another CDC within or adjoining the deficient CDC's Area of Operations. If there is no suitable CDC, SBA may approve a transfer to another entity. Future service fees from transferred loans will be paid to the transferee. In addition, the CDC's processing authority will be temporarily suspended.

§ 120.984 Suspension or revocation of CDC certification.

(a) *Suspend or revoke.* The AA/FA may suspend or revoke the CDC's certification if a CDC:

(1) Violates a statute, an SBA regulation, or the terms of a Debenture, authorization, or agreement with SBA;

(2) Makes a material false statement, knowingly misrepresents, or fails to state a material fact;

(3) Fails to maintain good character;

(4) Fails to operate according to prudent lending standards;

(5) Fails to correct servicing, collection, reporting, or other deficiencies; or

(6) Is unable or unwilling to operate in accordance with the requirements of this part.

(b) *Transfer portfolio.* Upon suspension or revocation, the CDC must transfer its remaining portfolio and any 504 applications or financings in process to another CDC designated or approved by SBA. If a pending 504 financing is completed after a transfer, any deposit must also be transferred. Any fees must be apportioned by SBA between the two CDCs in proportion to services performed.

(c) *Provide written notice.* SBA must give written notice to the CDC at least 10 business days prior to the effective date of a suspension or revocation, informing the CDC of the opportunity for a hearing pursuant to part 134 of this chapter.

Enforceability of 501, 502 and 503 Loans and Other Laws

§ 120.990 501, 502, and 503 loans.

SBA has discontinued loan programs for 501, 502, and 503 loans. Outstanding loans remain under these programs, and Borrowers, CDCs, and SBA must comply with the terms and conditions of the corresponding notes and Debentures, and the regulations in this part in effect when the obligations were undertaken or last in effect, if applicable.

§ 120.991 Effect of other laws.

No State or local law may preclude or limit SBA's exercise of its rights with respect to notes, guarantees, Debentures and Debenture Pools, or of its enforcement rights to foreclose on collateral.

PARTS 108, 116, 122, and 131—[REMOVED]

2. Parts 108, 116, 122, and 131 are removed.

Dated: January 22, 1996.

John T. Spotila,

Acting Administrator.

[FR Doc. 96–1432 Filed 1–30–96; 8:45 am]

BILLING CODE 8025–01–P

13 CFR Part 115

Surety Bond Guarantee

AGENCY: Small Business Administration (SBA).

ACTION: Final rule.

SUMMARY: This final rule revises the regulations found at 13 CFR Part 115, governing the Surety Bond Guarantee (SBG) Program. It eliminates inconsistencies, clarifies procedures, accommodates program experience and industry changes, and provides for more efficient program operation. It also clarifies and shortens regulations where appropriate, eliminates redundant provisions, consolidates and reorganizes sections, and clarifies ambiguous language.

EFFECTIVE DATE: This final rule is effective March 1, 1996.

FOR FURTHER INFORMATION CONTACT: Barbara Brannan, Office of Surety Guarantees, (202) 205–6540.

SUPPLEMENTARY INFORMATION: In response to a Memorandum from President Clinton for all federal agencies to simplify their regulations, SBA published a proposed rule on November 27, 1995, to revise the regulations governing the Surety Bond Guarantee Program. See 60 FR 58263 (November 27, 1995). The public was afforded a thirty-day period in which to submit comments on the proposed rule to SBA. During that period, SBA received 12 comment letters. After giving careful consideration to the concerns raised in those letters, SBA is today finalizing the proposed rule with certain modifications discussed below.

General Comments

Those comment letters that addressed the proposed renumbering and reorganization of Part 115 commended the rewrite for its clarity and comprehensibility. Those aspects of the proposed rule are being finalized as proposed. In this final rule, SBA has continued its effort to simplify Part 115 by creating smaller sections out of the largest proposed section (§ 115.60). Subsequent sections (§§ 115.61 through 115.64) have been renumbered to accommodate this change.

Definitions—Contract, etc.

All three of the comments received on the proposed change to the definition of ''contract'' objected to the exclusion of maintenance agreements covering defective materials. Under the proposal, a maintenance agreement covering defective workmanship would be considered a contract, but a maintenance agreement covering defective materials would not. It was argued in the comments that the typical maintenance agreement in use today covers both defective workmanship and defective materials. On reconsideration, SBA agrees that the definition of contract should permit coverage of defective materials since that accords with standard practice in the industry today. The definition is finalized accordingly. The final version also clarifies that maintenance agreements of longer than two years duration can be considered contracts if they meet the requirements set forth in the definition.

A new defined term has also been added to the final rule: ''final bond''. The term means a performance bond and/or a payment bond. This is one of several non-substantive changes SBA is making in the final rule to make the regulations clearer.

Eligibility of Payment Bonds

Proposed § 115.12(b) would have allowed payment bonds to be guaranteed by SBA only if performance bonds were issued at the same time. As four comment letters pointed out, recent amendments to the Miller Act eliminate the bonding requirement for federal contracts of less than $100,000, but allow for certain alternatives to protect subcontractors and suppliers against non-payment by the general contractor. As one alternative, the contracting officer may require a payment bond on the contract. Under SBA's proposed change to § 115.12(b), contractors in the SBG Program would have been unable to bid on those small public contracts that require payment bonds only.

Given the recent Miller Act changes, SBA agrees that payment bonds should not automatically be considered ineligible for guaranteed bonding when no performance bond is issued. The final version of § 115.12(b), therefore, does not restrict the eligibility of payment bonds. However, SBA does not intend to guarantee payment bonds that are essentially forfeiture bonds. If a payment bond allows the claimant to receive the full amount of the bond from the surety regardless of the amount of the damage or loss the claimant has

actually suffered, the bond is a forfeiture bond. The definition of payment bond has been changed in this final rule to clarify that no forfeiture bonds will be guaranteed by SBA.

In response to a comment from the Surety Association of America, a technical change to proposed § 115.12(b) is also being adopted. The reference in the current and proposed regulation to the Surety Association's ''Rating Manual'' has been changed to its ''Manual of Rules, Procedures and Classifications'' to conform to the Association's current name for its publication.

Transfer of Surety's Files

SBA's proposal to prohibit the transfer or sale of surety files and accounts is finalized with certain changes to clarify SBA's intent. As the commenters surmised, the provision (proposed § 115.12(f)) was not intended to apply to the sale of a surety's entire property and casualty operations. SBA does not want to restrict the sale of a surety's entire book of business. In addition to this clarification, the final rule now provides that when the prohibition against the transfer or sale of files and accounts does apply, it can be overridden with SBA's prior approval.

Principal's Eligibility

Several comment letters expressed concern regarding SBA's proposal to exclude from participation in the SBG Program those principals who are primarily brokers or construction managers. SBA recognizes that many small general contractors subcontract out a high percentage of the work under a contract. This is not necessarily objectionable. Rather, SBA is trying to weed out those principals whose subcontracting results in the principal losing control over the project. In the most egregious cases, the principal may be fronting for the subcontractor. This objectionable activity may not be discernible solely from the percentage of work subcontracted on a project, although that is often a good indicator. To clarify SBA's position, proposed § 115.13(e) has been rewritten to delete the reference to ''construction managers''. Instead, the final version excludes from participation in the SBG Program principals who are brokers or who, through subcontracting out work under the contract, have effectively lost control over the project. The final version (now designated § 115.13(a)(5)) still requires principals to specify the percentage of work under the contract to be subcontracted.

Proposed § 115.13(g) seems to have created a misunderstanding. It was not SBA's intent to prohibit a contractor whose spouse works for a surety company from obtaining bonds through the SBG Program. Such ''conflicts of interest'' would not preclude contractors from participating in the program, but they might bar contractors from obtaining guaranteed bonds through the ''affiliated'' surety. For example, if the spouse of a contractor (1) is ''empowered to act on behalf of the surety'' (and is therefore included under the definition of ''surety'') and (2) is considered to own at least 10% of the contractor business, then that surety company can not issue a guaranteed bond for that contractor. Any other surety company in the SBG Program, however, could issue a guaranteed bond for that principal. The final version of the subsection (now designated § 115.13(b)) clarifies that it addresses the eligibility of a principal to receive guaranteed bonds issued by a particular surety, not by all sureties in the SBG Program. The other paragraphs in the section have been relettered accordingly.

Loss of Principal's Eligibility

Subsections (1) and (2) of proposed § 115.14(a) provided that principals would lose eligibility for further SBA bond guarantees if legal action under the bond had been initiated or if the principal had been declared in default under the contract. The comments received on these two paragraphs questioned the wisdom of an automatic loss of eligibility under these two situations. It was argued that taking such action could cause financial hardship to the contractor and might even put the contractor out of business. The suggestion was made that the surety company's underwriter or claims department should make the determination as to loss of a principal's eligibility in these two cases.

SBA believes that the subsections governing a principal's loss of eligibility must be read in conjunction with the section on reinstating the principal's eligibility (proposed § 115.36(b)). SBA is rewording proposed § 115.36(b) to allow for reinstatement of the principal's eligibility in the event SBA and the surety agree to reinstate. With that change, if legal action is initiated under the bond, or if any of the other events in § 115.14(a) occurs, the principal still loses eligibility for further guaranteed bonding, but reinstatement of eligibility can occur almost immediately if both SBA and the surety agree it is appropriate. SBA expects that, with that mechanism in place, frivolous lawsuits and baseless claims under the bond will not stand in the way of further guaranteed bonding of an otherwise eligible principal. Subsections (1) and (2) of proposed § 115.14(a) are therefore unchanged in the final rule.

Subsection (3) of proposed § 115.14(a) provided that a principal's eligibility would be lost if the surety established a claim reserve for the bond in excess of $100. All five of the comments received on this subsection objected to the $100 threshold as too low. The argument was made that some sureties routinely set up a claim reserve in excess of $100 every time a trouble notice is received on a project, and that claim reserves do not necessarily reflect actual loss potential. Two of the comments recommended a $500 claim reserve as the minimum level which indicated the potential for serious loss.

SBA's proposal had been intended as a liberalization of the current regulation (§ 115.34(a)), which provides that a claim reserve of any amount results in automatic loss of the principal's eligibility. SBA believes, though, that with the other triggers for loss of eligibility in place in § 115.14(a), it is appropriate to increase the minimum claim reserve threshold. SBA has concluded that claim reserves below $1000 should not result in the loss of the principal's eligibility. The rule is finalized accordingly.

A new provision has been added to § 115.14(b) to clarify that in the PSB Program a principal's eligibility is reinstated upon the surety's own determination that reinstatement is appropriate.

Underwriting and Servicing Standards

Four comments were received on the proposed rewrite of the program's underwriting standards (proposed § 115.15(a)). All were opposed to the proposed 150% limit on contracts for contractors new to the SBG Program. SBA had intended the 150% limit as general guidance for underwriting decisions, not as an absolute requirement. Upon reconsideration, SBA believes that underwriting guidelines need not appear in the regulations. Accordingly, the guidance on limits for contractors new to the SBG Program is being moved to an SBA Standard Operating Procedure (SOP) for the SBG Program. Also moved to the SOP are SBA's recommendations as to type and size of contract for guaranteed bonding and other general underwriting guidelines. SBA expects that sureties will follow the recommendations in the SOP when making their underwriting determinations. The balance of § 115.15(a) is finalized as proposed.

Four comments were also received on the proposed rewrite of the program's

servicing standards (proposed § 115.15(b)). All four addressed the requirement for sureties to obtain job status reports from obligees on final bonds guaranteed by SBA. The comments pointed out the difficulty in obtaining job status reports from an obligee who refuses to respond to job status inquiries. SBA agrees that sureties should not be held to a requirement that is outside of their control. Instead of requiring sureties to obtain job status reports, therefore, the final rule provides that sureties must request job status reports and document the request in their files.

Determination of Loss

Two comment letters asked for clarification of the terms ''mark-up on expenses'' and ''overhead,'' as used in the computation of the surety's ''loss'' in proposed § 115.16(f)(1). The proposal would have prohibited reimbursement from SBA for any mark-up on expenses or any overhead of ''the surety, its attorney or any other party.'' SBA believes the terms in question are generally understood business terms, but that some confusion may have been generated by the words ''or any other party.'' SBA is remedying that problem by changing the words to ''or any other party hired by the Surety or the attorney.'' In particular, consultants hired by either the surety or the surety's counsel cannot indirectly charge SBA for their overhead or for anything over their actual costs.

Using photocopying costs as an example, the restriction on mark-up on expenses would mean that if the surety's attorney copies documents on its office xerox machine and charges the surety for its actual per copy cost, plus 20%, the surety cannot include in ''loss'' the 20% excess over the attorney's actual cost of making those copies. The same would be true of photocopying by the surety itself; only the actual per copy cost could be included in loss. If the surety or the attorney has documents copied at a photocopying store, however, the amount of the copying expense included in the surety's loss is the full amount the store charges the surety or the attorney, regardless of the actual cost to the store of that job. The retailer's markup is a permitted expense because the retailer has not been ''hired'' by the surety.

In general, SBA would consider ''mark-up on expenses'' to include any add-on to the actual cost of an expense item. ''Overhead'' means the general costs of running a business. Some examples of overhead include rent, electricity, and heating and air conditioning costs.

Salvage and Recovery

SBA received three comments on proposed § 115.17(b)(2), the subsection establishing SBA's share of the salvage and recovery received by a surety when a principal defaults on a bonded contract that SBA has guaranteed. The three comments opposed SBA's proposal that it share not only in any recovery received by the surety in connection with the guaranteed bond for the principal, but also in any recovery received in connection with any other bond issued by the surety on behalf of that principal. The commenters suggested that the surety be allowed to apply contract funds from the defaulted non-guaranteed project to that project's losses first, and then give SBA any excess it receives. Ordinarily, the excess would be paid over to the principal.

Upon reconsideration, SBA believes its proposal was overly broad. Under the final rule, SBA will not share in contract proceeds and other forms of salvage and recovery that are clearly identifiable as related solely to a bonded contract that SBA has not guaranteed. On the other hand, if the surety's recovery could apply to both a contract without a guaranteed bond and a contract with a guaranteed bond, SBA will be entitled to its share of the entire amount of that recovery. For example, if the surety collects from an individual who has indemnified the surety for its losses under both a guaranteed bond and a non-guaranteed bond, the entire recovery from that party will be assumed to relate to the guaranteed bond for purposes of determining SBA's share.

Renegotiation of guarantee percentage

Several comment letters requested clarification of SBA's ability under proposed § 115.18(a)(3) to renegotiate a surety's guarantee percentage in the event the surety experiences excessive losses. In response to those requests, SBA assures the participants in the SBG Program that the guarantee percentage for bonds already written by a surety cannot be renegotiated. In the event a surety's losses are determined to be excessive by SBA, the surety may be required to renegotiate the guarantee percentage for bonds issued after that date. The final version of proposed § 115.18(a)(3), now designated § 115.18(a)(4), clarifies this point.

Denial of Liability—Excess Bond Amount

Under proposed § 115.19(a), SBA would not be liable under its guarantee if the bond amount at any time exceeded the total contract amount determined at the time of the bond's execution. The four comments received on this subsection made two points. The first point was that certain public (government) projects require bonding in excess of 100% of the contract amount. An exception for such projects was requested. SBA's proposal limiting bonds to 100% of the contract amount, while new to the regulations, has long been a policy of the SBG Program. The restriction has been a part of the Program's Standard Operating Procedure for over ten years. See SOP 50 45, Revision 1, page 22. The reason for the restriction is that SBA has determined that any situation in which the surety and SBA have a greater liability than the obligee is inherently not reasonable in light of the risks involved. It would be statutorily impermissible for SBA to issue a guarantee under those circumstances. See 15 USC 694b(a)(4)(D). Public projects requiring bonding in excess of 100% will have to continue to be bonded outside of the SBG Program.

The second point raised in the comment letters was that as contract amounts increase by change order, bond amounts may increase as well. If the bond can never exceed the original contract amount, there is no possibility for increases in the bond amount when the contract amount is increased. SBA has reconsidered its position on this issue. The final rule permits the bond amount to exceed the original contract amount but, as discussed in the preceding paragraph, the bond amount must never exceed the contract amount measured at the same time.

Denial of Liability—Substantial Regulatory Violation

Under proposed § 115.19(d), SBA would not be liable under its guarantee if the surety committed a substantial violation. A substantial violation was proposed to include a violation which caused an increase in the contract or bond amount of 25% or $50,000. Upon consideration of the one comment received on this paragraph, SBA has concluded that it is extremely unlikely that a regulatory violation could cause an increase in the contract amount. SBA's real concern is with increases in the bond amount. The final rule deletes the reference to the contract amount in § 115.19(d).

Denial of Liability—Alteration

Under proposed § 115.19(e), SBA would not be liable under its guarantee if the surety agreed to or acquiesced in any material alteration of the contract or bond without SBA's prior written approval. This differs from the current regulation, § 115.13(e), which does not include alterations in the contract as a basis for SBA to deny liability. The single comment received on proposed § 115.19(e) pointed out that the standard bond form in the surety industry provides that the surety waives notice of changes to the contract. Changes to the contract frequently occur without any approval from the surety. Accordingly, SBA has decided to remove contract alterations as a basis for denial of liability in the final rule.

Denial of Liability—Timeliness

Under proposed § 115.19(f), SBA would not be liable under its guarantee if the surety executed the bond before SBA's guarantee was executed. This provision complies with the statutory requirement that an SBA bond guarantee may be issued only if the principal is not able to obtain the bond on reasonable terms and conditions without the guarantee. See 15 USC 694b(a)(4)(C). A bond dated prior to SBA's guarantee is a bond that is obtainable without such guarantee.

The two comments received on this subsection expressed concern that the current industry practice of back-dating the bond at the request of the obligee could result in an SBA determination to deny liability under the guarantee. Apparently, many obligees require that the bond be dated the same date as the contract, regardless of the actual execution date of the bond. SBA does not object to a bond carrying an ''effective date'' (e.g., ''dated as of July 1, 1996'') that is earlier than its execution date (e.g., ''signed July 20, 1996'') as long as there is proper documentation of the actual date of execution of the bond and such execution date is no earlier than the date of SBA's guarantee. SBA does not believe that any change to the proposed language in § 115.19(f) is necessary, as the proposal speaks only of execution of the bond. The provision is finalized as proposed.

Denial of Liability—Other Regulatory Violations

In accordance with the suggestion in the one comment received on proposed § 115.19(h)(6), SBA is correcting the language of the proposed subsection to clarify that sureties are permitted to make payments under payment bonds even though such payments may not result from the principal's breach of the bonded contract. SBA had not intended for the proposal to be interpreted any other way. The final version of § 115.19(h)(6) makes this technical correction.

Audits and Investigations

In connection with the requirement under the final version of § 115.15(b) for sureties to document the job status inquiries they make, SBA is including such documentation, together with any job status reports received by the surety, in the list of records required to be maintained by the surety under the final version of § 115.21(b).

Prior Approval Program—SBA Approval

SBA is finalizing proposed § 115.30(b) without change. The proposal, which provided that SBA's written approval of a guarantee application would control over any conflicting verbal approval, was not different substantively from the current regulation (§ 115.31(a)). Nevertheless, SBA appreciates the concern of the two commenters who requested some protection for sureties relying on a verbal approval from an SBA officer, only to learn that the guarantee agreement was not signed until the following day. SBA intends to make clear to all SBG Program personnel that no verbal approval of a guarantee application may be communicated unless the guarantee application has already been executed by an authorized official. Sureties requiring greater certainty than the regulation affords are advised to request a telecopy of the signed guarantee form as confirmation.

Prior Approval Program—Principal's and Surety's Fees

Ten of the eleven comments received on the proposed increase in the principal's fee (proposed § 115.32(b)) were opposed to the increase. The eleventh comment commended SBA's attempt to make the program self-financing and recommended an even greater increase in the principal's fee than had been proposed by SBA. The vast majority of the comments on this topic, however, cited the adverse impact on the contractors and on the SBG Program. In particular, there was concern that the increase would impose a financial burden on the contractors in the program and would result in a dramatic cut-back in program participation. Only the higher risk contractors—those without collateral or other alternatives to the SBG Program—were predicted to remain in the program.

Ten comments were also received on the proposed increase in SBA's charge to the surety (proposed § 115.32(c))—all opposed. According to several sureties, writing bonds in the SBG Program already costs the surety more than writing equivalent bonds with standard reinsurance. It was predicted that some sureties would leave the program and that sureties remaining in the program would attempt to pass the increase on to the contractor by raising premium rates.

SBA has given careful consideration to the concerns surrounding the proposed increases in the principal's fee and the surety's fee. SBA continues to believe that the long-term goals of the SBG Program will be best served if the program can become self-financing. However, the costs of any transition to a self-funding program should not outweigh the benefits to be derived from the change.

To allow time for further consideration, SBA has decided to keep the fees at their current levels (.06% of the contract amount for the principal fee; 20% of the bond premium for the surety fee) at this time. Future changes in the fee percentages will be published by SBA in the form of a Notice in the Federal Register. SBA is completing an analysis of the performance of the SBG Program and evaluating whether changes in the fees are warranted, and will publish a Notice within 30 days of the date of publication.

Prior Approval Program—Contract Increases/Decreases

Proposed § 115.32(d) elicited nine comments from readers, none of which supported the proposal. The proposal contained several components. First, sureties would be required to notify SBA of all increases or decreases in the contract or bond amount as soon as the surety learned of the change. All notifications of increases would have to be accompanied by the associated increase in the principal's fee. The increase in the surety's fee would be payable in the ordinary course of business. Under the current regulation, by contrast, notification is required only when the changes in the contract or bond amount aggregate at least $10,000 (current § 115.35(c)). No increase in the principal's or the surety's fee is computed at that time.

Second, under the proposal, any single change in the contract or bond amount of at least 25% or $50,000 would require prior SBA approval. Under the current regulation, changes in the bond amount aggregating at least

25% or $50,000 require SBA's approval and simultaneous payment of any increase in the principal's fee. The increase in the surety's fee is payable in the normal course of business.

Third, under the proposal, payment for the increased fees would be due and payable regardless of the size of the check. No exception would be made for small sums. Under the current regulation, if the increase in the principal's or the surety's fee is less than $40, the amount is ''disregarded''.

Fourth, under both the proposal and the current regulation, decreases in the contract or bond amount are treated the same as increases of an equivalent amount would be treated. Decreases resulting in refunds from SBA of a portion of the principal's fee, however, are paid directly to the principal under the proposal, but are paid to the surety (who then transmits the refund to the principal) under the current regulation.

The comment letters uniformly registered objections to the greater administrative burden considered to be imposed by the proposed notification and payment requirements. Opposition to the removal of the $40 threshold was also expressed consistently, although some commenters suggested a $100 threshold in its place. No objection was raised to the proposed mechanism for refunding the excess principal's fee.

SBA has reconsidered its proposal in light of the comments received. Instead of requiring notification of all increases and decreases in the contract or bond amount, and the payment of associated fees, the final rule requires notification of increases or decreases only when they aggregate 25% of the contract or bond amount or $50,000. Such notification must be accompanied by the increase in the principal's fee; however, increases (or decreases) in the principal's or the surety's fee will not be due and payable until they aggregate at least $40. Increases in the surety's fee will be payable in the ordinary course of business, as they are presently. Any single change order that increases the bond amount by 25% or $50,000 will require the prior approval of SBA. Except for the changes discussed in this paragraph, § 115.32(d) is finalized as proposed.

Prior Approval Program—Events Requiring Notification

Under proposed § 115.35(a)(1)(iv), SBA would require sureties in the Prior Approval Program to notify SBA if the surety were to receive any adverse information concerning the principal's financial condition or possible inability to complete the project or to pay laborers or suppliers. One commenter expressed concern that if such notification were to be the cause of a principal's loss of eligibility for the program, lawsuits against the surety by the principal could follow. SBA believes such concern to be unfounded. Section 115.14 of this final rule details the grounds for a principal's loss of eligibility to participate in the program; adverse information, absent anything else, is not among the permitted grounds. SBA's proposal to require notification of adverse information is adopted without change.

PSB Program—Premium Rates

The Surety Association of America has advised SBA that it no longer keeps advisory premium rates for the surety industry. Proposed § 115.60(a)(2), as well as current § 115.10(d)(2), require that PSB Sureties charge principals no more than the Association's advisory premium rates. The Association suggested using their advisory premium rates in effect on August 1, 1987, as the standard. SBA considers that a satisfactory solution for now, but will continue to explore alternatives. The final version of § 115.60(a)(2) incorporates that change.

PSB Program—Retention of Information

SBA agrees with the two comment letters received on proposed § 115.60(g)(1). PSB Sureties should not be required to keep a record of the time of execution of each bond. A record of the date of execution of the bond is sufficient. The final version of the subsection, redesignated § 115.65(a), reflects this correction.

PSB Program—Principal's and Surety's Fees

The proposal to increase the principal's and surety's fees in the PSB Program (§ 115.60(g)(4)) is being revised in the same manner as the equivalent provisions in the Prior Approval Program. See the discussion above under ''Prior Approval Program—Principal's and Surety's fees.''

PSB Program—Contract Increases/Decreases

The final version of § 115.60(g)(5), redesignated § 115.67, mirrors the changes made to the equivalent provision in the Prior Approval Program (§ 115.32 (b) and (c)), as discussed above under ''Prior Approval Program—Contract increases/decreases.''

Miscellaneous

A comment from one of the surety trade associations was received on the substitution of SBA form names for SBA form numbers in the proposed rule. According to the comment, sureties refer to SBA documents by their respective SBA form numbers, not names. SBA recognizes that the names of its forms are not as familiar to program participants as its form numbers. In order to avoid confusion, SBA has retained the form numbers in the final rule.

In the **SUPPLEMENTARY INFORMATION** section of the proposed rule, SBA discussed the proposed deletion of current § 115.30(b), including the requirement for the principal to file SBA Form 1624 (Lower Tier Certification form) with its initial guarantee application. As SBA explained, the requirement would be removed from the regulations and would be issued as internal guidance, with the following change: the Lower Tier Certification would have to be submitted with each application for a principal, not simply the principal's first application. One commenter objected to the change as overly burdensome. Nevertheless, as was explained in the proposed rule, SBA believes the change is necessary to comply with Part 146 of Title 13 of the Code of Federal Regulations and that it is consistent with current practice in SBA field offices.

Except as discussed above, SBA adopts as final its proposal to amend Part 115.

Compliance With Executive Orders 12778, 12612 and 12866, the Regulatory Flexibility Act and the Paperwork Reduction Act

SBA certifies that this final rule will *not* constitute a significant regulatory action for purposes of Executive Order 12866, since it is not likely to result in an annual effect on the economy of $100 million or more.

For purposes of the Regulatory Flexibility Act, 5 U.S.C. 604, SBA has determined that this rule will not have a significant impact on a substantial number of small entities. Final action on the proposed increases in the principal's and the surety's fees has been deferred until further study of the issue has been completed. There are no fee increases in this final rule.

There are no reporting, recordkeeping and other compliance requirements not approved by the Office of Management and Budget which would come under the Paperwork Reduction Act, 44 U.S.C. Ch. 35.

SBA certifies that this rule is drafted, to the extent practicable, in accordance with the standards set forth in Section 2 of Executive Order 12778.

SBA certifies that this regulation does not warrant the preparation of a Federal

Assessment in accordance with Executive Order 12612.

List of Subjects in 13 CFR Part 115

Small business, Surety bonds.

For the above reasons, SBA is revising part 115, title 13 of the Code of Federal Regulations, to read as follows:

PART 115—SURETY BOND GUARANTEE

Authority: 5 U.S.C. app. 3; 15 U.S.C. 687b, 687c, 694a, 694b; Pub. L. 101–574, 104 Stat. 2823 (1990).

§ 115.1 Overview of regulations.

The regulations in this part cover the SBA's Surety Bond Guarantee Programs under Part B of Title IV of the Small Business Investment Act of 1958, as amended. Subpart A of this part contains regulations common to both the program requiring prior SBA approval of each bond guarantee (the Prior Approval Program) and the program not requiring prior approval (the PSB Program). Subpart B of this part contains the regulations applicable only to the Prior Approval Program. Subpart C of this part contains the regulations applicable only to the PSB Program.

§ 115.2 Savings clause.

Transactions affected by this part 115 are governed by the regulations in effect at the time they occur.

Subpart A—Provisions for All Surety Bond Guarantees

§ 115.10 Definitions.

AA/SG means SBA's Associate Administrator for Surety Guarantees.

Affiliate is defined in part 121 of this chapter.

Ancillary Bond means a bond incidental and essential to the performance of a Contract for which there is a guaranteed Final Bond.

Bid Bond means a bond conditioned upon the bidder on a Contract entering into the Contract, and furnishing the required Payment and Performance Bonds. The term does not include a forfeiture bond unless it is issued for a jurisdiction where statute or settled decisional law requires forfeiture bonds for public works.

Contract means a written obligation of the Principal requiring the furnishing of services, supplies, labor, materials, machinery, equipment, or construction. A Contract must not prohibit a Surety from performing the Contract upon default of the Principal. A Contract does not include a permit, subdivision contract, lease, land contract, evidence of debt, financial guarantee (e.g., a contract requiring any payment by the Principal to the Obligee), warranty of performance or efficiency, warranty of fidelity, or release of lien (other than for claims under a guaranteed bond). It includes a maintenance agreement of 2 years or less which covers defective workmanship or materials only. With SBA's written approval, it can also include a longer maintenance agreement covering defective workmanship or materials, or a maintenance agreement covering something other than defective workmanship or materials. To qualify for such approval, the agreement must be ancillary to the Contract for which SBA is guaranteeing a bond, must be required to be performed by the same Principal, and must be customarily required in the relevant trade or industry.

Execution means signing by a representative or agent of the Surety with the authority and power to bind the Surety.

Final Bond means a Performance Bond and/or a Payment Bond.

Imminent Breach means 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.

Investment Act means the Small Business Investment Act of 1958 (15 U.S.C. 661), as amended.

Loss has the meaning set forth in § 115.16.

Obligee means:

(1)(i) In the case of a Bid Bond, the Person requesting bids for the performance of a Contract; or

(ii) In the case of a Final Bond, the Person who has contracted with a Principal for the completion of the Contract and to whom the primary obligation of the Surety runs in the event of a breach by the Principal.

(2) In either case, no Person (other than a Federal department or agency) may be named co-Obligee or Obligee on a bond or on a rider to the bond unless that Person is bound by the Contract to the Principal (or to the Surety, if the Surety has arranged completion of the Contract) to the same extent as the original Obligee. In no event may the addition of one or more co-Obligees increase the aggregate liability of the Surety under the bond.

OSG means SBA's Office of Surety Guarantees.

Payment Bond means a bond which is conditioned upon the payment by the Principal of money to persons who have a right of action against such bond, including those who have furnished labor, materials, equipment and supplies for use in the performance of the Contract. A Payment Bond can not require the Surety to pay an amount which exceeds the claimant's actual loss or damage.

Performance Bond means a bond conditioned upon the completion by the Principal of a Contract in accordance with its terms.

Person means a natural person or a legal entity.

Premium means the amount charged by a Surety to issue bonds. The Premium is determined by applying an approved rate (see §§ 115.32(a) and 115.60(a)(2)) to the bond or contract amount. The Premium does not include surcharges for extra services, whether or not considered part of the ''premium'' under local law.

Principal means, in the case of a Bid Bond, the Person bidding for the award of a Contract. In the case of Final Bonds and Ancillary Bonds, Principal means the Person primarily liable to complete the Contract, or to make Contract-related payments to other persons, and is the Person whose performance or payment is bonded by the Surety. A Principal may be a prime contractor or a subcontractor.

Prior Approval Agreement means the Surety Bond Guarantee Agreement (SBA Form 990) entered into between a Prior Approval Surety and SBA under which SBA agrees to guarantee a specific bond.

Prior Approval Surety means a Surety which must obtain SBA's prior approval on each guarantee and which has entered into one or more Prior Approval Agreements with SBA.

PSB Agreement means the Preferred Surety Bond Guarantee Agreement entered into between a PSB Surety and SBA.

PSB Surety means a Surety that has been admitted to the Preferred Surety Bond (PSB) Program.

Surety means a company which:

(1)(i) Under the terms of a Bid Bond, agrees to pay a sum of money to the Obligee if the Principal breaches the conditions of the bond;

(ii) Under the terms of a Performance Bond, agrees to pay a sum of money or to incur the cost of fulfilling the terms of a Contract if the Principal breaches the conditions of the Contract; and

(iii) Under the terms of a Payment or an Ancillary Bond, agrees to make payment to all who have a right of action against such bond, including those who have furnished labor, materials, equipment and supplies in the performance of the Contract.

(2) The term Surety includes an agent, independent agent, underwriter, or any other company or individual empowered to act on behalf of the Surety.

§ 115.11 Applying to participate in the Surety Bond Guarantee Program.

Sureties interested in participating as Prior Approval Sureties or PSB Sureties should apply in writing to the AA/SG at 409 3rd Street, SW., Washington, DC 20416. OSG will determine the eligibility of the applicant considering its standards and procedures for underwriting, administration, claims and recovery. Each applicant must be a corporation listed by the U.S. Treasury as eligible to issue bonds in connection with Federal procurement contracts.

§ 115.12 General program policies and provisions.

(a) *Description of Surety Bond Guarantee Programs.* SBA guarantees Sureties participating in the Surety Bond Guarantee Programs against a portion of their Losses incurred and paid as a result of a Principal's breach of the terms of a Bid Bond, Final Bond or Ancillary Bond, on any eligible Contract. In the Prior Approval Program, the Surety must obtain SBA's approval before a guaranteed bond can be issued. In the PSB Program, selected Sureties may issue, monitor, and service SBA guaranteed bonds without further SBA approval.

(b) *Eligibility of bonds.* Bid Bonds and Final Bonds are eligible for an SBA guarantee if they are executed in connection with an eligible Contract and are of a type listed in the ''Contract Bonds'' section of the current Manual of Rules, Procedures and Classifications of the Surety Association of America (100 Wood Avenue South, Iselin, New Jersey 08830). Ancillary Bonds may also be eligible for SBA's guarantee. A Performance Bond must not prohibit a Surety from performing the Contract upon default of the Principal.

(c) *Expiration of Bid Bond Guarantee.* A Bid Bond guarantee expires 120 days after Execution of the Bid Bond, unless the Surety notifies SBA in writing before the 120th day that a later expiration date is required. The notification must include the new expiration date.

(d) *Guarantee agreement.* The terms and conditions of SBA's bond guarantee agreements, including the guarantee percentage, may vary from Surety to Surety, depending on past experience with SBA. If the guarantee percentage is not fixed by the Investment Act, it is determined by OSG after considering, among other things, the rating or ranking assigned to the Surety by recognized authority, and the Surety's Loss rate, average Contract amount, average bond penalty per guaranteed bond, and ratio of Bid Bonds to Final Bonds, all in comparison with other Sureties participating in the same SBA Surety Bond Guarantee Program (Prior Approval or PSB) to a comparable degree. Any guarantee agreement under this part is made exclusively for the benefit of SBA and the Surety, and does not confer any rights (such as a right of action against SBA) or benefits on any other party.

(e) *Amount of Contract.*—(1) *Statutory ceiling.* The amount of the Contract to be bonded must not exceed $1,250,000 in face value at the time of the bond's Execution.

(2) *Aggregation of Contract amounts.* The amounts of two or more Contracts for a ''single project'' are aggregated to determine the Contract amount unless the Contracts are to be performed in phases and the prior bond is released before the beginning of each succeeding phase. A bond may be considered released even if the warranty period it is covering has not yet expired. For purposes of this paragraph, a ''single project'' means one represented by two or more Contracts of one Principal or its Affiliates with one Obligee or its Affiliates for performance at the same location, regardless of job title or nature of the work to be performed.

(3) *Service and supply contracts.* A service or supply Contract covering more than a 1 year period is eligible for an SBA guaranteed bond if neither the annual Contract amount nor the penal sum of the bond exceeds $1,250,000 at any time.

(f) *Transfers or sales by Surety.* Sureties must not sell or otherwise transfer their files or accounts, whether before or after a default by the Principal has occurred, without the prior written approval of SBA. A violation of this provision is grounds for termination from participation in the program. This provision does not apply to the sale of an entire business division, subsidiary or operation of the Surety.

§ 115.13 Eligibility of Principal.

(a) *General eligibility.* In order to be eligible for a bond guaranteed by SBA, the Principal must comply with the following requirements:

(1) *Size.* Together with its Affiliates, it must qualify as a small business under part 121 of this title.

(2) *Character.* It must possess good character and reputation. A Principal meets this standard if each owner of 20% or more of its equity, and each of its officers, directors, or general partners, possesses good character and reputation. A Person's good character and reputation is presumed absent when:

(i) The Person is under indictment for, or has been convicted of a felony, or a final civil judgment has been entered stating that such Person has committed a breach of trust or has violated a law or regulation protecting the integrity of business transactions or business relationships; or

(ii) A regulatory authority has revoked, canceled, or suspended a license of the Person which is necessary to perform the Contract; or

(iii) The Person has obtained a bond guarantee by fraud or material misrepresentation (as described in § 115.19(b)), or has failed to keep the Surety informed of unbonded contracts or of a contract bonded by another Surety, as required by a bonding line commitment under § 115.33.

(3) *Need for bond.* It must certify that a bond is expressly required by the bid solicitation or the original Contract in order to bid on the Contract or to serve as a prime contractor or subcontractor.

(4) *Availability of bond.* It must certify that a bond is not obtainable on reasonable terms and conditions without SBA's guarantee.

(5) *Partial subcontract.* It must certify the percentage of work under the Contract to be subcontracted. SBA will not guarantee bonds for Principals who are primarily brokers or who have effectively transferred control over the project to one or more subcontractors.

(6) *Debarment.* It must certify that the Principal is not presently debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from transactions with any Federal department or agency, under governmentwide debarment and suspension rules.

(b) *Conflict of interest.* A Principal is not eligible for an SBA-guaranteed bond issued by a particular Surety if that Surety, or 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 Principal. This prohibition also applies to ownership interests in any of the Principal's Affiliates.

§ 115.14 Loss of Principal's eligibility for future assistance.

(a) *Ineligibility.* A Principal and its Affiliates lose eligibility for further SBA bond guarantees if any of the following occurs under an SBA-guaranteed bond issued on behalf of the Principal:

(1) Legal action under the guaranteed bond has been initiated.

(2) The Obligee has declared the Principal to be in default under the Contract.

(3) The Surety has established a claim reserve for the bond of at least $1000.

(4) The Surety has requested reimbursement for Losses incurred under the bond.

(5) The guarantee fee has not been paid by the Principal.

(6) The Principal committed fraud or material misrepresentation in obtaining the guaranteed bond.

(b) *Reinstatement of Principal's eligibility.* Prior Approval Sureties should refer to § 115.36(b) for provisions on reinstatement of the Principal's eligibility. A PSB Surety may reinstate a Principal's eligibility upon the Surety's determination that reinstatement is appropriate.

§ 115.15 Underwriting and servicing standards.

(a) *Underwriting.* (1) Sureties must evaluate the credit, capacity, and character of a Principal using standards generally accepted by the surety industry and in accordance with SBA's Standard Operating Procedures on underwriting and the Surety's principles and practices on unguaranteed bonds. The Principal must satisfy the eligibility requirements set forth in § 115.13. The Surety must reasonably expect that the Principal will successfully perform the Contract to be bonded.

(2) The terms and conditions of the bond and the Contract must be reasonable in light of the risks involved and the extent of the Surety's participation. The bond must satisfy the eligibility requirements set forth in § 115.12(b). The Surety must be satisfied as to the reasonableness of cost and the feasibility of successful completion of the Contract.

(b) *Servicing.* The Surety must ensure that the Principal remains viable and eligible for SBA's Surety Bond Guarantee Program, must monitor the Principal's progress on bonded Contracts guaranteed by SBA, and must request job status reports from Obligees of Final Bonds guaranteed by SBA. Documentation of the job status requests must be maintained by the Surety.

§ 115.16 Determination of Surety's Loss.

Loss is determined as follows:

(a) *Loss under a Bid Bond* is the lesser of the penal sum or the amount which is the difference between the bonded bid and the next higher responsive bid. In either case, the Loss is reduced by any amounts the Surety recovers by reason of the Principal's defenses against the Obligee's demand for performance by the Principal and any sums the Surety recovers from indemnitors and other salvage.

(b) *Loss under a Payment Bond* is, at the Surety's option, the sum necessary to pay all just and timely claims against the Principal for the value of labor, materials, equipment and supplies furnished for use in the performance of the bonded Contract and other covered debts, or the penal sum of the Payment Bond. In either case, the Loss includes interest (if any), but Loss is reduced by any amounts recovered (through offset or otherwise) by reason of the Principal's claims against laborers, materialmen, subcontractors, suppliers, or other rightful claimants, and by any amounts recovered from indemnitors and other salvage.

(c) *Loss under a Performance Bond* is, at the Surety's option, the sum necessary to meet the cost of fulfilling the terms of a bonded Contract or the penal sum of the bond. In either case, the Loss includes interest (if any), but Loss is reduced by any amounts recovered (through offset or otherwise) by reason of the Principal's defenses or causes of action against the Obligee, and by any amounts recovered from indemnitors and other salvage.

(d) *Loss under an Ancillary Bond* is the amount covered by such bond which is attributable to the Contract for which guaranteed Final Bonds were Executed.

(e) *Loss includes* the following expenses if they are itemized, documented and attributable solely to the Loss under the guaranteed bond:

(1) Amounts actually paid by the Surety which are specifically allocable to the investigation, adjustment, negotiation, compromise, settlement of, or resistance to a claim for Loss resulting from the breach of the terms of the bonded Contract. Any cost allocation method must be reasonable and must comply with generally accepted accounting principles; and

(2) Amounts actually paid by the Surety for court costs and reasonable attorney's fees incurred to mitigate any Loss under paragraphs (a) through (e)(1) of this section including suits to obtain sums due from Obligees, indemnitors, Principals and others.

(f) *Loss does not include* the following expenses:

(1) Any unallocated expenses, or any clear mark-up on expenses or any overhead, of the Surety, its attorney, or any other party hired by the Surety or the attorney;

(2) Expenses paid for any suits, cross-claims, or counterclaims filed against the United States of America or any of its agencies, officers, or employees unless the Surety has received, prior to filing such suit or claim, written concurrence from SBA that the suit may be filed;

(3) Attorney's fees and court costs incurred by the Surety in a suit by or against SBA or its Administrator; and

(4) Fees, costs, or other payments, including tort damages, arising from a successful tort suit or claim by a Principal or any other Person against the Surety.

§ 115.17 Minimization of Surety's Loss.

(a) *Indemnity agreements and collateral.*—(1) *Requirements.* The Surety must take all reasonable action to minimize risk of Loss including, but not limited to, obtaining from each Principal a written indemnity agreement which covers actual Losses under the Contract and Imminent Breach payments under § 115.34(a) or § 115.69. The indemnity agreement must be secured by such collateral as the Surety or SBA finds appropriate. Indemnity

agreements from other Persons, secured or unsecured, may also be required by the Surety or SBA.

(2) *Prohibitions.* No indemnity agreement may be obtained from the Surety, its agent or any other representative of the Surety. The Surety must not separately collateralize the portion of its bond which is not guaranteed by SBA.

(b) *Salvage and recovery.*—(1) *General.* The Surety must pursue all possible sources of salvage and recovery. Salvage and recovery includes all payments made in settlement of the Surety's claim, even though the Surety has incurred other losses as a result of that Principal which are not reimbursable by SBA.

(2) *SBA's share.* SBA is entitled to its guaranteed percentage of all salvage and recovery from a defaulted Principal, its guarantors and indemnitors, and any other party, received by the Surety in connection with the guaranteed bond or any other bond issued by the Surety on behalf of the Principal unless such recovery is unquestionably identifiable as related solely to the non-guaranteed bond. The Surety must reimburse or credit SBA (in the same proportion as SBA's share of Loss) within 90 days of receipt of any recovery by the Surety.

(3) *Multiple Sureties.* In any dispute between two or more Sureties concerning recovery under SBA guaranteed bonds, the dispute must first be brought to the attention of OSG for an attempt at mediation and settlement.

§ 115.18 Refusal to issue further guarantees; suspension and termination of PSB status.

(a) *Improper surety bond guarantee practices.*—(1) *Imprudent practices.* SBA may refuse to issue further guarantees to a Prior Approval Surety or may suspend the preferred status of a PSB Surety, by written notice stating all reasons for such decision and the effective date. Reasons for such a decision include, but are not limited to, a determination that the Surety (in its underwriting, its efforts to minimize Loss, its claims or recovery practices, or its documentation related to SBA guaranteed bonds) has failed to adhere to prudent standards or practices, including any standards or practices required by SBA, as compared to those of other Sureties participating in the same SBA Surety Bond Guarantee Program to a comparable degree.

(2) *Regulatory violations, fraud.* Acts of wrongdoing such as fraud, material misrepresentation, breach of the Prior Approval or PSB Agreement, or regulatory violations (as defined in §§ 115.19(d) and 115.19(h)) also constitute sufficient grounds for refusal to issue further guarantees, or in the case of a PSB Surety, termination of preferred status.

1(3) *Audit; records.* The failure of a Surety to consent to SBA's audit or to maintain and produce records constitutes grounds for SBA to refuse to issue further guarantees for a Prior Approval Surety, to suspend a PSB Surety from participation, and to refuse to honor claims submitted by a Prior Approval or PSB Surety until the Surety consents to the audit.

(4) *Excessive Losses.* If a Surety experiences excessive Losses on SBA guaranteed bonds relative to those of other Sureties participating in the same SBA Surety Bond Guarantee Program to a comparable degree, SBA may also require the renegotiation of the guarantee percentage and/or SBA's charge to the Surety for bonds executed thereafter.

(b) *Lack of business integrity.* A Surety's participation in the Surety Bond Guarantee Programs may be denied, suspended, or terminated upon the occurrence of any event in paragraphs (b) (1) through (5) of this section involving any of the following Persons: The Surety or any of its officers, directors, partners, or other individuals holding at least 20% of the Surety's voting securities, and any agents, underwriters, or any individual empowered to act on behalf of any of the preceding Persons.

(1) If a State or other authority has revoked, canceled, or suspended the license required of such Person to engage in the surety business, the right of such Person to participate in the SBA Surety Bond Guarantee Program may be denied, terminated, or suspended, as applicable, in that jurisdiction or in other jurisdictions. Ineligibility or suspension from the Surety Bond Guarantee Programs is for at least the duration of the license suspension.

(2) If such Person has been indicted or otherwise formally charged with a misdemeanor or felony bearing on such Person's fitness to participate in the Surety Bond Guarantee Programs, the participation of such Person may be suspended pending disposition of the charge. Upon conviction, participation may be denied or terminated.

(3) If a final civil judgment is entered holding that such Person has committed a breach of trust or violation of a law or regulation protecting the integrity of business transactions or relationships, participation may be denied or terminated.

(4) If such Person has made a material misrepresentation or willfully false statement in the presentation of oral or written information to SBA in connection with an application for a surety bond guarantee or the presentation of a claim, or committed a material breach of the Prior Approval or PSB Agreement or a material violation of the regulations (all as described in § 115.19), participation may be denied or terminated.

(5) If such Person is debarred, suspended, voluntarily excluded from, or declared ineligible for participation in Federal programs, participation may be denied or terminated.

(c) *Notification requirement.* The Prior Approval or PSB Surety must promptly notify SBA of the occurrence of any event in paragraphs (b) (1) through (5) of this section, or if any of the Persons described in paragraph (b) of this section does not, or ceases to, qualify as a Surety. SBA may require submission of a Statement of Personal History (SBA Form 912) from any of these Persons.

(d) *SBA proceedings.* Decisions to suspend, terminate, deny participation in, or deny reinstatement in the Surety Bond Guarantee program are made by the AA/SG. A Surety may file a petition for review of suspensions and terminations with the SBA Office of Hearings and Appeals (OHA) under part 134 of this chapter. SBA's Administrator may, pending a decision pursuant to Part 134 of this chapter, suspend the participation of any Surety for any of the causes listed in paragraphs (b) (1) through (5) of this section.

(e) *Effect on guarantee.* A guarantee issued by SBA before a suspension or termination under this section remains in effect, subject to SBA's right to deny liability under the guarantee.

§ 115.19 Denial of liability.

In addition to equitable and legal defenses and remedies under contract law, the Act and the regulations in this part, SBA is not liable under a Prior Approval or PSB Agreement if any of the circumstances in paragraphs (a) through (h) of this section exist.

(a) *Excess Contract or bond amount.* The total Contract amount at the time of Execution of the bond exceeds $1,250,000 in face value (see § 115.12(e)), or the bond amount at any time exceeds the total Contract amount.

(b) *Misrepresentation or fraud.* The Surety obtained the Prior Approval or PSB Agreement, or applied for reimbursement for losses, by fraud or material misrepresentation. Material misrepresentation includes (but is not limited to) both the making of an untrue statement of material fact and the omission of a statement of material fact necessary to make a statement not

misleading in light of the circumstances in which it was made. Material misrepresentation also includes the adoption by the Surety of a material misstatement made by others which the Surety knew or under generally accepted underwriting standards should have known to be false or misleading. The Surety's failure to disclose its ownership (or the ownership by any owner of at least 20% of the Surety's equity) of an interest in a Principal or an Obligee is considered the omission of a statement of material fact.

(c) *Material breach.* The Surety has committed a material breach of one or more terms or conditions of its Prior Approval or PSB Agreement. A material breach is considered to have occurred if:

(1) Such breach (or such breaches in the aggregate) causes an increase in the Contract amount or in the bond amount of at least 25% or $50,000; or

(2) One of the conditions under Part B of Title IV of the Investment Act is not met.

(d) *Substantial regulatory violation.* The Surety has committed a ''substantial violation'' of SBA regulations. For purposes of this paragraph, a ''substantial violation'' is a violation which causes an increase in the bond amount of at least 25% or $50,000 in the aggregate, or is contrary to the purposes of the Surety Bond Guarantee Programs.

(e) *Alteration.* Without obtaining prior written approval from SBA (which may be conditioned upon payment of additional fees), the Surety agrees to or acquiesces in any material alteration in the terms, conditions, or provisions of the bond, including but not limited to the following acts:

(1) Naming as an Obligee or co-Obligee any Person that does not qualify as an Obligee under § 115.10; or

(2) In the case of a Prior Approval Surety, acquiescing in any alteration to the bond which would increase the bond amount by at least 25% or $50,000.

(f) *Timeliness.* (1) Either:

(i) The bond was Executed prior to the date of SBA's guarantee; or

(ii) The bond was Executed (or approved, if the Surety is legally bound by such approval) after the work under the Contract had begun, unless SBA executes a ''Surety Bond Guarantee Agreement Addendum'' (SBA Form 991) after receiving all of the following from the Surety:

(A) Satisfactory evidence, including a certified copy of the Contract (or a sworn affidavit from the Principal), showing that the bond requirement was contained in the original Contract, or other documentation satisfactory to SBA, showing why a bond was not previously obtained and is now being required;

(B) Certification by the Principal that all taxes and labor costs are current, and listing all suppliers and subcontractors, indicating that they are all paid to date, and attaching a waiver of lien from each; or an explanation satisfactory to SBA why such documentation cannot be produced; and

(C) Certification by the Obligee that all payments due under the Contract to date have been made and that the job has been satisfactorily completed to date.

(2)(i) For purposes of paragraph (f)(1)(ii) of this section, work under a Contract is considered to have begun when a Principal takes any action at the job site which would have exposed its Surety to liability under applicable law had a bond been Executed (or approved, if the Surety is legally bound by such approval) at the time.

(ii) For purposes of this paragraph (f), the Surety must maintain a contemporaneous record of the Execution and approval of each bond.

(g) *Principal fee.* The Surety has not remitted to SBA the Principal's payment for the full amount of the guarantee fee within the time period required under § 115.30(d) for Prior Approval Sureties or § 115.66 for PSB Sureties. SBA may reinstate the guarantee upon a showing that the Contract is not in default and that a valid reason exists why a timely submission was not made.

(h) *Other regulatory violations.* The occurrence of any of the following:

(1) The Principal on the bonded Contract is not a small business;

(2) The bond was not required under the bid solicitation or the original Contract;

(3) The bond was not eligible for guarantee by SBA because the bonded contract was not a Contract as defined in § 115.10;

(4) The loss occurred under a bond that was not guaranteed by SBA;

(5) The loss incurred by the Surety was not a Loss as determined under § 115.16; or

(6) The Surety's loss under a Performance Bond did not result from the Principal's breach or Imminent Breach of the Contract.

§ 115.20 Insolvency of Surety.

(a) *Successor in interest.* If a Surety becomes insolvent, all rights or benefits conferred on the Surety under a valid and binding Prior Approval or PSB 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.

(b) *Filing requirement.* The trustee or receiver must submit to SBA quarterly status reports accounting for all funds received and all settlements being considered.

§ 115.21 Audits and investigations.

(a) *Audits.*—(1) *Scope of audit.* SBA may audit in the office of a Prior Approval or PSB Surety, the Surety's attorneys or consultants, or the Principal or its subcontractors, all documents, files, books, records, tapes, disks and other material relevant to SBA's guarantee, commitments to guarantee a surety bond, or agreements to indemnify the Prior Approval or PSB Surety. See § 115.18(a)(3) for consequences of failure to comply with this section.

(2) *Frequency of PSB audits.* Each PSB Surety is subject to audit at least once each year by examiners selected and approved by SBA.

(b) *Records.* The Surety must maintain the records listed in this paragraph (b) for the term of each bond, plus any additional time required to settle any claims of the Surety for reimbursement from SBA and to attempt salvage or other recovery, plus an additional 3 years. If there are any unresolved audit findings in relation to a particular bond, the Surety must maintain the related records until the findings are resolved. The records to be maintained include the following:

(1) A copy of the bond;

(2) A copy of the bonded Contract;

(3) All documentation submitted by the Principal in applying for the bond;

(4) All information gathered by the Surety in reviewing the Principal's application;

(5) All documentation of any of the events set forth in § 115.35(a) or § 115.65(c)(2);

(6) All records of any transaction for which the Surety makes payment under or in connection with the bond, including but not limited to claims, bills (including lawyers' and consultants' bills), judgments, settlement agreements and court or arbitration decisions, consultants' reports, Contracts and receipts;

(7) All documentation relating to efforts to mitigate Losses, including documentation required by § 115.34(a) or § 115.69 concerning Imminent Breach;

(8) All records of any accounts into which fees and funds obtained in mitigation of Losses were paid and from which payments were made under the

bond, and any other trust accounts, and any reconciliations of such accounts;

(9) Job status reports received from Obligees and documentation of each unanswered request for a job status report; and

(10) All documentation relating to any collateral held by or available to the Surety.

(c) *Purpose of audit.* SBA's audit will determine, but not be limited to:

(1) The adequacy and sufficiency of the Surety's underwriting and credit analysis, its documentation of claims and claims settlement procedures and activities, and its recovery procedures and practices;

(2) The Surety's minimization of Loss, including the exercise of bond options upon Contract default; and

(3) The Surety's loss ratio in comparison with other Sureties participating in the same SBA Surety Bond Guarantee Program to a comparable degree.

(d) *Investigations.* SBA may conduct investigations to inquire into the possible violation by any Person of the Small Business Act or the Investment Act, or of any rule or regulation under those Acts, or of any order issued under those Acts, or of any Federal law relating to programs and operations of SBA.

Subpart B—Guarantees Subject to Prior Approval

§ 115.30 Submission of Surety's guarantee application.

(a) *Legal effect of application.* By submitting an application to SBA for a bond guarantee, the Prior Approval Surety certifies that the Principal meets the eligibility requirements set forth in § 115.13 and that the underwriting standards set forth in § 115.15 have been met.

(b) *SBA's determination.* SBA's approval or decline of a guarantee application is made in writing by an authorized SBA officer. The officer may provide telephone notice before the Prior Approval Surety receives SBA's guarantee approval form if the officer has already signed the form. In the event of a conflict between the telephone notice and the written form, the written form controls.

(c) *Reconsideration-appeal of SBA determination.* A Prior Approval Surety may request reconsideration of a decline from the SBA officer who made the decision. If the decision on reconsideration is negative, the Surety may appeal to an individual designated by the AA/SG. If the decision is again adverse, the Surety may appeal to the AA/SG, who will make the final decision.

(d) *Notice and payment to SBA.* When the Surety has Executed a Final Bond, including a Final Bond under a bonding line, the Surety must complete the Prior Approval Agreement, and submit the form, together with the Principal's payment for its guarantee fee (see § 115.32(b)) to SBA within 45 days, or in the case of a bonding line, within 15 business days (see § 115.33(d)(2)) after Execution of the bond.

§ 115.31 Guarantee percentage.

(a) *Ninety percent.* SBA reimburses a Prior Approval Surety for 90% of the Loss incurred and paid if:

(1) The total amount of the Contract at the time of Execution of the bond is $100,000 or less; or

(2) The bond was issued on behalf of a small business owned and controlled by socially and economically disadvantaged individuals. See part 124 of this chapter for applicable definitions and criteria.

(b) *Eighty percent.* SBA reimburses a Prior Approval Surety in an amount not to exceed 80% of the Loss incurred and paid on bonds for Contracts in excess of $100,000 which are executed on behalf of non-disadvantaged concerns.

(c) *Contract increase to over $100,000.* 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%. This provision applies only to guarantees which qualify under paragraph (a)(1) of this section.

(d) *Contract increase to over $1,250,000.* If the Contract amount increases above the statutory limit of $1,250,000 after Execution of the bond, SBA's share of the Loss is limited to that percentage of the increased Contract amount which the statutory limit represents, multiplied by the guarantee percentage approved by SBA. For example, if a Contract amount increases to $1,375,000, SBA's share of the Loss under an 80% guarantee is limited to 72.73% [1,250,000 / 1,375,000=90.91%×80%=72.73%].

(e) *Contract decrease to $100,000 or less.* If the Contract amount decreases to $100,000 or less after Execution of the bond, SBA's guarantee percentage increases to 90% if the Surety provides SBA with evidence supporting the decrease and any other information or documents requested.

§ 115.32 Fees and Premiums.

(a) *Surety's Premium.* A Prior Approval Surety must not charge a Principal an amount greater than that authorized by the appropriate insurance department. The Surety must not require the Principal to purchase casualty or other insurance or any other services from the Surety or any Affiliate or agent of the Surety. The Surety must not charge non-Premium fees to a Principal unless the Surety performs other services for the Principal, the additional fee is permitted by State law, and the Principal agrees to the fee.

(b) *SBA charge to Principal.* SBA does not charge Principals application or Bid Bond guarantee fees. If SBA guarantees a Final Bond, the Principal must pay a guarantee fee equal to a certain percentage of the Contract amount. The percentage is determined by SBA and is published in Notices in the Federal Register from time to time. The Principal's fee is rounded to the nearest dollar and is to be remitted to SBA by the Surety together with the form required under § 115.30(d). See paragraph (d) of this section for additional requirements when the Contract amount changes.

(c) *SBA charge to Surety.* SBA does not charge Sureties application or Bid Bond guarantee fees. Subject to § 115.18(a)(4), the Surety must pay SBA a guarantee fee on each guaranteed bond (other than a Bid Bond) in the ordinary course of business. The fee is a certain percentage of the bond Premium, determined by SBA and published in Notices in the Federal Register from time to time. The fee is rounded to the nearest dollar. SBA does not receive any portion of a Surety's non-Premium charges. See paragraph (d) of this section for additional requirements when the bond amount or the Contract amount changes.

(d) *Contract or bond increases/decreases.*—(1) *Notification and approval.* The Prior Approval Surety must notify SBA of any increases or decreases in the Contract or bond amount that aggregate 25% or $50,000, as soon as the Surety acquires knowledge of the change. Whenever the original bond amount increases as a result of a single change order of at least 25% or $50,000, the prior written approval of such increase by SBA is required on a supplemental Prior Approval Agreement (Supplemental Form 990) and is conditioned upon payment by the Surety of the increase in the Principal's guarantee fee as set forth in paragraph (d)(2) of this section.

(2) *Increases; fees.* Notification of increases in the Contract or bond amount under this paragraph (d) must be accompanied by payment of the increase in the Principal's guarantee fee computed on the increase in the Contract amount. If the increase in the Principal's fee is less than $40, such

increase is not due until all unpaid increases in the Principal's fee aggregate at least $40. The Surety's check for payment of the increase in the Surety's guarantee fee, computed on the increase in the bond Premium, may be submitted in the ordinary course of business. Increases in the Surety's fee are not due until they aggregate at least $40.

(3) *Decreases; refunds.* Whenever SBA is notified of a decrease in the Contract or bond amount, SBA will refund to the Principal a proportionate amount of the Principal's guarantee fee and rebate to the Surety a proportionate amount of SBA's Premium share in the ordinary course of business. If the amount to be refunded or rebated is less than $40, such refund or rebate will not be made until the amounts to be refunded or rebated, respectively, aggregate at least $40. Upon receipt of the refund, the Surety must promptly pay a proportionate amount of its Premium to the Principal.

§ 115.33 Surety bonding line.

A surety bonding line is a written commitment by SBA to a Prior Approval Surety which provides for the Surety's Execution of multiple bonds for a specified small business strictly within pre-approved terms, conditions and limitations. In applying for a bonding line, the Surety must provide SBA with information on the applicant as requested. In addition to the other limitations and provisions set forth in this part 115, the following conditions apply to each surety bonding line:

(a) *Underwriting.* A bonding line may be issued by SBA for a Principal only if the underwriting evaluation is satisfactory. The Prior Approval Surety must require the Principal to keep it informed of all its contracts, whether bonded by the same or another surety or unbonded, during the term of the bonding line.

(b) *Bonding line conditions.* The bonding line contains limitations on the following:

(1) The term of the bonding line, not to exceed 1 year subject to renewal in writing;

(2) The total dollar amount of the Principal's bonded and unbonded work on hand at any time, including outstanding bids, during the term of the bonding line;

(3) The number of such bonded and unbonded contracts outstanding at any time during the term of the bonding line;

(4) The maximum dollar amount of any single guaranteed bonded Contract;

(5) The timing of Execution of bonds under the bonding line—bonds must be dated and Executed before the work on the underlying Contract has begun, or the Surety must submit to SBA the documentation required under § 115.19(f)(1)(ii); and

(6) Any other limitation related to type, specialty of work, geographical area, or credit.

(c) *Excess bonding.* If, after a bonding line is issued, the Principal desires a bond and the Surety desires a guarantee exceeding a limitation of the bonding line, the Surety must submit an application to SBA under regular procedures.

(d) *Submission of forms to SBA.*—(1) *Bid Bonds.* Within 15 business days after the Execution of any Bid Bonds under a bonding line, the Surety must submit a ''Surety Bond Guarantee Underwriting Review'' (SBA Form 994B) to SBA for approval. If that form is already on file with SBA and no new financial statements are required or have been received from the Principal, a ''Surety Bond Guarantee Review Update'' (SBA Form 994C) may be submitted instead. If the Surety fails to submit either form within this time period, SBA's guarantee of the bond will be void from its inception unless SBA determines otherwise upon a showing that a valid reason exists why the timely submission was not made.

(2) *Final Bonds.* Within 15 business days after the Execution of any Final Bonds under a bonding line, the Surety must submit a signed Prior Approval Agreement and a ''Surety Bond Guarantee Underwriting Review'' (SBA Form 994B) to SBA for approval. If that form is already on file with SBA and no new financial statements are required or have been received from the Principal, a ''Surety Bond Guarantee Review Update'' (SBA Form 994C) may be submitted instead. If the Surety fails to submit these forms together with the Principal's payment for its guarantee fee within this time period, SBA's guarantee of the bond will be void from its inception unless SBA determines otherwise upon a showing that the Contract is not in default and a valid reason exists why the timely submission was not made.

(3) *Additional information.* The Surety must submit any other data SBA requests.

(e) *Cancellation of bonding line.*—(1) *Optional cancellation.* Either SBA or the Surety may cancel a bonding line at any time, with or without cause, upon written notice to the other party. Upon the receipt of any adverse information concerning the Principal, the Surety must promptly notify SBA, and SBA may cancel the bonding line.

(2) *Mandatory cancellation.* Upon the occurrence of a default by the Principal, whether under a contract bonded by the same or another surety or an unbonded contract, the Surety must immediately cancel the bonding line.

(3) *Effect of cancellation.* Cancellation of a bonding line by SBA is effective upon receipt of written notice by the Surety. Bonds issued before the effective date of cancellation remain guaranteed by SBA. Upon cancellation by SBA or the Surety, the Surety must promptly notify the Principal in writing.

§ 115.34 Minimization of Surety's Loss.

(a) *Imminent Breach.*—(1) *Prior approval requirement.* SBA will reimburse its guaranteed share of payments made by a Surety to avoid or attempt to avoid an Imminent Breach of the terms of a Contract covered by an SBA guaranteed bond only if the payments were made with the prior approval of OSG. OSG's prior approval will be given only if the Surety demonstrates to SBA's satisfaction that a breach is imminent and that there is no other recourse to prevent such breach.

(2) *Amount of reimbursement.* The aggregate of the payments by SBA to avoid Imminent Breach cannot exceed 10% of the Contract amount, unless the Administrator finds that a greater payment (not to exceed the guaranteed share of the bond penalty) is necessary and reasonable. In no event will SBA make any duplicate payment pursuant to this or any other provision of this part 115.

(3) *Recordkeeping requirement.* The Surety must keep records of payments made to avoid Imminent Breach.

(b) *Salvage and recovery.* A Prior Approval Surety must pursue all possible sources of salvage and recovery until SBA concurs with the Surety's recommendation for a discontinuance or for a settlement. The Surety must certify that continued pursuit of salvage and recovery would be neither economically feasible nor a viable strategy in maximizing recovery. See also § 115.17(b).

§ 115.35 Claims for reimbursement of Losses.

(a) *Notification requirements.*—(1) *Events requiring notification.* A Prior Approval Surety must notify OSG of the occurrence of any of the following:

(i) Legal action under the bond has been initiated.

(ii) The Obligee has declared the Principal to be in default under the Contract.

(iii) The Surety has established a claim reserve for the bond.

(iv) The Surety has received any adverse information concerning the

Principal's financial condition or possible inability to complete the project or to pay laborers or suppliers.

(2) *Timing of notification.* Notification must be made in writing at the earlier of the time the Surety applies for a guarantee on behalf of an affected Principal, or within 30 days of the date the Surety acquires knowledge, or should have acquired knowledge, of any of the listed events.

(b) *Surety action.* The Surety must take all necessary steps to mitigate Losses resulting from any of the events in paragraph (a) of this section, including the disposal at fair market value of any collateral held by or available to the Surety. Unless SBA notifies the Surety otherwise, the Surety must take charge of all claims or suits arising from a defaulted bond, and compromise, settle and defend such suits. The Surety must handle and process all claims under the bond and all settlements and recoveries as it does on non-guaranteed bonds.

(c) *Claim reimbursement requests.* (1) Claims for reimbursement for Losses which the Surety has paid must be submitted (together with a copy of the bond, the bonded Contract, and any indemnity agreements) with the initial claim to OSG on a ''Default Report, Claim for Reimbursement and Record of Administrative Action'' (SBA Form 994H), within 1 year from the time of each disbursement. Claims submitted after 1 year must be accompanied by substantiation satisfactory to SBA. The date of the claim for reimbursement is the date of receipt of the claim by SBA, or such later date as additional information requested by SBA is received.

(2) The Surety must also submit evidence of the disposal of all collateral at fair market value.

(3) SBA may request additional information prior to reimbursing the Surety for its Loss.

(4) Subject to the offset provisions of part 140, SBA pays its share of the Loss incurred and paid by the Surety within 90 days of receipt of the requisite information.

(5) Claims for reimbursement and any additional information submitted are subject to review and audit by SBA, including but not limited to the Surety's compliance with SBA's regulations and forms.

(d) *Status updates.* The Surety must submit semiannual status reports on each claim 6 months after the initial default notice, and then every 6 months. The Surety must notify SBA immediately of any substantial changes in the status of the claim or the amounts of Loss reserves.

(e) *Reservation of SBA rights.* The payment by SBA of a Surety's claim does not waive or invalidate any of the terms of the Prior Approval Agreement, the regulations set forth in this part 115, or any defense SBA may have against the Surety. Within 30 days of receipt of notification that a claim or any portion of a claim should not have been paid by SBA, the Surety must repay the specified amounts to SBA.

§ 115.36 Indemnity settlements and reinstatement of Principal.

(a) *Indemnity settlements.* (1) An indemnity settlement occurs when a defaulted Principal and its Surety agree upon an amount, less than the actual loss under the bond, which will satisfy the Principal's indebtedness to the Surety. Sureties must not agree to any indemnity settlement proposal or enter into any such agreement without SBA's concurrence.

(2) Any settlement proposal submitted for SBA's consideration must include current financial information, including financial statements, tax returns, and credit reports, together with the Surety's written recommendations. It should also indicate whether the Principal is interested in further bonding.

(3) The Surety must pay SBA its *pro rata* share of the settlement amount within 90 days of receipt. Prior to closing the file on a Principal, the Surety must certify that SBA has received its *pro rata* share of all indemnity recovery.

(b) *Conditions for reinstatement.* At any time after a Principal becomes ineligible for further bond guarantees under § 115.14(a), the Surety may recommend that such Principal's eligibility be reinstated. OSG may agree to reinstate the Principal and its Affiliates if:

(1) The Principal's guarantee fee has been paid to SBA and SBA receives evidence that the Principal has paid all delinquent amounts due to the Surety (including amounts for Imminent Breach); or

(2) The Surety has settled its claim with the Principal for an amount and on terms accepted by OSG; or

(3) The Principal contests a claim and provides collateral, acceptable to the Surety and OSG, which has a liquidation value of at least the amount of the claim including related expenses; or

(4) The Principal's indebtedness to the Surety is discharged by operation of law (e.g., bankruptcy discharge); or

(5) OSG and the Surety determine that further bond guarantees are appropriate.

(c) *Underwriting after reinstatement.* A guarantee application submitted after reinstatement of the Principal's eligibility is subject to a very stringent underwriting review.

Subpart C—Preferred Surety Bond (PSB) Guarantees

§ 115.60 Selection and admission of PSB sureties.

(a) *Selection of PSB Sureties.* SBA's selection of PSB Sureties will be guided by, but not limited to, these factors:

(1) An underwriting limitation of at least $1,250,000 on the U.S. Treasury Department list of acceptable sureties;

(2) An agreement to charge Principals no more than the Surety Association of America's advisory premium rates in effect on August 1, 1987;

(3) Premium income from contract bonds guaranteed by any government agency (Federal, State or local) of no more than one- quarter of the total contract bond premium income of the Surety;

(4) The vesting of underwriting authority for SBA guaranteed bonds only in employees of the Surety;

(5) The vesting of final settlement authority for claims and recovery under the PSB program only in employees of the Surety's permanent claims department; and

(6) The rating or ranking designations assigned to the Surety by recognized authority.

(b) *Admission of PSB Sureties.* A Surety admitted to the PSB program must execute a PSB Agreement before approving SBA guaranteed bonds. No SBA guarantee attaches to bonds approved before the AA/SG or designee has countersigned the Agreement.

§ 115.61 Duration of PSB program.

The PSB program terminates on September 30, 1997, unless extended by legislation. SBA guarantees effective under this program on or before September 30, 1997, will remain in effect after such date.

§ 115.62 Prohibition on participation in Prior Approval program.

Neither a PSB Surety nor any of its Affiliates is eligible to submit applications under subpart B of this part.

§ 115.63 Allotment of guarantee authority.

(a) *General.* SBA allots to each PSB Surety a periodic maximum guarantee authority. No SBA guarantee attaches to bonds approved by a PSB Surety if the bonds exceed the allotted authority for the period in which the bonds are approved. No reliance on future authority is permitted. An allotment can be increased only by prior written permission of SBA.

(b) *Execution of Bid Bonds.* When the PSB Surety Executes a Bid Bond, SBA debits the Surety's allotment for an amount equal to the guarantee percentage of the estimated penal sum of the Final Bond SBA would guarantee if the Contract were awarded. If the Contract is then awarded for an amount other than the bid amount, or if the bid is withdrawn or the Bid Bond guarantee has expired (see § 115.12(c)), SBA debits or credits the Surety's allotment accordingly.

(c) *Execution of Final Bonds.* If the PSB Surety Executes a guaranteed Final Bond, but not the related Bid Bond, SBA debits the Surety's allotment for an amount equal to the guarantee percentage of the penal sum of the Final Bond. SBA will debit the allotment for increases, and credit the allotment for decreases, in the bond amount.

(d) *Release and non-issuance of Final Bonds.* The release of Final Bonds upon completion of the Contract does not restore the corresponding allotment. If, however, a PSB Surety approves a Final Bond but never issues the bond, SBA will credit the Surety's allotment for an amount equal to the guarantee percentage of the penal sum of the bond. In that event, the Surety must notify SBA as soon as possible, but in no event later than 5 business days after the non-issuance has been determined. Until the Surety has so notified SBA, it cannot rely on such credit.

§ 115.64 Timeliness requirement.

There must be no Execution or approval of a bond by a PSB Surety after commencement of work under a Contract unless the Surety obtains written approval from the AA/SG. To apply for such approval, the Surety must submit a completed ''Surety Bond Guarantee Agreement Addendum'' (SBA Form 991), together with the evidence and certifications described in § 115.19(f)(1)(ii).

§ 115.65 General PSB procedures.

(a) *Retention of information.* A PSB Surety must comply with all applicable SBA regulations and obtain from its applicants all the information and certifications required by SBA. The PSB Surety must document compliance with SBA regulations and retain such certifications in its files, including a contemporaneous record of the date of approval and Execution of each bond. See also § 115.19(f). The certifications and other information must be made available for inspection by SBA or its agents and must be available for submission to SBA in connection with the Surety's claims for reimbursement. The PSB Surety must retain the certifications and other information for the term of the bond, plus such additional time as may be required to settle any claims of the Surety for reimbursement from SBA and to attempt salvage or other recovery, plus an additional 3 years. If there are any unresolved audit findings in relation to a particular bond, the Surety must maintain the related certifications and other information until the findings are resolved.

(b) *Usual staff and procedures.* The approval, Execution and administration by a PSB Surety of SBA guaranteed bonds must be handled in the same manner and with the same staff as the Surety's activity outside the PSB program. The Surety must request job status reports from Obligees in accordance with its own procedures.

(c) *Notification to SBA.* (1) *Approvals.* A PSB Surety must notify SBA by electronic transmission or monthly bordereau, as agreed between the Surety and SBA, of all approved Bid and Final Bonds, and of the Surety's approval of increases and decreases in the Contract or bond amount. The notice must contain the information specified from time to time in agreements between the Surety and SBA. SBA may deny liability with respect to Final Bonds for which SBA has not received timely notice.

(2) *Other events requiring notification.* The PSB Surety must notify SBA within 30 calendar days of the name and address of any Principal against whom legal action on the bond has been instituted; whenever an Obligee has declared a default; whenever the Surety has established or added to a claim reserve; of the recovery of any amounts on the guaranteed bond; and of any decision by the Surety to bond any such Principal again.

§ 115.66 Fees.

The PSB Surety must pay SBA a certain percentage of the Premium it charges on Final Bonds. The PSB Surety must also remit to SBA the Principal's payment for its guarantee fee, equal to a certain percentage of the Contract amount. The fee percentages are determined by SBA and are published in Notices in the Federal Register from time to time. Each fee is rounded to the nearest dollar. The Surety must remit SBA's Premium share and the Principal's guarantee fee with the bordereau listing the related Final Bond, as required in the PSB Agreement.

§ 115.67 Changes in Contract or bond amount.

(a) *Increases.* The PSB Surety must process Contract or bond amount increases within its allotment in the same manner as initial guaranteed bond issuances (see § 115.65(c)(1)). The Surety must present checks for additional fees due from the Principal and the Surety on increases aggregating 25% of the contract or bond amount or $50,000, and attach such payments to the respective monthly bordereau. If the additional Principal's fee or Surety's fee is less than $40, such fee is not due until all unpaid increases in such fee aggregate at least $40.

(b) *Decreases.* If the Contract or bond amount is decreased, SBA will refund to the Principal a proportionate amount of the guarantee fee, and adjust SBA's Premium share accordingly in the ordinary course of business. No refund or adjustment will be made until the amounts to be refunded or rebated, respectively, aggregate at least $40.

§ 115.68 Guarantee percentage.

SBA reimburses a PSB Surety in an amount not to exceed 70% of the Loss incurred and paid. Where the Contract amount, after the Execution of the bond, increases beyond the statutory limit of $1,250,000, SBA's share of the Loss is limited to that percentage of the increased Contract amount which the statutory limit represents, multiplied by the guarantee percentage approved by SBA. For an example, see § 115.31(d).

§ 115.69 Imminent Breach.

(a) *No prior approval requirement.* SBA will reimburse a PSB Surety for the guaranteed portion of payments the Surety makes to avoid or attempt to avoid an Imminent Breach of the terms of a Contract covered by an SBA guaranteed bond. The PSB Surety does not need SBA approval to make Imminent Breach payments.

(b) *Amount of reimbursement.* The aggregate of the payments by SBA under this section cannot exceed 10% of the Contract amount, unless the Administrator finds that a greater payment (not to exceed the guaranteed portion of the bond penalty) is necessary and reasonable. In no event will SBA make any duplicate payment under any provision of these regulations in this part.

(c) *Recordkeeping requirement.* The PSB Surety must keep records of payments made to avoid Imminent Breach.

§ 115.70 Claims for reimbursement of Losses.

(a) *How claims are submitted.* A PSB Surety must submit claims for reimbursement on a form approved by SBA no later than 1 year from the date the Surety paid the amount. Loss is determined as of the date of receipt by

SBA of the claim for reimbursement, or as of such later date as additional information requested by SBA is received. Subject to the offset provisions of part 140, SBA pays its share of Loss within 90 days of receipt of the requisite information. Claims for reimbursement and any additional information submitted are subject to review and audit by SBA.

(b) *Surety responsibilities.* The PSB Surety must take all necessary steps to mitigate Losses when legal action against a bond has been instituted, when the Obligee has declared a default, and when the Surety has established a claim reserve. The Surety may dispose of collateral at fair market value only. Unless SBA notifies the Surety otherwise, the Surety must take charge of all claims or suits arising from a defaulted bond, and compromise, settle or defend the suits. The Surety must handle and process all claims under the bond and all settlements and recoveries in the same manner as it does on non-guaranteed bonds.

(c) *Reservation of SBA's rights.* The payment by SBA of a PSB Surety's claim does not waive or invalidate any of the terms of the PSB Agreement, the regulations in this part 115, or any defense SBA may have against the Surety. Within 30 days of receipt of notification that a claim or any portion of a claim should not have been paid by SBA, the Surety must repay the specified amounts to SBA.

§ 115.71 Denial of liability.

In addition to the grounds set forth in § 115.19, SBA may deny liability to a PSB Surety if:

(a) The PSB Surety's guaranteed bond was in an amount which, together with all other guaranteed bonds, exceeded the allotment for the period during which the bond was approved, and no prior SBA approval had been obtained;

(b) The PSB Surety's loss was incurred under a bond which was not listed on the bordereau for the period when it was approved; or

(c) The loss incurred by the PSB Surety is not attributable to the particular Contract for which an SBA guaranteed bond was approved.

Dated: January 22, 1996.

John T. Spotila,

Acting Administrator.

[FR Doc. 96–1347 Filed 1–30–96; 8:45 am]

BILLING CODE 8025–01–P

13 CFR Part 121

Small Business Size Standards

AGENCY: Small Business Administration.

ACTION: Final rule.

SUMMARY: In response to President Clinton's government-wide regulatory reform initiative, the Small Business Administration (SBA) has completed a page-by-page, line-by-line review of all of its existing regulations. As a result, SBA is clarifying and streamlining its regulations. This final rule improves the Agency's size program by simplifying and clarifying language in the existing rules, conforming these rules to present SBA policies and practices, and providing some substantive modifications to streamline the delivery of services to the public. The revised regulations will be more understandable and much easier to use, and will reduce the number of sections comprising Part 121 from eighteen to thirteen. The rule improves language, but does not change the existing size standards which apply to particular industries.

EFFECTIVE DATE: This rule is effective on March 1, 1996.

FOR FURTHER INFORMATION CONTACT: John W. Klein, Chief Counsel for Special Programs, Office of General Counsel, at (202) 205–6645.

SUPPLEMENTARY INFORMATION: On November 24, 1995, SBA published a proposed rule in the Federal Register (60 FR 57982) to completely revise its regulations governing the size determination program. SBA's intent in finalizing that rule is to streamline the size standards operation by simplifying and clarifying existing regulatory language and by eliminating unnecessary, irrelevant, or obsolete provisions. The final rule amends office titles to reflect a previous reorganization of functions within the structure of SBA. SBA has attempted to rewrite Part 121 in plain English in order to make the regulations more readable and less confusing.

The proposed rule contained eligibility requirements for organizations for the handicapped to receive awards of contracts set aside for small business and procedures for filing protests regarding the status of handicapped organizations (proposed §§ 121.1201–121.1206). Those sections have been removed from this final rule because the authority for such eligibility has expired. As a consequence, §§ 121.1301–121.1305 of the proposed rule have been renumbered as §§ 121.1201–121.1205 in this final rule.

SBA received and considered 25 timely comments in response to the proposed rule. The comments, as well as SBA's response to them, are discussed below. Other than the changes identified below in response to the comments and the elimination of proposed §§ 121.1201–121.1206 (as discussed above), the regulatory text of Part 121 has not been changed from the proposed rule. For a section by section analysis of the revised Part 121 and SBA's rationale for any changes from the pre-existing regulations, see the supplementary information published as part of the proposed rule (60 FR 57982).

Analysis of Comments Received

SBA received and considered eight comments to the proposed text for its affiliation regulation (proposed § 121.103). Six of these comments responded to the proposed exclusion from affiliation coverage afforded certain private investors that are engaged in the business of providing equity and/or debt financing to third parties. In addition to the existing exclusion from affiliation for Small Business Investment Companies (SBICs) and Development Companies, the proposed rule added an exclusion, for purposes of SBIC assistance only, for concerns owned by certain venture capital firms, pension funds, and charitable entities exempt from federal taxation under § 501(c) of the Internal Revenue Code. The proposed rule imposed the same control limitations on these investors as those imposed by SBA on SBICs under 13 CFR Part 107.

While the commenters supported SBA's intent to add an exclusion from affiliation for the listed investors, they thought that the proposal did not go far enough. One commenter agreed with the proposal to include venture capital operating companies (VCOCs) in the list of investors which would not be affiliated with applicant concerns, but felt that limiting the exception to financial investors that technically qualify as VCOCs might not achieve the desired goal. The commenter pointed out that a fund which resembles a VCOC because it has at least 50% of its portfolio in ''qualified venture capital investments'' and it obtains and exercises certain ''management rights'' with respect to those investments may nevertheless fail to qualify as a VCOC if its first investment was a passive investment. The commenter suggested that the affiliation exemption should be made available to any investing company that (1) has 50% of its portfolio in ''qualified venture capital investments'' at the time size is determined, or (2) would qualify as a VCOC but for its first investment.

SBA has considered the suggestion but has decided to limit § 121.103(b)(5)(i) to VCOCs, as proposed. SBA understands that other investors may exist whose investment goals, policies and activities are