

Annual Report

CY 2015

The Surety & Fidelity Association of America is a rating, advisory, statistical and trade association licensed in all states. SFAA performs a leadership role in promoting and preserving the use of fidelity and surety bonds to protect public and private interests.

The Surety & Fidelity Association of America

Tel 202.463.0600
Fax 202.463.0606

1140 19th Street NW, Ste. 500
Washington, DC 20036

www.surety.org
information@surety.org

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Message from the President

It has been an exciting year

It seems as if each year SFAA has more excitement, opportunities and changes both internally and across the globe. 2015 saw the implementation of an updated statistical plan to gather data that allows us to better promote surety bonds, success in Congress and the states in truly significant legislation, a sea change in the way many government representatives and small and emerging contractors are talking about surety bonds, updated fidelity policies, a dramatic upgrade in our communications, industry recruiting and diversity efforts, an increase in the use of surety globally, increased education for our members, increased statistical filing efficiency and faster statistical reporting, and much more. At the same time, we reduced our office footprint dramatically and completed a massive analysis of our paper files, resulting in significant savings in 2015 and beyond.

In this annual report we highlight just some of the accomplishments from 2015, and include some information that we believe you will find interesting. SFAA is powered by the SFAA members, through the Board of Directors, the Executive Committee and all of the committee and working group members. Thank you to each and every one of you for your support of SFAA, and your work on behalf of the surety and fidelity industry.

Lynn M. Schubert
President



Board of Directors May 2015 - May 2016

Ace USA Group Stephen M. Haney - Chair Division President, ACE USA Surety Chief Underwriting Officer, Global Surety	Merchant's Bonding Company Group Larry Taylor Chairman of the Board & President
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Hanover Insurance Group Robert Thomas President, Hanover Surety	Zurich Surety Michael Bond Executive Vice President - Head of Surety
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Liberty Mutual Group Timothy Mikolajewski - Immediate Past Chair, Ex Officio President, Liberty Mutual Surety	

SFAA Committees

Actuarial Advisory Committee Chair: Larry Seymour, CapSpecialty Staff: Alan Clark	EBusiness Advisory Committee Chair: Mitch Epstein, Chubb Staff: Joe Orgovan
Bail Bond Advisory Committee Chair: Brian Frank, Lexington National Insurance Corp. Staff: Robert Duke	Fidelity Advisory Committee Chair: Tracey Santor, Travelers Staff: Robert Duke
Commercial Surety Advisory Committee Chair: George James, International Fidelity Insurance Company Staff: Robert Duke	Fidelity Claims Advisory Committee Chair: Delores Parr, Zurich Staff: Robert Duke
Communications Advisory Committee Chair: Therese Wielage, Merchants Bonding Staff: Kate Woerheide	Government Affairs Advisory Committee Chair: Joe Manero, CAN Staff: Lenore Marema
Contract Bond Advisory Committee Chair: Mike Foster, Merchants Bonding Staff: Joanne Brooks	International Advisory Committee Chair: Dekker Buckley, Chubb Staff: Lynn Schubert
Corporate Counsel Advisory Committee Chair: Rosemary Quinn, CNA Staff: Robert Duke	Statistical Advisory Committee Chair: Stephen Granato, Travelers Staff: Edward O'Donnell
Diversity and Human Resources Advisory Committee Chair: Ed Hubbard, Travelers Staff: Barbara Reiff	Surety Claims Advisory Committee Chair: Scott Cochrane, The Hartford Financial Services Group Staff: Joanne Brooks

SFAA Staff

<p>Lynn M. Schubert President lschubert@surety.org</p>	<p>Lenore Marema Vice President of Government Affairs lmarema@surety.org</p>
<p>Joanne Brooks Vice President & Counsel jbrooks@surety.org</p>	<p>Edward O'Donnell Statistical Manager eodonnell@surety.org</p>
<p>Alan Clark Actuary aclark@surety.org</p>	<p>Joseph Orgovan Director of Information Technology jorgovan@surety.org</p>
<p>JaLissa Coffee Executive Assistant and Meeting Planner jcoffee@surety.org</p>	<p>Peniner Shade Administrative Associate pshade@surety.org</p>
<p>Robert Duke Corporate Counsel rduke@surety.org</p>	<p>Barbara Reiff Director of Operations breiff@surety.org</p>
<p>Eli Gilbert Director of Underwriting egilbert@surety.org</p>	<p>Daniel Wanke Manager – Regulatory & Government Affairs dwanke@surety.org</p>
<p>Janice Johnson Administrative Assistant jjohnson@surety.org</p>	<p>Kate Woerheide Communications Manager kwoerheide@surety.org</p>
	<p><u>Consultants</u> Edward Gallagher Outside Counsel egallagher@surety.org Samuel Carradine Model Contractor Development Program Consultant scarradine@surety.org</p>

Promotion & Preservation of the Use of Bonds

Priority

SFAA works towards the promotion and preservation of bonds each day, both with external audiences and providing resources to member companies and subscribers. We work towards this priority across every department because it is important to our members and our industry. Our members represent 96 percent of industry premiums in both surety and fidelity.

Accomplishments

Federal Legislation - The enactment of legislation in Congress affecting two key surety issues this year was due to SFAA's effective leverage of its activities through participation in the federal Construction Industry Procurement Coalition. Members of Congress heard not just from sureties and bond producers about our issues, but rather heard strong support for bonding from AGC and ASA, among the many other construction-related trades in the Coalition. In addition, SFAA's legislative work in 2014 brought about the enactment of a new bonding legislation in congress in 2015.

- Enacted legislation in Congress to increase the bond guarantee to the sureties from not more than 70% to not more than 90% in the SBA's Bond Guarantee Program, encouraging more sureties and bond producers to participate in the program.
- Enacted legislation in Congress to require individual sureties to play by the same rules as any other person or entity that pledges assets to the federal government. Individual sureties will have to post reliable assets and surrender them to the contracting officer for the duration of the contract. The losses that several agencies have suffered affected subcontractors and suppliers as well, and this will be prevented in the future. And, of course, this should prevent further damage to the reputation and value of legitimate surety bonds caused by unscrupulous individual sureties.
- Federal law now requires entities submitting bids to supply durable medical equipment, prosthetics, orthotics and supplies (DMEPOS) under the Medicare competitive acquisition program to furnish a "bid surety bond" in an amount not less than \$50,000 and not more than \$100,000 for each area in which it is bidding. Under the 2014 legislation that SFAA addressed, the bid bond would have become a performance bond that guaranteed that the bidder would perform the contract and deliver all the medical equipment and supplies required. Under the Medicare program, providers bid to provide a specific item of medical equipment to a

geographical area where the ultimate demand during the time period of the contract is unknown or unlimited. That lack of clarity and certainty in the bonding obligation would have made it difficult for sureties to guarantee that the bidder would perform the contract.

State Legislation - At the state level, SFAA worked to educate, inform, and empower local stake holders and associations about impending legislation and bond issues.

P3 - SFAA continues to play an active role in P3 legislation and the promotion of bonding. Our efforts include, but are not limited to, the drafting of amendments to current P3 legislation and sharing the importance of bonding with local stakeholders and contractors.

SFAA took a lead role in drafting amendments to state P3 legislation to require bonding for the construction portion of the P3 project. In **Ohio** the P3 law was amended to clarify the bonding obligation under the performance bond so that it covers the construction under the P3 and not all work done on the project. The new law also eliminates the DOT's discretion to require additional terms and conditions for the bond. In **Maryland**, the P3 law was amended to limit the amount of the performance bond to the costs of the construction rather than the total amount of the P3 project. The limitation was in the law for the payment bond, but not for the performance bond. Also, even though the P3 legislation was not enacted for many other reasons, SFAA and AIA successfully amended the bills in the following states to require bonding: **Arkansas, Missouri, Minnesota, and New Mexico**. We also successfully amended the **New Jersey** bill to require the concessionaire to obtain or cause the contractor to obtain the bonds.

Thresholds and Individual Sureties - SFAA produced loss data that showed the legislature the exposure they would assume if bonds were not in place. This data assisted in the defeat of a \$1 million bond threshold increase and a bill to permit individual sureties in **Nevada**. The **Nevada** individual surety bill was driven by small and minority contractor businesses and SFAA presented the success of its MCDP as a better solution that makes bonding a tool of empowerment for small and emerging contractors.

Surety Eligibility Requirements - In **Washington**, a new law was enacted that repealed provisions in the procurement law that allowed all state and local entities to impose eligibility requirements on sureties issuing bonds on their projects and replacing it with a restriction to an "A-" or better rating of financial strength. SFAA worked with the local sureties to preserve the robust market for this bond.

Pre-need Funeral Bond - SFAA worked with local stakeholders in each state, **Illinois, Iowa, North Carolina, and Tennessee**, to explain the benefit of the bond and defeated efforts to repeal the pre-need funeral bond.

Nullem Tempus - In response to a 2012 Connecticut Supreme Court Case (State of Connecticut v), Lombardo Bros. Mason Contractors, Inc., et al., 307 Conn. 106

(2012), which held that actions brought by the state were not subject any limitations period, SFAA worked closely with the Connecticut Construction Industries Association (CCIA) to establish a reasonable statutory limitations period and to eliminate the ancient common law doctrine of nullum tempus, which precludes any limitations in the law from applying to the State and local governments. In 2015, SFAA staff provided testimony in favor of Connecticut SB 1032 & HB 6925, which established a limitation period for state action against a construction contract or related surety bond. Together we achieved a ten year statute of limitations for public entities to bring actions resulting from public works projects.

Model Contractor Development Program® - The success of SFAA's MCDP® around the country combined with SFAA's talking points on the value of bonds to public owners led to the defeat of legislation in **Connecticut**. The legislation would have allowed bonds to be waived for small, emerging and minority contractors for contracts under \$500,000 and an unusual bill that attempted to permit a new state guarantee fund to issue or guarantee bonds in excess of \$500,000. (Legislation to increase the state bond threshold was proposed but never drafted and considered.) Through the cooperative work of SFAA, AIA and the Insurance Association of Connecticut, the legislature instead agreed to put \$2 million in the budget for a bonding education and technical assistance program, which SFAA will pursue as a MCDP®.

Friend of the Court (amicus curiae) - SFAA is in a unique position to lend expertise and surety and fidelity industry perspective in court cases involving significant surety or fidelity issues. In 2015, SFAA submitted "friend of the court" briefs in the following matters. The decisions for both cases are pending.

- *Postmaster Services v. Travelers Casualty & Surety Co. of America* (U.S.C.A 9th Cir.) (scope and interpretation of computer fraud coverage).
- *Independent Trust Corporation v. Kansas Bankers* (Ill. Ct. App.) (classification of a financial institution bond as "fidelity and surety in Illinois insurance statutes).

AM Best - Based in inquiries by AM Best to certain members regarding their commercial surety book of business, it became apparent that SFAA could provide valuable guidance to AM Best regarding how to assess commercial surety exposure. In December 2014, a SFAA working group finalized an analytical framework. SFAA staff provided a copy of the framework to the Board for review and then presented the framework to staff from AM Best. In August 2015, staff and members of the Commercial Surety Advisory Committee and Actuarial Advisory Committee met with representatives of AM Best to discuss the proposed framework. Based on the discussion at the meeting, it appears that Best will utilize the framework to guide its inquiry regarding a surety's commercial surety portfolio.

Maryland Insurance Administration - In response to members' concerns that the Maryland Insurance Administration (MIA) was rejecting filed bond forms because they contained

Accomplishments Member & Subscribers

Priority

SFAA each year continues to enhance its services to members, subscribers, statistical filers and state regulators in collecting, analyzing and reporting data on the surety and fidelity industries. In 2015, we accomplished numerous advancements that already have provided value to the industry.

Accomplishments

Improvements to Data Collection - As the statistical agent for surety and fidelity, SFAA continuously reviews the Statistical Plan to ensure that the data collected is credible and useful. In 2015 SFAA revised the Statistical Plan so that more data more clearly illustrates the value of bonds. The changes involve new fields (streamlined underwriting program indicator and small contractor indicator), new transactions (allocated loss adjustment expense, salvage, and subrogation), and new class codes (P3 projects). As P3 bonds are increasingly important in the industry, new class codes were added to capture premium and loss data related to them. In addition, new transaction type codes were added to collect ALAE data. The revisions are scheduled to apply to 2015 data that will be collected by SFAA in 2016. We are continuing to seek to amend the Texas Commercial Lines Statistical Plan to add P3 classification codes and to include a Small Business Indicator.

Company Edit Package - Working with ISO, SFAA helped introduce the revised Company Edit Package (CEP) and Statistical Web Service (SWS). Combining the CEP, FTP upload and electronic Submission Analysis Reports, this new application developed by ISO specifically for SFAA data, allows members to edit, correct and submit data from the same interface. The effort is part of the SFAA continuing effort to utilize new electronic tools to facilitate the submission, processing and distribution of industry data.

Actuarial Review - In 2015 SFAA conducted an actuarial review of the surety loss cost rates.

Actuarial Updates - Updates were made to the Construction Surety Loss Severity Study and PEL/PML Model this year enhancing the value of these important tools.

New Resources - We are pleased to provide additional valuable resources in 2015 for SFAA Subscribers including Excel versions of all SFAA data reports (Top 100, Top 50, 12 Year, 5 Year, IEE, Quarterly Results) and access to previous years' Annual Meeting presentations.

Electronic Submissions - Electronic copies of financial statements, including Annual Statements, Quarterly Statements and Insurance Expense Exhibits, are now being accepted instead of paper copies. This change in the Call for Financial Statements procedure is another step in the SFAA's plan to streamline the data submissions required of SFAA members.

Story

All detailed transaction data collected through the SFAA Call for Statistics is now entered into a secure SQL database after receipt and processing. This SQL database provides much greater capacity to aggregate and analyze detailed surety and fidelity statistics, including the data involved in the SFAA Loss Costs. Previously, multiple MS Access databases were employed in sequence, causing the computation of loss costs alone to take weeks. With the advent of the SQL database, the same computations can be run in hours.





Finding
Operational
Efficiencies

More Dollars
Towards
Member Services



Financial Responsibility

Priority

SFAA must be and is a faithful financial steward of your assessment dollar. SFAA management constantly focuses on finding operational efficiencies to maintain and control expenses.

Accomplishments

Office Move - In 2015, SFAA obtained a subtenant for its existing space of over 8,000 square feet, and moved into less than 6,000 square feet. Driving the move was a desire to reduce the rent expense and be more efficient. With only one Board meeting a year in the SFAA office, and the shift to online legal research, there simply no longer was a need for our Board room/library. The giant file room also needed to become a thing of the past. Negotiating the best deal possible in a great location, we now have completely new, open, efficient space at a savings of approximately \$1 million over the next 10 years. All of this was accomplished within the existing SFAA 2015 Budget that did not contemplate an office move.

Electronic Files - In order to reduce the size of the office so dramatically, we determined that we had to reduce our paper files and design a much smaller file room. While never dropping the ball on our regular activities and goals, staff literally reviewed all files in our file room, dating back to the 1930s, culled them, and the remaining are being digitized for inclusion in our electronic files. As a resource not only to SFAA members but to all state insurance departments, accurate filing records are critical. We are pleased to report that the electronic system allows us to find requested information just as quickly as in the paper files, and in many instances faster. This also has allowed us to reduce the expense of our off-site storage.

Budget - The SFAA Budget did not contemplate an office move, so did not include funds for either build out of office space or moving and furniture expenses. Through negotiations with the new landlord on free rent and buildout allowance, negotiations with the subtenant and reductions in planned expenses, and an increase in non-dues revenue, we were able to accomplish the move and the file project and still come in less than 1% over budget.

Story

In November of 2015, SFAA moved to new office space with a smaller footprint, which has reduced significantly monthly rent expense. This means that more budget dollars can go toward SFAA member services.



Education

Priority

Education goes hand in hand with the promotion of our industry and SFAA is intensifying its efforts to offer SFAA members and other surety professional's valuable educational opportunities.

Accomplishments

Fundamentals of Commercial Surety - For many years, SFAA has offered a seminar on the fundamentals of commercial surety in Chicago. This seminar provides an overview of the commercial surety line of business. This seminar in 2015 once again was sold out and received positive feedback.

Credit Analysis Seminars - On a more advanced level, SFAA has teamed with Moody's to offer credit analysis seminars. SFAA offered its first program on problem credits in March 2015 and will be offering a seminar on financial statement analysis in March 2016. SFAA is testing courses with Moody's as we work towards our vision of a five course curriculum with a "Surety Credit Analyst" certification.

Member Webinars - In 2015, SFAA provided three webinars for members (Basic Bankruptcy, Advanced Bankruptcy, and Professional Employer Organizations).

Case Summary Subscribers - The Case Summary Subscribers traditionally have had authorization to share the email summaries within their organizations to research issues. In 2015, SFAA made this a little easier by allowing other employees within the case summary subscribers' organization to have a personal login account on the SFAA website to access the Case Summary Subscriber portion of the website.

SDI Seminar - SFAA had a lead role in the educational seminar that the Massachusetts Surety Association conducted on SDI in response to pending legislation claims.

Claims Handling Seminar - In conjunction with the Pearlman, SFAA sponsored the Exceptional Claims Handling Seminar with Carl Van, the expert who conducted the previous SFAA claims seminars.

Model Contractor Development Program® (MCDP®) - In October 2015 the Model Contractor Development Program® offered an eight week educational workshop in partnership with Miami-Dade County Public Schools (M-DCPS). Out of 21 contractor participants, 20 had interviews and follow-up meetings with bond producers to work one-on-one on bond readiness and to develop prescriptive plans that are specifically tailored to individual issues of bondability.

Bond Education Programs - In 2015 in partnership with USDOT, there were 19 Bond Education Programs conducted around the nation creating a total bonding capacity of \$55,289,866.00. This increased the total bonding capacity from 2010 to present to \$468,407,620.00.



Story

In October 2015, SFAA ran another successful Bond Education Program in conjunction with Sugar Creek Construction, LLC, the South Atlantic Small Business Transportation Resource Center of the U.S. Department of Transportation, and Central Piedmont



Community College. Sugar Creek is the prime contractor on the \$600 million dollar project that will widen a 26 mile stretch of highway I-77 in Charlotte, NC. The goal of the I-77 Sugar Creek BEP program was to provide small businesses with technical support and access to resources to enable them to build capacity and compete successfully for subcontracting opportunities. Since the program one of the participants achieved \$750,000 bonding.

Talent

Priority

Recruiting talented young professionals into the surety and fidelity industry and finding ways to keep them in the industry always are priorities for SFAA. However, in 2015 additional resources and staff time were allocated to increase our efforts under this topic. The results of this have been exciting and we will continue these and undertake new efforts into 2016. We also continue with the critical priority of providing data to assist SFAA members in their own internal recruitment and retention efforts.

Accomplishments

Compensation Survey - Given the shift from an employers' job market toward an employees' job market, a competitive total compensation strategy is critical. Each year SFAA sponsors a one-of-a-kind industry specific compensation survey that provides comprehensive data not found in other compensation surveys. The 2015 survey was completed on schedule and on time. Participants return year after year due to the value of the data and the opportunity to obtain specific industry benchmarking data.

Summit - The DHR Committee sponsored the second Diversity and Inclusion Summit in conjunction with SFAA's Annual Meeting in 2015 and the program was a resounding success. Diversity and Inclusion author and speaker Joe Gerstandt served as the keynote speaker and led a half-day workshop, *In Pursuit of Inclusion*, addressing the value of diverse thought to business results and recognition of unconscious bias.

Industry Resource Group - A high note of the Summit was the opportunity provided to participants to express interest in the development of an Industry Resource Group (IRG), the objective of which will be to promote the varied industry career opportunities, including exploration of methods for promoting the industry among students. The IRG Group will focus on industry recruitment and promotion. This group is up and running and already providing value to the recruitment efforts of the SFAA.

Young Professionals Group - A key responsibility of current industry leadership is the development of tomorrow's leaders. Through a Chief Bonding Officer nomination process, SFAA has formed a group of individuals with anywhere between three and ten years of experience and leadership potential to explore the industry through liaison with the National Association of Surety Bond Producers (NASBP) 5-15 group. The YPG is exploring other areas of interest as well.

Gamma Iota Sigma - Once again, SFAA promoted career opportunities in the industry as well as The Surety Foundation's internship and scholarship program for minority students through participation in the Annual Gamma Iota Sigma Conference in October. Gamma Iota Sigma (GIS) is an international professional fraternity organized to promote and encourage student



interest in insurance, risk management and actuarial science as professions. GIS membership exceeds 3,000 students and represents an alumni population of over 22,000.

The Surety Foundation - SFAA staff and member company representatives participated in a faculty roundtable as well as a professional association informational networking event and conducted a student workshop on careers in the industry. A new recruiting video highlighting several young professionals in the industry was used for the first time at the conference. Mark Vonnahme, a Trustee on The Surety Foundation Board of Trustees, former President and CEO of CNA Surety Corporation, former Chair of the SFAA Board of Directors and currently a Professor in the College of Business, University of Illinois at Urbana-Champaign, represented the Association at the Faculty Roundtable. It is our belief that development of relationships with organizations such as GIS, risk management faculty at various colleges and universities and other relevant associations will facilitate meaningful promotion of the minority scholarship and internship program and careers in the industry in general.

Howard University - In partnership with The Surety Foundation, the SFAA established a relationship with Howard University in Washington, DC. This newly formed relationship increased awareness of the Intern and Scholarship Program, leading to increased applications, as well as the opportunity to participate in their Summer Program to promote fidelity and surety to their students.

Story

In Partnership with The Surety Foundation, SFAA increased our marketing efforts towards the promotion of the Surety and Fidelity Industry Intern and Scholarship Program for Minority Students (SFIISP). A recruitment video was created and shared at the Gamma Iota as well as through our social media channels and on our website. SFAA received positive feedback on the video which has translated into an increase in the number of inquiries into the SFIISP and a 134% increase in the number of applications received.



New Challenges

Priority

Each year we face new challenges as an industry whether they are local, national, or international. As an organization we strive to anticipate, when possible, and respond to the challenge, always with our member companies and the surety and fidelity industry best interests in mind.

Accomplishments

Crime Protection - As an advisory organization, SFAA develops standard fidelity and crime insurance forms. This role requires that SFAA monitor the forms and ensure that they remain relevant to today's coverage needs and business practices. In that regard, SFAA developed new coverage for the Crime Protection Policy to address growing frequency of social engineering schemes.

Computer Systems - The evolving nature and use of computers and technology has mandated that substantial revisions be made to the Policy, which was drafted initially in the 1980s. The revisions provide a new definition for "Computer", which could be a hand-held device and include the internet within a "Computer Network." The Policy offers insuring agreements— Computer to Computer Systems Fraud, Access Credentials; Computer to Computer Systems Fraud, Hacker or Interloper; Fraudulent Transfer Instructions; Fraudulently Induced Transfer.

Electronic Bonding Systems - As technology changes and streamlines the bonding process, SFAA continues to advocate best practices and data standards regarding surety automation. This includes maximizing interoperability among disparate systems, security, and maintaining the validity of the bond. SFAA monitors developments of new electronic bonding systems and works with partners to help streamline the processes, reduce redundancies and increase productivity in the surety bond process. SFAA worked with multiple partners on Electronic Customs Bonds, Electronic Mortgage Broker Bonds, Missouri Department of Transportation (MoDOT) pilot project to accept electronic performance and payment bonds, Iowa Department of Transportation pilot system, and Michigan Department of Transportation (MDOT) pilot for electronic performance and payment bonds.

Virtual Currency - Legislation is being introduced to include virtual currency in the money transmitter's license bond, and SFAA stepped up to explain the increase in risk. Legislation pending in North Carolina includes an insurance requirement to cover risks not normally covered by a bond in response to SFAA advising the Banking Commissioner on the typical scope of a surety bond.

Ban the Box - Recently introduced Ban the Box legislation would require employers to remove inquiries about criminal records on job applications. SFAA worked on an exception that would allow employers who would require the applicant to obtain a fidelity bond if offered the job to

ask about the applicant's criminal background during the interview process. Ban the Box bills were introduced in Alabama, Georgia, Illinois, Iowa, Mississippi, Oklahoma, and Pennsylvania. We were successful in Illinois where the bill passed with this exception for fidelity bonds.

Story



SFAA helped to defeat a bill in Illinois that would have required insurers and sureties to offer fidelity bonds to any individual, regardless of his or her record of arrest conviction or imprisonment. Ban the Box legislation recently has surfaced, which bans employers from including a question on an initial job application that asks about the applicant's criminal convictions. Such legislation is intended to give ex-convicts a better chance at employment by assisting them in getting a job interview. Illinois went beyond the Ban the Box approach. SFAA and AIA worked with the bill sponsor and committee staff to explain that many fidelity bonds provide blanket coverage for all employees so

that the Ban the Box laws would make it more likely that those with the history of being dishonest could be in the employ of the employer who buys a fidelity bond. Sureties also need information on the employees of the bondholder and that information may be harder to obtain without the check box. Most bonds permit the surety to exclude coverage for employees who the employer knows to be dishonest. Without the check box, sureties will have more disputes regarding whether the employer knew or not. Once the bond coverage was explained, the bill died in committee. Most of the second generation of Ban the Box bills exempt from the ban any job positions for which a fidelity bond will be required as a condition of employment.

Thank you

Thank you to our members and subscribers for your support and for your dedication to the surety and fidelity industry. If you have any questions regarding this report or have suggestions for the 2016 report please feel free to contact a SFAA staff member. All SFAA members are invited to join one or more of our committees. If you are interested in joining an advisory committee, visit <http://www.surety.org/?page=AboutCommittees> for more information.

Association Information

The Surety & Fidelity Association of America

1140 19th Street NW, Ste. 500
Washington, DC 20036

Tel 202.463.0600

Fax 202.463.0606

www.surety.org

