

Department of Labor Issues Guidance on ERISA Bonding Requirements

by Bradley A. Benedict*

On November 25, 2008, the U.S. Department of Labor (DOL) furnished new guidance concerning the bonding requirements that protect employee benefit plan assets from losses caused by the fraud or dishonesty of “plan officials.” Field Assistance Bulletin 2008-04 provides a set of 42 questions and answers that addresses numerous aspects of the rules under ERISA Section 412, as amended by the Pension Protection Act of 2006, and its associated regulations. Topics include who must be bonded and who is exempt, the amount and type of coverage required, and who is responsible for compliance.

Background

ERISA Section 412 imposes a bonding requirement for any person who handles plan funds or other property in order to carry out administrative functions on behalf of the plan (termed “plan officials”). Whether a person “handles” plan funds depends on his or her access to, or decision-making authority over, the assets so as to make them susceptible to the risk of loss from wrongdoing. Thus, plan officials would include some but not necessarily all plan fiduciaries and would apply to certain nonfiduciaries as well if they receive, handle, disburse or otherwise exercise custody or control over plan assets. For example, plan committees that either have the authority to direct a corporate trustee to pay benefits to plan participants or make investment decisions for the plan are considered to be “handling” plan assets.

The bond must protect the plan against losses caused by “fraud or dishonesty” by the plan officials, which would include, for example, the larceny, theft, embezzlement, forgery, or misappropriation of plan funds. These so-called “fidelity bonds” are distinct from fiduciary liability insurance, which is not required by ERISA and generally covers losses arising from breaches of fiduciary duties.

Ensuring that each non-exempt plan official is appropriately bonded is a fiduciary duty that falls upon the plan fiduciary who has authority and control over plan funds (or the power to delegate such authority and control). Although it is not necessary that the plan pay for the bond, if it does so, the bond may be paid out of plan assets.

Exemptions

There are three statutory exemptions to the bonding requirements:

- Plans that are entirely unfunded or that are not subject to Title I of ERISA are exempt.
- Plan fiduciaries that are banks or insurance companies subject to state or federal supervision or examination, and that meet certain capitalization requirements, are exempt.
- Broker/dealers registered under Section 15(b) of the Securities Exchange Act of 1934 that are subject to the fidelity bonding requirements of a self-regulatory organization under that Act are exempt.

Each of the above exemptions also applies to individuals working for the exempted entities.

The regulations under Section 412 provide three more exemptions:

- Banking institutions and trust companies (whether or not they are plan fiduciaries) that are subject to regulation and examination by the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, or the Federal Deposit Insurance Corporation are exempt.
- Insurance carriers (whether or not plan fiduciaries) that provide welfare or pension benefits in accordance with state law with respect to benefit plans maintained for the benefit of persons other than the organization's own employees are exempt.
- Certain savings and loan associations that are administrators of plans on behalf of their own employees are exempt.

Requirements

Amount of Bond. Generally, for each plan under which handling functions are performed, a plan official must be bonded in an amount equal to at least 10% of the amount of that plan's funds which he or she handled in the preceding plan year. However, the amount may not be less than \$1,000 and need not exceed \$500,000 (or \$1,000,000 for plans that hold a substantial amount of employer securities). The Secretary of Labor may require a larger bond than these ceilings pursuant to a hearing, but not in excess of the general rule of 10% of funds handled.

Approved Surety. Compliance with Section 412 requires that plan officials are bonded by one of the companies on the Department of the Treasury's Listing of Approved Sureties (available at fms.treas.gov/c570/c570html) or, in certain circumstances, with the Underwriters at Lloyds of London.

Prohibited Sureties and Agents. No plan or party-in-interest may have any control or significant financial interest in the surety or reinsurer, or in an agent or broker who arranges for the bond.

Required Bond Features. The plan must be the named insured or otherwise identified on the bond to enable the plan representatives to make a claim in the event of a covered loss. Deductibles are not allowed, at least up to the amount of the mandated coverage. Also, the bond must provide for a one-year discovery period upon termination in which the plan may assert a claim for events occurring during the term of the bond.

Other than the requirements listed above, however, the DOL allows for great flexibility in the arrangements and types of bonds it permits. A plan may be covered under a single bond or multiple ones and one bond may cover multiple plans. Examples of permissible bond forms includes individual, name schedule, position schedule, and blanket bonds. Even a blanket bond that provides for an “aggregate penalty” applied “per occurrence” satisfies the requirements of Section 412 as long as each plan official is covered up to the applicable amount. For example, if two investment managers handled all the assets of a plan in the preceding year, a blanket bond covering both plan officials could cover 10% of that amount and still be in compliance even though the plan might lose a greater amount due to the fiduciaries’ collaborative wrongful act.

Compliance

The DOL’s new Bulletin clarifies the statutory and regulatory provisions covered here, among others, providing a useful guide for assessing the bonding status of ERISA plans.

Plan fiduciaries with oversight responsibilities for plan assets should review their current bonding arrangements annually to ensure that they remain in compliance with the statute and regulations.

The full text of new DOL release can be found at the link below.

Live Links

U.S. Department of Labor, Guidance Regarding ERISA Fidelity Bonding Requirements, Field Assistance Bulletin No. 2008-04; November 25, 2008

Department of the Treasury’s Listing of Approved Sureties (Department Circular 570), Financial Management Service; July 1, 2008

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