ERISA FIDELITY BONDS:

Myth Busting Five Common Misconceptions

In the complex world of employee benefit plans, fidelity bonds serve as a crucial safeguard against losses caused by financial malfeasance. Given the costs and vagaries of litigation, plan sponsors and participants may have no recourse when plan assets are stolen except for fidelity bonds that cover first dollar losses with no deductible. In fact, the Employee Retirement Income Security Act (ERISA) requires most retirement plans to have such coverage regardless of the number of participants or the value of plan assets.

However, misconceptions and confusion surrounding these bonds can often lead to compliance pitfalls for plan sponsors. **This article aims to provide clarity by "busting" common myths and misunderstandings about ERISA fidelity bonds and leading sponsors on a path to compliance**.

Fidelity Bond Facts

Gaining a basic understanding of fidelity bonds can aid in uncovering the truth about them:

GENERAL

- Bonds are mandatory for most retirement plans, with exceptions for unfunded plans and those not subject to ERISA Title I, such as some government and church plans.
- Form 5500, which is signed under penalty of perjury, asks whether the plan has a fidelity bond.
- Bonds may be standalone or included in an insurance policy.
- Plan sponsors must obtain bonds from a company approved by the **Department of the Treasury's Listing of Approved Sureties**. The company name does not need to include the word "fidelity."

BOND AMOUNTS

- As mandated by ERISA, generally, fidelity bonds must cover 10% of fund assets (determined as of the last day of the prior year) up to a certain dollar amount limit.
- The minimum required amount is $1,000. The maximum required for most plans is $500,000, but the maximum required for plans that include employer securities (e.g., ESOPs and KSOPs) is $1,000,000.

COVERAGE

- Fidelity bonds must cover anyone who handles the funds or property of an employee benefit plan, including but not limited to fiduciaries and some third-party service providers.
- The bond must cover the handling of all plan assets, regardless of type or location.
- ERISA fidelity bonds must provide first dollar coverage with no deductible to the plan.

Armed with this basic knowledge, common myths can be tackled.

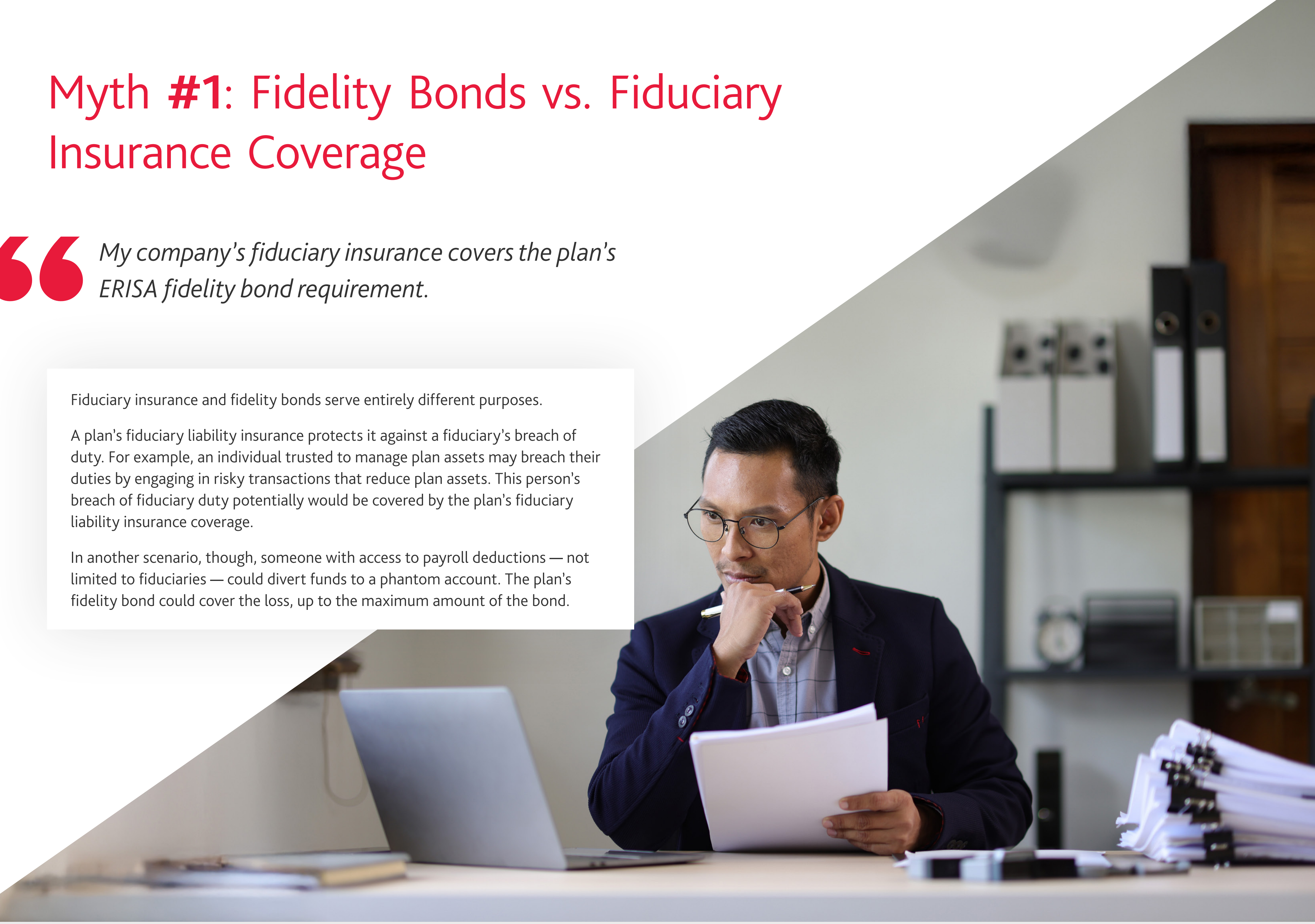
Myth **#1**: Fidelity Bonds vs. Fiduciary Insurance Coverage

> *My company's fiduciary insurance covers the plan's ERISA fidelity bond requirement.*

Fiduciary insurance and fidelity bonds serve entirely different purposes.

A plan's fiduciary liability insurance protects it against a fiduciary's breach of duty. For example, an individual trusted to manage plan assets may breach their duties by engaging in risky transactions that reduce plan assets. This person's breach of fiduciary duty potentially would be covered by the plan's fiduciary liability insurance coverage.

In another scenario, though, someone with access to payroll deductions — not limited to fiduciaries — could divert funds to a phantom account. The plan's fidelity bond could cover the loss, up to the maximum amount of the bond.



Myth **#2**: Obtaining Retroactive Coverage

Retroactive fidelity bonds are easy to get.

Plan audits often reveal that a plan has been operating without a fidelity bond. In such cases, the Department of Labor (DOL) will require the plan sponsor to obtain coverage and may ask that the coverage should be obtained for all years where a bond was not in place. However, retroactive fidelity bonds may be unavailable because insurers are typically prohibited by state law from issuing retroactive coverage. Instead, a plan sponsor can work with the DOL to document its attempts to comply with the fidelity bonding requirement and can maintain proper coverage going forward.

Myth **#3**: Fidelity Bond vs. Plan Audit Requirement

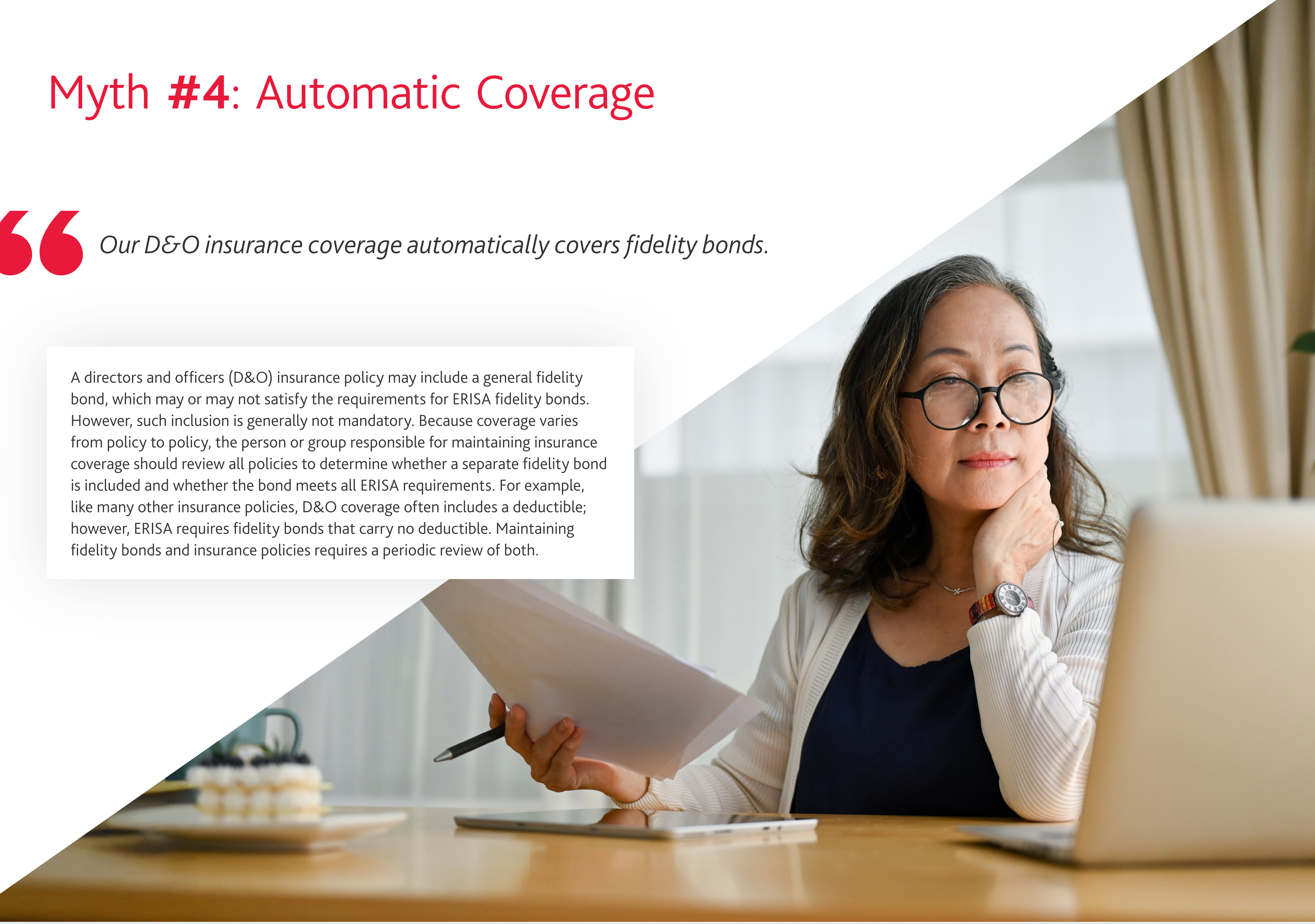
We don't need a fidelity bond because our plan doesn't meet plan audit requirements.

This myth is fairly easy to debunk. It's true that ERISA does contain provisions about both fidelity bonds and plan audit requirements; the size of the company matters with plan audits but not with fidelity bonds. ERISA specifically requires fidelity bonds for most plans, regardless of the number of employees or the size of the plan. The plan audit requirements typically apply to plans with 100 or more participants. A plan can be exempt from the audit requirements yet still be required to have a fidelity bond.

Myth **#4**: Automatic Coverage

> *Our D&O insurance coverage automatically covers fidelity bonds.*

A directors and officers (D&O) insurance policy may include a general fidelity bond, which may or may not satisfy the requirements for ERISA fidelity bonds. However, such inclusion is generally not mandatory. Because coverage varies from policy to policy, the person or group responsible for maintaining insurance coverage should review all policies to determine whether a separate fidelity bond is included and whether the bond meets all ERISA requirements. For example, like many other insurance policies, D&O coverage often includes a deductible; however, ERISA requires fidelity bonds that carry no deductible. Maintaining fidelity bonds and insurance policies requires a periodic review of both.

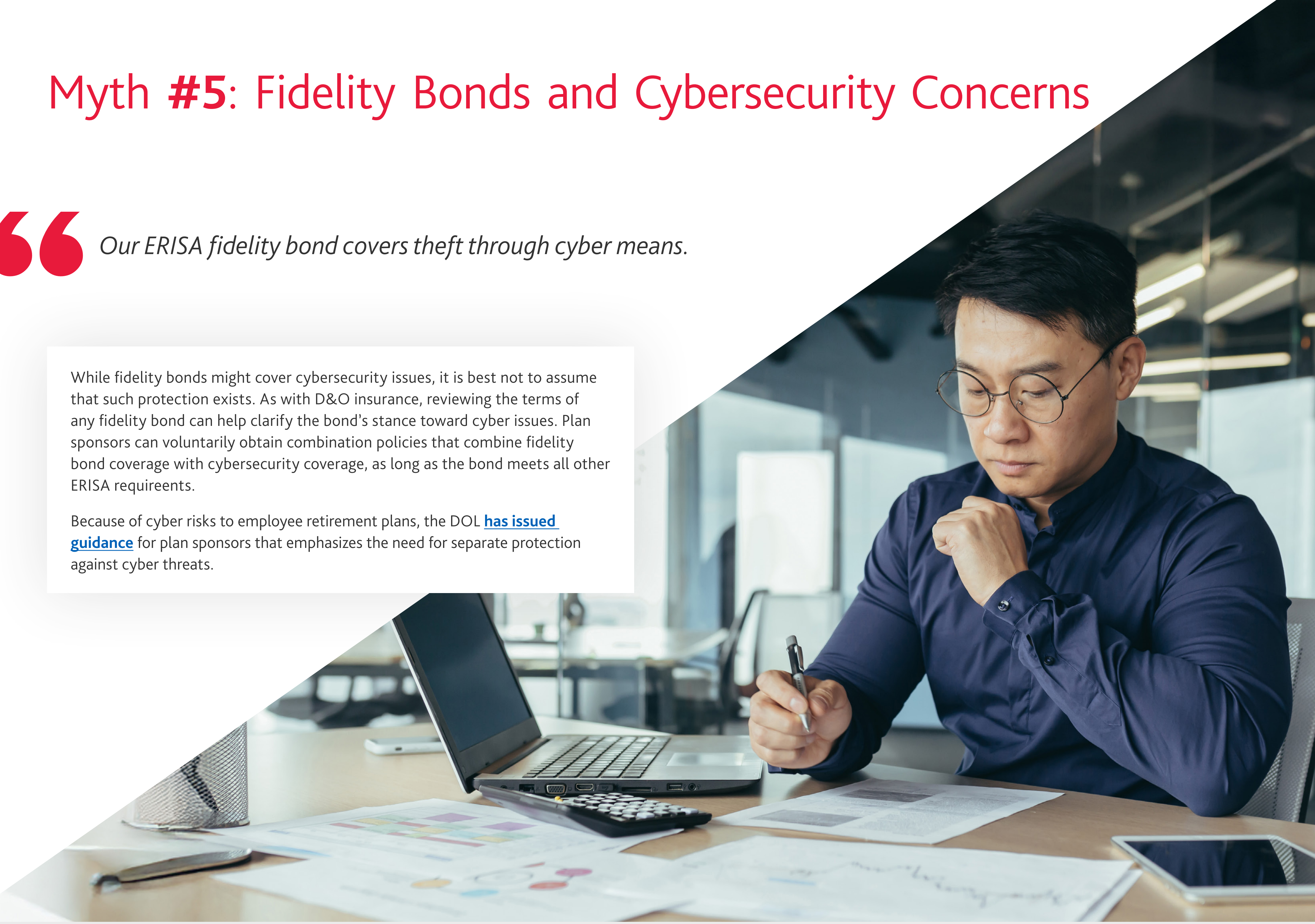


Myth **#5**: Fidelity Bonds and Cybersecurity Concerns

Our ERISA fidelity bond covers theft through cyber means.

While fidelity bonds might cover cybersecurity issues, it is best not to assume that such protection exists. As with D&O insurance, reviewing the terms of any fidelity bond can help clarify the bond's stance toward cyber issues. Plan sponsors can voluntarily obtain combination policies that combine fidelity bond coverage with cybersecurity coverage, as long as the bond meets all other ERISA requireents.

Because of cyber risks to employee retirement plans, the DOL **has issued guidance** for plan sponsors that emphasizes the need for separate protection against cyber threats.



DOES YOUR PLAN FULLY COMPLY WITH ERISA AND OTHER LAWS?

How well is your employee retirement plan protected from theft and fraud? Before falling victim to any myths mentioned in this article, consider asking our **Employee Benefit Plan Audit** team to review your plan.