

ASSOCIATION OF LLOYD'S BROKERS

Crime Insurance and Economic Espionage Seminar



**Presented by Lee Brodsky
February 21, 2012**

Property Values in 2012 are down to 2003 Levels



Who's Here?

How many people here today are either Fidelity Bond Underwriters or Fidelity Bond Insurance Brokers?

What is a Fidelity Bond?



- A first party policy which indemnifies the named insured (not a liability cover) but only for dishonest or fraudulent acts ‘as defined’
- Covers dishonest or fraudulent acts committed by an employee acting alone or in collusion with others with the manifest intent to cause a loss and to obtain an improper personal financial gain by the employee.
 - Dishonest acts do not include employee benefits earned in the normal course of employment such as salary, commissions, fees, bonuses, etc.
- A Discovery Policy (with or without a retro date) – so it only covers loss discovered during the policy period or Ext. Reporting Period.

Basic FI Bond Insuring Clauses

- A. **Fidelity** (Employee Dishonesty)
- B. **On Premises** – robbery, burglary, mysterious unexplainable disappearance
- C. **In Transit** – robbery, larceny, theft while property is in transit in the custody of a messenger
- D. **Forgery or Alteration** – covers forgery or alteration of any negotiable instrument as specified
- E. **Securities Forgery** – loss from insured having acquired, sold, delivered, extended credit on faith of any original written document such as a document of title, deed, mortgage, evidence of debt
- F. **Counterfeit Money** – receipt by Insured of any counterfeit money – U.S. or any other country

Optional FI Bond Insuring Clauses

- **Claims & Audit Expense** – reasonable expenses by insured in preparing any covered claim for loss under the fidelity clause
- **Servicing Contractors** – dishonest or fraudulent act committed by a Servicing Contractor (collect mortgage payments, establish tax & insurance escrows, manage real estate)
- **Safe Deposit Box** – covers both the bank's legal liability and loss of customers' property

Optional FI Bond Insuring Clauses

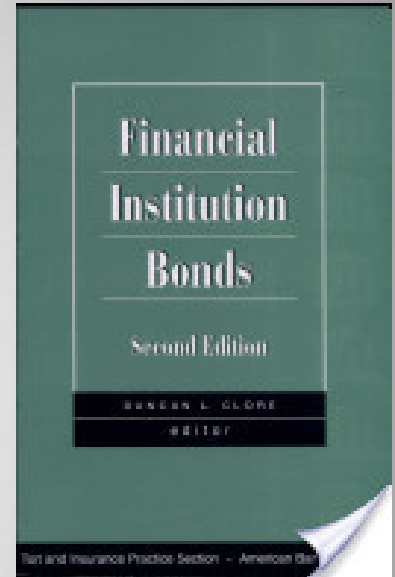
- **Real Property Mortgages** – real signature but defective by being obtained through trick, artifice or fraud



- **Stop Payment Liability** – liability for failure to comply with customer notice for stop payment on a check/draft
- **Computer Systems Fraud** – fraudulent entry of electronic data or computer program into computer which creates unauthorized electric data

Types of Financial Institution Bonds

- **Form #14** - for Stockbrokers, Stock Exchanges, Investment Bankers, Commodity Brokers
- **Form #15** – for Finance Companies, Small Loan Companies, Mortgage Bankers, Title Insurance Companies principally engaged in the mortgage business
- **Form #23** – for Credit Unions, Mutual Benefit Associations



Types of Financial Institution Bonds

- **Form #24** – Commercial Banks & Trust Companies, Title Insurance Companies, Federal Reserve Banks, Federal Home Loan Banks, Savings Banks and Savings & Loan Associations
- **Form #25** – Insurance and Reinsurance Companies
- **Form #28** – Excess Bank Employee Dishonesty Bond for Commercial Banks

Financial Institution Insurance Market

The Surety & Fidelity Association of America

Premium and Loss Experience Summary for Financial Institution Blanket Bonds

Year	Direct Earned Premium	Direct Losses Incurred	Loss Ratio
2008	\$302 M	\$128 M	42.50%
2009	\$319 M	\$202 M	63.30%
2010	\$319 M	\$221 M	69.40%

What To Do When Suspicions Arise

- First, locate and read policy to see when 'Discovery' occurs
- Next, check notification requirement
- Then, review proof of loss requirement



Bank Officer Sentenced for Embezzlement

- “Lisa C,” former Vice President of a bank in Central USA
- Used falsified checks and electronic transfers on about 180 different occasions to steal over \$500,000 from customer accounts
- Illegally transferred money to her personal accounts and entered a plea deal on Wednesday, December 7, 2011 to serve 2 years in prison and pay \$518,535 in restitution



Former Bank Teller Confesses to Embezzlement Charges

- Bank officials in a Midwest Community Bank uncovered a loss of \$182,000 after an audit was done in 2010
- Former head teller was sentenced to 30 days in jail, 5 years probation, and to repay \$50,000 in restitution after pleading guilty to a reduced charge of Embezzlement
- Insurance covered the loss, but bank officials are unsatisfied with the punishment and say he/she broke the trust and confidence of the bank's customers

Corporate Bank Accountant Accused of Embezzling \$19.2 Million

- “Gary F” could face up to 30 years in jail
- Accused of moving money from the Corporate Bank’s interest expense account and debt adjustment account into the bank’s main cash account
- He then moved the money to personal bank Accounts
- He allegedly covered his trail by placing false contract and deal numbers on the reference line of wire transfers



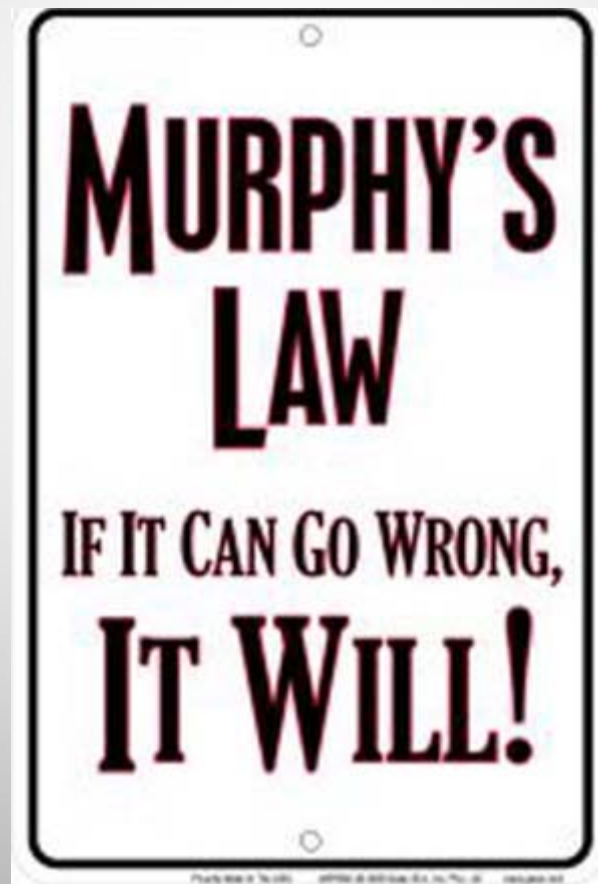
Man Charged with Embezzling from Escrow Bank Accounts

- “Elvis P,” of “Some” Title and Trust Company, was charged with embezzling \$50,000 from an escrow account
- He authorized a wire transfer from a construction company’s escrow account to an unknown third party bank account, which he held
- Also accused with transferring \$1.5 million in cashier’s checks and cash from the escrow account to personal accounts
- He was ordered to be held without bond and is possibly facing 30 years incarceration

A Thought to Leave You With...

Remember Murphy's First Law of Insurance

“What the large print gives, the small print takes away”!



Commercial Crime Insurance

Richard Nowell

Stateside Underwriting Agency

That's a Fact Jack

- The Association of Certified Fraud Examiners has found that:
- Fraud and abuse costs U.S. businesses more than \$400 billion annually
- Fraud and abuse costs employers an average of \$9 a day per employee
- The average organization loses 6% of its total annual revenue to fraud and abuse committed by its own employees

Commercial Claim Examples

- Fictional entities with funds transferred out to overseas entity (about \$2 million)
- Kickback scheme with over-billing for “office needs” by company manager (\$10 million claimed)
- Stealing inventory and reselling for profit
- Goods held in warehouse transferred or sold to another innocent party who did not know property belonged to the insured

Why is Commercial Crime Different from Bank/FI related Crime Coverage

- While similar Insuring Agreements, each have different wordings
- Different types of insureds that are non-FI related (note - not always easy to discern)
- Different Risk Characteristics of commercial risks
- Can sometimes be offered in a limited fashion as part of a BOP or GL package policy

Difference in Wording of Crime Bonds

- No manifest intent doctrine (intent to cause a loss and in fact benefited from the loss)
- Theft wording included which can be broader than simply an act of dishonesty
- Can include some limited credit card coverage
- Premise wording is slightly broader - covers money and securities from exposures such as theft, disappearance, burglary, robbery

Types of Commercial Insureds

- Manufacturers
- Retailers
- Government Entities
- Auto Dealerships
- Certain Service Businesses
- Non Profit Entities
- Restaurants
- Many Others

Different Risk Characteristics for Commercial Crime Insureds

- Some have true cash currency exposure
- More than funds exposed to criminal activity
- Inventory at risk or warehouse exposure
- High exposure to computer driven exposures
- Less focus on internal controls in some firms
- Small mom and pop type operations
- Theft exposure (equipment)

Crime as Part of Package Policy

- Not recommended, low sub limits and very little coverage
- No room to negotiate or add necessary endorsement
- GL or BOP limits can be used up, which dilutes crime limit
- Highly recommend separate crime bond, which can then be tailored for your client

Insuring Agreements

- Dishonesty
- On Premise
- Off Premise (transit)
- Forgery (outgoing checks)
- Note - similar to FI Bond insuring agreements, but key to Crime Bond is the add-on riders that can be utilized where necessary
- Counterfeit Currency

Add-On Endorsements to Enhance Coverage

- Extortion (note similar to Kidnap & Ransom coverage but not as broad)
- Warehouse Receipts
- Agents Extension
- ERISA Plans covered
- Credit Card
- Computer Crime
- Wire Transfer Fraud

Special Comments on Endorsements

- Warehouse receipts are representation of ownership for commodities or other goods held in a third party warehouse
- These receipts can be negotiable or non-negotiable (goods sold to others and remain in warehouse, such as gold or other commodities)
- Key question for an applicant for crime coverage is whether they store goods in outside warehouse

Agents Extension Endorsement

- Need to understand whether applicant has agent exposure (third party non employee status)
- Need to examine **closely** whether the applicant wants to provide insurance for the agents that may dilute the applicant's limit
- Consider higher limits if obtain agents coverage

Other Coverage Considerations

- Retro-date
- Definition of “Employee”
- Termination of coverage for employee once discovered such employee committed employee dishonesty
- Recommending loss prevention - which a good underwriter can help with, and there may be as much value in that as the policy itself