Fidelity Bond Versus Fiduciary Insurance

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PRACTICE AREAS

Employee Benefits and ERISA

Employment and Labor

Is your ERISA plan bonded or insured? Is there a difference? Why does it matter? This article addresses a compliance requirement that is often misunderstood–the fidelity bond requirement of ERISA and its relationship to fiduciary liability insurance.

Introduction

ERISA requires that any person who "handles" plan assets must be covered by a fidelity bond, which must be purchased from a surety who is on an approved list maintained by the Treasury Department. The fidelity bond protects the plan against losses caused by theft or embezzlement of plan assets. A fidelity bond is not the same thing as ERISA fiduciary liability insurance. Fiduciary insurance protects fiduciaries against personal liability for losses to the plan caused by a breach of fiduciary responsibility (and further pays for attorney's fees incurred when defending against claims of breach of fiduciary duty).

Who Must Be Bonded?

Every person (including a third party service provider) who "handles" funds or other property of an employee benefit plan must be bonded unless they qualify for an exemption under ERISA. Where a plan administrator, service provider, or other person who must be bonded is an entity (such as a corporation), ERISA's bonding requirement applies to the natural persons who "handle" the plan's assets.

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A person is deemed to be "handling" funds or other assets of a plan whenever his or her duties or activities could cause a loss to the plan due to fraud or dishonesty. In general, the term "handling" includes:

- Physical contact with cash, checks or similar property;
- The power to transfer funds from the plan to oneself or to a third party;
- Disbursement authority or authority to direct disbursement;
- The authority to sign checks; or
- Supervisory or decision-making responsibility over activities that require bonding.

A fidelity bond is not required for employee benefit plans that are completely unfunded (i.e., the benefits are paid directly out of an employer's or union's general assets), or to plans that are not subject to Title I of ERISA, such as church plans or governmental plans. In addition, banks, insurance companies, and registered securities brokers and dealers are exempted. Other plan service providers, such as claims administrators and investment advisors, are subject to the fidelity bond requirement if they "handle" plan assets.

How Much Coverage Must the Bond Provide?

Each person must be bonded in an amount equal to at least 10% of the amount of plan assets he or she "handled" in the preceding year. The bond amount cannot be less than $1,000, and the Department of Labor cannot require a person to be bonded for more than $500,000 per plan ($1,000,000 for plans that hold employer securities). The following example, provided by the Department of Labor, illustrates these requirements:

Assume your company's plan holds assets totaling $1,000,000. The plan trustee, the company officer who serves as the named plan fiduciary, and the plan's administrator are three different company employees who each have access to the full $1 million, and each has the power to transfer plan funds, approve distributions, and sign checks. Under ERISA, each person must be bonded for at least 10% of the $1 million or $100,000.

Bonds covering more than one plan may be required to be over $500,000 if the persons covered by the bond handle funds or other property for more than one plan.

What Is the Penalty for Noncompliance?

If your plan has only fiduciary insurance, technically the plan is out of compliance with the fidelity bond requirement. On the annual Form 5500 report, there is a checkbox that asks if the plan is bonded. If the plan does not have a fidelity bond, this box should be checked "No." If it is mistakenly checked "Yes," the maximum civil penalty in 2018 for a plan administrator who fails to file an accurate Form 5500 report is up to $2,140 a day. For plans having 100 or more participants, this type of mistake is often caught by the plan's auditor, who will ask to see proof of the plan's fidelity bond as part of the routine annual audit. Much of the confusion regarding fidelity bonding and fiduciary insurance lies with plans that have fewer than 100 participants because these plans are not reviewed by outside auditors for compliance with the fidelity bond requirement.

The responsibility for ensuring that the plan has proper fidelity bond coverage does not just fall on the plan administrator. All persons who handle plan assets are responsible for complying with the fidelity bonding requirement. In addition, any person who has authority to authorize other persons to perform "handling" functions also is responsible for ensuring that those persons are properly bonded. For example, if a fiduciary hires a trustee for a plan, the fiduciary must ensure that the trustee is properly bonded or covered by an exemption. If a service provider is required to be bonded, typically the service provider purchases its own separate fidelity bond and names the plan as the insured on the bond. Plan fiduciaries can add a service provider to the plan's existing fidelity bond. When selecting a third party service provider, fidelity bond coverage is one of the key questions to address as part of an engagement agreement.