Legislative Analysis

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BAIL BOND SURETY COMPANY: CAPITAL AND SURPLUS

House Bill 5281 (Substitute H-1)
Sponsor: Rep. Mickey Mortimer
Committee: Insurance

First Analysis (2-24-04)

BRIEF SUMMARY: The bill would provide a new, lower minimum capital and surplus standard for a company that operates solely as a bail bond surety company.

FISCAL IMPACT: This legislation would create new duties and responsibilities for the Office of Financial and Insurance Services, which will affect its budget. Insurance companies pay an annual assessment to support the OFIS budget.

THE APPARENT PROBLEM:

To be licensed as an insurance company in Michigan, a firm must have unimpaired capital and surplus of at least $7.5 million. This is part of the state's solvency regulation, and is the minimum requirement. The insurance commissioner is charged with determining the actual amount based on a company's risk in order to ensure that an insurer is considered safe, reliable, and entitled to public confidence. Advocates for companies that deal solely in bail bonds say the $7.5 million capital and surplus minimum is excessive for the kinds of business they conduct. They say that the requirement keeps businesses that operate in other states (at least one of which is owned by a Michigan-based holding company) from operating in Michigan, with its higher surplus and capital requirement.

Bail bonds differ from other kinds of insurance lines, say industry spokespersons, because the risk is collateralized and because bail bond agents can mitigate losses by pursuing the assets of the insured. Losses tend to be minimal, they say, and there is little risk to the public-at-large of the kind posed by the insolvency of a multi-line insurance company. In order to promote competition in the bail bond field and stimulate job opportunities by encouraging new entries into the market, legislation has been introduced that would lower the minimum capital and surplus requirement for bail bond companies only.

THE CONTENT OF THE BILL:

The bill would amend the Insurance Code to establish the amount of unimpaired capital and surplus required of a company that operates solely as a bail bond surety company to ensure that the company is safe, reliable, and entitled to public confidence. After February 1, 2004, such a company that is in good standing in its state of domicile would have to possess and thereafter maintain unimpaired capital and surplus in an amount determined

adequate by the insurance commissioner, but no less than $4.5 million. In addition, the company would be required to have at least $3 million in current guarantees and security with respect to bail bonds issued in states in which it was authorized to conduct business.

The insurance commissioner (actually, the commissioner of the Office of Financial and Insurance Services, or OFIS) would have to take into account the risk-based capital requirements developed by the National Association of Insurance Commissioners (NAIC) and the claims history for Michigan bail bonds issued by the licensed bail bond agencies for which the company was to be issuing bail bonds in the state in order to determine adequate compliance with the requirement in Section 403 of the Insurance Code that companies be considered safe, reliable, and entitled to public confidence in order to be authorized to conduct business in the state.

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BACKGROUND INFORMATION:

An individual charged with a crime may be required to furnish bail so that he or she can remain at large while awaiting trial. One method of accomplishing this is the posting of a bail surety bond with the court. A bail bond is issued by a bonding company, which is then guaranteeing that the defendant will appear in court as scheduled. Reportedly, the customer pays a non-refundable percentage of the total bond amount (typically about ten percent), plus expenses. If the accused fails to appear, the bond is forfeited as a penalty by the surety insurer. According to industry information, bail bonds typically require collateral to protect the bonding company (a residence or other assets, for example) and sometimes involve co-signors.

ARGUMENTS:

For:

A lower minimum surplus and capital requirement for bail bond surety companies is defensible because of the nature of the risk involved in that industry. Loss ratios are said to be small, and bail bond surety companies have ways to mitigate losses by pursuing the assets of customers. Bail bonds are typically collateralized. Bail bond companies are overseen not only by state insurance regulators but also by the courts. The lower financial standard will have no adverse impact on the safety and soundness of the bail bond surety industry in the state. The bill is very narrowly tailored to apply just to companies writing only bail bond surety business. It will not affect other insurers. Furthermore, bringing new entrants into the market will have economic benefits. The $4.5 million figure required in the proposed legislation, it should be noted, is substantially higher than the old capital and surplus minimum for all insurers prior to 1998. Further, in addition to this amount, a bail bond surety company would need to have at least $3 million in current guarantees and security with respect to bail bonds issued in states where it was authorized to conduct business.

Against:

The Office of Financial and Insurance Services (OFIS) has raised a number of concerns with the bill. Spokespersons have said the office believes Michigan courts and citizens would be best served if reputable and solvent companies are in place to sell bail bonds, and it believes the current $7.5 million capital and surplus requirement assures the public that companies doing business in Michigan can meet their obligations. High financial standards protect Michigan courts and citizens from undercapitalized and overleveraged companies. It is not clear how the $4.5 million figure was arrived at. Further, OFIS says it does not accept guarantees (as this bill would require) as a solvency protection because of prior failures to be able to collect on them and is not willing to endorse their use as proposed in the bill. The kind of "securitization" common in the bail bond industry tend to be personal assets (such as real estate) and in the case of a company insolvency, would likely not be available to state regulators.

OFIS also has objected to the narrow scope of the bill. It applies to a very limited set of entities and creates lower financial standards especially for them. This could lead to additional entreaties for special treatment for other kinds of insurers, which would make the Insurance Code, over time, difficult to administer and enforce. The uniform requirement currently in place is easy to monitor and enforce and has worked well. There is at present no special licensure for bail bond-only companies or separate reporting requirements for such companies. Moreover, OFIS does not receive information on claims histories for bail bonds. Separate tracking of this category of companies for risk assessment purposes would be difficult.

Response:

As regards how the $4.5 million figure contained in this legislation was arrived at, proponents of the bill note that there likewise does not seem to be any empirical justification for the current $7.5 million minimum applied to all insurers. Prior to Public Act 457 of 1998, the required amount was $1.5 million. Other states have lower requirements.

POSITIONS:

A representative of Universal Fire and Casualty Insurance indicated support for the bill. (2-18-04)

The Office of Financial and Insurance Services is opposed to the bill. (2-18-04)

Legislative Analyst: Chris Couch

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