
REPORT

to the

GOVERNOR OF THE STATE OF MARYLAND

and

**SENATE EDUCATION, HEALTH, AND
ENVIRONMENTAL AFFAIRS COMMITTEE**

and

**HOUSE HEALTH AND GOVERNMENT
OPERATIONS COMMITTEE**

on

INDIVIDUAL SURETY BONDS



FISCAL YEARS 2010-2011

Chapter 299, Laws of 2006 as amended by Chapter 266, Laws of 2008

EXECUTIVE SUMMARY

State Procurement Law requires bid, performance, and payment security for construction contracts expected to exceed \$100,000.¹ State Procurement Law authorizes – but does not require – bid security for non-construction contracts expected to exceed \$50,000.² State law authorizes – but does not require – performance and payment security on non-construction procurement contracts if the contract is expected to exceed \$100,000.³ One traditional form of security is a bond issued by a surety company authorized to do business in the State (corporate surety).⁴ The General Assembly enacted legislation that authorized *individuals* to issue bonds (individual surety).⁵ An individual surety bond differs from a corporate surety bond in that it is secured by assets from an individual in contrast to being secured by the assets of a corporate surety company. The General Assembly extended the individual surety bond program through September 30, 2014.⁶

The Procurement Advisor of the Board of Public Works is tasked with reporting to the Governor, the Senate Education, Health, and Environmental Affairs Committee, and the House Health and Government Operations Committee regarding the implementation of this law including its impact on small and minority businesses.

No agencies reported receiving individual surety bonds in FY 2010 and FY 2011.

BOARD OF PUBLIC WORKS

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¹ State Finance and Procurement Article, §§13-207 and 17-103, Annotated Code of Maryland.

² COMAR 21.06.07.02

³ State Finance and Procurement Article, §§13-207 and 17-104

⁴ State Finance and Procurement Article, §§13-207 and 17-104

⁵ Chapter 299, Laws of 2006

⁶ Chapter 266, Laws of 2008

I. Background

State Procurement Law requires bid, performance, and payment security for construction contracts expected to exceed \$100,000.⁷ State Procurement Law authorizes – but does not require – bid security for non-construction contracts expected to exceed \$50,000.⁸ State law authorizes – but does not require – performance and payment security on non-construction procurement contracts if the contract is expected to exceed \$100,000.⁹ Bid, performance, and payment security is required for construction contracts over \$100,000. Security is discretionary for other types of contracts regardless of dollar amount.¹⁰ Typically in response to State solicitations, bidders submit bonds issued by surety companies.¹¹ But State law authorizes bid, payment, and performance security in other forms¹² including:

- Cash or bank-certified check
- Pledge of securities
- Irrevocable letters of credit
- Bonds issued by individual sureties

The 2006 General Assembly added the latter category of bonds issued by an *individual surety* to provide more State contracting opportunities for businesses unable to obtain corporate bonding.¹³

Although State Procurement Regulations provide discretion to procurement agencies to reject any type of security (including individual surety bonds)¹⁴, the Board of Public Works has instructed agencies that “*all* acceptable security should be permitted if the procurement officer requires bid, performance, or payment security.”¹⁵ Agencies must consider the following before excluding any acceptable forms of security:

- Impact on small and minority businesses participation
- Whether setting guidelines for the category of security is possible rather than excluding the security altogether
- Degree of risk to the State if all acceptable security is permitted

⁷ State Finance and Procurement Article, §§13-207 and 17-103, Annotated Code of Maryland

⁸ COMAR 21.06.07.02

⁹ State Finance and Procurement Article, §§13-207 and 17-104

¹⁰ MDOT may require bonds for certain maintenance projects, but agencies typically do not impose bonding requirements on projects other than construction.

¹¹ The surety company must be authorized to do business in the State. State Finance and Procurement Article, §§13-207(d) and 17-104(a)(1)

¹² COMAR 21.06.07.01(B)

State Finance and Procurement Article, §§13-207, 13-216, and 17-104

¹³ Chapter 299, Laws of 2006

¹⁴ COMAR 21.06.07.01(F)

¹⁵ Board of Public Works Advisory 1996-3 (www.bpw.state.md.us/procurement/advisories.asp)

Scope of Report. The General Assembly tasked the Procurement Advisor of the Board of Public Works with reporting to the Governor, the Senate Education, Health, and Environmental Affairs Committee, and the House Health and Government Operations Committee regarding the implementation of the Law during the immediately preceding fiscal year, including the impact on small and minority business enterprises.

II. Requirements For Acceptable Individual Surety Bonds

To submit an individual surety bond acceptable to a State procurement agency, the bidder or offeror must demonstrate that:

1. It has been denied bonding by a corporate surety;
2. The individual surety transacts business only through an insurance agency licensed by the Maryland Insurance Administration;
3. The individual surety attaches an Affidavit of Individual Surety;
4. The individual surety is a U.S. citizen (corporations and partnerships cannot act as individual sureties);
5. The individual surety pledges one or more of the following assets in an amount equal to or greater than the total penal amount of the bond.
 - (i) Cash or certificates of deposit;
 - (ii) Cash equivalents held with a federally-insured financial institution;
 - (iii) Certain assets evidenced by a security interest including irrevocable trust receipts;
 - (iv) U.S. Government securities at market value;
 - (v) Stocks and bonds that meet certain criteria;
 - (vi) Real property that meets certain criteria; or
 - (vii) Irrevocable letters of credit that meet certain criteria.

Before accepting a bond from an individual surety, the procurement officer must consult with the Office of the Attorney General to determine whether the requirements for an individual surety bond have been met.

Pledged Assets. Following are further requisites for the assets that the surety pledges.¹⁶

Personal Property. An individual surety must provide a current UCC-1 financing statement at the time the bond is furnished for the personal property assets listed above (not real property). The financing statement is filed to perfect the State's security interest in the property and establishes its priority in case of debtor default or bankruptcy.

Real Property. Pledged real property must be located in the State and owned by the contractor or individual surety in fee simple or by cotenants that all agree to act jointly.

¹⁶ The pledge asset requirements are important because they provide guidelines to procurement officers for assessing the risk to the State in accepting individual surety bonds.

III. FY 2010 and FY 2011 - Use of Individual Surety Bond

The Board of Public Works requested information from each procurement agency to assess the frequency of individual surety bond use. No agencies reported receiving individual surety bonds in FY 2010 and FY 2011. Over the five years that individual surety bonds have been tracked, only one bond has been submitted in response to a State solicitation.¹⁷

An individual surety bond is one of many forms of bid, performance, and payment security available to State bidders. Because individual surety bonds are authorized only after a business has been denied credit by a corporate surety,¹⁸ the inactivity may be attributable to improved conditions for accessing corporate sureties. The Maryland Small Business Development Financing Authority also offers an alternative for bidders who have been denied credit by a corporate surety. MSBDFA provided one surety bond in FY 2011.

IV. Recommendation

Examine State's requirement for multiyear bonds.

To mitigate the State's risk on construction projects, State agencies often require bidders to provide multiyear bonds to cover the life of the project. Sureties are sometimes hesitant to commit to large, long-term bonds, especially for smaller businesses, because of the risk inherent to them. That leaves small and minority businesses with few options. The Procurement Advisor recommends exploring whether the State can accept annual bonds for certain procurements to maximize opportunities for small and minority businesses.

¹⁷ That individual surety bond was submitted in 2007 to the State Highway Administration which rejected it.

¹⁸ COMAR 21.06.07.02