LEGAL UPDATE

ERISA Bonds

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When Congress enacted ERISA in 1974, it borrowed from pre-existing laws where available. For example, the requirement that funded employee benefit plans, with some exceptions, be required to secure a fidelity bond was effectively an extension of the then current requirements under the Welfare and Pension Plan Disclosure Act of 1962 (WPPDA). When the DOL issued regulatory guidance on ERISA's bonding requirements in 1975, it transformed pre-existing regulations under the WPPDA into temporary regulations under ERISA. Those regulations have been largely untouched since 1975, and have never been finalized, although the IRS published a modernized version of the regulations in Field Assistance Bulletin 2008-04.

The DOL conducted a National Bonding Project in 2015, and the results of that project indicated that language found in fidelity bonds is often inconsistent with ERISA Section 412. For example, the DOL determined that fidelity bond policies frequently: cover losses only if an employee intends to cause a loss to the insured; fails to list the plan as the named insured; and covers losses only if the employee obtains a financial benefit for himself or herself or for another person or entity. In part because of this concern about noncompliance, the DOL asked the ERISA Advisory Council to consider whether the DOL's guidance on bonding should be updated and whether any of the rules provided in the temporary regulations should be updated. In response, the ERISA Advisory Council recommended that the DOL issue a new Interpretive Bulletin incorporating much of the content of its 2008 Field Assistance Bulletin as well as a summary of the requirements for securing a fidelity bond that complies with DOL guidance. Pending the issuance of such updated guidance, it is useful to review some of the findings and comments of the ERISA Advisory Council, as well as some general observations about ERISA's bonding requirements.

The witnesses appearing before the Council stated that the protection against the risk of loss due to theft, dishonesty, or fraud offered by a fidelity bond, if ever a substantial problem, has become less important as compared to other forms of insurance. Today, losses due to theft, fraud, or dishonesty on the part of persons who handle plan funds or other property are far less significant than losses due to social engineering fraud and cybercrime. Fidelity bonds would not generally protect a plan from losses due to these latter risks, because they do not result from theft, fraud, or dishonesty by employees, but rather from the fraudulent and criminal acts of third parties.

Additionally, in practice, fidelity bonds generally do not cover third-party plan officials, such as investment managers, for acts of fraud or dishonesty committed by them or their employees, even though these parties do handle funds or property of ERISA plans and are subject to ERISA's bonding requirements. Typically such parties maintain their own fidelity bond, but it is the obligation of the plan's named fiduciary to ensure such fidelity bonds are secured in circumstances where the third party is not a covered person under the plan's bond.

In general, each person must be bonded in an amount equal to at least 10 percent of the amount of the funds that he or she handles, up to $500,000 or $1,000,000 for plans holding employer securities. A plan can purchase coverage for more than the required amount. If a bond ensures multiple plans, these amounts apply for each plan named on a bond. Therefore, when a bond ensures more than one plan, the bond's limit of liability must be sufficient to insure each plan as if it were bonded separately. Deductibles are generally not permitted, although if a plan chooses to purchase coverage in excess of the ERISA statutory requirements, a deductible may apply to such amounts. The exclusionary language of a policy should be carefully reviewed to ensure that it complies with the ERISA requirements. For example, an exclusion for situations where an employer knew or should have known that a theft was likely are not permissible in an ERISA fiduciary bond because the insured party is the plan, rather than the employer or plan sponsor. Additionally, the bond must either provide for a one-year period after the termination of the bond to discover losses that occurred during the term of the bond, or give the plan the right to purchase a one-year discovery period following the termination or cancellation of the bond.

Takeaway: It may well be time (or past time!) to review your plan's fidelity bond.

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