in disaster reconstruction efforts. See U.S. Small Business Administration, "Surety Bond Guarantee Program; Disaster and Miscellaneous Amendments," *76 Federal Register* 2571, January 14, 2011.

⁶¹ 13 C.F.R. §115.68.

The guarantee rate is 80% under the Prior Approval Program if the contract is greater than \$100,000, and the business is not owned and controlled by socially and economically disadvantaged individuals, a qualified HUBZone small business, a veteran-owned or a service-disabled veteran-owned small business.⁶²

The SBA does not charge principals (small business applicants) application or bid bond guarantee fees. If the SBA guarantees a final bond, the principal must pay a guarantee fee equal to a percentage of the contract amount, which is determined by the SBA and published in notices in the *Federal Register*.⁶³ The current rate is 0.729% of the contract price for a final bond.⁶⁴ The principal's fee is rounded to the nearest dollar, paid to the surety, and the surety remits the fee to the SBA.⁶⁵

Sureties also charge principals a premium for issuing and servicing the bond. Sureties are not allowed to charge principals a premium that is more than the amount permitted under applicable state law.⁶⁶ On average, a small business will pay around \$19,000 for a \$500,000 contract.⁶⁷

Surety Eligibility Standards and Program Requirements

Sureties interested in participating in the Prior Approval Program or the Preferred Surety Bond Guarantee Program must apply in writing to the SBA. Each applicant must be a corporation listed by the U.S. Treasury as eligible to issue bonds in connection with federal procurement contracts.⁶⁸

The SBA considers several factors when considering sureties for the Preferred Surety Bond Guarantee Program. For example,

- the surety must have an underwriting limitation of at least \$2 million on the U.S. Treasury Department's list of acceptable sureties;

⁶² 13 C.F.R. §115.31. Under the Prior Approval Program, if the contract amount increases to more than \$100,000 after execution of the bond, the guarantee percentage decreases by one percentage point for each \$5,000 of increase or part thereof, but it does not decrease below 80%. If the contract or order is increased above the statutory limit after execution of the bond, the SBA's share of the loss is limited to that percentage of the increased contract or order amount that the applicable statutory limit represents multiplied by the guarantee percentage approved by the SBA. For example, if a contract amount increases to \$2.1 million, the SBA's share of the loss under an 80% guarantee is limited to 76.1% [$2,000,000/2,100,000=95.2\% \times 80\%=76.1\%$]. If the contract or order amount decreases to \$100,000, or less, after execution of the bond, the SBA's guarantee increases to 90% if the surety provides the SBA with evidence supporting the decrease.

⁶³ C.F.R. §115.32.

⁶⁴ U.S. Small Business Administration, "Surety Bond Guarantee Program Fee," 76 *Federal Register* 9632, February 24, 2006; and U.S. Small Business Administration, "Surety Bonds: The Basics," at <http://www.sba.gov/content/surety-bonds-basics>.

⁶⁵ 13 C.F.R. §115.32.

⁶⁶ U.S. Small Business Administration, "Surety Bond Guarantee Program-Preferred Surety Qualification, Increased Guarantee for Veteran and Service-Disabled Veteran-Owned Business," 72 *Federal Register* 34598, June 25, 2007.

⁶⁷ U.S. Small Business Administration, "Surety Bonds: Insurance and Reassurance for the Construction Industry," May 6, 2011.

⁶⁸ 13 C.F.R. §115.11.

- the surety must agree that it will neither charge a bond premium in excess of that authorized by the appropriate state insurance department nor impose any non-premium fee unless such fee is permitted by applicable state law and approved by the SBA;
- the surety's premium income from contract bonds guaranteed by any government agency (federal, state, or local) can account for no more than one-quarter of the surety's total contract bond premium income; and
- the surety must vest the underwriting authority for SBA guaranteed bonds to its own employees, and it must vest final settlement authority for claims and recovery to employees in the surety's permanent claims department.⁶⁹

The SBA will also take into consideration the surety's rating or ranking designation that is assigned to the surety by a recognized authority.⁷⁰ Sureties participating in the Preferred Surety Bond Guarantee Program are not eligible to participate in the Prior Approval Program. However, this prohibition does not apply to the surety's affiliates provided that the affiliate is not a participant in the Preferred Program and the relationship between the affiliate and the surety has been fully disclosed to the SBA and the affiliate has been approved by the SBA to participate in the Prior Approval Program.⁷¹

In the Prior Approval Program, the surety must obtain the SBA's approval before issuing a guaranteed bond. Sureties participating in the Preferred Surety Bond Guarantee Program may issue, monitor, and service SBA guaranteed bonds without SBA approval.⁷² However, sureties participating in the Preferred Program must notify the SBA electronically of all bonds issued and, for final bonds, the surety must report and submit to the SBA on a monthly basis all contractor and surety fees that are due.⁷³ These sureties are also subject to a periodic maximum guarantee authority amount set by the SBA.⁷⁴

The terms and conditions of the SBA's bond guarantee agreements with the surety, including the guarantee percentage, may vary from surety to surety, depending on past experience with the SBA. The SBA may take into consideration, among other things, the rating or ranking assigned to the surety by recognized authorities, the surety's loss rate, average contract amount, average bond penalty per guaranteed bond, and the ratio of bid bonds to final bonds, all in comparison with other sureties participating in the same SBA Surety Bond Guarantee Program (Prior Approval Program or Preferred Surety Bond Guarantee Program).⁷⁵

Sureties are required, among other things, to

- evaluate the credit, capacity, and character of a principal using standards generally accepted by the surety industry and in accordance with the SBA's

⁶⁹ 13 C.F.R. §115.60.

⁷⁰ Ibid.

⁷¹ 13 C.F.R. §115.62.

⁷² 13 C.F.R. §115.12.

⁷³ U.S. Small Business Administration, "Bond Guarantee Application – Surety Company/Agent," at <http://www.sba.gov/content/bond-guarantee-application%E2%80%93surety-companyagent>.

⁷⁴ 13 C.F.R. §115.63.

⁷⁵ 13 C.F.R. §115.12.

- Standard Operating Procedures on underwriting and the surety's principles and practices on unguaranteed bonds;
- reasonably expect that the principal will successfully perform the contract to be bonded;
 - provide bond terms and conditions that are reasonable in light of the risks involved and the extent of the surety's participation;
 - be satisfied as to the reasonableness of cost and the feasibility of successful completion of the contract;
 - ensure that the principal remains viable and eligible for the program;
 - monitor the principal's progress on guaranteed contracts; and
 - maintain documentation of job status requests;
 - take all reasonable action to minimize risk of loss, including, but not limited to, obtaining from each principal a written indemnity agreement, secured by such collateral as the surety or the SBA finds appropriate, which covers actual losses under the contract and imminent breach payments; and
 - in the case of loss, the surety must pursue all possible sources of salvage and recovery.⁷⁶

Sureties participating in the program are subject to audits by examiners selected and approved by the SBA. Sureties participating in the Prior Approval Program are audited at least once each year and sureties participating in the Preferred Surety Bond Guarantee Program are audited at least once every three years.⁷⁷

The SBA does not charge sureties or small businesses application or bid bond guarantee fees. The surety pays the SBA a guarantee fee on each guaranteed bond (other than bid bonds) within 60 days calendar days after the SBA's approval of the prior approval payment or performance bond. The fee is equal to a percentage of the bond premium which is determined by the SBA and published in notices in the *Federal Register*.⁷⁸ The current rate is 26% of the fee charged by the surety company to the small business.⁷⁹ The fee is rounded to the nearest dollar.⁸⁰ The SBA does not receive any portion of a surety's non-premium charges.

Program Statistics

As shown in **Table 2**, the number and amount of bid bonds guaranteed by the SBA has generally increased in recent years. For example, in FY2007, the SBA guaranteed 4,192 bid bonds totaling

⁷⁶ 13 C.F.R. §115.15; and 13 C.F.R. §115.17. Imminent breach is a threat to the successful completion of a bonded contract which, unless remedied by the surety, makes a default under the bond appear to be inevitable. 13 C.F.R. §115.10.

⁷⁷ 13 C.F.R. §115.21.

⁷⁸ C.F.R. §115.32.

⁷⁹ U.S. Small Business Administration, "Surety Bond Guarantee Program Fee," 76 *Federal Register* 9632, February 24, 2006.

⁸⁰ 13 C.F.R. §115.32.

\$1.7 billion. In FY2013, the SBA guaranteed 9,793 bid bonds totaling \$4.9 billion. The increased number and amount of bid bonds guaranteed by the SBA in recent years may reflect recent economic conditions, in which many small businesses eager to secure additional work are increasingly seeking SBA surety bid bond assistance, but are not necessarily winning the contract.

As shown in **Table 2**, the number and amount of final bonds guaranteed by the SBA declined somewhat from FY2007 through FY2009, and has generally increased since FY2009. These increases coincided with the passage of P.L. 111-5, which temporarily increased, from February 17, 2009, through September 30, 2010, the program's maximum individual contract amount from \$2 million to \$5 million, and up to \$10 million if a federal contracting officer certifies that such a guarantee is necessary; and P.L. 112-239, which increased the program's maximum individual contract amount from \$2 million to \$6.5 million, and up to \$10 million if a federal contracting officer certifies that such a guarantee is necessary.

Table 2. Number and Amount of SBA Guaranteed Bid Bonds and Final Bonds, FY2007-FY2013

(\$ in billions)

Fiscal Year	Bid Bonds (# and \$)		Final Bonds (# and \$)	
2007	4,192	\$1.70	1,617	\$0.55
2008	4,479	\$1.92	1,576	\$0.54
2009	4,915	\$2.30	1,220	\$0.47
2010	6,760	\$3.39	1,588	\$0.61
2011	6,775	\$3.00	1,863	\$0.61
2012	7,180	\$3.10	2,323	\$0.78
2013	9,793	\$4.90	3,073	\$1.20

Source: U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 5, 2013.

As shown in **Table 3**, excluding program costs of about \$6.2 million annually, the program has experienced a net positive cash flow in each of the past six fiscal years. For example, in FY2013, the program collected \$16.2 million from fees and recoveries, paid out \$4.7 million for claims, and had a net gain of \$11.5 million.⁸¹ There is about \$61 million in the Surety Bond Guarantee Program Revolving Fund.⁸²

⁸¹ U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 5, 2013.

⁸² U.S. Office of Management and Budget, *Budget of the United States Government: FY2014: Appendix: Small Business Administration*, p. 1177.

Table 3. Surety Bond Guarantee Program, Net Cash Flow
(excluding program costs of about \$6.2 million annually)

Fiscal Year	Fees and Recoveries Collected	Claims Paid	Net Cash Flow
2007	\$8.3 million	\$5.2 million	\$3.1 million
2008	\$7.3 million	\$6.6 million	\$0.7 million
2009	\$7.8 million	\$6.0 million	\$1.8 million
2010	\$9.2 million	\$4.3 million	\$4.9 million
2011	\$8.9 million	\$5.8 million	\$3.1 million
2012	\$10.5 million	\$8.0 million	\$2.5 million
2013	\$16.2 million	\$4.7 million	\$11.5 million

Sources: U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, March 24, 2011; Office of Congressional and Legislative Affairs, correspondence with the author, December 15, 2011; Office of Congressional and Legislative Affairs, correspondence with the author, December 5, 2012; and Office of Congressional and Legislative Affairs, correspondence with the author, December 5, 2013.

Historically, the program's default rate has averaged about 2%.⁸³ According to the SBA, on average, the default rate on larger contracts tends to be lower than for smaller contracts and the recovery rate for larger contract defaults tends to be greater than for smaller contract defaults.⁸⁴

There are currently 17 sureties participating in the Prior Approval Program and 4 sureties participating in the Preferred Surety Bond Guarantee Program.⁸⁵ Agents empowered to represent a participating surety company are located, or licensed, in all 50 states, American Samoa, the District of Columbia, Guam, the Marshall Islands, Micronesia, the Northern Mariana Islands, Palau, Puerto Rico, and the Virgin Islands.⁸⁶

⁸³ The default rate was 3.7% in FY2011, 3.1% in FY2012, and 1.59% in FY2013. U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, September 29, 2011; U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 11, 2012; and U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 5, 2013.

⁸⁴ U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 5, 2012. The SBA also reports that there is no significant difference in the loss rates for the Surety Bond Guarantee Program and the Prior Approval program. U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 5, 2013.

⁸⁵ U.S. Small Business Administration, "Participating Surety Companies and Agents," at <http://www.sba.gov/content/list-participating-surety-companies-agents>.

⁸⁶ U.S. Small Business Administration, "Participating Surety Company/Agent Search," at http://web.sba.gov/orasbgpub/dsp_welcome.cfm.

Congressional Issues: Bond Limits

111th Congress

P.L. 111-5, the American Recovery and Reinvestment Act of 2009 (ARRA), provided the program an additional appropriation of \$15 million and temporarily increased, from February 17, 2009, through September 30, 2010, the maximum bond amount from \$2 million to \$5 million.⁸⁷ The act also authorized the SBA to guarantee a bond of up to \$10 million if a federal contracting officer certified in writing that a guarantee in excess of \$5 million was necessary.⁸⁸ It also revised the program's size standard to "the size standard for the primary industry in which such business concern, and the affiliates of such business concern, is engaged, as determined by the Administrator in accordance with the North American Industry Classification System."⁸⁹ The new size standard (e.g., up to \$33.5 million in average annual receipts over the previous three years for general building and heavy construction contractors, and up to \$14.0 million in average annual receipts over the previous three years for specialty trade contractors) increased the number of businesses that qualified for the program.⁹⁰ Using its rulemaking authority, the SBA made ARRA's temporary size standard permanent on August 11, 2010.⁹¹

Proponents argued that the increased bond limit and size were necessary to "ensure that small businesses are able to secure the surety bonds they need to compete for contracts, grow, and hire more employees."⁹² They also argued that "in our current economic recession, small businesses are finding it even more difficult to secure the credit lines necessary to get bonds in the private sector."⁹³ In their view, the temporary changes would create "significant opportunities to create

⁸⁷ The temporary higher maximum limit did not apply if the statement of work involved, directly or indirectly, construction, operation, renovation or improvement of a casino or other gambling establishment, aquarium, zoo, golf course, or swimming pool. 13 C.F.R. §115.12.

⁸⁸ The contracting officer's certification had to include a statement that the small business was experiencing difficulty obtaining a bond and that an SBA bond guarantee would be in the best interests of the government. 13 C.F.R. §115.13.

⁸⁹ P.L. 111-5, §508. Surety Bonds. The program's size standard at that time had three parts: up to \$7 million in average annual receipts for any construction (general or special trade) business, together with its affiliates; any other business had to meet the size standard for the primary industry in which it, combined with its affiliates, was engaged; and for any contract or subcontract, public or private, to be performed in the presidentially-declared disaster areas resulting from the 2005 Hurricanes Katrina, Rita or Wilma, a construction (general or special trade) business performing a contract for services was small if it met either of the above conditions, whichever was higher. 13 C.F.R. §121.301.

⁹⁰ U.S. Small Business Administration, "Table of Small Business Size Standards," at <http://www.sba.gov/content/table-small-business-size-standards>. Land subdivision contractors may have up to \$7 million in average annual receipts over the previous three years and dredging and surface cleanup contractors may have up to \$20 million in average annual receipts over the previous three years.

⁹¹ U.S. Small Business Administration, "Surety Bond Guarantee Program; Size Standards," 76 *Federal Register* 48549, August 11, 2010. In addition, for any contract or subcontract, public or private, to be performed in the presidentially declared disaster areas resulting from the 2005 Hurricanes Katrina, Rita or Wilma, a construction (general or special trade) concern or concern performing a contract for services is small if it meets the size standard set forth in paragraph (d)(1) of this section, or the average annual receipts of the concern, together with its affiliates, do not exceed \$7.0 million, whichever is higher. 13 C.F.R. §121.301(d)(2).

⁹² Senator Olympia Snowe, "Consideration of H.R. 1 American Recovery and Reinvestment Act of 2009," Senate debate, *Congressional Record*, vol. 155, no. 22 (February 4, 2009), p. S1485.

⁹³ *Ibid.*

jobs now in which small businesses will participate and be the driving engine for creation of new jobs in our country.”⁹⁴

There was no apparent organized opposition to these specific temporary changes to the Surety Bond Guarantee Program. However, there was opposition to ARRA’s package of program enhancements for the SBA as a whole, which among other things, provided the SBA \$730 million in additional funding, including \$255 million for a temporary, two-year small business stabilization program to guarantee loans of \$35,000 or less to small businesses for qualified debt consolidation, later named the America’s Recovery Capital (ARC) Loan program and \$375 million to temporarily subsidize fees for the SBA’s 7(a) and 504/CDC loan guaranty programs and increase the 7(a) program’s maximum loan guaranty percentage to 90%. Instead of modifying the SBA’s program requirements and increasing the SBA’s appropriation, opponents advocated business tax reduction, reform of financial credit market regulation, and federal fiscal restraint as the best means to assist small businesses, generate economic growth, and create jobs.⁹⁵

112th Congress

On September 12, 2011, the Obama Administration advocated, as part of its proposed American Jobs Act, a temporary increase in the SBA surety bond limit to \$5 million until the end of FY2012. The Administration argued that raising the program’s bond limit “will make it easier for small businesses to take advantage of contracting opportunities generated by the American Jobs Act’s proposed infrastructure investments.”⁹⁶

On December 7, 2012, the Administration also recommended, as part of its request for an additional \$60.4 billion in federal resources to address damage caused by Hurricane Sandy, that the SBA surety bond limit be increased to \$5 million to enable “more small businesses to participate in the recovery efforts.”⁹⁷

There were several legislative efforts during the 112th Congress to increase the program’s bond limit. S. 1334, the Expanding Opportunities for Main Street Act of 2011, and its companion bill in the House, H.R. 2424, would have reinstated and made permanent ARRA’s higher limits (up to \$5 million and up to \$10 million if a federal contracting officer certifies in writing that a guarantee in excess of \$5 million is necessary). Neither of these bills was reported by a committee for consideration by the House or the Senate.

S. 1660, the American Jobs Act of 2011, and its companion bill in the House, H.R. 12, would have provided \$3 million in additional funding to pay for the cost of temporarily increasing the program’s bond limit to \$5 million from \$2 million until the end of FY2012. Cloture on a motion to proceed to S. 1660 was not invoked in the Senate on October 11, 2011, by a vote of 50 to 49. H.R. 12 was not reported by a committee for consideration in the House.

⁹⁴ Senator Benjamin Cardin, “Stimulus Package Report,” Senate debate, *Congressional Record*, vol. 155, no. 30 (February 13, 2009), p. S2283.

⁹⁵ For further information and analysis of the small business provisions in P.L. 111-5, see CRS Report R40985, *Small Business: Access to Capital and Job Creation*, by Robert Jay Dilger.

⁹⁶ The White House, “Section-by-Section Analysis and Explanation of the American Jobs Act of 2011,” September 12, 2011, at <http://www.whitehouse.gov/blog/2011/09/12/president-obama-sends-american-jobs-act-congress>.

⁹⁷ Jeffrey D. Zients, Deputy Director for Management, U.S. Office of Management and Budget, “Letter sent to the Honorable Harry Reid, Majority Leader of the Senate,” December 7, 2012, p. 59.

On December 12, 2012, the Senate Committee on Appropriations released its draft of the Hurricane Sandy Emergency Assistance Supplemental bill. It included a provision to increase the program's bond limit to \$5 million.⁹⁸ This provision was later removed following congressional approval of H.R. 4310, the National Defense Authorization Act for Fiscal Year 2013, which became law (P.L. 112-239) on January 2, 2013. It increased the program's bond limit to \$6.5 million, and up to \$10 million if a federal contracting officer certifies that such a guarantee is necessary.

113th Congress

In a related effort to enhance surety participation the program, H.R. 776, the Security in Bonding Act of 2013, introduced and referred to the House Committee on the Judiciary and the House Committee on Small Business on February 15, 2013, would increase the surety bond program's minimum guaranty to 90% from 70%.⁷ No further action, to date, has been taken on the bill.

Discussion: Bond Limits

There was relatively little discussion in the legislative record concerning the reasons for increasing the surety bond program's bond limits, and even less discussion of the reasons for not increasing the limits.⁹⁹ There was no apparent organized opposition to raising the program's bond limits on a temporary basis under ARRA. Hearings were not held on S. 1334 and H.R. 2424. Also, only one witness during hearings on H.R. 4310 addressed the SBA surety bond program. That witness supported an increase in the surety bond limit to \$5 million, and up to \$10 million if a federal contracting officer certifies that such a guarantee is necessary.¹⁰⁰

Advocates of raising the program's bond limits argued that the limits should be raised to bring them more in line with the contracting amounts for other small business programs, such as the 8(a) Minority Small Business and Capital Ownership Development Program, the Historically Underutilized Business Zone (HUBZone) Program, the Women-Owned Small Business Federal Contract program, and the Service-Disabled Veteran-Owned Small Business Concerns Program.¹⁰¹ For example, under 8(a) Minority Small Business and Capital Ownership

⁹⁸ U.S. Senate, Committee on Appropriations, "Text of Hurricane Sandy Supplemental," December 12, 2012, §5501, p. 24, at <http://www.appropriations.senate.gov/news.cfm?method=news.view&id=0f718f5d-c9e1-49a1-9b5a-33a313bb423d>.

⁹⁹ See U.S. Congress, House Committee on Armed Services, Panel on Business Challenges Within the Defense Industry, *Doing Business With DOD: Unique Challenges Faced by Small and Mid-Sized Businesses*, 112th Cong., 2nd sess., January 17, 2012, HASC No. 112-94 (Washington: GPO, 2012), pp. 48-55. In 2007, the SBA supported a legislative effort to increase the program's bond limit to \$3 million as a means to increase the program's use. U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Legislation Updating and Improving the SBA's Investment and Surety Bond Programs*, 110th Cong., 1st sess., September 6, 2007, Serial No. 110-44 (Washington: GPO, 2007), p. 55.

¹⁰⁰ U.S. Congress, House Committee on Armed Services, Panel on Business Challenges Within the Defense Industry, *Doing Business With DOD: Unique Challenges Faced by Small and Mid-Sized Businesses*, 112th Cong., 2nd sess., January 17, 2012, HASC No. 112-94 (Washington: GPO, 2012), p. 52.

¹⁰¹ For further information and analysis of small business contracting programs see CRS Report R41945, *Small Business Set-Aside Programs: An Overview and Recent Developments in the Law*, by Kate M. Manuel and Erika K. Lunder, CRS Report R40744, *The "8(a) Program" for Small Businesses Owned and Controlled by the Socially and Economically Disadvantaged: Legal Requirements and Issues*, by Kate M. Manuel, and CRS Report R41268, *Small Business Administration HUBZone Program*, by Robert Jay Dilger.

Development Program federal contracting officials may provide a sole source award to a 8(a) small business if the anticipated award price of the contract will not exceed \$6.5 million for manufacturing contracts or \$4.0 million for other contract opportunities, and the contracting officer believes that the award can be made at a fair and reasonable price.¹⁰² Advocates argued that increasing the surety bond program's bond limit would provide more consistency across small business contracting programs and make it easier for some agencies that have experienced some difficulty issuing contracts in increments of \$2 million or less (e.g., the Department of Defense, the General Services Administration, and the Department of State) to increase their participation in the program.¹⁰³

Advocates also argued that small businesses awarded contracts under these other small business contracting programs that exceed the surety bond program's \$2 million limit could be at risk of not being able to complete those contracts due to difficulties related to securing a surety bond. For example, the House Committee on Armed Services' Panel on Business Challenges in the Defense Industry has argued that the SBA surety bond program's limit should be increased to \$6.5 million to match the 8(a) program's \$6.5 million threshold for manufacturing contracts and to "increase the opportunities for small businesses to compete for federal contracts, especially in those departments, such as the Department of Defense, where the average size of construction contracts awarded to small businesses for FY2010 exceeded \$5.9 million – nearly triple the size for which SBA can provide bonding support."¹⁰⁴

There was no organized opposition to raising the program's bond limits. One possible argument that could have been raised against raising the limits is that higher limits could lead to higher amounts being guaranteed by the SBA and, as a result, increase the risk of program losses. However, the SBA's experience with Recovery Act bonds (over \$2 million) suggests that raising the limit may not lead to an increased risk of program losses. The SBA reported that the program's default rate on Recovery Act bonds was lower, in 2009 and 2010, than for its other bonds. The SBA guaranteed 166 Recovery Act bid bonds valued at \$518.0 million and 52 Recovery Act final bonds valued at \$145.4 million. There were two defaults, with a bond value of \$2.7 million and \$2.2 million, respectively.¹⁰⁵

Congressional Issues: Program Structure

The SBA has reported that it is focusing on "strengthening relationships with individual surety companies and the large network of bond agents and producers across the country in order to reach more small businesses in need of bonding."¹⁰⁶ As part of this outreach effort, the SBA has

¹⁰² 13 C.F.R. §124.506; 48 C.F.R. §19.1306(a)(1)-(6) (increasing the price thresholds, among other things); and Department of Defense, General Services Administration, and National Aeronautics and Space Administration, "Federal Acquisition Regulation: Inflation Adjustment of Acquisition-Related Thresholds," *75 Federal Register* 53129, August 30, 2010.

¹⁰³ U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, March 31, 2011.

¹⁰⁴ U.S. Congress, House Committee on Armed Services, Panel on Business Challenges Within the Defense Industry, *Challenges to Doing Business with the Department for Defense*, Findings of the Panel on Business Challenges in the Defense Industry, 112th Cong., 2nd sess., March 19, 2012 (Washington: GPO, 2012), pp. 18-19.

¹⁰⁵ U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 5, 2012.

¹⁰⁶ U.S. Small Business Administration, "FY2012 Congressional Budget Justification and FY2010 Annual Performance (continued...)"

reported that it will continue to emphasize “process improvements that will streamline the application requirements for small businesses and surety companies and their agents.”¹⁰⁷ For example, in August 2012, the SBA announced a “Quick APP” for surety bonds under \$250,000 which provides a streamlined application process by combining “two applications into one to make it easier and faster for small businesses and contractors, including veteran-owned small businesses, to compete for contracts.”¹⁰⁸

One of the proposed means to streamline the application requirements for surety companies and their agents that the SBA is considering is to combine the Prior Approval Program and Preferred Surety Bond Guarantee Program into a single program featuring the streamlined bond approval and monitoring processes under the Preferred Program. Several industry groups, including the National Association of Surety Bond Producers and The Surety & Fidelity Association of America, have recommended that the programs be merged, the emphasis on reduced regulatory burdens under the Preferred Program be maintained, and the program’s fees kept as low as economically feasible as a means to encourage more sureties to participate in the program.¹⁰⁹

Perhaps because the proposal has not been formally introduced as a bill, there are no public statements opposing the merger of the two programs. Opposition might come from those who are not convinced that the Surety Bond Guarantee Program is necessary to supplement the private market for surety bonds and would prefer that the program be eliminated rather than reformed, or from those who believe that a federal program is necessary to supplement the private market for surety bonds, but the existing program is sufficient to meet that need and does not require changes to encourage its expansion. Other opponents might argue that providing additional authority to sureties to approve and monitor bonds might increase the risk of defaults and program losses.

Concluding Observations

Throughout the program’s history, both congressional testimony and GAO examinations have indicated that smaller contracting firms, and especially minority-owned and women-owned small business contracting firms, often have a more difficult time accessing surety bonds in the private marketplace than larger firms. For example, in 1995, GAO reported that “it is not unusual for a small construction company to have some difficulty in obtaining a surety bond.”¹¹⁰ GAO found that about one in three of the smallest contracting firms it surveyed at that time, compared with

(...continued)

Report,” p. 40, at http://www.sba.gov/sites/default/files/FINAL%20FY%202012%20CBJ%20FY%202010%20APR_0.pdf.

¹⁰⁷ Ibid.

¹⁰⁸ Interagency Task Force on Veterans Small Business Development, “Heroes on the Home Front: Supporting Veteran Success as Small Business Owners,” pp. 5, 10 at http://www.sba.gov/sites/default/files/files/Veterans_Report_FINAL.pdf.

¹⁰⁹ National Association of Surety Bond Producers and The Surety & Fidelity Association of America, “Revitalizing the SBA Bond Guarantee Program,” Washington, DC, May 24, 2010.

¹¹⁰ U.S. General Accounting Office, *Small Business: Construction Firms’ Access to Surety Bonds*, GAO/RCED-95-173FS, June 26, 1995, p. 1, at <http://www.gao.gov/archive/1995/rc95173f.pdf>.

about one in six of the larger contracting firms it surveyed, reported that they were required to provide collateral.¹¹¹ GAO also reported

The experiences of the minority-owned firms differed from those of the firms not owned by minorities in several areas. For example, these firms were more likely to be asked to provide certain types of financial documentation, as well as to provide collateral or to meet other conditions; were more likely to be denied a bond and to report losing an opportunity to bid because of delays in processing their request for a bond; and were more likely to depend on jobs requiring bonds for a higher proportion of their revenues.

The women-owned firms differed from the firms not owned by women in a few key respects. For example, they ... were more likely to be asked to provide more types of financial or other documentation to obtain a bond.

In addition, the minority-owned firms reported more often than the firms not owned by minorities that they had to (1) establish an escrow account controlled by the surety company, (2) hire a CPA or a management or consulting firm selected by the surety company to manage the contract, and (3) enter into an arrangement that allows the surety company to manage the job even when the firm is not in default.¹¹²

Although congressional testimony and GAO examinations have supported the need for a program like the SBA's Surety Bond Guarantee Program, that testimony and GAO's surveys of businesses have been somewhat less useful in helping Congress determine the appropriate size for the program. For example, a review of congressional hearings since the program's inception suggests that congressional witnesses representing the surety companies and various construction organizations, including minority-owned small contracting businesses, have focused their testimony on the need to reduce the SBA's paperwork requirements, which are designed to prevent fraud but increase the sureties' costs; keep the program's fees as low as possible; and keep the program's guarantee rates as high as possible. The SBA's testimony has tended to focus on the need to attract more sureties to the program so that it can reverse the slow downward trajectory the program has experienced over the past two decades in the number and amount of final bonds guaranteed. There has been relatively little testimony provided concerning the broader issue of how large the program should be relative to the private sector and what measures or metrics might be used to help make that determination.

One possible starting point for determining how large the program should be relative to the private sector is to examine congressional testimony concerning the supply and demand for sureties in the private sector. That testimony suggests that the supply and demand for sureties tends to fluctuate with changes in the overall economy, with the supply of sureties contracting during economic recessions and expanding during economic expansions and the demand for sureties slowing during economic recessions and increasing during economic expansions.¹¹³ It could be argued that federal policies could take these fluctuations into account—enacting policies that expand federal support for surety guarantees when supply is tight and reducing federal support for surety guarantees when supplies are more plentiful. Of course, when making these determinations it is necessary to first establish measures or metrics to determine current market

¹¹¹ Ibid., p. 27.

¹¹² Ibid., pp. 19, 20, 29.

¹¹³ U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Legislation Updating and Improving the SBA's Investment and Surety Bond Programs*, 110th Cong., 1st sess., September 6, 2007, Serial No. 110-44 (Washington: GPO, 2007), p. 64.

conditions. Also, this line of reasoning assumes that having a federal presence in the surety marketplace is desirable, an assumption not held by all. Ultimately, while having established measures or metrics concerning the supply and demand for surety bonds might be helpful in determining the appropriate size for the SBA's Surety Bond Guarantee Program, that decision will largely rest on personal views concerning the role of the federal government in the private marketplace and the level of acceptable risk in assisting small businesses gain greater access to surety bonds.

Appendix. SBA Surety Bond Guarantee Program Statistics

Table A-1. SBA Surety Bond Guarantee Program Volume, Final Bonds, FY1971-FY2013

Fiscal Year	Final Bonds Guaranteed	Contract Value (SBA Share)	Contract Value Adjusted for Inflation (2013 dollars)
1971	7	\$312,252	\$1,800,622
1972	1,339	\$94,434,157	\$527,624,871
1973	5,597	\$351,189,011	\$1,847,270,017
1974	9,182	\$633,229,829	\$2,999,762,548
1975	11,595	\$706,152,366	\$3,065,410,045
1976	7,831	\$503,607,938	\$2,067,058,339
1977	15,485	\$886,500,000	\$3,416,477,376
1978	19,044	\$1,177,500,000	\$4,217,797,776
1979	20,095	\$1,390,900,000	\$4,474,368,201
1980	19,928	\$1,534,400,000	\$4,348,943,961
1981	17,821	\$1,400,000,000	\$3,596,968,096
1982	10,306	\$763,800,000	\$1,848,522,640
1983	7,703	\$567,400,000	\$1,330,461,851
1984	7,262	\$571,000,000	\$1,283,491,491
1985	10,778	\$959,100,000	\$2,081,728,332
1986	11,200	\$1,043,900,000	\$2,224,440,414
1987	11,128	\$957,400,000	\$1,968,282,926
1988	11,097	\$1,051,000,000	\$2,074,867,675
1989	11,183	\$1,151,600,000	\$2,168,964,303
1990	9,943	\$1,071,200,000	\$1,914,112,281
1991	7,544	\$896,300,000	\$1,536,911,011
1992	7,262	\$848,300,000	\$1,412,096,021
1993	6,478	\$944,000,000	\$1,525,726,117
1994	6,591	\$1,090,000,000	\$1,717,713,495
1995	6,807	\$1,200,000,000	\$1,838,944,881
1996	4,684	\$724,596,082	\$1,590,120,654
1997	4,021	\$615,000,000	\$894,895,888
1998	2,860	\$414,000,000	\$593,178,184
1999	2,399	\$426,000,000	\$597,182,449
2000	1,774	\$242,784,741	\$329,276,452

Fiscal Year	Final Bonds Guaranteed	Contract Value (SBA Share)	Contract Value Adjusted for Inflation (2013 dollars)
2001	1,703	\$254,295,891	\$335,535,526
2002	2,123	\$350,782,086	\$455,384,953
2003	2,400	\$459,331,071	\$583,015,947
2004	2,230	\$475,347,150	\$587,694,153
2005	1,680	\$387,401,149	\$463,266,711
2006	1,706	\$427,666,723	\$495,435,776
2007	1,617	\$444,852,668	\$501,073,401
2008	1,576	\$429,437,158	\$465,824,120
2009	1,220	\$377,896,791	\$411,380,246
2010	1,588	\$487,550,613	\$522,187,042
2011	1,863	\$488,102,579	\$506,779,193
2012	2,323	\$625,301,882	\$636,065,199
2013	3,073	\$1,002,076,616	\$1,002,076,616
Total	294,046	\$30,425,648,753	NA

Sources: U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Oversight of SBA Set-Aside, Lease Guaranty, and Surety Bond Programs*, 94th Cong., 2nd sess., March 8, 1976 (Washington: GPO, 1976), p. 28; U.S. Congress, House Committee on Small Business, Subcommittee on General Oversight and Minority Enterprise, *Overview of SBA's Activities*, 96th Cong., 1st sess., February 28, 1979 (Washington: GPO, 1979), p. 108; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of State, Justice, and Commerce, The Judiciary, and Related Agencies, *Departments of State, Justice, and Commerce, The Judiciary, and Related Agencies Appropriations for 1980, Part 6*, 96th Cong., 1st sess., March 27, 1979 (Washington: GPO, 1979), p. 603; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of State, Justice, and Commerce, The Judiciary, and Related Agencies, *Departments of State, Justice, and Commerce, The Judiciary, and Related Agencies Appropriations for 1981, Part 4*, 96th Cong., 2nd sess., March 10, 1980 (Washington: GPO, 1980), p. 532; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1982, Part 7*, 97th Cong., 1st sess., March 16, 1981 (Washington: GPO, 1981), p. 15; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1983, Part 5*, 97th Cong., 2nd sess., March 22, 1982 (Washington: GPO, 1982), p. 162; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1984, Part 4*, 98th Cong., 1st sess., March 9, 1983 (Washington: GPO, 1983), p. 625; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1985, Part 5*, 98th Cong., 2nd sess., March 26, 1984 (Washington: GPO, 1984), p. 573; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1986, Part 4*, 99th Cong., 1st sess., March 14, 1985 (Washington: GPO, 1985), p. 716; ; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1987, Part 5*, 99th Cong., 2nd sess., March 24, 1986 (Washington: GPO, 1986), p. 305; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1988, Part 3*, 100th Cong., 1st sess., March 4, 1987 (Washington: GPO, 1987), pp. 289, 323; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary,*

and Related Agencies Appropriations for 1989, Part 1, 100th Cong., 2nd sess., March 3, 1988 (Washington: GPO, 1988), pp. 278; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1990, Part 6, 101st Cong., 1st sess., March 15, 1989* (Washington: GPO, 1989), p. 406; U.S. General Accounting Office, *Small Business: Information on and Improvements Needed to Surety Bond Guarantee Programs*, (GA)/RCED-91-99, April 23, 1991, p. 19, at <http://archive.gao.gov/d20t9/143966.pdf>; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1991, Part 6, 101st Cong., 2nd sess., March 21, 1990* (Washington: GPO, 1990), p. 810; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1992, Part 6, 102nd Cong., 1st sess., March 14, 1991* (Washington: GPO, 1991), p. 233; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1993, Part 5, 102nd Cong., 2nd sess., February 19, 1992* (Washington: GPO, 1992), p. 131; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1994, Part 5, 103rd Cong., 1st sess., March 24, 1993* (Washington: GPO, 1993), pp. 960, 1122; U.S. Congress, House Committee on Small Business, *Small Business Reauthorization and Amendment Act of 1994*, report to accompany H.R. 4801, 103rd Cong., 2nd sess., July 21, 1994, H. Rept. 103-616 (Washington: GPO, 1994); U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1995, Part 5, 103rd Cong., 2nd sess., March 4, 1994* (Washington: GPO, 1994), pp. 716; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1996, Part 6, 104th Cong., 1st sess., March 30, 1995* (Washington: GPO, 1995), p. 529; U.S. Congress, House Committee on Small Business, Subcommittee on Procurement, Exports and Business Opportunities, *Small Business Administration's Surety Bond Guarantee Program*, 104th Cong., 1st sess., April 5, 1995, Serial No. 104-24 (Washington: GPO, 1995), p. 98; U.S. Congress, House Committee on Appropriations, Subcommittee on the Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies, *Departments of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations for 1997, Part 5, 104th Cong., 2nd sess., April 33, 1996* (Washington: GPO, 1996), p. 733; U.S. Small Business Administration, Office of the Chief Financial Officer, *Annual Report, 1997*, p. 27; U.S. Small Business Administration, Office of the Chief Financial Officer, *Annual Report, 1998*, p. 27; U.S. Small Business Administration, *FY 1999 Performance and Accountability Report*, p. 29; and U.S. Small Business Administration, *FY 2002 Performance and Accountability Report*, p. 78.

Notes: The number of final bonds guaranteed in FYs 1990-1992, 1996, and 2000-2004, and the contract values for FYs 1996 and 2000-2010 were provided by the U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, September 29, 2011. The number of final bonds guaranteed in FY2011, and the contract value for FY2011 was provided by the U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 15, 2011. The number of final bonds guaranteed in FY2012, and the contract value for FY2012 was provided by the U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 11, 2012. The number of final bonds guaranteed in FY2013, and the contract value for FY2013 was provided by the U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 5, 2013.

**Table A-2. SBA Surety Bond Guarantee Program Volume,
Bid and Final Bonds Combined, FY2000-FY2013**

Fiscal Year	Bid and Final Bonds Approved	Contract Value	Contract Value Adjusted for Inflation (2013 dollars)
2000	7,034	\$1,672,000,000	\$2,267,647,572
2001	6,320	\$1,400,000,000	\$1,847,256,497
2002	7,372	\$461,001,775	\$598,472,043
2003	8,974	\$593,572,000	\$753,404,165
2004	7,803	\$594,669,000	\$735,217,397
2005	5,678	\$907,674,000	\$1,085,425,663
2006	5,214	\$1,730,000,000	\$2,004,139,781
2007	5,809	\$2,250,000,000	\$2,534,356,280
2008	6,055	\$2,450,000,000	\$2,657,592,787
2009	6,135	\$2,760,000,000	\$3,004,549,145
2010	8,348	\$4,000,000,000	\$4,284,166,838
2011	8,638	\$3,607,069,163	\$3,745,089,000
2012	9,503	\$3,917,114,158	\$3,984,539,418
2013	12,866	\$6,151,424,437	\$6,151,424,437

Sources: U.S. Small Business Administration, “FY 2000 Performance and Accountability Report,” p. 37; U.S. Small Business Administration, “FY 2001 Performance and Accountability Report,” p. 16; U.S. Small Business Administration, “FY 2002 Performance and Accountability Report,” p. 78; U.S. Small Business Administration, “FY2002 Budget Request and Performance Plan,” p. 34; U.S. Small Business Administration, “FY2003 Budget Request and Performance Plan,” pp. 17, 19; U.S. Small Business Administration, “SBA Budget Request & Performance Plan, FY2004,” pp. 3, 4; U.S. Small Business Administration, “Congressional Submission Fiscal Year 2005,” p. 15; U.S. Small Business Administration, “Congressional Submission Fiscal Year 2006,” pp. 19, 78; U.S. Small Business Administration, “FY2007 Congressional Budget Request and Performance Plan,” pp. 25, 71; U.S. Small Business Administration, “FY2009 Congressional Budget Justification and FY207 Annual Performance Report,” p. 65; U.S. Small Business Administration, “FY2012 Congressional Budget Justification and FY2010 Annual Performance Report,” p. 40; U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 15, 2011; U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 11, 2012; and U.S. Small Business Administration, Office of Congressional and Legislative Affairs, correspondence with the author, December 5, 2013.

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