

Draft Report of the Tennessee Advisory Commission on Intergovernmental Relations

Insurance as an Alternative to Surety Bonds for Public Officials

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Insurance as an Alternative to Public Official Surety Bonds

Good government depends on able, loyal, and dedicated public officials. Particularly for those officials who handle large amounts of money or have duties that, if not properly performed, could lead to financial loss for the government, safeguards are necessary to protect the public interest. To guard against the risk that public officials will not faithfully perform their duties and thereby protect public funds, governments have long required individual surety bonds, contracts in which a surety bond company guarantees the governmental entity that the office holder will successfully perform his or her duties.

Individual surety bonds have been required in Tennessee since the 19th century to protect against losses caused when public officials do not faithfully perform their official duties. These bonds are intended to protect the public and compensate those suffering loss or injury by reason of misconduct or neglect in office.¹ These bonds do more than cover losses. They also encourage officials to perform the duties of office by holding them personally liable, giving them “skin in the game”, for any claims that are made against the bond. Surety companies will require the public official to pay the difference between the price of the bond and the amount of the claim. The amount of the bond depends on the office and in some cases the amount of money handled by the office. Bond amounts range from \$2,000 for county surveyors to well over \$10 million for offices such as the county trustees in Shelby and Davidson Counties.

Tennessee law requires various local officials, mostly those serving county governments, to execute individual surety bonds as a prerequisite to taking office. The laws requiring these bonds appear in several parts of state law, covering 29 different offices of local government.² Tennessee statutes require surety bonds for only two city offices; no state offices require individual surety bonds, although blanket coverage in the form of insurance is required for state officials and employees.³ County governments are also required to provide blanket coverage for all employees not covered by individual surety bonds.⁴ City governments are not.

Senate Bill 624 by Senator Norris [House Bill 1004 (Todd)], which was sent to the Commission by the Senate State and Local Government Committee, proposed changing current law to allow insurance as an alternative to individual surety bonds.⁵ The bill would allow a governmental entity to buy a policy or cover the same risk by participating in an insurance pool.⁶ The bill allows any one of three options: (1) government crime coverage, (2) employee dishonesty insurance, or (3) equivalent coverage that insures the faithful performance by officials and their employees of their fiduciary duties and responsibilities. The bill sets the minimum amount of coverage at \$400,000 per occurrence. According to the legislature’s Fiscal Review Office, the bill could increase local governments’ tort liability, which could increase their expenditure if the number of lawsuits increased. However, the cost of insurance

¹ Holben et al. 2012.

² Titles 5, 6, 7, 8, 9, 13, 18, 49, 54, and 67 of the Tennessee Code Annotated each contain surety bond requirements for public officials.

³ Tennessee Code Annotated, Section 4-4-108.

⁴ Tennessee Code Annotated, Section 8-19-101.

⁵ See appendix A.

⁶ The bill refers to pools established pursuant to Tennessee Code Annotated, Section 29-20-401.

should be less than the cost of surety bonds, but the likely difference is impossible to determine because the coverage limits and deductibles are unknown.

It is unclear whether an insurance policy can be written that provides the same coverage as Tennessee's public official surety bonds. However, even if such policy could be written and found in the marketplace, it is widely believed that it would be prohibitively expensive. While other states allow insurance instead of surety bonds, no state requires the insurance to be the equivalent of Tennessee's surety bonds.⁷ If it did everything a surety bond did and was available at the same cost, it would essentially be a surety bond. In that case, there seems to be no advantage in providing insurance as an alternative.

The consensus of the Commission is that this bill is not needed, at least not in its current form. It is not clear that it would provide the same safeguards as Tennessee's individual surety bond requirements, particularly as they relate to holding individual office holders accountable. The Commission would, however, endorse a provision allowing blanket coverage that is the equivalent of the individual surety bonds currently required. For example, the State of Virginia buys a bond that covers multiple officers, is conditioned on faithful performance of their duties, and holds them individually accountable by allowing the company selling the bond to recover any claim paid to the state because of the failure of any office holder to faithfully perform his or her duties.⁸

Terminology

Terminology used in the discussion of bonds and insurance is confusing. The terminology in current law is inconsistent, sometimes even within a single statute. For example, Tennessee's statute requiring a city manager's surety bond refers in some places to it as a fidelity bond, though it is not one.⁹ It's unclear whether this is the cause or the result of inconsistent use in the bond and insurance industries. For clarity, more precise meanings of the terms are given below:

- **Public Official Bond (or official bond):** A broad term used to describe required coverage for a public official, traditionally used to enforce the faithful performance of official duties, and to indemnify the public against official delinquency.¹⁰ If the obligations are not successfully performed, the surety will pay the governmental entity, up to the bond amount, for any resulting loss. The public official is responsible for reimbursing the surety.
- **Surety Bond:** A contract between three parties in which one party (the surety bond company) guarantees a second party (the obligee, the city or county) the successful performance of a third party (the principal, the public official):

⁷ See appendix D.

⁸ See appendix E.

⁹ Tennessee Code Annotated, Section 6-21-104.

¹⁰ Public Officers 2013.

1. **Surety:** This is the company selling the surety bond, typically an insurance company. The surety is one who agrees to pay money or to do any other act in the event that the principal fails to perform the obligations of the bond. "One bound with his principal for the payment of a sum of money or for the performance of some duty or promise and who is entitled to be indemnified by someone who ought to have paid or performed if payment or performance be enforced against him."¹¹
 2. **Obligee:** The recipient of the obligation. It is the party to whom a guarantee is made. In our context, the governmental entity, such as a county or city would be the obligee.
 3. **Principal:** This is the public official—the person whose performance is covered by the bond.
- **Insurance:** A two-party contract that transfers the risk of loss from one party to another in exchange for payment (premium).
 - **Blanket Bond (or blanket surety bond):** In the public official context, this term refers to coverage for a group of officials or employees of a designated office or political subdivision and allows for several individuals to be covered under one bond, instead of a separate bond for each.
 - **Bond Amount:** Also called the penal sum, this term refers to the maximum amount that the surety will pay if the principal does not meet the obligations of the bond. Minimum bond amounts are set by statute in Tennessee for positions requiring individual surety bonds.
 - **Pool (or group self-insurance):** A group of entities that self-insure by combining their funds. These pools are formed under state-specific laws. Each pool member shares in the risks of all other member entities.
 - **Self-insurance:** Retaining risk by setting aside an amount of money to compensate for potential future loss.

Who is Liable?

The choice among risk management tools can be seen as a decision about who will be liable for losses resulting from the actions of public officials, the official or the taxpayer. Surety bonds hold the official personally liable for not faithfully performing the duties of office. This approach is widespread; forty-four states have individual official bond requirements for their county officials. With individual surety bonds (and the less commonly used blanket bond), the official owes a duty of indemnification to the surety if the surety makes payment under the bond. Insurance would not hold the official personally liable and would transfer the liability to the insurance company, and if the specific act is not covered by the policy, ultimately the taxpayer. Further, with insurance, taxpayers are liable for covering any deductibles, not to

¹¹ Black's Law Dictionary 1441 (6th ed. 1991).

mention the premium payments. The key difference is that a surety bond, in holding the official personally responsible, provides an incentive for the official to properly perform the duties of office that an insurance policy would not. On the farthest extreme, self-insurance, taxpayers are entirely liable for covering any losses.

Individual Surety Bonds

Tennessee's statutes requiring public official bonds give guidance on

- the officials required to give bond,
- the coverage and amount of the bond,
- the process for approval of the bonds, including the approval authority,
- the financial responsibility for paying the cost of the bonds, and
- the ramifications of not providing a required bond.

In Tennessee, the surety bond process is regulated at every step. Title 8, Chapter 19 "Bond of Officers," provides the general bond requirements, procedures, and authority for the issuance of the bonds. The requirements of both the official and the sureties on the official bond are controlled by the statutory language. Statute requires that the forms for official bonds be prescribed by the Comptroller of the Treasury, with the approval of the Attorney General and Reporter.¹² This requirement is to ensure that the proper form and legal language in the bond will be used to guarantee adequate and standardized coverage for governmental entities. Tennessee statutes also generally require that the governmental entity pay for the bond. Surety bonds are typically sold by insurance companies, which are regulated by the Department of Commerce and Insurance.

Tennessee Code Annotated, Section 8-19-106, provides that "the respective counties shall pay the premiums for such bonds and the registration fees." Statutes also generally require that the official must be bonded before taking office. For example, the statute for the county trustee states in part that "the county trustee may enter upon the discharge of the duties of office, after first giving bond, and an oath for the faithful performance of the duties of the office."¹³ And if the bond is not executed within the prescribed time, then the individual vacates the office.¹⁴

Amount of Bond

Tennessee statutes requiring individual surety bonds for public officials generally set minimum bond amounts of coverage that must be provided by the surety. See table 1. The statutes make clear that the local governments can require higher bond amounts. Public Chapter 315, Acts of 2013, increased the bond amounts for many officials. Tennessee statute also allows the official to deposit cash, equal to the amount of the bond, in place of acquiring a surety bond.¹⁵

¹² Tennessee Code Annotated, Section 8-19-101(b) (1).

¹³ Tennessee Code Annotated, Section 8-11-102.

¹⁴ Tennessee Code Annotated, Section 8-19-117.

¹⁵ Tennessee Code Annotated, Section 8-19-120.

Bond amounts are determined by a few different ways: revenue based calculations, population based calculations, court determination, county legislative body or presiding judge determination, and often simply set at a specific amount. For certain positions that handle large sums of money, the minimum bond amount is based on a revenue calculation. For example, a county trustee’s minimum bond amount “shall be based on the revenues as follows: (1) Four percent (4%) up to three million dollars (\$3,000,000) of the funds collected by the office; (2) Two percent (2%) of the excess over three million dollars (\$3,000,000) shall be added; and (3) The amounts indicated in subdivision (b)(1)-(2) shall be cumulative.” The bond amounts for some county trustees are several million dollars. Furthermore, city charters often have surety bonding requirements for certain officers and employees who handle money. The charters usually require the bond amounts to be set by a city legislative body or board.

Table 1. Public Officials and Their Bond Amounts

Office/Agency	TCA Reference	Amount of Bond	Elect/Appoint
Assessor of Property	67-1-502 & 505	\$50,000	Elected. 4 years
Chancery Court Clerk & Master	18-2-201 through 213 & 18-5-101	\$50,000-\$100,000 Population based	Appointed. 6 years
Circuit/Criminal/Special/General Sessions Clerk	18-2-201 through 213 & 18-4-101	\$50,000-\$100,000 Population based	Elected. 4 years
Commissioner/Receiver	18-2-201 through 213	Court determined	Court determined
Constable	8-10-101 & 106	\$4,000 to \$8,000 County discretion	Elected. 2 to 4 years
Coroner	8-9-101 & 103	\$2,500	Elected by County Board. 2 years
County Clerk	18-2-201 through 213/18-6-101 through 115	\$50,000-\$100,000 Population based	Elected. 4 years
County Engineer	54-9-131 & 132	\$10,000	Employed by Road Commission.
County Executive/Mayor	5-6-101 & 109	\$100,000	Elected. 4 years
County Road Commission	54-9-116 & 119	Set by County Board	Elected. 1, 2, or 3 years
County Highway/Bridge Funds	54-4-103 (c)	\$100,000 or greater	
County Highway Superintendent	54-7-105 & 108	\$100,000	Elected. 4 years

Office/Agency	TCA Reference	Amount of Bond	Elect/Appoint
Development District	13-14-114	Revenue-based Calculation Formula	4 years. Some statutorily required. Some appointed by Senators.
Director of Accounts & Budgets (1957 Act)	5-13-103	\$100,000 or greater	Appointed by County Mayor
Director of Finance (1981 Act)	5-21-106 & 109	\$100,000 or greater	Appointed by Financial Management Committee
E911 District	7-86-119	Revenue-based Calculation Formula	Appointment varies based on population size.
Human Resource Agency	13-26-110	Revenue based Calculation Formula	4 years. Some statutorily required. Some appointed by Senators.
LEA/Fiscal Agent	49-3-315(b)(3)	Revenue-based Calculation Formula	
Notary Public	8-16-101 through 104	\$10,000	Elected by County Board. 4 years
Process Server	8-8-108	\$5,000 (Shelby \$15,000)	Judicial Appointment
Purchasing Agent	5-14-103(c)	\$100,000 or greater	Appointed by County Mayor
Register of Deeds	8-13-101 through 103	\$50,000-\$100,000 Population based	Elected. 4 years
Sheriff	8-8-103	\$100,000 or greater	Elected. 4 years
Special Deputy	8-8-303	\$50,000	Appointed by Sheriff
Director of Schools	49-2-301 & 9-3-301(c) & 49-2-102	\$50,000 or greater	Appointed by Board of Education

Office/Agency	TCA Reference	Amount of Bond	Elect/Appoint
Surveyor	8-12-101 & 102	\$2,000	Elected by County Board. 4 years
Trustee	8-11-101 through 103	Revenue-based Calculation Formula	Elected. 4 years
City Manager (and employees dealing with funds)	6-21-104 & 105	Set by ordinance of board of commissioners, except where the amount is prescribed in charter.	Appointed by Board of Commissioners
All city officers/employees dealing with funds (Modified City Manager-Council Charter)	6-35-411	Council sets the bond amount and determines who must have one.	

Source: Tennessee Code Annotated and Tennessee Comptroller of the Treasury

Cost

The price of a surety bond depends on the bond amount required, the obligations the bond covers, and the relevant background of the individual being bonded. Surety companies have specific underwriting guidelines for determining the price of the bond. Typically, personal credit history, criminal background, and prior bonding history all go into determining the price paid for the bond. The higher the bond amount, the higher the price for that bond. For example, based on information provided by Williamson County, a \$50,000 bond for the county clerk costs \$113 annually, while a near \$10 million bond for the county trustee cost the county approximately \$6,000 annually.

Coverage

To fully understand what a public official surety bond covers in Tennessee, one should: (1) analyze the bond; (2) analyze the statute calling for the bond's issuance; (3) analyze any statutes governing the conduct of the bonded official; and (4) analyze the applicable case law.¹⁶ Tennessee has a required public official bond form provided on the Comptroller of the Treasury's website. The individual surety bond form provided by the Comptroller of the Treasury's office can be found in appendix B. The statutes on public official bonds require the bond forms to have specific legal phrases that obligate the principal and the surety. In state statute, the legislature provided the exact coverage language that the surety bond must include. This language places two obligations upon the official and is listed at Tennessee Code Annotated at Section 8-19-111(b):

¹⁶ Shreves and Coffee 1997.

“That if the _____(Principal) shall:

Faithfully perform the duties of the Office of _____County during such person’s term of office or continuance therein; and

Pay over to the persons authorized by law to receive them, all moneys, properties, or things of value that may come into such principal’s hands during such principal’s term of office or continuance therein without fraud or delay, and shall faithfully and safely keep all records required in such principal’s official capacity, and at the expiration of the term, or in case of resignation or removal from office, shall turn over to the successor all records and property which have come into such principal’s hands, then this obligation shall be null and void; otherwise to remain in full force and effect.”

The first and most significant obligation in the bond is for the principal to “faithfully perform the duties of the office.” This phrase has great meaning in determining coverage. The most common-sense meaning of faithfully performing duties would mean an officer or employee has performed his or her official duties without dishonesty, malfeasance, or negligence. Faithful performance of duty requires an official to do his or her job so that all duties required of the position are successfully completed without any associated damage to the governmental entity. And the lack of faithful performance means the failure to do one’s job—whether intentionally or negligently.¹⁷ This term, along with the bond contract, obligates the surety to pay up to the bond amount for any lack of faithful performance of duties by the principal. In a public official bond, “faithful performance” is what the correlating statute defines it to be.¹⁸ Part 2 of the bond form, generally speaking, obligates the official to be responsible for all money, property, and records.

The duties that must be faithfully performed by bonded individuals are found in the statutes that describe the office held by that individual. For example, Tennessee Code Annotated, Section 8-11-104, lists several specific duties for county trustees. Other officials have similar statutes detailing the duties of office. Tennessee has a statute that broadly outlines the obligations covered by required official bonds at Section 8-19-301:

Every official bond executed under this code is obligatory on the principal and sureties thereon: (1) For any breach of the condition during the time the officer continues in office or in the discharge of any of the duties of such office; (2) For the faithful discharge of the duties which may be required of such officer by any law passed subsequently to the execution of the bond, although no such condition is expressed therein; (3) For the use and benefit of every person who is injured, as well by any wrongful act committed under color of such officer’s office as by the failure to perform, or the improper or neglectful performance, of the duties imposed by law.

¹⁷ Price, McDonnell, and Howald 2006.

¹⁸ Ibid.

Some officials also have specific statutes addressing the scope of liability on the bonds, such as the county clerk: “the official bonds of clerks, executed under this code, are obligatory on the principal and sureties for every wrongful act or failure of duty in the clerk’s official capacity, whether embraced in the condition of the bond or not, or growing out of a law passed subsequently to its execution.” Case law also provides insight into what events or acts of the official will be covered.

Claims against Surety Bonds

Typically, the governmental entity, such as the county, is the party that would file a claim against the public official’s surety bond if there is a loss. However, Tennessee statute provides that the public can make claims on the official surety bond by stating that it is “for the use and benefit of every person who is injured.”¹⁹ Under an insurance policy, unless third party recoveries are specifically allowed by the policy, only the insured will be able to recover for any loss. Surety bond claims are rare and unexpected because of the screening process required. To have a claim against a bond, the governmental entity must show a loss. When a claim is made, the surety investigates and, if it is a valid claim, will pay and then turn to the official for reimbursement.

Blanket Bonds

“Blanket bond” is a generic term that refers to a bond that covers a group of officials or employees under one bond, instead of a separate bond for each. Twenty-three states allow the use of blanket bonds instead of individual bonds, and two of these states, New Hampshire and Virginia, require only blanket bonds. States’ statutes rarely define the term “blanket bond,” and the types of blanket bonds used vary from state to state.

Blanket bonds can be set up to provide the same safeguards and coverage as an individual bond with liability remaining with the official. These bonds would likely be less expensive and easier to acquire because of less paper work than having an individual bond for each official. Tennessee law purports to allow “blanket bonds” in place of individual bonds; however, what it allows is really just a collection of individual bonds.²⁰

The State of Virginia uses a true blanket bond. The state buys a bond that covers multiple state and local officers, is conditioned on faithful performance of their duties, and holds them individually accountable by allowing the company selling the bond to recover any claim paid to the state because of the failure of any office holder to faithfully perform his or her duties.²¹ A list of positions to be covered, along with the dollar amounts of coverage for each position, is attached to the bond and submitted to the surety company. Their blanket bond totals \$200 million and covers approximately 1,119 state officials and local constitutional officers for an annual premium of \$467,976. The dollar amount of coverage varies based on the position being covered, ranging from \$3,000 to \$3 million.

¹⁹ Tennessee Code Annotated 8-19-101.

²⁰ Tennessee Code Annotated, Section 8-19-101(c) requires blanket bonds to have “a separate rider or attachment to the blanket bond” for each official and signed by that named official.

²¹ See appendix E for Virginia’s blanket bond.

Alternatives to Surety Bonds

The use of other forms of risk management in place of public official bonds is not entirely novel. Other states have had alternative methods of risk management in place for years. The use of insurance to cover this risk, as proposed in Senate Bill 624, is allowed in six states. Appendix D includes a table listing other states' individual bond requirements for county governments along with any alternatives that are used or allowed. In addition to insurance, alternative methods include risk pools and self-insurance.

Insurance

Senate Bill 624 would allow any governmental entity to purchase insurance instead of an individual surety bond. This bill was presented as a way to save local governments money, give them more flexibility, and reduce what some saw as too much governmental red tape. The bill allows for three types of insurance coverage: (1) government crime coverage, (2) employee dishonesty insurance coverage, or (3) equivalent coverage that insures the faithful performance by officials and their employees of their fiduciary duties and responsibilities. The coverage can be provided either by an insurance company authorized to do business in the state or by a risk pool. The minimum limit of such policy would be set at \$400,000 per occurrence. A certificate of insurance would "satisfy all requirements for the filing of the official bonds by the named officials."

The actual cost of an insurance policy, as proposed by the bill, is currently unknown because a specific insurance policy was not provided to evaluate. The bill only lists types of policy coverage and does not address a required deductible amount or the contents of such policy (other than a minimum limit). This seemingly gives great discretion to local governments on the contents of an insurance policy—such as deductible amount, exclusions, and types of crimes covered—if they choose to use insurance instead of public official surety bonds. The result could be significant differences in coverage from county to county.

With less cost, comes less coverage. The bill's fiscal note, while not giving a specific cost, does state that "insurance policies may ultimately be less expensive, but insurance comes with coverage limits and deductibles." The fiscal note on the bill indicated that insurance may increase tort liability, but "there should be a recurring decrease in local government expenditures because the cost associated with insurance policies are deemed less expensive than the cost associated with surety bonds."

It would likely be easier to acquire a policy of insurance to cover a group of officials than it would be to acquire an individual surety bond for each official. The application process of surety bonds requires an investigation into the financial background of the official being bonded, typically with more investigation for those bonds with larger dollar amounts of coverage. The public official being bonded must also complete the appropriate surety bond form, at the statutorily defined dollar amount, and file it with the appropriate office. An insurance policy covering a group of those officials would likely be easier to acquire because insurance companies do not typically investigate the individuals. And because one policy could cover all of a local government's officials, it would also simplify the process for local

governments. With insurance coverage, risk is transferred from the individual and the official would no longer have any “skin in the game.”

The \$400,000 minimum amount of coverage, as stated in the bill, may be too low for certain public official positions. State officials expressed concern that local governments may only provide the minimum amount stated in the bill. If this is the case, the minimum amount would be a significantly lesser dollar amount of coverage compared to current surety bond amounts for certain officials that handle large sums of money. For example, county trustees, especially those in more populated counties, have surety bond coverage amounts in the millions of dollars. Other states have encountered this same issue when allowing insurance in place of official bonds. For instance, those in charge of Idaho’s policy covering county officials indicated that they remedied such issues by providing additional coverage for those officials that needed it such as those handling large amounts of money.

There are a number of other general differences between surety bonds and insurance policies. See table 2. For example, insurance policies are generally cancelable, while surety bonds may not be. The surety bond is issued for the term of office, whereas an insurance policy is typically on an annual term. Also, insurance coverage is triggered by a covered occurrence while coverage under the surety bond is triggered by the official not faithfully performing the duties of office that cause a loss to the governmental entity. In general, surety bonds make people individually accountable, while insurance does not. A surety bond will not be issued until the individual has been investigated, and the price of the bond will depend on what the investigation reveals. In fact, the bonding company may refuse to issue a bond if they consider the risk too great. In other words, everything depends on the individual.

With insurance, individuals are not investigated; the experience of the entire organization is considered instead. The insurance premium is based on that experience and the amount of coverage desired or required. Unlike individual surety bonds, insurance assumes losses will occur and is a mechanism to set money aside through premiums to cover them.

Insurance is written in favor of the insurance company, with many exclusions and exemptions. Surety bonds are written in favor of the governmental entity as broadly defined in the law specifying the duties of the office covered.

Table 2. Comparison of Insurance and Surety Bonds

Surety Bond	Insurance
Three party agreement. The surety guarantees the faithful performance of the principal to the obligee.	Generally, two party agreement. The insurance company agrees to pay the insured directly for certain losses incurred.
Losses not expected. The surety takes only those risks which its underwriting experience indicates is safe. A surety will usually look at the applicant’s credit, arrest, and bankruptcy history, as well as any previous bond claims made against the applicant.	Losses expected. Insurance rates are adjusted to cover losses and expenses as the law of averages fluctuates.

Surety Bond	Insurance
Losses recoverable. After a claim is paid, the surety expects to recoup its losses from the principal. This means the public official has "skin in the game," and the risk of loss stays with the official.	Losses usually not recoverable. When an insurance company pays a claim, it usually doesn't expect to get repaid by the insured. Risk of loss is transferred to the insurance company.
The cost of the bond covers expenses. A large portion of the surety bond price is really a service charge for weeding out unqualified candidates and for issuing the bond.	Premium covers losses and expenses. Insurance premiums are collected to pay for expected losses.
Sureties are selective.	Insurers cover most risks. The insurance agent generally tries to write a policy on anything that comes along (at the appropriate premium rate) and allows for a large volume to cover the risk.
2 or 3 page document.	Often a multipage document containing many exclusions and exemptions.
Written in favor of the state. Statute requires that the bond form be "prescribed by the Comptroller of the Treasury, with the approval of the Attorney General and Reporter." ²²	Typically, written in favor of the insurance company.
Dollar Amount of Coverage: Bond amounts vary from \$2,000 to well over \$10 million depending on the applicable statutory requirements for the position. For some officials, this is a specific amount as stated in the law. For other officials the amount is based on the amount of local revenues or on population. And for some, the amount of the bond is determined by the legislative body or presiding judge.	Dollar Amount of Coverage: Senate Bill 624 proposes that "any such policy shall have limits of not less than \$400,000 per occurrence."

²² Tennessee Code Annotated, Section 8-19-101(b)(1).

Surety Bond	Insurance
<p>Tennessee’s official bonds allow any injured party to recover on the bond. Part (3) of 8-19-301 states that official bonds under this code are “for the use and benefit of every person who is injured, as well as by any wrongful act committed under color of such officer's office as by the failure to perform, or the improper or neglectful performance, of the duties imposed by law.”</p> <p>Official bonds are not issued for the protection of the official himself, but rather to protect the government or the public from any injuries caused by the public official while in office.</p>	<p>Third party may not bring suit. Policy usually written to only allow recovery for the insured. That is, the policy is written for the sole benefit of the insured, the governmental entity.</p>
<p>Coverage:</p> <p>The statutes contain two basic obligations: (1) that the official faithfully discharge or perform the duties of the office; and (2) that the official truly account for and turn over public money, property, and records entrusted to the official by the duties of office.</p> <p>The public official bond covers the failure of the bonded official to carry out either one of these duties with the motives of the official being irrelevant.</p> <p>A breach of the bond can occur as the result of the failure to act, negligence of the principal, or intentional conduct, i.e., nonfeasance, misfeasance, and malfeasance. In essence, the failure to faithfully discharge one's duties may be attributed to either failing to take a required act or failing to refrain from doing something which by its nature should not have been done. Provided that loss occurs to one entitled to recover on a bond, all liability on a public official bond is absolute and is predicated on breach of duty.</p>	<p>Coverage:</p> <p>In theory, insurance could cover everything that the bond covers.</p> <p>Senate Bill 624 proposes allowing the optional use of a policy of insurance or an agreement with an administrative agency or pool established pursuant to Tennessee Code Annotated, Section 29-20-401, that provides government crime coverage, employee dishonesty insurance coverage, or equivalent coverage that insures the faithful performance by officials and their employees of their fiduciary duties and responsibilities.</p>

Source: CNA Surety. 2012. "Suretyship: A Practical Guide to Surety Bonding," <http://www.cnasurety.com/services/pdf/Suretyship.pdf> (accessed July 1, 2013)

Crime or Dishonesty Insurance

If an insurance policy were used that provided only crime coverage or dishonesty coverage in place of the bond, the cost of that policy would likely be less than that of a bond; however, the coverage would also be less. For example, the typical crime or dishonesty type policy would not provide coverage for negligence or faithful performance of duties unless specific endorsements for those types of coverage were added to the policy, which could increase the price. Even if those endorsements were included, there would be exemptions and exclusions, thus limiting overall coverage. Individuals cannot insure themselves against intentional unlawful acts. Consequently, a crime policy must be purchased by the governmental entity to insure against the risk of its officials committing a crime. That is, the governmental entity would be the insured and not the official. Again, the public official would not be personally accountable, and the cost of claims and losses would fall to the taxpayers.

Six states allow for some form of insurance to be used in place of an official bond requirement. Four of the states (California, Colorado, Idaho, and Indiana) specifically require crime insurance to be used. Indiana requires that the crime insurance include an endorsement for “faithful performance.” Pennsylvania allows for “crime-fidelity” insurance endorsed for “faithful performance” to be used in place of the individual bond. Utah allows for a “fidelity bond or theft and crime insurance” to be used in instead of the individual bond requirements.

Insurance Equivalent to Surety Bond Coverage

No examples were found of an insurance policy that replicates the coverage provided by a public official surety bond. Since this specific type of insurance coverage has not been used for risk management of individual public officials in Tennessee, at best, only an estimate could be made on the cost of initial premiums. Insurance agents and state officials interviewed have indicated that the initial premiums for an insurance policy that attempted to replicate the coverage provided by the state’s public official surety bond would be set high because there is no market experience in Tennessee with this particular type of insurance product. Even if such a policy could be written and found in the marketplace, it would probably be prohibitively expensive. To provide equal coverage, multiple endorsements for various types of coverage would have to be included in the policy. This policy would also require having no deductible, just as Tennessee’s official surety bond provides a guarantee with no deductible amount. Like coverage provided through an insurance crime policy, accountability and liability shifts from the individual to the governmental entity and taxpayers.

Risk Pools

As mentioned above, Senate Bill 624 would allow the insurance to be provided through a risk pool established pursuant to Tennessee Code Annotated, Section 29-20-401. This section of the Tennessee Code was created to allow governmental entities to enter into pooling agreements to protect against the risk created by the Governmental Tort Liability Act. With risk pools, the member entities transfer their exposure for financial loss to the pool, sharing with others in the transfer of related risks.²³ The services related to the transfer of that risk are provided by the new entity, the pool, or by third parties (underwriters, excess carriers, etc.)

²³ Doucette 2001.

retained by the pool.²⁴ The governmental entity and taxpayers become liable for any losses not covered by the pool and the public official no longer has any “skin in the game.”

Risk pools are created and regulated differently from state-to-state, with some states regulating pools like insurance.²⁵ Pools are not regulated like insurance in Tennessee. State insurance regulation typically has four objectives: (1) ensuring that consumers are charged fair and reasonable prices for insurance products; (2) protecting the solvency of insurers; (3) preventing unfair practices and overreaching by insurers; and (4) guaranteeing the availability of coverage to the public.²⁶ If pools are used to provide coverage, additional risks would exist. With pools, a governmental entity would have joint and several liability with the other governmental entities that are members of the pool.

Risk pools are allowed to provide coverage in place of an individual bond for officials in six states. Arkansas established a state-run, statewide pool that provides coverage for all state and local officials in place of the previously required surety bonds. Their pool only covers losses up to \$250,000 caused by fraudulent or dishonest acts, with no coverage for faithful performance of duties. North Dakota’s State Bonding Fund, created by statute, operates as a pool to provide coverage for public officials. Idaho allows counties and cities the option to use insurance provided through a pool to cover public officials instead of individual bond requirements. The Idaho County Risk Management Program is a member-owned local government risk pool that provides this coverage, which is broader than Arkansas’s coverage, and includes endorsements for faithful performance. Georgia, Maine, and New Jersey all allow for the use of different types of risk pools to provide coverage of public officials as a substitute for official bonds.

Self-insurance

Self-insurance is another alternative—while not specifically mentioned in the bill—that was found in the examination of other states’ laws. Four states allow self-insurance as a substitute for individual bonds for county officials. This refers to setting aside a planned amount of funds to cover potential future losses and should be distinguished from simply doing nothing. California allows the board of supervisors of a county to adopt a “program of self-insurance.” Illinois allows counties that self-insure under the Local Governmental Tort Immunity Act to also self-insure in place of official bonds. Louisiana allows the office of risk management the option to self-insure bonds for public officers. In 2013, Texas passed a law that allows counties to self-insure in place of individual bonds if approved by the local governing body and county judge.

The risk management tools used or allowed in other states, and those mentioned in the bill, do not hold the individual official individually accountable like the Tennessee public official surety bond. The surety bond includes an agreement that the official signs, agreeing to pay back the

²⁴ Ibid.

²⁵ Ibid.

²⁶ Jerry 2001.

surety if the surety has to pay out any claims on the official's behalf. Insurance, including risk pools, do not have this same requirement.

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