

THE SURETY & FIDELITY ASSOCIATION OF AMERICA

MEMORANDUM

TO: Government Affairs Advisory Committee
FROM: Lenore S. Marema
DATE: August 8, 2007
RE: Overview of the 110th Congress at the Summer Recess –Commercial Surety

Congress adjourned on August 6 for its summer recess. To date in the 110th Congress, there has been no final action on any issues impacting contract surety; but there are issues of interest pending in Congress. The following is a status report on SFAA's efforts regarding issues affecting commercial surety. Congress reconvenes on September 4.

Fiscal 2008 Appropriations

The new Democratic leadership initially aimed to be the first Congress to complete the budget by July 4 and, later, to be the first Congress in a long time to complete the budget by the August recess. Now appropriations will be one of the first things that Congress needs to address and complete when it reconvenes, as there is still much work to be done. The 2008 fiscal year begins on October 1; and, unless the budget gets done, continuing resolutions will be needed to avoid a shut down of the federal government.

The House passed all 12 of its appropriations bills, but at issue is a \$23 billion spending gap between what the House appropriated and what President Bush requested, and that is with the Pentagon appropriations bill being \$3.5 billion less than requested. The President has threatened vetoes of most of the bills. The House deliberately separated out spending for the war in Iraq and will take that up in September, as the Administration must give Congress a new report on conditions in Iraq on September 15.

By contrast, the Senate passed the fiscal 2008 Homeland Security bill on July 27 as the summer recess was approaching. This was the first appropriations bill to reach the Senate floor. It appears that the Senate is headed in the direction of the House, namely, passing bills that exceed the President's requests. The first item on the Senate's agenda when it returns is the Military Construction and Veteran's Affairs appropriations bill.

Conference committees likely will be needed to resolve differences in the House and Senate versions of some of the appropriations bills, and there will be some veto override votes. Both chambers are working to avoid vetoes on many of the appropriations bills.

Earmarks have been in the spotlight this session. Early on in the session, the House changed its rules to require earmarks to be disclosed. Both the House and Senate passed new legislation, introduced near the end of the session, which would require Senators to disclose earmarks they have sponsored and Committee chairs to certify that earmarks have been disclosed 48 hours

before a vote in the Senate on the bill or conference report containing the earmark. Failure of a Senator to properly disclose earmarks will open up the bill or conference report to a point of order. For the first time, Senators will be able to move on the Floor to eliminate earmarks added in a conference report that were in neither the original House or Senate bill.

Issues Pending in Congress that Impact Commercial Surety

Bills on the Move:

--Mortgage Broker Bonds. H.R. 1852 would require correspondent lenders and mortgage brokers post a surety bond in the amount of \$75,000 in order to be a mortgagee participating in the mortgage insurance programs under the National Housing Act. SFAA has been working with the staff of Representative Gary Miller (R-CA) and the National Association of Mortgage Brokers (NAMB) to assure that the terms and conditions of the bond are clear and represent guarantees that sureties can underwrite.

Under the proposed revisions SFAA drafted in conjunction with the NAMB, all mortgage brokers would be required to post a surety bond instead of audited financial statements and minimum net worth requirements, in an aggregate amount to be determined by the Secretary of the Department of Housing and Urban Development, based on the aggregate loan amount of Federal Housing Administration (FHA) loans placed in a calendar year, but not less than \$50,000 or more than \$100,000. The bond amount would be adjusted annually by the Secretary by the change for such year in the Consumer Price Index for All Urban Consumers published monthly by the Bureau of Labor Statistics of the Department of Labor. The bond would guarantee compliance with all relevant rules and regulations of the FHA and payment of damages caused by violation of those relevant rules and regulations to the extent of the liability of the correspondent lender or broker, up to the penal sum of the bond. Without regard to the number of years the bond remains in effect, the number of claims or claimants and the number of premiums paid, the aggregate liability of the surety cannot exceed the penal sum of the bond. A surety may cancel the bond with 30-days notice.

We previously expected the above language to be added to H.R. 1852 as a floor amendment and passed by the U.S. House before the summer recess because affordable housing issues are a high priority for House Financial Services Committee Chair Barney Frank (D-MA). There also is considerable interest in Congress in regulating subprime lenders. The mortgage broker bond issue is part of a greater housing package in H.R. 1852 that addresses other issues. Congress got bogged down, however, with appropriations issues, and this issue was put to the side until the fall. NAMB has made initial contacts with the staff of Senator Dodd (D-CT), Chair of the Senate Banking Committee, which will address the housing and banking issues in the Senate. NAMB received a positive reception to the mortgage broker bond. After the recess, SFAA will coordinate visits to key Senate Banking Committee members with the NAMB in an attempt to move the bill in the Senate.

--Energy Legislation. H.R. 3221 is an omnibus alternative energy bill combining several measures, resulting from negotiations taking place in Congress to get a bill passed and to the President, which provides for alternative sources of energy production. The bill passed the House prior to the summer recess.

The bill would require a post-lease surface use agreement between the operator for oil or gas operations and the surface owner, specifying certain rights and obligations including site reclamation. The bill would allow, however, the Secretary of the Interior (Secretary) to authorize an operator to conduct operations without such an agreement if the operator had made a good faith effort to reach an agreement with the owner. If the operator made such an effort and no agreement was reached after 90 days, the operator could proceed after submitting a plan of operation that complied with all applicable state and federal laws and posting a bond or other financial assurance. The bond or financial assurance would have to be in an amount that the Secretary determined to be adequate to ensure compensation to the owner for any damages to the site; and it could be in the form of a surety bond, trust fund, letter of credit, government security, a certificate of deposit, cash or the equivalent.

H.R. 3221 also provides for reclamation bonding for oil and gas leases. Under the permit that the bill would require, bonds for reclamation would have to be sufficient to cover the operations of the oil and gas drilling as well as reclamation costs for the area. This provision came from H.R. 2337, for which there is a similar Senate bill, S. 1931.

The bill also would create a loan guarantee program for loans from private institutions for the construction of facilities for the manufacture of advanced vehicle batteries and battery systems developed and produced in the United States. The program would be for the financing of the construction only, not for the development of the battery systems. As a condition of the guarantee, a form of assurance for repayment of the loan would be required. This could be in the form of a performance bond, insurance, collateral or any other means that the Secretary finds acceptable. The assurance would have to be in an amount not less than 20% of the amount of the loan. The loan guarantee provisions were contained in H.R. 3239.

--Boxing Commission. S. 84 would establish the U.S. Boxing Commission (Commission) and would require promoters to post a surety bond, cashier's check, letter of credit, cash or other security in an amount acceptable to the Commission in connection with obtaining approval for a professional boxing match from a state boxing commission. The bill is on the Senate floor and will be taken up when the Senate reconvenes.

Recent Introductions:

The following bills of interest to commercial surety have been introduced since our last federal report in June:

--Reclamation Bonds. S. 1268 would enact the Domestic Offshore Energy Security Act, which would allow for offshore exploration drilling for hydrocarbon fuel resources. The bill requires that the regulations adopted pursuant to the proposed law include provisions requiring surety bonds with a "sufficient value to ensure the mitigation of any foreseeable incident."

--Payroll Tax Agents. S. 1773 would regulate payroll tax deposit agents (agents). Such agents provide payroll processing, tax filing and deposit services to one or more employers and have the contractual authority to access an employer's funds to make employment tax deposits. Such agents would be required to post a bond that could not be less than \$50,000, but not more than \$500,000. The Secretary of the Treasury Department would be authorized to adopt regulations providing for a method to determine the amount required for each agent. Any bond or security would have to be in the form and "with such sureties" as provided in the regulations.

--Miscellaneous Bonds. S. 1892 would authorize the Secretary of Homeland Security (Secretary) to require a surety bond from seafarers in lieu of withholding or revoking clearance required under existing law for vessels leaving a port in the United States and either traveling to a foreign port or to another port or place in the U.S. if the vessel has foreign merchandise on board for which entry has not been made or if the vessel will travel outside the territorial sea to visit a hovering vessel or to receive merchandise while outside the territorial sea. The Secretary could require the bond if surety if the Secretary deems it necessary for facilitating an investigation, reporting, documentation or an adjudication of any matter related to the administration or enforcement of any treaty, law or regulation by the Coast Guard. The sureties on the bond would have to be corporate sureties that the Department of the Treasury has certified to write federal bonds.

--Mortgage Broker Bonds. H.R. 3081 would amend the Federal Truth in Lending Act to protect consumers from certain practices in connection with the origination of consumer credit transactions secured by the consumer's principal dwelling (home equity loans). Mortgage brokers conducting such transactions would be required to maintain a minimum net worth of \$500,000 or furnish a surety bond or letter of credit in the amount of \$50,000.

Issues in Congress Affecting the Insurance Industry

The natural catastrophe issue has dominated the insurance agenda in Congress. Some of the interest in Congress is a backlash against the insurance industry, while some is industry-generated efforts to seriously address coverage for the enormous losses arising from natural disasters. The industry lobby in this session of Congress has been a series of tap dances. On one hand, most of the industry opposes any federal role in insuring natural disasters, yet one of the industry's primary goals is the revision and extension of the Terrorism Risk and Insurance Act (TRIA) before it expires again at year's end. Many in Congress do not grasp the distinction that the risk of terrorism is uninsurable so that the private market will not respond, but that there is a robust market for coverage resulting from natural disasters, particularly if the private market is allowed to operate without burdensome regulatory intervention. The industry thinks that Representative Gene Taylor's (D-MS) bill – H.R. 990 – to expand the National Flood Insurance Program (NFIP) to cover wind losses would substantially exacerbate the potential deficits in that Program. Yet, the bill is hard to oppose with the private markets adjusting in the Gulf Coast region and insurers responding by reducing their writing, limiting coverage and increasing deductibles. Although it is DOA in this session, the optional federal charter (OFC) has been introduced in the House and Senate. It contains provisions that would limit the industry's antitrust immunity for federally-chartered insurers but keep it intact for state regulated companies. This creates the misperception that the industry is willing to "give up" McCarran for the OFC while the industry is united in opposition to the bills in the House and Senate Judiciary Committees to repeal McCarran. Similarly, the industry supports federal regulation by the Treasury Department while opposing regulation by the Federal Trade Commission under the pending antitrust bills.

The natural catastrophe issue appeared to be headed to a National Study Commission in this Congress, as this was the only action on which consensus seemed possible in both the House and the Senate. The Senate Banking Committee marked up S. 292, which is legislation creating such a commission. On the final day of the session, however, Florida Representatives Ron Klein (D-FL) and Tim Mahoney (D-FL) introduced H.R. 3355, the Homeowners Defense Act of 2007.

The bill would create a non-profit Natural Catastrophe Risk Consortium, which would be a federal-state pool to buy reinsurance and sell catastrophe bonds on behalf of the participating states. The bill also would create a federal loan program to provide bridge loans to states to provide liquidity and to help respond to a catastrophic event. In essence, the bill provides a mechanism for the states to pool their resources to obtain reinsurance for natural catastrophes or to sell catastrophe bonds to raise revenue to pay for losses. The Consortium would be a quasi-public corporation. House Financial Services Committee (HFSC) Chair Barney Frank (D-MA) has indicated that there will be hearings on this approach in early September.

The HFSC passed H.R. 2761, the Terrorism Risk Insurance Revision and Extension Act (TRIREA) before adjourning for the summer. It extends TRIA for 15 years with the current co-payments and deductibles. H.R. 2761 also makes some significant changes in coverage – expanding coverage to include domestic terrorism and covering risks from “weapons of mass destruction (nuclear, biological, chemical and radiological) – but also requires that such coverage must be “made available” and sets the program trigger at losses of \$50 billion. An HFSC subcommittee previously conducted a seven-hour hearing on its mark up. The White House strongly opposed the bill and threatened a veto. A Senate bill will be introduced after the summer recess.

HFSC also marked up H.R. 3121, Representative Taylor’s multi-peril coverage bill for the NFIP after defeating numerous amendments to derail it. The vote went down on a partisan basis.

The bills on the natural catastrophe commission, TRIA and the NFIP are expected to hit the floors of the House and Senate in late September or early October.

The activities and positions of the National Association of Insurance Commissioners (NAIC) remain puzzling on federal insurance issues. In testifying on H.R. 920, Rep. Taylor’s multi-peril insurance bill to allow the National Flood Program to offer wind coverage, the NAIC did not oppose it. Instead, the NAIC suggested that the NFIP be structured more like a reinsurer so that issues regarding what caused the loss would be between the insurer and reinsurer, not the consumer. In the alternate, the private insurance market might offer an all-perils policy if there were a federal backstop or credit line that would cap and back the industry’s losses. The NAIC also has wavered on opposition to repeal or amend McCarran-Ferguson.

Future Directions

When Congress returns in the fall, it has a full agenda; but what gets done depends on how many Congressional legislative days are consumed with the appropriation bills, which need to be finished before the October 1 start of the new fiscal year, and the debate on the supplemental spending bill for the war in Iraq. At this point, it looks like Congress will be in session well into December.