

**SBA**

**SOP 50 46 2**

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**Claims and Recovery Program**

**Office of Surety Guarantees**



SMALL BUSINESS ADMINISTRATION  
STANDARD OPERATING PROCEDURE

National

SUBJECT: Claims and Recovery Program	S.O.P.		REV
	SECTION 50	NO. 46	2

INTRODUCTION

1. Purpose. To establish written guidelines and procedures for surety bond guarantee claims reimbursement and recovery activity.
2. Personnel Concerned. Office of Surety Guarantees' claims and recovery personnel.
3. Directives Canceled. SOP 50 46 1.
4. Originator. Office of Surety Guarantees.

AUTHORIZED BY:		EFFECTIVE DATE 9/23/2016
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## **Chapter 1. General Overview of Surety Bond Guarantee Program**

### **1.1. The General Scope and Purpose of this SOP**

This Standard Operating Procedure (SOP) describes policy and procedures for handling defaults, claims, and recoveries resulting from surety bonds issued by participating sureties and guaranteed by SBA.

### **1.2. The Program's Statutory Basis**

The Small Business Investment Act of 1958, as amended, empowers SBA to reimburse a Surety participating in the Surety Bond Guarantee (SBG) Program up to a specified percentage of its losses incurred and paid as a result of the contractor's default of a bonded contract. Contracts or total work orders eligible for SBA's guarantee cannot exceed the applicable statutory limit at the time of bond execution. As of January 3, 2013, this limit is \$6.5 million, which may be adjusted for inflation in accordance with 41 U.S.C. 1908, and SBA may also approve a guarantee not to exceed \$10 million if a contracting officer of a Federal agency certifies that such a guarantee is necessary. Chapter 13, Part 115 of the Code of Federal Regulations (13 CFR Part 115) provides regulatory guidelines and provisions for the SBG Program.

### **1.3. Program Objectives**

The primary objective of the bond guarantee is to enable small contractors to obtain bonds for contracts which they could not obtain in the traditional surety market without an SBA guarantee. The program helps qualified small and emerging contractors grow their businesses and compete in the marketplace.

### **1.4. Program Authority**

#### **a. Headquarters Office**

The Office of Surety Guarantees (OSG) is responsible for the oversight and control of SBG-related activities. Its primary claims function is to minimize SBA's losses and maximize recoveries by:

- (1) Reviewing and approving, or denying claims for reimbursement under the guarantee;
- (2) Establishing SBA loss reserves;
- (3) Determining whether cancellation or denial of SBA liability in whole or in part is warranted under the guarantee;
- (4) Establishing procedures for ensuring that SBA receives its share of any surety recovery in a timely manner.

b. Surety Companies

Participating sureties are required to take all reasonable actions necessary to minimize loss and pursue recovery on any defaulted bond for which the Surety seeks reimbursement of its losses and/or expenses. A surety must have salaried staff that is employed directly with the surety to perform all claims and recovery functions other than specialized services the costs of which may be reimburseable. Final settlement authority for claims and recovery must be vested only in the surety's salaried claims staff.

SBA's only contractual relationship is with the participating surety company, and not with the individual contractor.

## **Chapter 2. Claim Reimbursement Procedures for the Prior Approval Program**

### **2.1. Rumble**

A Surety must notify OSG's Claims and Recovery Division (CRD) in writing (by regular mail or email), within 30 days of the date the Surety acquires knowledge, or should have acquired knowledge, that a claim has been made against the bond, but may indicate that the Contractor either intends to satisfy the claim or that the claim is being disputed. Generally, the Surety sets a small reserve in these cases. Based on the reserve amount and if SBA anticipates that there will be no loss (i.e., collateral is posted, or claim paid), CRD will not consider the contractor as having defaulted. This type of possible claim situation is referred to as a "rumble" and CRD will notify the respective area office immediately upon receipt. (CRD or the respective area offices will in turn notify responsible SBA district offices on "rumble" cases pertaining to 8(a) contractors and contractors that have SBA loans.)

### **2.2. Surety Notification of a Claim Situation**

A Surety must notify CRD in writing (by regular mail or email) at the earlier of the time the Surety applies for a guarantee on behalf of an affected Contractor, or within 30 days of the date the Surety acquires knowledge, or should have acquired knowledge of any of the following events:

- a. Legal action is initiated under the bond,
- b. The Obligee declares the Contractor to be in default under the Contract,
- c. The Surety establishes a claim reserve for the bond, or
- d. The Surety receives any adverse information concerning the Contractor's financial condition or possible inability to complete the project or to pay laborers, subcontractor, or suppliers.

### **2.3. Loss of Eligibility for Further SBA Bond Guarantees**

The Contractor and its Affiliates are ineligible for further SBA bond guarantees under any of the following conditions:

- a. Legal action under the bond has been initiated;
- b. The Obligee has declared the Contractor to be in default under the Contract;
- c. The Surety has established a claim reserve for the bond of at least \$1,000;
- d. The Contractor, or any of its Affiliates, has defaulted on an SBA-guaranteed bond resulting in a Loss that has not been fully reimbursed to SBA, or SBA has not been fully reimbursed for any Imminent Breach payments;



- e. The guarantee fee has not been paid by the Contractor; and
- f. The Contractor committed fraud or material misrepresentation in obtaining the bond guarantee.

Upon receipt by CRD of any of the events listed above, the CRD will enter in SBA's Capital Access Login System (CLS) that the Contractor has been placed in a default status, under which the Contractor is ineligible for further SBA bond guarantees. If any of the above events occurs on a different contract involving the same Contractor, CRD will check CLS to ensure that the Contractor has already been placed in a default status. Ineligible Contractors may be reinstated in accordance with the provisions of paragraph 3.5.

## **2.4 Office of Inspector General (OIG) Referrals**

### **a. Matters That Should be Referred to the OIG**

All SBA officials, Sureties and other program participants should be on the lookout for fraud, and must report any known or suspected irregularities involving SBA programs, program participants, or personnel to the OIG. (13 CFR § 120.197) Whether acting alone or in collusion with others, surety bond guarantee applicants, Sureties or other Obligors may intentionally provide false information to SBA. Examples of irregularities that must be referred include:

- a. Overstating income;
- b. Understating or failing to disclose liabilities and debts;
- c. Overvaluing collateral;
- d. Failing to disclose criminal record;
- e. Making false claims of U.S. citizenship.
- f. Failing to disclose true ownership of the business;
- g. Using false Social Security numbers to conceal poor credit history;
- h. Submitting altered tax returns;
- i. Creating false work histories';
- j. Actions by corrupt Surety agents who orchestrate, facilitate or otherwise support any of the illegal acts committed by SBG applicants; or
- k. Misconduct by a Surety, Surety agent or representative, or SBA official such as the solicitation, offer or acceptance of a bribe to approve a surety bond guarantee.

### **b. Referral Process**

A referral to the OIG can be made by:

- a. Calling the toll –free OIG Hotline at 1-800-767-0385;
- b. Completing the on-line OIG Complaint Submission Form at [http://web.sba.gov/oigcss/client/dsp\\_welcome.cfm](http://web.sba.gov/oigcss/client/dsp_welcome.cfm) and submitting the referral via the Internet; or

c. Mailing the referral to:

U.S. Small Business Administration  
Office of Inspector General  
Investigations Division, Mail Code 4113  
409 Third Street, SW  
Washington, DC 20416

## **2.5. Imminent Breach**

Imminent Breach is a threat to the successful completion of a bonded contract that, unless remedied by the Surety, makes a default under the bond inevitable. Subject to the conditions set forth below, SBA will share, to the same extent that it would share in any other loss, a loss arising out of a Contractor's failure to repay in full funds advanced to it by the Surety in order to avoid, or attempt to avoid, an imminent breach of contract. To qualify for such reimbursement, a Prior Approval Surety must first request in writing SBA approval for such advances not to exceed in total 10% of the contract price (unless the Administrator determines that advances in excess of 10% are necessary and reasonable). The Surety must demonstrate that the circumstances make default imminent and describe the basis for the Surety's belief that the Contractor can successfully complete the contract if the advances are made. In no event shall SBA pay a Surety an amount exceeding the guaranteed share of the bond. (See § 411(b)(3) of the Small Business Investment Act).

## **2.6. Processing Imminent Breach Requests**

- a. Once SBA receives an Imminent Breach request, CRD will notify the appropriate Area Office, or will request if needed, the Contractor file that may be stored, or review the contractor's electronic file. (Please note that the contractor is not in default.) CRD will review the case file with emphasis on current work in progress; the contractor's ability to repay the Surety; the amount of potential claims; and the nature and extent of work to be completed.
- b. CRD will provide a brief summary of the case with recommendations on whether SBA should reimburse the Surety for imminent breach payments to the Director of OSG (D/OSG). If the D/OSG agrees to reimburse the Surety for imminent breach, CRD must enter the imminent breach payments information into CLS. This will set-up a computerized file so that SBA can reimburse the Surety and monitor repayment activity.

## **2.7. Review of Contractor File**

Upon receiving notification under paragraph 2.2 above, CRD will review the electronic file and/or will request, if needed, the Contractor's paper file from the Area Office. For bond guarantees approved before October 2007, CRD requests a hard copy of the contractor file by contacting the Area Office via email. The documents contained in the contractors' files for bond guarantees approved after October 2007 are available electronically in CLS.

## 2.8. Surety Status Reports on Claim and Recovery Activity

- a. The CRD uses status reports from participating Surety companies to monitor a Surety's claims and recovery activity on defaulted bond guarantees. Status reports must include the project's completion status, remaining contract balances, performance and payment bond activities, Surety's indemnity efforts, and the Surety's claim reserve. This information is also used to adjust SBA's loss reserves and to update the computer database. These administrative updates may be submitted by the Surety either through the CLS or via email using the SBA Form 994H "Default Report, Claim for Reimbursement and Record of Recoveries".
- b. At the time of the initial status report, much of the information may not be available to the Surety; therefore, SBA requires the Surety to submit semiannual status reports on each claim beginning six months after the initial notice, and then every six months thereafter. The Surety must notify SBA immediately of any substantial changes in the status of the claim or the amount of loss reserves.

## 2.9. Claim Status Codes

Based on the status report(s), the Surety places the bond in one of the claim statuses listed below in CLS if the Surety submits the claim electronically, and CRD performs this function if the Surety submits the claim by mail.

The following is a list of the possible categories and descriptions.

- a. Claim Status "1": This is an "Active" status used to establish the case in claims when the Surety indicates that there is contingent liability and that the Surety will be submitting claims for reimbursement.
- b. Claim Status "2": This is a "Closed-No Loss" status used after SBA has received full recovery from the Surety for its claims for reimbursement paid by SBA; or when no payment was made by the Surety or SBA after contractor was placed in a claim status.
- c. Claim Status "3": This is a "Closed-to-Subrogation" status used when the project has been completed and all outstanding claims have been paid by the Surety and recovery is being pursued from the indemnitor(s), and/or the obligee (contract retainage), and/or the Contractor. See paragraph 3.1.
- d. Claim Status "4": This is a "Closed-Final" status that is used only after the Surety has exhausted all reasonable recovery efforts and has received SBA's approval to cease further pursuit of recovery. See paragraph 3.3.
- e. Claim Status "5": This is a "Settlement" status that is used when the Surety has executed an agreement with the principal/indemnitor for less than the actual losses and/or expenses

paid on behalf of the principal/indemnitor. The Surety must obtain SBA's concurrence before entering into any settlement agreement. See paragraph 3.4.

## **2.10. Analysis of the Contractor File**

- a. CRD examines the financial conditions, business, underwriting, and default/claim information for bond guarantees in default to verify the Surety's compliance with the regulations and SOP provisions of the SBG Program.
- b. A review of the financial, business, and underwriting information is the first step in analyzing the claims file. The following underwriting forms are examined to determine that the guarantee was executed in accordance with the regulations and SOP provisions of the SBG program.
  - (1) [SBA Form 912, "Statement of Personal History"](#). Review for character and reputation eligibility requirements. See 13 CFR 115.13 to determine who is required to submit this form.
  - (2) [General Indemnity Agreement \(GIA\)](#). Make certain this is signed by the principal(s) of the Contractor and indemnitor(s), and notarized by an authorized person(s). The GIA must indemnify the Surety that appears on the bonds and the SBA guarantee agreement.
  - (3) [SBA Form 994, "Application for Surety Bond Guarantee Assistance"](#). Review for pertinent information about the company's gross annual receipts, the project, its location, starting and completion dates, contract amount, penalty clause, and the Contractor's experience with other SBA programs. It also includes information on the Contractor's minority status, which may affect the guarantee percentage.
  - (4) [SBA Form 994F, "Schedule of Work in Process"](#). Review for a listing of all of the uncompleted work (bonded and unbonded) of the contractor (and any of its subcontractors) at the time the guarantee was issued.
  - (5) [SBA Form 990, "Surety Bond Guarantee Agreement"](#). This form is SBA's commitment to guarantee bonds issued by the Surety. Verify both the Surety and SBA representative signatures to ensure they were authorized to execute the SBA Form 990. SOP 50 45 Chapter 1, "General Overview of the Surety Bond Guarantee Program," should be used to verify the delegated authority of the SBA signature on the SBA Form 990.
  - (6) [SBA Form 990A, "Quick Bond Guarantee Application and Agreement"](#). This form is SBA's commitment to guarantee bonds which were issued by the Surety up to the amount authorized by regulation. Verify both the Surety and SBA representative signatures to ensure they were authorized to execute the SBA Form 990A. SOP 50 45 Chapter 1, "General Overview of the Surety Bond Guarantee Program," should be used to verify the delegated authority of the SBA signature on the SBA Form 990A.

- (7) [SBA Form 991, "Surety Bond Guarantee Agreement Addendum"](#). This form is used when work under the contract has started prior to the Surety receiving SBA's guarantee. It provides evidence from the Contractor that the Surety bond requirement was contained in the original contract and sufficient documentation as to why the Surety bond was not previously obtained. The SBA Form 991 also provides certification that all subcontractors and suppliers were paid before the SBA Form 991 is approved is correct, based on the contract amount and program regulations. It is important that the percentage of guarantee on the SBA Forms 990 or 990A.
- (8) Financial/Business Data is reviewed to determine if principal met program eligibility requirements for the SBG Program, at the time of the guarantee.
- c. CRD will thoroughly review the applicable bond(s), bonded contract, bid solicitation, and contract award letter to verify that the bonds were required, that the contract amount is the same on the SBA Forms 990 or 990A, that the contract amount was within statutory limits, that the contract itself fell within the regulatory definition of "Contract", that any notification and approval of increases or decreases in the Contract or bond amount was provided as required by 13 CFR § 115.32(d), and that the project was eligible for the SBG Program. (Refer to SOP 50 45, "Surety Bond Guarantee Program," for more details.)
- d. CRD will also review the default notification and current status reports to ascertain the following information:
- (1) A description of the claim(s) filed against the bond;
  - (2) The status of the project and completion arrangements;
  - (3) Remaining contract funds;
  - (4) Surety's plan for settling or defending the claim(s);
  - (5) The anticipated loss plus reserve amount;
  - (6) Liquidated damages asserted; and
  - (7) Other information pertinent to the claim.
- e. CRD will request clarification from the Surety on any discrepancy or inconsistency in information provided in the status reports and case files. Once the analysis is completed and CRD determines that payment can be made under its guarantee, CRD places the contractor in default status in the SBA CLS Application System. The SBG Specialist will prepare an initial write-up with recommendation to process, deny, or request additional information on the reimbursement request.
- f. Denial of Liability.

The D/OSG may deny liability under SBA's guarantee (in whole or in part within its

discretion) in accordance with 13 CFR § 115.19. For any claim for reimbursement for which there are grounds for denial, CRD will prepare and submit a written referral to the D/OSG.

Listed below are examples of the circumstances that are grounds for denial of liability. See also 13 CFR § 115.19:

- a. Work began prior to obtaining SBA's Guarantee;
- b. Original contract amount exceeds statutory limit;
- c. Ineligible type of Contract (*e.g.*, Contracts for Financial Guarantees);
- d. Surety's failure to obtain a GIA;
- e. Bond(s) amount exceeds contract amount
- f. Surety did not notify SBA timely of possible default/claims
- g. Surety's negligence in handling losses
- h. Surety's material misrepresentation or omission of statement of material fact; and
- i. Surety has committed a substantial violation of SBA regulations.

### **2.11. Steps Taken When a Bid Bond Default Occurs**

- a. A bid bond default occurs when the Surety declines to issue the final bond or when the contractor refuses to enter the contract after notification of proposed award. To process a claim under the bid bond, SBA must receive the following information:
  - (1) A copy of the demand letter from the obligee;
  - (2) A copy of the lawsuit (if applicable);
  - (3) A copy of the bid bond; and
  - (4) A copy of the contract.
- b. For a bid bond guarantee executed under a bonding line, CRD should review the bonding line in addition to the bid bond, lawsuit, or demand letter from the obligee when no SBA Form 990 or SBA Form 990A exists. The Surety must prepare a SBA Form 990 or SBA Form 990A, which must be signed by the area office Surety bond guarantee personnel with the appropriate delegated authority. This action does not constitute a new guarantee; it is used only to document a previous commitment under a bonding line. Carefully review information pertaining to the bid bond default to see if

the bid bond was issued after the contract was awarded and/or the job had started.

## **2.12. Surety Request for Reimbursement from SBA**

The Surety may submit reimbursement requests either via regular mail or through CLS, except that SBA Form 994H with the Surety's original signature must be submitted by regular mail for payment to be issued.

Under the Rule of Two, a request for reimbursement must be approved by the combined action of two SBA employees who hold delegated or re-delegated authority. An SBA professional staff member must recommend the action and the approval official must concur with the recommendation. If the recommender and approval official disagree, the reimbursement request will proceed through the chain of command until a final decision is made. The following officials have the authority to approve a request for reimbursement under a single bond up to the amounts set forth below:

### **Claims and Recovery Division Approval Authority**

<b>Position</b>	<b>Dollar Amount (in the aggregate)</b>
Director, OSG	More than \$2,000,000
Deputy Director, OSG	More than \$650,000 but not in excess of \$2,000,000
Director, Claims and Recovery Division	Up to \$650,000

## **2.13. Processing Claims for Reimbursement**

In processing requests for claims reimbursement, CRD reviews the following items in detail:

### **a. Initial Payment**

Review SBA Form 994H to ensure that the information corresponds with information contained in the documents in CLS.

- (1) Review the SBA Forms 990 or 990A, to determine the following.
  - (a) Approval signature of SBA official is within appropriate authority.
  - (b) The guarantee percentage is:
    - (i) 80 percent for contracts more than \$100,000;
    - (ii) 90 percent for contracts up to and including \$100,000. If the contract amount increases more than \$100,000 after execution of the bond, the guarantee percentage decreases by 1 percentage point for each \$5,000 increase or part thereof, but it does not decrease below 80 percent; and

- (iii) 90 percent for all contracts awarded to firms owned and controlled by socially and economically disadvantaged individuals, by qualified HUBZone businesses, or by veterans or service-disabled veterans.
- (iv) Contract or Order increases exceed Applicable Statutory Limit. If the Contract or Order amount is increased above the Applicable Statutory Limit after Execution of the bond, 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 SBA. For example, if a contract amount increases to \$6,800,000, SBA's share of the loss under an 80% guarantee is limited to 76.5% [ $6,500,000/6,800,000 = 95.6\% \times 80\% = 76.5\%$ ].
- (c) Correct name of the Surety - When there are two sureties (co-sureties) named on the SBA Forms 990 or 990A, the lead Surety is specified. All transactions with SBA will be done through the lead Surety.
- (d) Request and review current status reports with sufficient loss reserves (loss reserves are estimated future liabilities that must be settled at a later date). If the validity of the claim for reimbursement or justification for payment appears to be questionable, refer the file to the supervisor for appropriate action.

(2) Page two (2) of the SBA Form 994H provides a list of itemized disbursements by date, draft number, payee, and amount, any recovery received and the loss summary. Documentation to support the itemizations on all attorney and/or consultant fees must be entered by the Surety in CLS. Once the information is entered, CLS will preliminarily calculate the payment amount owed the Surety or the amount due to SBA by the Surety.

994H Reimbursement Request must be submitted within 90 days from the time of each disbursement.

**Example #1:**

Loss Disbursements	\$	4,000.00
Loss Disbursements Previously Reported	\$	-
<b>Total Loss of Disbursements</b>	<b>\$</b>	<b>4,000.00</b>
Recovery	\$	-
Recovery Previously Reported	\$	-
Undisbursed Trust Account Balance	\$	-
<b>Total Recovery</b>	<b>\$</b>	<b>-</b>
Surety Net Loss	\$	4,000.00
Less Deductible Amount	\$	-
Share of Surety Reimbursable Loss (90%)	\$	3,600.00
Prior Total SBA Payments	\$	-



**Balance Due Surety**   **\$ 3,600.00**

CRD staff, with the appropriate delegated authority, must review and approve the SBA Form 994H in CLS for payment to be issued.

(3)    Reinsurance

If the Surety has an existing reinsurance treaty covering SBA guaranteed bonds, any amounts that the Surety receives under this treaty is applied first to the Loss, and SBA would reimburse Surety the guaranteed percentage of any part of the Loss that is not covered by reinsurance. For example, the Surety has treaty reinsurance that covers the first \$100,000 in losses in excess of \$50,000. A loss of \$75,000 occurs on an SBA guaranteed bond. The reinsurance is applied first to the Loss before SBA’s guarantee as follows: (Assume no other salvage or recovery is available).

Claims and Expenses Paid	=	\$75,000
Reinsurance Recovered	=	\$25,000
Loss to Surety (gross)	=	\$50,000
SBA pays the Surety (80%)	=	\$40,000*

\* (80% guarantee of \$50,000 = \$40,000, 90% guarantee of \$50,000 = \$45,000)

b.    Subsequent Payments

- (1)    The same procedures used for the initial payment are used for subsequent payments. However, it is important that CRD review the itemizations closely for any duplication of payment from prior requests. All items that have been previously paid are considered duplicates and are disallowed from the itemized total amount. Note disallowances(s) on the SBA Form 994H and notify the Surety of the disallowance(s) and advise the Surety of the corrected amount that is approved for payment.
- (2)    Request and review current status reports with sufficient loss reserves (loss reserves are estimated future liabilities that must be settled at a later date). If the validity of the claim for reimbursement or justification for payment appears to be questionable, refer the file to the supervisor for appropriate action.

An example of how CLS will preliminarily calculate a subsequent payment is as follows:

**Example #2:**

Loss Disbursements	\$	5,500.00
Loss Disbursements Previously Reported	\$	<u>4,000.00</u>
Total Loss of Disbursements	\$	9,500.00
Recovery	\$	-

Recovery Previously Reported	\$	-
Undisbursed Trust Account Balance	\$	-
Total Recovery	\$	-
Surety Net Loss	\$	9,500.00
Less Deductible Amount	\$	-
Share of Surety Reimbursable Loss (90%)	\$	8,550.00
Prior Total SBA Payments	\$	(3,600.00)
Balance Due Surety	\$	4,950.00

c. Approval of SBA Form 994H

After the SBA Form 994H has been recommended for payment in CLS and the original SBA Form 994H with the original signature has been received, it is sent to the approving official for review/approval. CRD will scan and enter the original SBA Form 994H in CLS and file and retain the original paper copy in accordance with SOP 41 2, Records Management Program.

**2.14. Avoiding Delays in Reimbursements to Sureties**

SBA will reimburse the Surety within 45 days of receipt of their payment request in accordance with 13 CFR 115.35 provided that all necessary information is submitted. To help expedite the payment process, CRD requires the sureties to provide the following items with the initial claims for reimbursement:

- (1) Initial Default Notification;
- (2) Signed copy of the General Indemnity Agreement;
- (3) Documentation for all fees and expenses;
- (4) An original signature and date of execution of the 994H;
- (5) A narrative status report that includes percentage of completion, contract balance, cost to complete, appropriate reserve, and details regarding the claim situation; and
- (6) A Copy of the Agent's power of attorney.

When additional information is still needed on a claim payment, CRD can disallow the questionable amount pending receipt of the information, unless the requested information pertains to the entire claim. If the requested information pertains to the entire amount of the claim, return the reimbursement request to the Surety with an explanation.

**2.15. Tracking Missing Payments**

If a Surety informs SBA that it has not received a check or electronic deposit, CRD should contact SBA's Denver Finance Center (DFC) in Denver, CO, for assistance. DFC will need the SBG number, the Surety name, the payment amount, and the approval date.

## **2.16. Release of Case File Information**

- a. Public access to information contained in SBA case files is governed by provisions established by the Freedom of Information Act and Privacy Act. It is essential that you recognize the importance of complying with the policies and procedures governing public access to files, records, and documents of SBA. See SOP 40 03, "Disclosure of Information" and 13 CFR 102, "Record Disclosure and Privacy".
- b. Disclosure of information in an unofficial manner may compromise SBA's position and increase vulnerability of the Agency, and may result in legal action against both SBA and the employee responsible for the release of the material.
- c. If SBA receives a subpoena and/or court order for a file in claims, you should notify the D/OSG and the Office of General Counsel immediately. Under no circumstances should you release a case file from OSG without notifying and consulting with the D/OSG and the Office of General Counsel. Make sure that you complete a file release form and maintain a copy of any documents released.

## Chapter 3. Subrogation and Recovery Procedures for Prior Approval Program

### 3.1. Subrogation and Recovery Activities

#### a. Conditions Necessary to Transfer a Bond to Subrogation/Recovery Status

CRD will place the defaulted bond into a “Closed-to-Subrogation” status (Claim Status “3”) in the CLS when the Surety advises SBA that the project has been completed, all claim payments have been made, no further contingent liability remains, and recovery is being actively pursued from the Contractor, the principal(s), indemnitors, and obligee. CRD then monitors Surety’s recovery efforts through regular status reports.

#### b. Status Reports

- (1) CRD uses status reports from sureties to monitor recovery and to check the expenses anticipated relative to recovery efforts. In accordance with 13 CFR § 115.35(d), the Surety must submit these reports semi-annually; however, the Surety must notify SBA immediately of any substantial changes in the status of the claim or the amounts of Loss reserves. CRD can also request additional information at any time, if necessary. CRD compares information contained in the current status report to that in previous status reports, as well as to other information on file to check for consistency, accuracy, and to verify that the Surety is taking all steps necessary to minimize the loss and is pursuing all possible sources of recovery.
- (2) As part of a status report, a Surety must include an update, if applicable, of the approved repayment plan for a defaulted contractor. CRD will review and monitor the repayment plan to ensure receipt of SBA’s share of monies received by the Surety.
- (3) CRD also monitors actual and anticipated legal fees and costs associated with the Surety's subrogation and recovery efforts, and refers any abnormalities or apparent non-compliance with the terms and conditions of the SBA Forms 990 or 990A in writing to the D/OSG, through the appropriate supervisor, with a recommendation for appropriate action.

#### c. Sources of Recovery and Related Documentation

The following is a list of documentation required for SBA’s review of the Surety’s recovery activities:

- (1) GIA: This is an agreement signed by an individual or entity holding the Surety harmless from any loss or exposure incurred on a bond that it issues. The signatures on this form determine who the Surety holds liable and what assets may be pursued by the Surety.

- (2) Investigative Reports: Two of the most common investigative reports are obtained from Equifax and Dun and Bradstreet. Both are used to locate the indemnitors and ascertain what assets are available for indemnity pursuit.
- (3) Financial Statements and Reports: These reports include the assets and liabilities of the individual indemnitors or the Contractor at a given point in time. Current financial statements should be compared to those that were submitted with the underwriting package. Question any discrepancies. Examples of the types of assets that would be included in these reports are:
- (a) Corporate Assets
    - (i) Real Estate
    - (ii) Machinery and Equipment
    - (iii) Accounts Receivable
    - (iv) Supplies and Materials
    - (v) Bank Accounts
    - (vi) Insurance Policies
  - (b) Personal Assets
    - (i) Residence (In some states, subject to Homestead Acts)
    - (ii) Land and Real Estate
    - (iii) Bank Accounts/Stocks and Bonds
    - (iv) Insurance Policies
    - (v) Luxury Items (Jewelry, automobile, boats, etc., check with the Department of Motor Vehicles for registration)
- (4) Letters of Credit: Issued by banks, these are sometimes required by the Surety as collateral at the time that the bond was underwritten. If a default occurs, this can be pursued as recovery.
- (5) Discharge in Bankruptcy: This may be requested from the Surety as documentation of the actual parties to the bankruptcy and the date of discharge, as well as the type of bankruptcy.
- (6) Judgment: A copy of the judgment against the Contractor and/or Indemnitors is requested from the Surety to clarify the details of the judgment.
- (7) Accounting of Contract Funds: Since the contract funds remaining on a defaulted project may represent a substantial amount of recovery, a complete accounting of the remaining funds is conducted by CRD.

### **3.2. Funds Due SBA**

A “Due SBA” account occurs when the Surety’s reimbursable loss amount is less than SBA’s paid amount. SBA is entitled to its guaranteed percentage of all salvage and recovery obtained by the Surety. The Surety must reimburse or credit SBA its guaranteed share within 45 days of receipt of any recovery by the Surety. A “Due SBA” account can also occur when

a refund is due SBA because an overpayment was made to the Surety as the result of over billing or otherwise.

For Active (currently participating) Sureties, all recovery and refund payment are sent through Pay.gov For a Non-Active (not currently participating) or Defunct Surety, the check should be sent to SBA at the following address:

Director  
 Claims and Recovery Division  
 Office of Surety Guarantees  
 U.S. Small Business Administration  
 409 Third Street, S.W.  
 Washington, DC 20416

The following procedures are to be used with respect to "Due SBA" accounts:

- a. Incoming Payment Procedures for Due SBA Accounts  
 Due SBA account can be submitted through Pay.gov. Pay.gov is a financial management transaction portal that is managed by the U.S. Treasury's Financial Management Service that enables the public to electronically remit payment to Federal agencies 7 days a week, 24 hours a day.
- (1) Date stamp all incoming related correspondence, if payment is made via check.
  - (2) Check the case file for the appropriate SBG number.
  - (3) Prepare letter with SBG Number, Bond Number, and Amount of Payment with a copy of 994H(s) on all correspondence. If the payment pertains to several SBG numbers, itemize under each SBG number the proportionate amount to each bond.
  - (4) If applicable, make two copies of the check and the related correspondence and distribute as follows: a copy with the 994H to be uploaded into CLS and a copy for the surety file. Inactive, defunct, insolvent i.e., sureties submitting payment monies to be sent no longer have ACH accounts.
  - (5) Place the check(s) and applicable documents in an envelope addressed to DFC and put it in the Denver overnight box in the Office of the Chief Financial Officer (CFO).
  - (6) Monitor the file for at least 30 days to see if payment is submitted. At that time, follow the "Due SBA" procedures described in the next section.
- b. Due SBA Procedures

The "Due SBA" amount is submitted by the Surety on SBA Form 994H, "Claim for Reimbursement." CRD uses the following steps to process a "Due SBA."

- (1) Check the trade name and the SBG number on the "Due SBA" to make sure that the name and number corresponds to the correct contractor file, and to bond and claim number(s) on previous correspondence.
- (2) Check the figures on the SBA Form 994H using the same procedures described in Chapter 2, "Claim for Reimbursement Procedures." The SBA Form 994H may indicate that the Surety's recovery was offset by the loss paid.
- (3) If the Surety's calculation and the amount due to SBA are incorrect, notify the Surety of the discrepancies and monitor the file for follow-up.
- (4) Check the "Accounting Transactions" screen in the CLS for the appropriate SBG number to determine if SBA has received its share of the recovery funds.

c. Recovery Not Received by SBA

If a period of 45 calendar days has passed since the receipt of the "Due SBA" and there is no indication that the recovery monies have been credited to the appropriate bond, CRD will proceed as follows.

- (1) Contact the Surety to verify that the monies were sent. If the monies have not been sent, request remittance from the Surety in writing.
- (2) Monitor the file for approximately two weeks and follow-up at that time.
- (3) A Surety's failure to remit recovery monies to SBA within 45 days should be reported in writing to the Director of Claims for further action.
- (4) Director prepares demand letter with the assistance of OGC.

d. Recovery Applied to an Incorrect SBG Number

If recovery monies have been applied to an incorrect bond, the CLS database records must be adjusted. Contact SBA's DFC in Denver, CO and the Director, Office of Performance and Systems Management in Headquarters with the correct information for assistance.

e. Refund of Recovery Money

Request a Form 994H from the Surety to process a refund due the Surety for overpayments of SBA's share of the recovery. Once CRD receives the information and agrees with the refund, send letter to DFC and instruct how to code the monies recovered.

### **3.3. Procedures for Placing a File in "Closed-Final" Status**

A Surety must obtain SBA's written consent to discontinue recovery efforts when further

indemnity pursuit is considered economically impractical or when the indemnitor(s) have been discharged in bankruptcy. CRD must take the following steps to complete the closing process.

a. File Review

- (1) CRD reviews the case file for each defaulted bond guarantee listed in the Surety's request. Request the financial background information on each respective indemnitor to verify that it is no longer practical to continue indemnity pursuit. Make sure that final reimbursement to the Surety has been made.
- (2) If the indemnitor(s) have been discharged in bankruptcy, the file must contain a copy of the Bankruptcy Discharge. Make sure that the indemnitor(s) listed on the GIA are listed on the Discharge.

b. Closing Process

- (1) Usually the final request for reimbursement is submitted with the Surety's request to close. If it is not, CRD maintains the file in the "Closed to Subrogation" status until the final billing is received. Any disbursement by the Surety that occurs more than 90 days after the Surety's request to close must be accompanied by supporting documentation. Once the final payment request and any applicable documentation have been received, place the specific bond guarantee into a "Closed Final" status in the CLS.
- (2) Complete a "Closing Summary Sheet" when the file is being closed. Include a brief summary of the Surety's subrogation and recovery attempts on each defaulted project in the closing request, reasons for closing the file, and CRD's recommendations concerning the Surety's request to discontinue subrogation and recovery efforts. Submit this summary to the supervisor for approval to close the file. Once approval is received, prepare a letter to the Surety for the supervisor's signature.
- (3) Update the CLS with the closing information.

c. Disposition of a Closed-Final File

- (1) Notate the file and update the computer file tracking system that the file is "Closed-Final."
- (2) Forward the file to the warehouse for storage if applicable.
- (3) A listing of the closed-final files are accessible in CLS.



### 3.4. Indemnity Settlements

#### a. Definition of a Settlement

A settlement occurs when a defaulted contractor and its Surety agree upon an amount less than the total loss amount that will satisfy the contractor's indebtedness to the Surety. SBA must concur, in writing, to a Surety's recommendations regarding the settlement offer before the settlement can be finalized. Once the settlement has been executed, the Surety must submit SBA's guaranteed share of such amount within 45 days of receipt. (For details on submitting payments to SBA, see paragraph 3.2 "Funds Due SBA.")

#### b. Types of Settlements. CRD will identify in CLS the type of settlement approved as follows:

- (1) Settlement (Immediate Payment of SBA's Pro Rata Share of Recovery). The Surety settled its claim with the indemnitor(s) for an amount less than the Surety's total loss with terms accepted by OSG.
- (2) Settlement (Delayed Payment of Settlement Adequately Assured). The contractor has paid the Surety a portion of the settlement amount and the Surety has taken firm collateral from the contractor for the balance of the settlement amount. CRD must obtain a copy of the collateral document and SBA's share of the partial payment from the Surety.
- (3) Contested Claim (Scheduled Court Appearance). The contractor has been presented with a claim which it contests in court. The contractor posts collateral with the Surety in the amount of the possible loss from the claim, including legal and administrative fees reimbursed to the Surety by SBA. The Surety sends SBA a copy of the draft, money order, or collateral document plus confirmation that there are no other claims outstanding on this or any other SBA-guaranteed bond involving this contractor.

#### c. Policy Guidelines for Settlements

Under the terms and conditions of SBA Forms 990 or 990A, the authority to act upon proposed settlement offers in connection with defaulted Surety bonds lies with the Surety and not SBA; however, the Surety must obtain SBA's written concurrence with the terms negotiated by the Surety before the Surety may enter into a settlement agreement. The contractor's contractual relationship is with the Surety company, not SBA; therefore, all matters pertaining to settlement and reinstatement must be arranged with and through the Surety. SBA will not negotiate or discuss with the contractor any amount owed to the Surety by the contractor or settlement of such debts.

d. Procedures Used to Review a Settlement Proposal

CRD takes the following steps to review a Surety's recommendation for indemnity settlement.

- (1) Checks SBA's payment amount for all defaulted projects (including projects with other sureties) to determine SBA's total net loss on all projects.
- (2) Determines which defaulted projects are involved in the settlement proposal.
- (3) Reviews the facts outlined in the settlement letter and any other correspondence.
- (4) Reviews the following information in the file:
  - (a) GIA - Make sure that all of the indemnitors are accounted for in the Surety settlement proposal. If not, request information regarding what recovery actions have been taken against the indemnitor(s) in question.
  - (b) Status Reports, Financial Statements (including tax returns) - ascertain the financial status of the indemnitors.
  - (c) Investigative Reports (credit, asset reports, etc.) - Further evaluate the financial status of the indemnitors.
  - (d) If clarification of questionable items or supporting documentation is needed, contact the Surety for additional information.
  - (e) Compare the total net loss figure with the total amount of the settlement being offered. Consider whether the settlement offer is reasonable compared to the total loss amount.
  - (f) Prepare a written summarization of the facts of the case, including any pertinent recommendations concerning the settlement proposal. Explain any agreement or disagreement with the settlement offer.
  - (g) Submit recommendations to the D/OSG through your supervisor.
  - (h) Advise the Surety of SBA's decision concerning the settlement offer. This response may be in the form of a telephone call, email or a letter, depending upon the urgency of the situation. If the response is by phone, prepare a letter of confirmation no later than the next business day. The letter should outline the settlement terms as submitted to SBA.
  - (i) If the settlement proposal is not satisfactory to SBA, CRD will advise the Surety and request that it to re-negotiate the settlement terms.

- (j) Request a follow-up letter from the Surety representative outlining the settlement terms and the final outcome. If the settlement is executed, CRD must request a copy of the executed agreement and SBA's share of monies received.
- (k) Upon receipt of this follow-up letter, monitor the file for an appropriate period of time to be sure that the recovery monies have been received.

### **3.5. Reinstatement of the Contractor**

A reinstatement occurs when the Contractor becomes eligible for further Surety bond guarantee consideration and the SBA CLS Application System is updated accordingly.

#### **a. Circumstances Permitting Reinstatement**

At any time after a Contractor becomes ineligible for further bond guarantees, a Prior Approval Surety may recommend that such Contractor's eligibility be reinstated, and OSG may agree to reinstate the Contractor if:

- (1) The Surety has settled its claim with the Contractor, or any of its Affiliates, for an amount that results in no Loss to SBA or in no amount owed for Imminent Breach payments, or D/OSG finds good cause for reinstating the Contractor notwithstanding the Loss to SBA or amount owed for Imminent Breach payments. Good cause may exist, for example, if the loss was attributed solely to the acts or omission of a co-owner who is no longer a part of the business, or
- (2) D/OSG and the Surety determine that further bond guarantees are appropriate after the Contractor was deemed ineligible for further SBA bond guarantees under paragraphs 2.3(a), (b), (c), (e), and (f).

Note: As a result of the contractual relationships established by SBA Forms 990 or 990A, the Surety is the only party that may request reinstatement of a Contractor. Often, OSG and area office staff are contacted by the Contractor, the Contractor's attorney, or the Contractor's current agent regarding future bonding. In these instances, SBA personnel should refer the party to the Surety and encourage repayment negotiations between the two parties. The Surety must then notify OSG when the Contractor has resolved his/her claim obligations so that reinstatement procedures can be initiated.

#### **b. Impact of Surety Company Financial Status on Reinstatement**

- (1) **Settlement Effected Prior to the Surety Company's Status Change:** If a settlement between the Contractor or Contractor's legal representative and the Surety company was approved by SBA and was effected prior to the Surety company's status change to defunct, rehabilitation, or liquidation, then the amount and the terms of the settlement should stand as the duly renegotiated debt.

- (2) Settlement Effected After the Surety Company's Status Changed: Subject to SBA approval of the settlements terms, a new settlement on a defaulted SBA-guaranteed bond may be effected between a Contractor and a State Insurance Department as liquidator, if the Contractor's Surety is defunct, in rehabilitation, or in liquidation.

c. Reinstatement Procedures

CRD takes the following steps to reinstate a file.

- (1) Review the file in the CLS.
- (2) If the file was previously closed final and sent to storage, update the status in the CLS.
- (3) If a settlement has been approved, check the net loss figure, recovery total, and default status, and review to ascertain that the terms of the settlement have been satisfied.
- (4) Update the CLS SBA CLS Application System database records to reflect the reinstatement or closing status.
- (5) Prepare a reinstatement letter and submit it to the supervisor for approval.
- (6) After the reinstatement has been approved and the reinstatement letter signed, the following steps should be taken to return the file, if applicable, to the area office.
  - (a) The reinstatement letter and documentation that supports the reinstatement are to be uploaded to the electronic file contained in the SBA CLS Application System.
  - (b) Send notification of reinstatement to the appropriate area office via e-mail or with the file by overnight mail.

## **Chapter 4. Procedures for Sureties that are Defunct, in Rehabilitation, or in Liquidation, for Prior Approval Program**

### **4.1. Definitions**

- a. Defunct Surety: A defunct Surety has ceased to function and no longer conducts business operations.
- b. Surety in Rehabilitation: A Surety in rehabilitation is under corporate reorganization of Chapter 11 of the Bankruptcy Code in an attempt to reinstate the Surety to its former condition of successful operation and solvency.
- c. Surety in Liquidation: A Surety in liquidation is in the process of settling its financial affairs by reducing its assets to cash, discharging liabilities, and dividing surplus or loss. Liquidation may precede or follow dissolution, which is the end of the legal existence of a corporation.

### **4.2. Claims Handling Procedures for Sureties that are Defunct, in Rehabilitation, or in Liquidation**

If a Surety becomes insolvent (*i.e.*, defunct, in rehabilitation, or in liquidation), all rights or benefits conferred on the Surety under a valid and binding Prior Approval agreement will accrue only to the trustee or receiver of the Surety. SBA will not be liable to the trustee or receiver of the insolvent Surety except for the guaranteed portion of any loss incurred and actually paid by such Surety or its trustee or receiver under the guaranteed bonds. The State Insurance Department where the Surety is located becomes responsible for settling claims and handling all claims matters. The trustee or receiver must submit quarterly status reports accounting for all claims paid, all funds received and all settlements being considered to SBA. All correspondence concerning sureties that are defunct, in rehabilitation, or liquidation are referred to the supervisor for action. Payment requests from insolvent sureties will be processed in accordance with Chapter 2, "Claim Reimbursement Procedures for the Prior Approval Program," of this SOP.