ERISA Fidelity Bond and Fiduciary Liability Insurance

What's Required and what's Prudent?

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If you are a fiduciary with respect to your company retirement plan, you are personally liable for any losses incurred by the plan due to a fiduciary breach. Consider the dollar value of assets in your plan and the degree of your personal liability. How do you protect yourself, as well as the plan participants, from losses due to fraud or dishonesty?

ERISA requires plans to have a fidelity bond covering "every person who handles funds or other property of such plan." The purpose of ERISA's bonding requirement is to protect the plan against loss due to fraud or dishonesty by plan fiduciaries and others who handle plan funds, whether directly or through cooperation with others. A plan fiduciary or other person is considered to "handle" plan funds if the person has physical contact with cash, checks, or other similar property, is able to secure physical possession of plan funds, or has the potential ability to transfer plan funds to themselves or third parties. The fidelity bond needs to cover all fiduciaries and anyone who has actual authority over plan assets. The responsibility for calculating contributions or working on the payroll does not rise to the level of "handling" plan assets unless the person has the authority to cut the check and remit it to the trust.

The amount of the bond coverage is determined by plan assets at the beginning of the year. The plan is required to have a bond for at least 10% of the amount of plan assets, but generally no less than $1,000 and no more than $500,000 (unless the plan holds company stock). If your plan is under the $500,000 maximum, be sure to review your plan's coverage on an annual basis to determine if it meets ERISA coverage requirements.

The bond must be obtained from an approved corporate surety company. The bond cannot be obtained from a surety company in which the plan (or a party-in-interest to the plan) has any direct or indirect control or significant financial interest.

So what does your ERISA bond buy you? If you are at the maximum coverage, it provides insurance against $500,000 of losses caused by one of the covered persons due to fraud or dishonesty. But what if your loss or embezzlement exceeds $500,000? If you are a fiduciary, you may be personally liable for all or part of that loss to plan participants.

This is where fiduciary liability insurance can come into play. Where the ERISA fidelity bond protects the plan against certain losses, fiduciary liability insurance protects plan fiduciaries from losses incurred in their role as fiduciary, but generally NOT from losses caused by fraud or dishonesty. The purpose of the fiduciary liability coverage is to cover "innocent" fiduciaries that still may be liable to participants for plan losses.

Several companies offer fiduciary liability insurance designed to cover claims for breaches of fiduciary duty. The coverage provided by these policies, as well as other policy features, can vary widely. The employee or fiduciary usually purchases the insurance, or has the sponsoring employer pay for the coverage, to avoid any suggestion of a prohibited transaction (the plan paying to protect its own fiduciaries).

Other items to consider when looking at fiduciary liability coverage are: annual premium cost, amount of coverage necessary, the amount of the deductible and when it is charged (at the time of claim or at the time of settlement), and whether attorneys fees and costs of defending a claim are covered.

In closing, ERISA fidelity bond coverage is required to protect the plan. But you may want to also consider some form of fiduciary liability insurance to protect your key executives who are acting is some fiduciary capacity with respect to the plan.