

Approved:
Date: 3-12-02

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE.

The meeting was called to order by Chairperson Sandy Praeger at 9:30 a.m. on March 7, 2002 in Room 234 N of the Capitol.

All members were present except:

Committee staff present: Dr. Bill Wolff, Kansas Legislative Research Department
Ken Wilke, Office of the Revisor of Statutes
JoAnn Bunten, Committee Secretary

Conferees appearing before the committee:

State Representative Cindy Hermes, Topeka
John Koger, Jr., Koger Agency, Inc., Topeka
Tom English, Thomas McGee Agency, Kansas City
Jeff Brundrett, Chubb Surety, Kansas City
Kelly Deer, Zurich Surety, Kansas City
William W. Sneed, Mortgage Insurance companies of America

Others attending: See attached list.

Hearing on HB 2677 - Public works bonds; restrictions on requirements thereof

State Representative Cindy Hermes, Topeka, testified before the Committee in support of **HB 2677** which prohibits a public official or a contract from requiring a contractor or subcontractor to obtain a surety bond or any other bond from a specific vendor. Representative Hermes noted that directed surety reduces competition, invites favoritism and abuse, and **HB 2677** would support efforts of good government and reduce unnecessary costs to taxpayers. (Attachment 1) During Committee discussion Representative Hermes gave an example of directed surety abuse involving a Lincoln, Nebraska public school district.

The following conferees spoke in support of **HB 2677** and provided written testimony: John Koger, Jr., Koger Agency, Inc., Topeka, (Attachment 2); Tom English, Thomas McGee Agency, Kansas City, (Attachment 3); Jeff Brundrett, Chubb Surety, Kansas City, (Attachment 4); and J. Kelly Deer, Zurich Surety, Kansas City, (Attachment 5). Written testimony only in support of the bill was provided by Corey D. Peterson, Associated General Contractors of Kansas, Inc., (Attachment 6); Bob Totten, Kansas Contractors Association, Inc., (Attachment 7); and Larry Magill, Kansas Association of Insurance Agents, (Attachment 8) A representative from the Kansas Insurance Department stated they had taken no position on the bill.

Members of the Committee questioned the conferees regarding surety bonds, bid letting for contractors, and whether or not there exists in Kansas a problem of directed surety abuse. It was noted there was no evidence of abuse in Kansas that could be documented as existed in Nebraska.

There were no opponents to the bill.

Hearing on HB 2639 - Mortgage Guaranty insurance companies; authorizing real estate security

William W. Sneed, Mortgage Insurance companies of America, testified in support of **HB 2639** which would permit mortgage guaranty insurance companies to insure mortgage loans in an amount not exceeding 105% of the fair market value of the real estate. Mr. Sneed pointed out that removing the maximum loan-to-value ratio would expand mortgage markets to underserved groups of home buyers and allow Kansas citizens with a good credit history and stable income to not only afford their home, but also finance the closing costs and fees associated with the real estate transaction. (Attachment 9)

Kevin Glendening, Office of the State Bank Commissioner, did not provide written testimony but expressed his concern to the Committee that the removal of the ceiling would encourage lenders to make more high loan-to-value loans.

Adjournment

The meeting was adjourned at 10:30 a.m. The next meeting is scheduled for March 12, 2002.

SENATE FINANCIAL INSTITUTIONS & INSURANCE COMMITTEE GUEST LIST

DATE: 3-7-02

NAME	REPRESENTING
Bill Sneed	MICA
Jeff Brundrett	Chubb Insurance
Tom English	Thomas McGee
JOHN M. ROGER, JR.	ROGER AGENCY, Inc.
John Kelly Deer	Zurich North American Surety
Cindy Harmer	Legislature
LARRY MAGILL	KAIA
Kevin Davis	Am Family
Jillaney Cornijo	St. Brungard's Intern
Kevin Colandrea	OSRC
Hanni Ann Rouch	KA KS Govt Consulting
Bob Totten	KS Contractors Association
Linda J. McCuskey	St. J. Ass. Mgmt
Hillary Hayes	Federico Consulting
Tom Stattery	ABC/KS

HOUSE OF
REPRESENTATIVES

STATE REPRESENTATIVE

51ST DISTRICT
SHAWNEE &
POTTAWATOMIE COUNTIES

COMMITTEE ASSIGNMENTS
MEMBER: APPROPRIATIONS
ETHICS & ELECTIONS
LOCAL GOVERNMENT
TAX, JUDICIAL & TRANSPORTATION
BUDGET
PENSIONS, INVESTMENTS & BENEFITS



TOPEKA

CINDY HERMES

March 7, 2002

TO: Madame Chair Praeger
Chair, Financial Institutions and Insurance

FROM: Representative Cindy Hermes

RE: **House Bill 2677**

Madame Chair Praeger and distinguished committee members, thank you for the honor of appearing before the Financial Institutions and Insurance Committee to allow the hearing of House Bill 2677. House Bill 2677 amends current law pertaining to public works bonds.

This bill would prohibit public agencies from using "directed surety." Directed surety occurs when a **public** entity, in bidding a contract, designates a specific surety company that the contractor must use to obtain their bonding for the project.

Directed surety reduces competition, invites favoritism and abuse. This bill would support efforts of good government and would reduce unnecessary costs to taxpayers.

At this point, I will turn the presentation to my distinguished conferees to further explain the details of House Bill 2677.

Thank you again for the honor of considering House Bill 2677 and I ask for your humble approval of this good government bill.

OFFICE

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TOPEKA, KS 66612-1504
785-296-6014
Hermes@house.state.ks.us

HOME

Senate Financial Inst. & Insurance
Date: 3-7-02
Attachment No. /

Koger Agency, Inc.

March 7, 2002

The Honorable Senator Sandy Praeger, Chair
Financial Institutions and Insurance Committee
300 SW 10th Street, Room 234-N
Topeka, KS 66612-1504

Re: HB 2677 – Public works bond
Restriction on requirements thereof

Dear Senator Praeger and Members of the Committee:

My name is John M. Koger, Jr., representing Koger Agency, Inc. I have been providing public works bonds to construction firms since January, 1972. I favor the passage of the above measure.

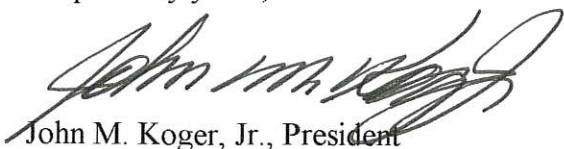
The above measure would prohibit public agencies in Kansas from using "directed surety". Directed surety occurs when an owner designates a specific producer or surety company from which contractors MUST obtain surety bonds for a specific project or series of projects. The federal government prohibits directed surety on federal projects. In 2001, eight (8) States enacted legislation prohibiting directed surety (AR, CT, FL, MN, MS, NE, ND, TX). All passed their legislatures unanimously. At this writing, twenty- nine (29) States prohibit directed surety.

To obtain a public works bond, a contractor will undergo a rigorous pre-qualification process (called underwriting) by a surety company to determine if the contractor is capable of performing the project on which the contractor wishes to bid. This requires the contractor to provide confidential personal and business financial information to the producer and surety company. In addition, the producer and surety company will be fully informed as to the contractor's plans for management succession, ownership succession, etc. The producer and surety company are more intimately familiar with the contractor than the contractor's banker, accountant, or attorney. Directed surety would require the contractor to divulge this highly confidential information to a producer and surety company with whom the contractor has not developed the bond of trust that the exchange of such information demands. Directed surety is similar to the owner choosing the contractor's banker, accountant and attorney.

From the above, it is very likely that many contractors, unwilling to disclose this information to an unknown producer or surety company, will be discouraged from bidding a project under the condition of directed surety. Thus competition is decreased and the lowest bidder may not bid. The taxpayers will likely spend more for the public improvement than they would have had directed surety not been used by the public agency.

Thank you for your time and consideration.

Respectfully yours,



John M. Koger, Jr., President
JMK/tim

P.O. Box 4587 • Topeka, KS 66604-0587

7154 SW Watling Court • Topeka, KS 66614-4649 • Telephone: 785/478-3200 •

Senate Financial Inst. & Insurance

Date: 3-7-02

Attachment No. 2

920 Main Street • Suite 1700
P.O. Box 419013 • Kansas City, Missouri 64141-6013
816-842-4800 • FAX 816-472-5018
Website: www.thomasmcgee.com



March 7, 2002

Honorable Senator Sandy Praeger, Chair
Financial Institutions and Insurance Committee
300 SW 10th Street, Room 234-N
Topeka, Kansas 66612-1504

**RE: HB 2677 – PUBLIC WORKS BOND
Restriction on Requirements Thereof**

Dear Senator Praeger and Members of the Committee:

My name is Tom English and I am with Thomas McGee, L.C. an insurance agency in Kansas City. I am here today to ask for your support of House Bill 2677 which is legislation that would prohibit public agencies from requiring contractors or subcontractors to obtain surety bonds from a particular surety company, agent or broker designated by the public owner. Such action on this issue is important not only for the surety industry in Kansas, but also for public owners, contractors, subcontractors and suppliers who work in Kansas.

A significant portion of Thomas McGee's business is generated from the construction industry. Thomas McGee has been managing surety programs for construction companies located in Kansas since 1910. In 2001, Thomas McGee, L.C. facilitated the surety bonding for approximately 75 construction firms performing public work in the state of Kansas. These bonded contracts combined for over \$400,000,000 in public works projects and generated nearly \$3,000,000 of surety premium (total cost is less than 1% of the contract value) underwritten by ten surety companies licensed in Kansas. Directed surety would place severe restrictions on the surety business transacted in Kansas and runs contrary to free enterprise. Directed surety occurs when an owner of a particular project designates a specific producer or surety company from which contractors must obtain surety bonds.

Outlined below are a number of key points to consider:

- **The federal government has enacted legislation prohibiting directed suretyship on federal projects.**
- **Twenty-nine states have legislation in place prohibiting directed suretyship.** Of the 29 states, eight states passed their legislation unanimously in 2001.
- Limiting a contractor's ability to use its regular surety agent and company **interferes with competitive bidding and runs contrary to the existence of a free and open marketplace.**
- **Directed or owner controlled surety is a violation of Freedom of Choice.** It is the right of public agencies to require that bonds be issued by reputable and financially sound surety companies. Beyond this, contractors should be allowed to furnish bonds from an agent and surety company of its choice.
- **Confidentiality of information is jeopardized.** The relationship between agent, contractor and surety company is established on trust, confidence and respect. Requiring a construction company to supply confidential information to a designated surety and/or agent presents an untenable situation for contractors.

The construction and surety industries in Kansas must continue to operate in a free and competitive marketplace while continuing to protect taxpayer dollars that finance public works projects. Passage of legislation to prohibit directed surety will preserve the integrity of all concerned parties. Thank you for your consideration.

Sincerely,

THOMAS MCGEE, L.C.

Thomas M. English
Account Executive

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Date: 3-7-02
Attachment No. 3



CHUBB GROUP OF INSURANCE COMPANIES

March 4, 2002

The Honorable Senator Sandy Praeger, Chairperson
Financial Institutions and Insurance Committee
300 S.W. 10th Street, Room 234-N
Topeka, Kansas 66612-1504

RE: H.B. 2677 – Public Works Bond, Restriction on Requirements Thereof

Dear Senator Praeger and Members of the Committee:

Senator Praeger and members of the committee, my name is Jeff Brundrett. I work for Chubb Insurance Company in Kansas City. I am the surety bond manager, employed with Chubb for the past 20 years, the last 14 years in our Kansas City office. I am a Kansas resident, living in Shawnee. I along with my colleagues from the Kansas City Surety Association are here today to ask for your support in passing **H.B. 2677**, legislation that is important not only to the surety industry in Kansas but also important to public owners and contractors, subcontractors and suppliers working in Kansas. This legislation we seek would prohibit public agencies from requiring contractors or subcontractors from obtaining surety bonds from a single source, be it a particular bonding company, agent or broker designated by a public owner.

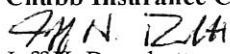
Chubb Insurance is a property and casualty insurance company actively involved in the surety bond industry and among the largest surety bond underwriters in the nation. Our office represents contractors across an 8-state region. We underwrite 15 contractors performing public work in Kansas. Those contractors generated combined annual sales of at least \$450 million and generated some \$1.2 million in surety premiums in 2001. Our group will touch on several key points of interest supporting this proposed legislation. The key points that I will focus upon include the following:

Customer relationships - Our group assembled before you today all maintain a loyal following of customers. These unusually strong relationships are unique to surety. Some relationships span several generations within contracting firms, our office has relationships with customers that span 6 decades. By asking contractors to obtain bonds from a designated agent or surety presents an untenable situation for our customers because it requires them to provide detailed personal and business and financial information to another agent and surety other than their own for the sake of one project.

Force contractors not to bid projects - Contractors may refuse to bid projects because they cannot provide bonds from their established agent and surety company. Because of this the number of interested bidders on a project is less, resulting in lesser competition and ultimately resulting in higher costs. The possibility exists that the contractor choosing not to submit a bid because of owner-controlled or directed surety may have been the lowest or most qualified bidder.

Claims - There is the issue that many contractors would be concerned that an owner directed surety would not be able to handle claims in a fair and unbiased manner.

We urge you to support H.B. 2677 prohibiting directed suretyship in the State of Kansas.

Sincerely,
Chubb Insurance Company

Jeff H. Brundrett
Surety Manager

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Attachment No. 4



ZURICH

05 March 2002

Honorable Senator Sandy Praeger, Chair
Financial Institutions and Insurance Committee
300 SW 10th St., Room 234-N
Topeka, KS 66612-1504

RE: HB 2677 – Public works bond
Restriction on requirements thereof

Dear Senator Praeger and Members of the Committee,

Ms. Chairperson and members of the committee, my name is John Kelly Deer, and I am here today to ask for your support of HB 2677. I am a resident of Kansas and I am employed with Zurich North America Surety, formerly known as the Fidelity & Deposit Company of MD. Through our Overland Park office, we service a significant amount of surety to the public owners in and of the state of Kansas.

HB 2677 is legislation that would restrict owner directed surety in the State of Kansas. Specifically this legislation would restrict public owners from requiring contractors or subcontractors to obtain surety bonds from a particular surety, agent, or broker designated by the public owner. Such action on this issue is very important to the surety and construction industry and to the taxpaying public.

Our industry is based on a relationship that is rooted in confidentiality. In essence, the surety acts as an unsecured creditor. Our only security is the contractor's character and the support of his financial condition. It is the surety product that successfully prequalifies a contractor to do work for public owners and protects the public property from contractor failure. Without the freedom to choose the credit relationship the taxpaying public is at risk. It is through this free enterprise system that the public receives the most qualified contractor at the best price to get the job done.

With directed suretyship, an unfortunate and preventable chain of events may occur.

- The director of a public project chooses the surety, then
- Small contractors are eliminated from consideration, as a single surety company would rarely accept all bidders, and
- Other contractors, unwilling to disclose confidential personal and business financial information to an unknown third party, are discouraged from bidding, thereby
- Competition is decreased, and
- The lowest bidder may be lost because of a directed surety program.

Passage of directed surety prohibition legislation would preserve free enterprise within the construction and surety industries and maintain the necessary integrity of all concerned parties. Thank you for your consideration of this legislation.

Best regards,


J. Kelly Deer

Senior Surety Account Executive

Zurich North America Surety
9225 Indian Creek Parkway, Ste.
700
Overland Park, KS 66201

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E-Mail kelly.deer@zurichna.com

Senate Financial Inst. & Insurance

Date: 3-7-02

Attachment No. 5

**TESTIMONY OF
ASSOCIATED GENERAL CONTRACTORS OF KANSAS
BEFORE HOUSE COMMITTEE ON ETHICS AND ELECTIONS
ON HB 2677**

February 4, 2002

By Corey D Peterson, Associated General Contractors of Kansas, Inc.

Mr. Chairman and members of the committee, my name is Corey D Peterson, Executive Vice President of the Associated General Contractors of Kansas, Inc. The AGC of Kansas is a trade association representing building general contractors and subcontractors throughout Kansas (with the exception of Johnson and Wyandotte counties).

The Associated General Contractors of Kansas asks that you recommend House Bill 2677 favorable for passage.

The Associated General Contractors of America, of which AGC of Kansas is a chapter, has adopted the following policy on directed surety:

The Associated General Contractors of America reaffirms its longstanding policy in opposition to any departure from the traditional freedom of a prime contractor to secure performance and payment bonds from the bond producer and surety of its choice. To direct that such bonds be secured from a particular producer or surety reduces competition, invites favoritism and abuse and interferes with the established, confidential relationship between the prime contractor and its chosen surety and producer.

Again, for reasons including those outlined in the above policy, AGC of Kansas requests that you recommend HB 2677 favorable for passage.

Thank you for your consideration.

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Attachment No. 6

THE KANSAS CONTRACTORS ASSOCIATION, INC.

316 SW 33RD ST PO BOX 5061
TOPEKA KS 66605-0061



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kca@ink.org
www.ink.org/public/kca

Testimony

By the Kansas Contractors Association

before the Senate Financial Institutions and Insurance Committee regarding

HB 2677

March 7, 2002

Madame Chairman and members of the Senate Financial Institutions and Insurance Committee, I am Bob Totten, Public Affairs Director for the Kansas Contractors Association. Our organization **represents over 400 companies** who are involved in the construction of highways and water treatment facilities in Kansas and the Midwest.

Today, I want to thank you for allowing me to testify in **support** of House Bill 2677. Our organization supports the present system which allows competitive bids to be submitted on public works projects. The measure before you today continues this position when it applies to securing surety bonds for construction projects.

Our members want to continue to be able to do business in which they can contract with whomever they want to, to provide a surety bond for a construction project. They have developed relationships over the years with various bond companies and it would be

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counterproductive in many instances to require a construction company to work with someone they are uncomfortable. We liken this to a similar relationship to an attorney. It would be unfortunate if the state required in their bids that only one law firm could be used for legal representation. The same appears to be the case when it comes to surety bonds.

We are only aware of one instance where an owner required a certain bond company to provide the surety bond. That instance occurred in Nebraska and we do not want the idea to come into Kansas. Such a requirement in a bid letting for contractors to use the same surety company may appear to be logical however when it undergoes further scrutiny, there could be a possibility of collusion or other illegal activity.

Our organization members compete on construction projects to get the lowest and best bid on projects. That way the state and our citizens get road construction projects for less money. If a requirement is ever made where a construction company has to buy its bonds or insurance from one carrier or agent, the opportunity to get the lowest bid may not be accomplished.

Our National Organization the Associated General Contractors of America have a similar position regarding directed surety. We urge you to support this measure which allows our construction companies to contract for services with whomever they desire. I will stand for questions.

Testimony on House Bill 2677
Before the Senate Financial Institutions and Insurance Committee
By Larry Magill
Kansas Association of Insurance Agents
March 7, 2002

Thank you madam Chair and members of the Committee for the opportunity to appear today in support of House Bill 2677. This bill prohibits the practice of owner directed surety arrangements and is designed to preserve the relationship of the contractor with their own surety company.

That relationship is very similar to the contractor's banking, legal or accounting relationships where they generally are developed over a period of time, involve sharing a significant amount of highly confidential information, involve mutual trust and respect for the professional ability of the adviser and do not involve the purchase of a "commodity".

In fact, being forced into a "directed suretyship" arrangement could disrupt a contractor's normal relationship with their surety since their normal surety would not have control over all the contractor's bonded work. And the contractor would be forced to give out multiple personal indemnity agreements, possibly jeopardizing the value of the indemnity to their own surety.

At the same time, it could actually reduce competition for work if a contractor could not qualify with the owners's surety but would have with their own.

The practice is prohibited on federal contracts and in 29 states including eight that passed legislation last year. We urge the committee to act favorably on the bill. Thank you and we would be happy to respond to questions or provide additional information.

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Polsinelli | Shalton | Welte

A Professional Corporation

Memorandum

TO: The Honorable Sandy Praeger, Chair
Senate Financial Institutions and Insurance Committee

FROM: William W. Sneed, Legislative Counsel
Mortgage Insurance Companies of America

RE: H.B. 2639

DATE: March 7, 2002

Madam Chair, Members of the Committee: My name is Bill Sneed and I represent Mortgage Insurance Companies of America ("MICA"). MICA is a national trade association that represents all seven private mortgage insurance companies, each of which is licensed to transact mortgage guaranty insurance in Kansas and throughout the United States.¹ We appreciate the Committee's willingness to take testimony on H.B. 2639 and respectfully request your favorable action on this bill.

H.B. 2639 would amend K.S.A. §40-3502(c) to permit mortgage guaranty insurers ("MI's") to insure mortgage loans up to 105% of the value of the underlying property. Currently K.S.A. §40-3502(c) limits MI's from insuring loans in excess of 100%. The bill as originally introduced would have eliminated the cap. Increasing the maximum loan to value ratio ("LTV"), which most states have already done, will allow Kansas citizens with a good credit history and

¹ The MICA members are: General Electric Mortgage Insurance Corporation, Mortgage Guaranty Insurance Corporation, PMI Mortgage Insurance Company, Radian Guaranty Inc., Republic Mortgage Insurance Company, Triad Guaranty Insurance Corporation, and United Guaranty Residential Insurance Company.

One AmVestors Place
555 Kansas Avenue, Suite 301

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stable income to not only afford their home, but also finance the closing costs and fees associated with the real estate transaction. Such costs typically account for three percent of the total amount of the loan itself, and most MI's in states that do not have a maximum restriction are offering insurance for up to 103% of the property value.

Lenders generally require mortgage insurance when a borrower makes less than a 20 percent down payment on the purchase price for a home and enables homebuyers to purchase homes with little or no down payment. In effect, the MI shares the risk of foreclosure with the lender. In addition, the lender and the MI share a common interest in the mortgage loan, since each stand to lose in the event of a borrower default.

The increase of the LTV is the culmination of a national legislative trend to allow greater numbers of homebuyers to purchase a home, including immigrants and other first time homebuyers, who are creditworthy but lack the savings necessary for a down payment. The Kansas Legislature increased the LTV from 95% to 97% in 1994, and subsequently to 100% in 2000. Such changes made a home purchase available to thousands of qualified homebuyers who otherwise would not have been able to purchase a home. The LTV limits were originally enacted to protect MI's and lenders from taking on what would be perceived to be loans which were too risky, with a higher LTV associated with a higher level of risk. The increase of the LTV limit over the years and the successful experience of the industry in underwriting loans have made legislatures more comfortable in allowing increases, especially given the public policy benefit of qualifying more home buyers.

Currently only nine state in addition to Kansas impose a maximum LTV restriction, as the remaining states have no limit on the maximum LTV for a loan insured by a mortgage

insurer.² In fact, the states in which several MI's are domiciled do not impose a maximum LTV, as North Carolina, Pennsylvania and Wisconsin, home of five of the seven MI's, do not limit the LTV on an uninsured loan. In effect, these three states with the most direct relationship and control over the mortgage insurance industry do not believe it is necessary to limit the LTV.

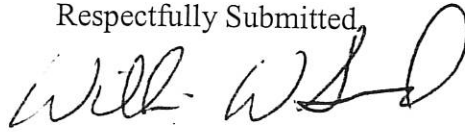
Upon passage of HB 2639, it is important to note that there will still exist effective protections against insurers assuming unacceptable risks and limits on the LTV's of programs offered by MI's. Of course, the MI's themselves have the experience and incentive to insure loans at LTV's prudently, in the same fashion as banks and other financial institutions issue mortgages and other loans. Most importantly, in order to insure loans, as a practical matter each insurer needs to maintain an investment grade claims-paying rating from Standard & Poor's or Moody's. Those rating agencies regularly monitor the types of risks that the insurers write. A substantial change in the characteristics of insured loans, including increases in LTV's, on a material part of an insurer's business would be analyzed by the rating agencies for the effect on the financial condition of the insurer and would need to be justified by the insurer. This rating analysis results in a very effective control on the risks that an insurer assumes and should be even more effective than a statutory maximum LTV limit.

Furthermore, the volume of loans above 100% LTV is not likely to be a large percentage of the mortgage insurance business given the higher premium rates and stricter underwriting standards that would apply to them. However, allowing mortgage insurers to insure loans above 100% LTV would expand mortgage markets to underserved groups of homebuyers and provide additional options to lenders and borrowers.

² The only other states that impose a maximum LTV are Arizona, California, Idaho, Missouri and New York at 100%, Oregon at 105%, Illinois and Ohio at 103% and New Jersey at 97%.

We appreciate the opportunity to present our testimony to the Committee and we respectfully request this Committee's favorable action on H.B. 2639. If you have any additional questions or comments, please feel free to contact me.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Will. W. Sneed". The signature is fluid and cursive, with a large loop at the end.

William W. Sneed

WWS

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