



Motor Vehicle Dealer Bonds—The Basics

The motor vehicle dealer bond typically protects consumers from any losses incurred as a result of fraudulent practices, violations of the law or misrepresentations of the dealer or its sales force. This bond differs by state, but it generally guarantees that the dealer will comply with the applicable laws and regulations and not engage in fraud.

In underwriting the bond, the surety generally will look at the following factors:

- financial condition;
- bank references;
- how long the dealer has been in business;
- prior violations or bond claims;
- whether the Principal on the bond sells cars “As Is” or gives a warranty;
- whether the Principal has liability insurance or other appropriate coverages;
- reputation and experience with the dealer (e.g. record of consumer complaints);
- bank financing arrangements;
- whether the dealers sells new cars, used cars or both; and
- whether the auto manufacturer conveys the title and is responsible for warranty work.

The two primary purposes of this license bond are: 1) to prequalify the license applicants who will comply with the statutory obligations for a license, and in so doing, prevent losses; and 2) to provide some reimbursement for losses, up to the penal sum of the bond, if the licensee defaults on its obligations. With a license bond, the surety provides the regulatory entity with the pre-qualification of license applicants who will perform as required, and the added benefit of the bond amount being available for payments if the licensee fails to perform.

As the bond amount increases or the scope of the obligations under the bond expand, the surety tightens its underwriting parameters. If the statute requires an unduly high bond size, or results in an unduly high aggregate liability, many motor vehicle dealers may not be able to obtain the required bonds.

States should require a bond in an amount that provides a strong incentive for compliance and that has some correlation to the risk being underwritten. A surety bond provides a strong incentive for motor vehicle dealers to comply with the terms of their license because if there is a legitimate claim under a license bond, the surety pays it, up to the penal sum of the bond, however the dealer must indemnify or repay the surety. The dealer who does not perform as required has his or her own assets at stake for the results of non-compliance. That kind of financial incentive, combined with the surety’s prequalification, does not require a bond amount that is so high that the small, but sound, dealers in the market will be eliminated from the business.