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## EBSA Provides Guidance on ERISA's Fidelity Bonding Requirements (12/08/2008)

**Pension and Benefits Week, 12/08/2008, Volume 14, No. 49****EBSA Provides Guidance on ERISA's Fidelity Bonding Requirements**

DOL's Employee Benefits Security Administration (EBSA) has issued a field assistance bulletin (FAB), which addresses various issues concerning application of ERISA's fidelity bonding requirements. ( *EBSA Field Assistance Bulletin No. 2008-04* )

**Background.**

Under ERISA § 412 , every plan fiduciary, and every person who handles funds or other plan property, must be bonded. ERISA's fidelity bonding requirements are intended to protect plans from risk of loss due to fraud or dishonesty on the part of persons (referred to as "plan officials") who handle plan funds or other property. A plan official must be bonded for at least 10% of the amount of funds handled, subject to a minimum bond amount of \$1,000. For plans that hold employer securities, the maximum bond amount that can be required for any one plan official is \$1,000,000.

To address issues raised by EBSA's regional offices concerning the application of these bonding requirements, the FAB has provided guidance, the highlights of which are discussed below.

**General issues regarding ERISA fidelity bonds.***What losses must an ERISA fidelity bond cover?*

The bond must provide recovery for plan losses caused by acts of fraud or dishonesty (like theft, embezzlement, or forgery), even though no personal gain accrues to the person committing the act, and the act is not subject to punishment as a crime or misdemeanor, as long as a court would award recovery under a bond providing protection against fraud or dishonesty. (FAB 2008-04, Q&A-1)

*Is an ERISA fidelity bond the same as fiduciary liability insurance?*

No. An ERISA fidelity bond required under ERISA § 412 specifically insures a plan against losses due to fraud or dishonesty (e.g., theft) on the part of persons (including plan fiduciaries) who handle plan funds or other property. Fiduciary liability insurance (which is allowed, but not required, by ERISA § 410 ), on the other hand, generally insures the plan against losses caused by breaches of fiduciary responsibilities. (FAB 2008-04, Q&A-2)

*Who are the parties to an ERISA fidelity bond?*

In a typical bond, the plan is the named insured and a surety company is the party that provides the bond. The persons covered by the bond are the persons who handle funds or other property of the plan (i.e., plan officials). As the insured party, the plan can make a claim on the bond if a plan official causes a loss to the plan due to fraud or dishonesty. (FAB 2008-04, Q&A-3)

*Can an ERISA fidelity bond be obtained from any bonding or insurance company?*

No. Bonds must generally be placed with a surety or reinsurer that is named on the IRS's Listing of Approved Sureties, Department Circular 570. (FAB 2008-04, Q&A-4)

*Who must be bonded?*

Every person who handles plan funds or other property (i.e., a plan official) is required to be bonded unless exempted (see below). Plan officials usually include the plan administrator and those officers and employees of the plan or plan sponsor who handle plan funds by virtue of their duties relating to the receipt, safekeeping, and disbursement of funds. Plan officials may also include other persons, like service providers, whose duties and functions involve access to plan funds or decision-making authority that can give rise to a risk of loss through fraud or dishonesty. Where a plan official is an entity (e.g., a corporation), ERISA's bonding requirements apply to the natural persons who perform handling functions on behalf of the entity. (FAB 2008-04, Q&A-5)

*Who is responsible for making sure that plan officials are properly bonded?*

The responsibility for ensuring that plan officials are bonded may fall on more than one individual simultaneously. In addition to a plan official being directly responsible for complying with the bonding requirements, a plan fiduciary who hires a trustee for the plan, for example, must ensure that the trustee is either subject to an exemption, or properly bonded, even if the fiduciary is not himself required to be bonded because he does not handle plan funds or other property. (FAB 2008-04, Q&A-6)

*Must all fiduciaries be bonded?*

No. Fiduciaries must be bonded only if they handle plan funds or other property and do not fall within an exemption (see below). (FAB 2008-04, Q&A-7)

*Must service providers to the plan be bonded?*

A service provider, like a third-party administrator or investment advisor, is subject to bonding only if that service provider handles plan funds or other property. (FAB 2008-04, Q&A-8)

*Must a person who renders investment advice to a plan be bonded solely by reason of rendering such investment advice?*

No. A person who provides investment advice, but who does not exercise, or have the right to exercise, discretionary authority over purchasing or selling securities or other property for the plan, is not required to be bonded solely by reason of providing investment advice. (FAB 2008-04, Q&A-9)

*If a service provider is required to be bonded, must the plan purchase the bond?*

No. A service provider can purchase its own separate bond insuring the plan, and nothing in ERISA specifically requires the plan to pay for that bond. (FAB 2008-04, Q&A-10)

*If the plan purchases a bond, can the plan pay for the bond out of plan assets?*

Yes. A plan's purchase of an ERISA fidelity bond does not constitute an ERISA § 406 prohibited transaction. (FAB 2008-04, Q&A-11)

### **Exemptions from the bonding requirements.**

*Do ERISA's bonding requirements apply to all plans?*

No. The bonding requirements do not apply to plans that are completely unfunded, or that are not subject to Title I of ERISA. (FAB 2008-04, Q&A-12)

*What plans are considered unfunded so as to be exempt from ERISA's bonding requirements?*

An unfunded plan pays benefits only from the general assets of a union or employer. The assets used to pay the benefits must remain in, and not be segregated in any way from, the employer's or union's general assets until the benefits are distributed. Thus, a plan will *not* be exempt from ERISA's bonding requirements as unfunded if:

- ... any plan benefits are provided or underwritten by an insurance carrier;
- ... there is a trust or other separate entity to which contributions are made, or out of which benefits are paid;
- ... plan contributions are made by employees, either through withholding or otherwise, or from any source other than the employer or union involved; or
- ... there is a separately maintained bank account or other evidence of the existence of a segregated or separately maintained or administered fund out of which plan benefits are to be provided. (FAB 2008-04, Q&A-13)

*Are fully-insured plans unfunded for purposes of ERISA's bonding requirements?*

No. Insured plan arrangements are *not* considered unfunded and are *not* exempt from the bonding requirements. The insurance company that insures benefits provided under the plan may, however, fall within a separate exemption from ERISA's bonding requirements (see below). In addition, if no one handles funds or other property of the insured plan, no bond will be required. (FAB 2008-04, Q&A-14)

*Are there any other exemptions from ERISA's bonding provisions for persons who handle plan funds or other property?*

Yes. ERISA § 412 specifically excludes any fiduciary (or any director, officer, or employee of the fiduciary) that is a bank or insurance company, as well as any entity which is registered as a broker or a dealer under section 15(b) of the Securities Exchange Act of 1934, if the broker or dealer is subject to the fidelity bond requirements of a self-regulatory organization. In addition, DOL regs exempt insurance carriers that provide or underwrite welfare or pension benefits. (FAB 2008-04, Q&A-15)

*Are SEPs and SIMPLE IRAs subject to ERISA's bonding requirements?*

There is no specific exemption in ERISA § 412 for Code Sec. 408(k) SEPs or Code Sec. 408(p) SIMPLE IRAs. These plans are generally structured in such a way, however, that if any person does handle plan funds or other property, that person will fall under one of ERISA's financial institution exemptions (see above). (FAB 2008-04, Q&A-16)

### **"Funds or other property" defined.**

*What constitutes a plan's "funds or other property"?*

The term "funds or other property" generally refers to all funds or property that the plan uses or may use as a source for the payment of benefits to plan participants or beneficiaries. Thus, plan "funds or other property" include contributions from any source, including employers, employees, and employee organizations, that are received by the plan, or segregated from an employer or employee organization's general assets, or otherwise paid out or used for plan purposes. (FAB 2008-04, Q&A-17)

### **What it means to "handle" plan funds or other property.**

*What does it mean to "handle" plan funds or other property so as to require bonding?*

The term "handling" carries a broader meaning than actual physical contact with plan funds or other property. A person is deemed to be "handling" plan funds or other property so as to require bonding whenever his duties or activities pose a risk that the funds or other property could be lost in the event of fraud or dishonesty on the part of that person, whether acting alone or in collusion with others. Subject to this basic standard, the general criteria for determining "handling" include, but are not limited to:

- ... physical contact (or power to exercise physical contact or control) with cash, checks or similar property;
- ... power to transfer funds or other property from the plan to oneself or to a third party, or to negotiate such property for value (e.g., mortgages, title to land and buildings, or securities);
- ... disbursement authority or authority to direct disbursement;
- ... authority to sign checks or other negotiable instruments; or
- ... supervisory or decision-making responsibility over activities that require bonding.

"Handling" does not occur, on the other hand, and bonding is not required, under circumstances where the risk of loss to the plan through fraud or dishonesty is negligible (e.g., where the risk of mishandling is precluded by the nature of the funds or other property at issue, like checks that cannot be negotiated by the persons performing duties with respect to them, or where physical contact is merely clerical in nature and subject to close supervision and control. (FAB 2008-04, Q&A-18)

*If the plan provides that a plan committee has the authority to direct a corporate trustee, who has custody of plan funds, to pay benefits to plan participants, are the committee members "handling" plan funds or property?*

Yes, if the committee's decision to pay benefits is final and not subject to approval by someone else, the committee members are "handling" plan funds, and each committee member must be bonded. (FAB 2008-04, Q&A-19)

*If the committee makes investment decisions for the plan, are the committee members "handling" plan funds or other property?*

Yes, if the committee's investment decisions are final and not subject to approval by someone else, the committee members are "handling" plan funds, and each committee member must be bonded. (FAB 2008-04, Q&A-20)

*Are the committee members considered to be "handling" funds if the committee only recommends investments?*

No, not if someone else is responsible for final approval of the committee's recommendations. (FAB 2008-04, Q&A-21)

### **Required form and scope of an ERISA fidelity bond.**

*Do DOL regs require that a bond take a particular form?*

DOL regs allow flexibility regarding bond forms, as long as the bond terms meet the substantive requirements of ERISA § 412 . Examples of bond forms include: individual; name schedule (covering a number of named individuals); position schedule (covering each of the occupants of positions listed in the schedule); and blanket (covering the insured's officers and employees without a specific list or schedule of those being covered). A combination of these forms may also be used. A plan may be insured on its own bond, or it can be added as a named insured to an existing employer bond or insurance policy. (FAB 2008-04, Q&A-22)

*Can a bond insure more than one plan?*

Yes. ERISA does not prohibit more than one plan from being named as an insured under the same bond. Any such bond must, however, allow for a recovery by each plan in an amount at least equal to that which would have been required for each plan under separate bonds. Thus, if a person covered under a bond has handling functions in more than one plan insured under that bond, the amount of the bond must be sufficient to cover that person for at least 10% of the total amount that person handles in all the plans insured under the bond, up to the maximum required amount for each plan. (FAB 2008-04, Q&A-23)

*If the bond insures more than one plan, can a claim by one plan reduce the amount of coverage available to other plans insured on the bond?*

No. When a bond insures more than one plan, the bond's limit of liability must be sufficient to insure each plan as though that plan were bonded separately. (FAB 2008-04, Q&A-24)

*Can a plan or service provider obtain bonds from more than one bonding company covering the same plan or plans?*

Yes. ERISA does not prohibit a plan from using more than one surety to obtain the necessary bonding, as long as the surety is an approved surety. (FAB 2008-04, Q&A-25)

### **Terms and provisions of an ERISA fidelity bond.**

*Can a bond provide that the one-year discovery period required under ERISA § 412 will terminate upon the effective date of a replacement bond?*

Yes, but only if the replacement bond provides the statutorily-required coverage that would otherwise have been provided under the prior bond's one-year discovery period. If the replacement bond does not provide that coverage, then the bonding arrangement does not meet the requirements of ERISA § 412 . ERISA requires that a plan have a one year period after termination of a bond to discover losses that occurred during the term of the bond. (FAB 2008-04, Q&A-26)

*Can a bond exclude coverage for situations where an employer or plan sponsor knew or should have known that a theft was likely?*

No. This exclusion is unacceptable in an ERISA fidelity bond because the plan is the insured party, not the employer or plan sponsor. (FAB 2008-04, Q&A-27)

*What should a plan do if it cannot obtain a bond covering a certain plan official who allegedly committed an act of fraud or dishonesty in the past?*

Many bonds contain provisions that exclude from coverage any persons known to have engaged in fraudulent or dishonest acts. A bond may also contain a provision that cancels coverage for any person who a plan official knows has engaged in any acts of dishonesty. In those situations, the plan must exclude that person from handling plan funds or other property if he cannot obtain bonding coverage. (FAB 2008-04, Q&A-28)

*If a plan is added as a named insured to a company's existing crime bond, which covers employees but specifically excludes the company owner, does the plan's coverage under the crime bond satisfy the requirements of ERISA § 412 ?*

If the crime bond excludes the company owner, and the owner handles plan funds, then the company bond does not fully protect the plan as required by ERISA § 412 . The company owner would then need to be covered under a separate bond or, alternatively, if the crime bond has an ERISA rider, that rider must ensure that the company owner is not excluded from coverage with respect to the plan. (FAB 2008-04, Q&A-29)

*Is every plan whose investments include employer securities subject to the increased maximum bond amount of \$1,000,000?*

No. A plan is not considered to be holding employer securities, for purposes of the increased bonding requirement, merely because the plan invests in a broadly-diversified common or pooled investment vehicle that holds employer securities, but which is independent of the employer and any of its affiliates. (FAB 2008-04, Q&A-38)

*Must a bond state a specific dollar amount of coverage?*

No. There is no requirement that a bond state a specific dollar amount of coverage, as long as the bond provides the required statutory amount per plan of at least 10% of funds handled, with minimum coverage of \$1,000, for each plan official covered under the bond. (FAB 2008-04, Q&A-39)

*If a plan has funds totaling \$1,000,000, and nine employees of the plan sponsor—who each handle all of those funds—are covered under the same bond, for what amount must the bond be written?*

ERISA requires that each of the nine plan officials handling the \$1,000,000 be bonded for at least 10% of the amount of funds he handles, or \$100,000, to protect the plan from losses caused by those plan officials, whether acting alone or in collusion with others. Bond amounts may be fixed either by referencing the statutory language of 10% of funds handled up to the required maximums, or by stating a specific dollar limit of coverage. (FAB 2008-04, Q&A-40)

*What happens if the amount of funds handled increases during the plan year after the bond is purchased—must the bond be updated during the plan year to reflect the increase?*

No. For each covered person, the bond amount must be fixed annually. The bond must be fixed or estimated at the beginning of the plan's reporting year (i.e., as soon after the date when the plan's reporting year begins as the necessary information from the preceding reporting year can practicably be ascertained. The amount of the bond must be based on the highest amount of funds handled by the person in the preceding plan year. (FAB 2008-04, Q&A-41)

*How can the plan set the bond amount if there is no preceding plan year from which to measure the amount of funds each person handled?*

If the plan does not have a complete preceding reporting year from which to determine the amounts handled, the amount handled by persons required to be covered by a bond must be estimated using the procedures described in Labor Reg. 2580.412-15 . (FAB 2008-04, Q&A-42)

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