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Jonathan Dahl
Editor in Chief
SmartMoney.com
1211 Avenue of the Americas
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RE: Concerns regarding article entitled "Obscure Insurance That Hurts Small Businesses" by Dyan Machan, posted April 9, 2012

Dear Mr. Dahl:

I wish to make you aware of significant concerns that the National Association of Surety Bond Producers (NASBP), a national trade organization of firms employing licensed surety bond producers placing bid, performance, payment and other types of surety bonds on contracts throughout the United States, has regarding a recent article entitled "Obscure Insurance That Hurts Small Businesses," authored by Dyan Machan, and published by WSJ.com. We believe that the author miscasts the purpose and function of surety bonding. At best, the portrayal of surety bonding in the article can be considered a "half-truth," one which distorts the underlying purposes of surety bonding and disregards the protection and value that surety bonds bring to public and private transactions. Such an incomplete article can do little credit to the reputation and standards of the Wall Street Journal/SmartMoney and provides the public with incorrect information about an important product and industry. We request your swift correction.

The surety commits its assets to guarantee the performance or financial obligations of others, such as those of a construction firm acting as a contractor. The embodiment of that commitment is the issuance of a surety bond, a three-party agreement among the principal (the contractor), the surety, and the obligee (the project owner). The principal is the party that undertakes the obligation; the surety guarantees that the obligation will be performed; and the obligee is the party who receives the benefit of the surety bond. *The surety views its underwriting as a form of credit, much like a lending arrangement, and places its emphasis on the qualifications of the construction firm to fulfill its obligations successfully*, examining in-depth the firm's credit history and financial strength, experience, equipment, work in progress and management capability. After the surety assesses such factors, it makes a determination as to the appropriateness and the amount, if any, of surety credit to extend to the firm.

Most surety companies are subsidiaries or divisions of insurance companies, and both surety bonds and traditional insurance policies are risk transfer mechanisms thoroughly regulated by state insurance departments, including the rates that sureties and insurers may charge for their products. Traditional insurance is designed to compensate the insured against unforeseen adverse events. The policy premium is actuarially determined based on aggregate premiums earned versus expected losses. Surety companies operate on a different business model. *Surety is designed to prevent a loss.* The surety prequalifies the contractor based on financial strength and construction expertise. Since the bond is underwritten with little expectation of loss, the premium charged is primarily a fee for prequalification services. Unfortunately, the bonding rates stated to be charged by sureties in the article do not appear to have been researched and are simply inaccurate.

In the construction context, different surety bonds are used for different purposes, but all of the bonds share the dual purposes of providing assurance and protection.

- The **bid bond** assures that the bid is submitted in good faith and that the construction firm, the contractor, will enter into the contract at the price bid and will provide the required performance and payment bonds.
- The **performance bond** protects the owner from financial loss should the contractor fail to perform the contract in accordance with its terms and conditions.
- The **payment bond** assures that the contractor will pay specified subcontractors, laborers, and materials suppliers associated with the project.

Every state jurisdiction in the U.S. has bonding requirements in place to protect publicly-funded construction projects exceeding a certain statutory dollar threshold. The bid bond makes sure that the public owner selects from a pool of qualified companies. The performance bond transfers the risk of contractor default to the surety, so no additional taxpayer dollars must be spent to complete the contract obligations. The payment bond provides a payment remedy to the many small businesses that serve as subcontractors and suppliers on constructions contracts and that would not be able to recover unpaid amounts from the public owner in the event of contractor default or insolvency. On public projects, these small businesses also do not have lien rights, as in virtually all jurisdictions such liens cannot be placed against public property.

Infrequently, public owners choose to ignore their bonding statutes and opt not to require surety bonds on projects. Such decisions can result in perilous fiscal consequences for their communities, such as the inability to complete or the necessity to apply additional public funds to complete a public structure or building, such as a firehouse, library or school. Sometimes the decision can have more severe fiscal consequences, as is the case for the City of Harrisburg, Pennsylvania, which elected not to require a performance bond of the contractor awarded the contract to retrofit a large municipal incinerator. The costs of addressing subsequent construction issues on that project necessitated expenditure of funds that forced the city to the brink of insolvency, from which they have yet to recover. If a performance bond had been in place, the city would have transferred risks to a responsible and knowledgeable corporate surety and likely would not be in the financial plight it is in today.

As made clear in Ms. Machan's article, not every business, regardless of size, merits surety credit. If all businesses were entitled to surety credit, surety bonds would be rendered meaningless as a means of assuring the qualifications of a particular company. Further, placing businesses in positions to be overmatched, overwhelmed, and vulnerable to failure by grant of indiscriminate surety credit not only is irresponsible but economically dangerous. Do we dare forget the lessons drawn from our recent past with mortgage lending practices? Again, remember the purpose of surety bonds; they are to qualify companies to avoid losses on publically-funded and private contracts. In the unusual situation where the surety has to pay out on a bond, the surety has a right to be reimbursed from the business on behalf of which it expended funds.

The surety industry and surety professionals expend considerable resources to make businesses—with a particular focus on small businesses—aware of how they may qualify for surety credit. It is in their vested interest, in fact, to do so. Bond producers have a vested interest in helping businesses of all sizes to qualify for surety credit, as they only make commissions upon the issuance of a surety bond for the bonded construction firm. Bond producers work every day to position construction businesses to qualify for and to maintain surety credit, and, indeed, Ms. Machan notes the value that a knowledgeable surety "agent" can bring in helping a firm gain surety credit. To that end, bond producers act in many critical roles—guide, educator, adviser, and match-maker. Many NASBP bond producers work with small and disadvantaged businesses daily or weekly so they can pursue federal and other public and private work that requires surety bonds. I personally invite you to speak with some of these producers, and I would be happy to connect you with them. Many NASBP bond producers also volunteer locally in their communities to make presentations on obtaining surety credit to local business groups, including those representing minority- and women-owned construction businesses. In short, bond producers work hard to position firms to qualify for surety credit.

The surety industry's commitment to bonding awareness and education goes well beyond individual action, however. NASBP, together with the Surety and Fidelity Association of America (SFAA), a trade organization representing more than 400 surety companies, have teamed together to assist the U.S. Department of Transportation (U.S. DOT) with its ongoing initiative to conduct bonding education workshops to small contractors around the country. Eleven such workshops were conducted in 2011; more are occurring this year, as 15 have been scheduled. Many years ago, SFAA pioneered the bonding curriculum used in these U.S. DOT workshops, and SFAA, with the assistance of NASBP bond producers, have offered the curriculum also in county and state agency-sponsored programs over the years, resulting in $150 million in bonding for contractor attendees. Through the Surety Information Office, the surety industry also maintains an information web site at www.sio.org, where small businesses can read and download basic information about bonding.

Interestingly, the referenced article intimates that few bonding markets are available to small and emerging businesses and that such businesses must resort to "the subprime lenders of the surety world." Further research by the author would have uncovered a different reality—that is, that many surety markets exist for qualified small construction firms. There are reputable surety companies that focus their entire business model on smaller contractors, and many other surety companies have specific programs tailored to smaller contractors. Those small firms that do not qualify for bonding in the standard market also have state and federal resources available to them to help them qualify. The U.S. Small Business Administration (U.S. SBA), for example, offers a bond guarantee program expressly for the purpose of helping small businesses obtain bonding. More information about this program is available from the U.S. SBA web site.

Contrary to the article's assertion that surety bonding "hurts small business," surety bonding has helped and continues to help countless small businesses to grow, to mature, and to confront the myriad challenges that they will encounter in becoming long-term business successes. A small business that establishes a surety relationship can expect all manner of assistance from that relationship—guidance, market intelligence, assistance in identifying business risks, continuity planning, referrals to knowledgeable service providers, among other benefits. The surety will do much "behind the scenes" to assist its contractor in avoiding problems so the firm can complete its bonded obligations successfully. I personally have heard many bond producers tell me that their most cherished professional moments are those where they were able through persistence and hard work to position a young company to gain its first surety bond and to see that company become a stalwart business in the construction community.

Now you have the other "half" of the story. I hope you will decide to tell the whole truth so a balanced article results. Please contact me should you have questions or require further information.

Yours sincerely,

Mark H McCallum

Mark H. McCallum
CEO