



**Government of the District of Columbia
Department of Insurance, Securities and Banking**

**Stephen C. Taylor
Commissioner**

**BEFORE THE
INSURANCE COMMISSIONER OF
THE DISTRICT OF COLUMBIA**

Re: **Report on Examination – Surety and Fidelity Association of America**

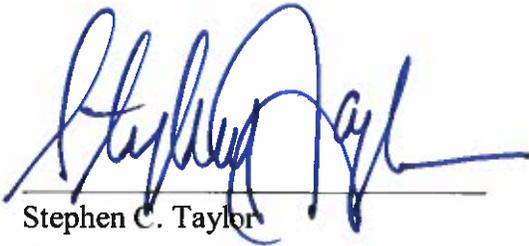
ORDER

In accordance with the authority established by D.C. Official Code § 31-2708(a)(1), a Market Conduct Examination of the **Surety and Fidelity Association of America** as of December 31, 2017 has been conducted by the District of Columbia Department of Insurance, Securities and Banking (“Department”) as a participating jurisdiction through the National Association of Insurance Commissioners’ Advisory Organization Examination Oversight (C) Working Group. The Department accepts the report in lieu of a single jurisdiction examination.

It is hereby ordered on this 3rd day of October 2019, that the attached Market Conduct Examination Report be adopted and filed as an official record of this Department.

Pursuant to D.C. Official Code § 31-1404(d)(1), this Order is considered a final administrative decision and may be appealed.

Pursuant to D.C. Official Code § 31-1404(e)(1), the Department will continue to hold the content of the report as private and confidential information for a period of 10 days from the date of this Order.



**Stephen C. Taylor
Commissioner**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
DEPARTMENT OF INSURANCE, SECURITIES AND BANKING



REPORT ON MARKET CONDUCT EXAMINATION
THE SURETY & FIDELITY ASSOCIATION OF AMERICA

AS OF

DECEMBER 31, 2017

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Washington, D.C.
July 25, 2019

Honorable Stephen C. Taylor, Commissioner
Department of Insurance, Securities and Banking
Government of the District of Columbia
1050 First Street, NE, Suite 801
Washington, D.C. 20002

Dear Commissioner Taylor:

In accordance with Sections 31-1402 and 31-2708(a)(1) of the District of Columbia Official Code, a market conduct examination has been conducted of the affairs and practices of

The Surety & Fidelity Association of America

(hereinafter referred to as the “Association”) at its home office located at 1140 19th Street, NW Suite 500, Washington, DC 20036. The following Market Conduct Report on Examination herein respectfully submitted.

SCOPE OF EXAMINATION

A Multi-State Market Conduct examination (the “Examination”) of The Surety & Fidelity Association of America (the “Association”) was called for the experience period of January 1, 2013 to December 31, 2017. The Examination was initiated by the Advisory Organization Examination Oversight (C) Working Group (the “Working Group”) of the National Association of Insurance Commissioners (the “NAIC”).

The Working Group solicited states and territories to serve as Participating States for the Examination. Participating jurisdictions included 39 states and the District of Columbia as identified in the listing below. The Examination was conducted at the direction and overall management and control of the District of Columbia Department of Insurance, Securities and Banking (the “Department”), with Washington, DC serving as Managing Lead.

Alaska	Florida	Maine	New Jersey	South Dakota
Arkansas	Georgia	Michigan	New Mexico	Tennessee
Arizona	Iowa	Missouri	Nevada	Utah
California	Idaho	Mississippi	New York	Virginia
Colorado	Indiana	Montana	Oklahoma	Vermont
Connecticut	Kentucky	North Dakota	Pennsylvania	Wisconsin
District of Columbia (Lead)	Louisiana	Nebraska	Rhode Island	West Virginia
Delaware	Maryland	New Hampshire	South Carolina	Wyoming

The scope of the Examination was a comprehensive review of the advisory organization’s regulated activities, including but not limited to, evaluation of the Association’s processes and procedures for preparation of Loss Cost Filings; Rules; Forms Development; Operations / Management / Governance; Statistical Plans; Regulatory Licenses or Other Authorization; Data

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Receipts and Controls; Data Processing, Editing and Compilation procedures; Error Handling and Related Correspondence with Reporting Insurers; Report Submission to Regulators, as well as confirmation of compliance with specific Standards from Chapter 20, Chapter 29 and its Appendices F and G of the NAIC *Market Regulation Handbook* (the “Handbook”) to the extent applicable.

The Examination was conducted in accordance with the applicable procedures outlines in the Handbook as adopted by the Department. The primary purpose of the Examination was to determine compliance with applicable statutory and regulatory requirements and specifically compliance with the relevant Standards of the Handbook referenced during the Examination.

Information received from the Association’s responses to the NAIC’s Comprehensive Annual Analysis form (“CAA”) was also considered to assist in defining the scope of the Examination. The CAA is a process by which an Advisory Organization (“AO”) is required to complete a CAA form on an annual basis, to update state insurance regulators of any significant changes made in the operation of an AO’s business during the preceding 12 months. In part based on the results of the CAA, the Examination focused on areas including, but not limited to, the following areas of the Association:

- Operations/Management/Governance
- Statistical Plans
- Data Collection and Handling
- Reports, Report Systems and Other Data Requests
- Loss Cost / Rate Filings
- Form Development

Further, based on the Association’s responses to the CAA, the scope of the Examination *excluded* the following areas, which were not addressed in the Examination as they were not applicable to the Association’s operations:

- Classification and Appeal Handling
- Inspection Services
- Residual Market Plan Administration
- Residual Market Functions - Reinsurance Administration

The Association’s function as a trade organization is also not included in the scope of this examination. The Examination was conducted by examiners (the “Examiners”) representing the Department. The Examination Team included Actuarial and Information Technology (“IT”) Specialists.

The Association has a contractual agreement with another advisory organization, Insurance Services Office, Inc. (“ISO”) based in New Jersey, whereby ISO handles the receipt, processing and editing of company submissions on behalf of the Association. ISO had a recent Multi-State Market Conduct examination completed as of December 31, 2016. The Examiners reviewed and placed substantial reliance on the results of that examination report dated August 27, 2018. This

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Examination Report (the “Report”) describes the review of practices, procedures and files, which was not exhaustive or all-inclusive; thus the omission of other unacceptable or non-complying practices does not constitute acceptance of these practices.

EXECUTIVE SUMMARY

The Examination was a market conduct examination of primarily the following business areas: procedures and processes in place during the examination period which included, but was not limited to, the review of the Association’s systems, operations and management for the collection and reporting of statistical data, preparation of loss cost filings, rules and forms filings, as well as compliance with applicable sections of Chapter 20, Chapter 29 and its appendices F and G of the Handbook.

The loss cost development process is designed to gather industry-wide statistical data and aggregate and disseminate loss information and expenses. The statistical component of the loss cost development process is to assure the public of fairness for rates ultimately developed and charged by members of the Association that opt to use the Association’s loss costs when submitting filings with insurance departments.

The Examiner prepared an examination work plan (the “Plan”) using the relevant guidance and standards of the Handbook to confirm that the Association utilizes consistent procedures for each jurisdiction it operates unless statutory regulation dictates certain other procedures. Accordingly, the examination team reviewed the Association’s activities to determine that the advisory organization is performing its’ permitted and regulated functions in a manner consistent with state rating laws and in a manner that results in accurate and compliant products and services for its’ subscribing or member companies.

Based on the work performed, consistent with the Plan in assessing the Association’s relevant processes and procedures, it was determined that the Association’s regulated operations appear to adequately address the Handbook Standards requirements. The Examiners identified certain observations and recommendations, which were further discussed and communicated to the Working Group and the Association’s Board of Directors under a separate Management Letter.

HISTORY AND PROFILE

General:

The Association is a District of Columbia non-profit corporation whose members are engaged in the business of writing fidelity and surety insurance. Member companies include the vast majority of insurance companies licensed to provide surety and fidelity bonds in the United States, and collectively write the majority of surety and fidelity premiums written. The Association is licensed as a rating or advisory organization for the lines of surety, fidelity, crime, burglary and theft in all fifty states, as well as in the District of Columbia and Puerto Rico, and has been designated by state insurance departments as a statistical agent for the reporting of fidelity and surety experience.

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As a licensed advisory and rating organization, the Association provides statistical agent services to the surety and fidelity insurance industry. The Association collects statistics on premiums and losses for the fidelity and surety insurance industry, and files as necessary, advisory prospective loss costs, standard policy forms, endorsements, and manuals of rating rules for the same industry. The Association also represents its member companies in matters of common interest before various trade associations, federal, state, and local government agencies.

The Association has published two statistical plan manuals in accordance with applicable statutes, rules and regulations, and is solely responsible for the development and modification of these plans. Member companies and groups and non-member statistical filers submit their statistical information to the Association's vendor ISO in accordance with the appropriate statistical plan. To encourage the reporting of timely and quality data, the Association utilizes a Performance Evaluation / Incentive Program, which provides insurers with key quality measures related to the reporting of their statistical data.

Since formation, the Association has undergone a series of changes in its operations and structure, which have included, but may not be limited to, the following:

- In 1908, the Association was formed as a voluntary, non-profit unincorporated association, under the name The Surety Association of America (the "SAA") to promote public understanding of and confidence in the surety industry, encourage the development of forms and coverages with respect to Fidelity, Surety, and guarantee bonds and Forgery Insurance, and to provide a forum for the discussion of problems of common interest to its members. At the same time, the Towner Rating Bureau, Inc. was formed to collect statistics and set rates for surety bonds.
- On October 23, 1947, the SAA and the Towner Rating Bureau merged, whereby the SAA absorbed the personnel and rating functions of the Towner Rating Bureau, under an amended Constitution that authorized the Association to operate as a Rating and / or Advisory Organization throughout the United States of America, its territories and possessions. Thereafter, all licenses issued to the Towner Rating Bureau either were transferred or reissued in the name of the SAA.
- The SAA Constitution was amended on June 6, 1996, to make the committee structure more flexible, to more clearly define eligibility to serve on the Board of Directors and to make gender and editorial changes to the document.
- On May 3, 2002, the SAA's Board of Directors voted to adopt a corporate form of organization. As a result, the Association formed a non-profit District of Columbia corporation and drafted bylaws to replace the constitution of the unincorporated Association.
- On May 12, 2005 at an annual meeting, the SAA members voted in favor of an amendment to the bylaws to allow companies to withdraw only by giving notice of at least 90 days before the beginning of the Association's fiscal year.
- On May 18, 2006, the general membership of the SAA voted to change the name of the Association to its current name, The Surety & Fidelity Association of America. The bylaws were further amended to reflect the new name following the affirmative vote.

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Management:

The Association’s Articles of Incorporation and Bylaws provide that the responsibility for the control and management of the affairs, property and interests of the Association is vested in its Board of Directors (the “Board”) composed of not less than nine (9) and no more than eighteen (18) persons designated as representative of Members who shall be elected annually by the Members of the Association. Board members, like officers, have a fiduciary duty to act in the best interests of the Association and shall not put their own interests ahead of the Association. The Board shall elect or appoint the officers of the Association at the regular annual meeting of the Board following the annual meeting of the Members.

According to the Bylaws, a majority of the Directors shall constitute a quorum for the transaction of business. The minutes of all meetings held indicated that a quorum was obtained at all meetings of the Board during the period under examination. Member companies have voting rights and may serve on the Board of Directors.

Board of Directors:

At December 31, 2017, the duly elected members of the Board of Directors were as follows:

<u>Name</u>	<u>Principal Business Affiliation</u>
Ross Fisher – Chair.....	Senior Vice President The Hartford Insurance Group
Larry Taylor – Vice Chair...	President Merchants Bonding Company Group
John Phinney.....	Chief Underwriting Officer AIG Property Casualty
John F. Welch.....	President and Chief Executive Officer CNA Surety Group
Dan Young.....	Chief Underwriting Officer AmTrust Group
Gary T. Dunbar.....	President, Bonding Division Great American Insurance Companies
Jeffrey Ryan.....	Senior Vice President Axis Reinsurance Company
Stephen C. Ruschak.....	President & COO The Guarantee Company of North America
Theodore Martinez.....	Vice President & Chief Underwriting Officer - Commercial Surety Hanover Insurance
Alan Pavlic.....	President & COO Old Republic Surety Group

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Tim Mikolajewski..... President
Liberty Mutual Group

John Knox, Jr. President & Chief Executive Officer
SureTec Insurance Company

Thomas M. Kunkel..... President & CEO – Bond & Specialty Insurance
The Travelers Companies, Inc.

Antonio C. Albanese..... Vice President – Head of Surety
Nationwide Mutual Insurance Company

Andrew Tuma..... President
W.R. Berkley Corporation Group

Dennis P. Baus..... National Surety Leader
Westfield Insurance Group

Bob Murray..... Executive Vice President – Head of Surety
Zurich

Officers:

The By-laws provide that the officers of the Association shall consist of a President, a Secretary and a Treasurer, and such other officers as may deemed necessary. The President shall be elected at each Annual Meeting of the Board and other officers shall be appointed by the Board.

The officers elected and/or appointed by the Board and holding office at December 31, 2017 were as follows:

<u>Name</u>	<u>Title</u>
Lynn M. Schubert*	President and Chief Executive Officer The Surety & Fidelity Association of America
Robert J. Duke	Secretary and General Counsel The Surety & Fidelity Association of America
Barbara F. Reiff	Director of Operations The Surety & Fidelity Association of America

* Effective October 1, 2018, Mr. J. Lee Covington II was appointed as the Association’s President pending the retirement of Ms. Schubert on December 31, 2018. Mr. Covington was elected as President on May 16, 2019.

Committees:

The Association operates under the stewardship of committees that perform an oversight function. According to the Bylaws, in order to facilitate the operation of the Association, there shall be an Executive Committee appointed annually by the Board and such other committees as the President shall designate with the approval of the Board. During the examination period, the Association had established an Executive Committee and various Board Advisory Committees

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comprised of Members of the Association that advise the Board on substantive issues so that the Board has the most up-to-date and comprehensive information when dealing with any subject. The Committees are very active and submit periodic reports to the Association's Board. There are 14 standing Advisory Committees of the Board as listed below:

- Actuarial Advisory Committee
- Bail Bond Advisory Committee
- Commercial Surety Advisory Committee
- Communications Advisory Committee
- Contract Bonds Advisory Committee
- Corporate Counsel Advisory Committee
- Diversity & Human Resources Advisory Committee
- Technology Advisory Committee
- Fidelity Advisory Committee
- Fidelity Claims Advisory Committee
- Government Affairs Advisory Committee
- International Advisory Committee
- Statistical Advisory Committee
- Surety Claims Advisory Committee

STATUS OF PRIOR EXAMINATION FINDINGS

The Examination included a review to determine the current status of any non-compliance matters maybe noted in our preceding Report on Examination dated July 15, 2014, which covered the period from January 1, 2006 to December 31, 2012. There were no prior examination findings.

EXAMINERS METHODOLOGY

This Examination is based on the Standards and Tests for a Market Conduct Examination of an Advisory Organization found in the 2018 *NAIC Market Regulation Examiners' Handbook (Volume IV)*. The Examiners primarily relied on the review of documentation and testing of records and information maintained by the Association concerning certain of their operations included within the scope of the Examination. Examiners also reviewed and placed substantial reliance on the results of ISO's recent Multi-State Market Conduct Examination dated August 27, 2018, concerning ISO's handling of the receipt, processing and editing of company submissions on behalf of the Association.

In planning and conducting our examination, we gave consideration to the concepts of materiality and risk, and our examination efforts were directed accordingly. The Examiners conducted interviews with the Association's representatives, reviewed the Association's practices and procedures, and conducted walkthroughs of the Association's operations, which included a high-level review of the Actuarial and IT infrastructure and controls, consistent with selected sections of Chapter 20 and Appendices F and G of Chapter 29 the Handbook. The Examiners also reviewed the prior examination report and internal management testing documentation and work papers. In defining the scope of the examination, consideration was also given to information received from the responses to the NAIC's CAA completed by the Association.

The loss cost development process is designed to gather industry-wide data and aggregate and disseminate loss information and expenses. The statistical component of the loss cost development process is to assure the public of fairness for rates ultimately developed and charged by members

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of the Association that opt to use the Association's loss costs when submitting filings with insurance departments.

Statistical plans review included procedures to ensure that reports from statistical agents are acceptably accurate as representations of the insurance written and the losses incurred by insurers. These plans were reviewed by looking at the procedures for collecting data and how that data is verified, how they have handled data submission errors that may have occurred, and how the data is reconciled. Correspondence with companies and regulators included a review of all reports submitted along with copies of all validation and control reports. All rate and forms filings submitted during the examination period were reviewed for their accuracy. Additionally, the Examiners investigated compliance matters from the prior examination, if any. The Examiners collaborated with the Working Group and engaged in ongoing communication with the Association throughout the course of the Examination.

The Actuarial Examiner's work included reviewing the Association's work product related to loss cost/rate filings (the "Filings"), with specific emphasis regarding the Association's assumptions in preparing the Filings as well as the completeness and accuracy of the information. The Actuarial Examiner conducted interviews of the key actuarial resources at the Association, including the Chief Actuary and Statistical Manager.

The IT Examiners approach and methodology was planned to gain a comprehensive understanding of the Association's IT Controls and Data Processing Procedures and as such, procedures included a focus on the design, implementation and operating effectiveness of the Association's IT process and associated IT general controls. The IT Examiners reviewed all IT-related information provided in response to the initial Request for Information. Supporting documentation and information was provided by the Association, including network diagrams, policies and other related documents.

The IT Examiners also conducted specific process walkthroughs of certain systems and applications, as well as conducted interviews with representatives of the Association. Targeted testing was performed consistent with the examination processes and sampling methodologies in concert with the Handbook guidance. Where appropriate, the Examiners tendered requests and follow-up inquires, to the Association for response.

Additionally, status updates to the Working Group were provided during NAIC meetings.

GENERAL EXAMINATION CONCLUSIONS AND OBSERVATIONS

The advisory organization examination is a review of the Association's systems in place, operations and management for the collection and reporting of statistical data, preparation of loss cost filings, and rule and form filings. The purpose is to verify that adequate statistical plans are maintained in accordance with various regulatory requirements, check the validity of the systems in place, the internal procedures for preparing rate/loss costs reviews and submissions to insurance departments and companies, including the timeliness and quality of the response. The advisory organization examination is neither a traditional market conduct or financial examination, as well

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as not an examination of the accuracy of the underlying company data reported to the Association. The main purpose of the examination is to determine that the Association is performing its permitted regulated functions in a manner consistent with state rating laws and in a manner that results in accurate and compliant products or services for its subscribers or member companies.

The Association was cooperative throughout the course of the examination and the Examiners had direct access to the Association's employees for meetings, interviews and walkthroughs. Documentation was provided to Examiners as requested and in general, information was provided in a timely manner. In some instances, the Association was delayed in providing responses to the Examiners request, resulting from schedule conflicts, vacations, illness, and related matters, which prevented the Association from submitting responses timely. Findings identified during the Examination were communicated to the Association in the form of concerns and observations.

The Associations policies and procedures were reviewed pertaining to its regulated functions in a manner consistent with the standards of the Handbook, state rating laws and in a manner that results in accurate and compliant products and services for its' subscribing or member companies. Overall, no material exceptions came to the attention of the Examiners during the course of this examination as material deviations from the requirements as stated in the Handbook.

ACKNOWLEDGMENT

The courtesy and cooperation of the officers and employees of the Association during the examination are acknowledged.

In addition to the undersigned, Kristina M. Gaddis, CFE, CISA, AES, Michael J. Maertz, Barry L. Wells, CCLA, AMCM of Risk & Regulatory Consulting, LLC participated in the IT review portion of the Examination. The actuarial portion of this examination was completed by David A. Christhilf, ACAS, MAAA of the Department.

Respectfully submitted,



Yohannes Negash CFE, CFE (Fraud)
Examiner-In-Charge
District of Columbia Department of
Insurance, Securities and Banking



Nathaniel Kevin Brown CPA, CFE
Chief Examiner
District of Columbia Department of
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