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Submitted to the ERISA Advisory Council, United States Department of Labor

Evaluating the Department's Regulations and Guidance on ERISA Bonding Requirements and Exploring Reform Considerations

My name is Diane McNally and I am a Senior Vice President and National Practice Leader of Segal Select Insurance Services, Inc. Segal Select is a wholly owned subsidiary of The Segal Group and operates as a national retail insurance broker. Segal Select specializes in four core insurance products for two main industry groups. The core products are:

- Fiduciary Liability Insurance,
- Fidelity Bonds,
- Cyber Liability Insurance, and
- Employment Practices Liability Insurance.

The two main industry groups are:

- Taft-Hartley jointly-trusted multiemployer plans, and
- Public Sector benefit plans.

I have been asked to address the topic of ERISA Bonding Requirements. More specifically, I will cover the five inquiries raised by the Department of Labor (DOL) as to whether future changes in bonding requirements would improve compliance and further protect plan funds and other property from acts of fraud and dishonesty.

Understanding the requirements under section 412 of ERISA can be complex and daunting for insurance brokers and their clients. My goal is to provide insight into how ERISA bonds are purchased in the insurance market today and general guidance to consider when exploring future bonding reform. I will respond to each of the five inquiries and address better ways to educate those who are responsible for complying with the ERISA bonding requirements.

- **On the topic to what extent are fidelity bonds being secured by plan officials insuring against losses resulting from *any* act of fraud and dishonesty that is currently required under section 412 of ERISA: Many carrier policy form changes have been made over the last few years to address growing fraudulent activity.**

  While not required under current bonding requirements under ERISA, third-party crime coverages have been made available in the insurance market. These coverages have been made under the ERISA bond policy by endorsement or as amended on the declarations page of the insurance policy to address fraudulent activity involving third parties.

  For example, forgery or alteration coverage protects against third-party forgery or alteration of written checks, bank drafts and similar instruments made or drawn by a plan or drawn on a plan's account(s). This coverage mainly applies to outgoing financial instruments. The following are common examples of claims under forgery and alteration coverage: A third party alters or forges a check or draft made or drawn in the name of a plan to be payable to a fictitious entity; a third party steals a plan's blank checks and makes the drafts payable to various other entities or individuals; or a third party alters the amount of a check or draft.

  Another third-party exposure is loss with a computer, known as computer theft. Carriers offer coverage to insure against theft of money, securities or other property by using a computer to transfer covered property from a plan's premises or bank to another person or place. While no coverage has been provided historically for the theft of information or for computer vandalism, recent new ERISA bond policy amendments by the carriers address this area of exposure.

Other third-party coverage's available is to provide protection for what is known as funds transfer fraud coverage. The insurer offers to cover direct loss of money, securities and other property resulting directly from the use of any computer to fraudulently transfer insured property from inside the plan's premises or bank premises to a person or place outside of the plan's premises or bank's premises.

Coverage for an expanding area of fraud commonly known as social engineering or fraudulent impersonation also has been made available in the ERISA fidelity bond insurance market. This coverage is meant to address fraudulent impersonation of an employee, customer, vendor or a plan participant, causing an employee who relied on fraudulent instructions to voluntarily part with money or securities and/or other property based on fraudulent instructions. Carriers can impose sublimits of coverage and higher policy retentions and coverage is subject to special conditions in the policy and underwriting requirements. Since these policy forms vary by carrier, there could be a potential gap in coverage for plan sponsors.

- **On the topic to what extent are fidelity bonds currently being secured by plan officials to insure <u>the coverage of *all* plan officials who handle plan funds or other property</u> as required under section 412 of ERISA: A request to obtain comprehensive bond coverage relies on the insurance carrier's business priorities and state-by-state regulatory compliance requirements.**

  Insurance policies vary by carrier and the definition of "plan official" varies by carrier and policy form. Requirements under 412 of ERISA could better clarify who must be bonded. This would be beneficial for plan sponsors when securing bond coverage. The fact that carrier bond forms are not uniform as to who is a plan official makes it difficult for plan sponsors to assure that all plan officials are properly insured.

  For example, the carriers' language can vary in extending their policy to read "any natural person required" or add language to include "not required to be bonded." Other carriers may limit their policy definitions of who is an "employee," a "plan official" or a "fiduciary."

  One recommendation is to review the requirements under the DOL Field Assistance Bulletin (FAB) 2008-04 and determine if additional changes are needed regrading who is responsible for how funds are handled.

- **On the topic to what extent fidelity bonds currently being secured by plan officials provide <u>sufficient recovery amounts to offset full losses</u> caused by acts of fraud and dishonesty: Based on the DOL's 2008 - 04 FAB, a compliant bond includes but is not limited to the following:**

  -- The plan must be a name insured on the bond,

  -- The bond must contain coverage for losses caused by acts of fraud and dishonesty,

  -- The amount of the bond must be compliant (per ERISA the maximum is $500,000 per plan), and

  -- The bond must provide first dollar coverage (requiring no deductible should be applied).

  Since the inception of ERISA, new technology has been introduced, risk issues have evolved and plan assets have increased. Further, inflation has continued to devalue ERISA's original bond limit requirement of 10 percent of handled assets up to $500,000. The DOL FAB confirms that nothing precludes a plan sponsor from purchasing a higher bond limit than what is required. Most bonds provide coverage on a "per occurrence" basis, which means the bond's limit of liability applies anew to each unrelated loss sustained during the bond's term.

  A further analysis of the bond loss activity would need to be conducted to gain greater understanding of the types of losses and average paid claims involving plan officials. It should also evaluate if the change in inflation rate over time would support a change in the bond limit requirements. This depends on insurers being able to meet the market demand for any limit increases and their ability to file and implement rate changes. It may take an insurance carrier more than a year to file and receive approval in all 50 states, especially when amending a rate filing for multiple policy forms.

- **Should the plan funds or other property mandated to be insured under section 412 of ERISA against losses attributable to acts of fraud and dishonesty be expanded to include participant contributions prior to their deposit in the plan?**

  The council raises a complex question about the ability to insure participant contributions prior to their deposit in the plan. The extent that these “pre-contributions” would be an insurable interest under the bond would depend on insurers’ business priorities and their ability rate for this exposure and offer the desired limits of coverage. This change could create an additional financial burden for plan sponsors.

  Other questions may be raised if funds are deemed uncollectable by a plan sponsor: To what extent would the bond be responsible if an employer could not meet its contribution requirements due to fraud or dishonesty? Would this potentially create a morale hazard in knowing that bond coverage was made available under a plan sponsor’s bond policy?

- **Should the DOL’s current guidance and reporting requirements be modified to clarify (and to better educate plan officials as to) the value of and the distinctions among fidelity bonds, insurance policies covering crime (including cybercrime), insurance policies covering liability and insurance policies indemnifying fiduciaries?**

  In our experience, the bonding requirement under ERISA Section 412 is not always well understood by clients. The FAB 2008-04 provides a useful standard. However, as new crime products and coverages emerge — including cybercrime and social engineering coverage — it would help to offer additional clarity and guidance. It would also help to better educate plan officials on the differences among the various policies and coverage. Finally, an updated list of approved surety companies for ERISA fidelity bonds would be beneficial.