Why Buy Crime/Fidelity Insurance?

The BusinessWeek Corporate Executive Board (CEB) recently published a chilling report describing how (and why) the global economic downturn has led to an increase in employee fraud and misconduct.[1] According to the CEB, employees are becoming more cynical about their employer's ethics, and this cynicism provokes disrespect for the employer and its rules. The result is increasing employee fraud and misconduct.

A survey conducted by the CEB highlights some disturbing trends:

- Observations of employee misconduct are up 20% in the second half of 2008 (compared to the first half of the year)
- Frontline employees' perceptions of the integrity of senior management is down 5%
- A doubling of the proportion of "disengaged employees", now 20% of the workforce – a 5% drop in organizational productivity is attributed to this group

These trends portend an increase in occupational fraud, which was already a significant problem for organizations, with a massive impact on businesses and agencies in all sectors of the economy. The Association of Certified Fraud Examiners reports: [2]

- U.S. organizations lose about 7% of annual revenues to fraud
- The median occupational fraud loss is $175,000, and more than 1 in 4 frauds involves losses of $1 million or more
- Small businesses (fewer than 100 employees) are especially vulnerable to occupational fraud, suffering median losses of $200,000
- Occupational fraud schemes frequently continue for years before they are detected

Chubb reports eight of ten crimes against businesses are carried out by employees.[3] According to the U.S. Chamber of Commerce, as many as 30% of small business failures are due to employee dishonesty.[4] The U.S. Chamber of Commerce report also points out small businesses are 35 times more likely than larger companies to become victims of crime. In an interview published by the American Management Association, Marvin A. Davis, CTP, estimates fraud plays a major role in fully 50% of business failures.[5]

Incredibly, fewer than 1 in 3 private companies purchase Crime insurance.[6]

These facts and trends underscore the need to review your Crime/Fidelity insurance program to ensure it offers coverage and limits adequate to respond to this growing threat.

Crime/Fidelity coverage can be written to cover not only theft by employees of money, securities and other property, but also actions by third parties, such as:

- Foregery and alteration
- Robbery and safe burglary
- Computer fraud and funds transfer fraud
- Theft of money and securities inside the premises
- Money orders and counterfeit money

Many Package and Property policies provide some coverage for crime. However, it is important to note the "basic" and "broad" Insurance Services Office (ISO) Property forms provide no coverage for theft. (ISO researches, writes, files, and distributes standard policy forms for use by the insurance industry.) Theft is a covered peril in the ISO "special" form. However, loss is limited to theft of only a portion of tangible property, such as office equipment. And Property insurance does not cover mysterious disappearance. The policy will respond only if there are obvious signs of a break-in. In addition, Property insurance provides no coverage for theft of money and securities.

1 http://www.businessweek.com/managing/content/jun2009/ca20090612_156983.htm

2 *2008 Report to the Nation on Occupational Fraud & Abuse*, Association of Certified Fraud Examiners

3 http://www.chubb.com/businesses/csi/chubb795.html

4 *The Impact of Crime on Business: A Model for Prevention, Detection & Remedy*, Martin S. Bressler, Journal of Management and Marketing Research, Volume Two - May, 2009, page 5 (http://www.aabri.com/manuscripts/09202.pdf)

5 *Common Lies Companies Tell Themselves*, Marvin A. Davis, CTP, Leader's Edge Newsletter, October 2008, Volume 3, Number 10

6 *Are private companies walking a high wire of risk? Highlights from the Chubb 2007 Private Company Survey*, Chubb Group of Insurance Companies

A common weakness in Crime/Fidelity coverage is inadequate limits. The Crime (sub)limit under a Package or Property policy may be as low as $10,000, less than 6 percent of the median occupational fraud loss. A standalone Crime/Fidelity policy offers more customized coverage with higher limits. Large firms that employ professional risk managers are more highly attuned to their exposures, and tend to purchase broader Crime/Fidelity coverage with higher limits. Mid-sized and smaller firms are more likely to be underinsured.

It is also important to note the Employee Retirement Income Security Act of 1974 (ERISA) requires any person, not just an employee, who handles funds of an ERISA plan to be bonded. The ERISA Bond requirement is a limit of 10 percent of the funds handled, subject to a minimum limit of $1,000 and a maximum limit of $500,000. ERISA requires a limit of $1 million per plan if the plan holds employer securities other than through a pooled investment vehicle. To cover an employee benefit plan under a Crime/Fidelity policy, the plan must be listed as a named insured.

(N.B. Rules regarding ERISA Bonds recently changed. Please refer to the section related to ERISA Bonds in Field Assistance Bulletin 2008-4 (http://www.dol.gov/ebsa/regs/fab2008-4.html). The Bulletin provides a Q&A format to help employers understand the new requirements.)

Crime/Fidelity insurance is relatively inexpensive and widely available. Given the potentially devastating impact of an uninsured theft loss, adequate Crime coverage is a necessity, and a thorough understanding of employee and non-employee theft exposures is essential to help an organization identify appropriate coverages and limits. Kibble & Prentice can also be a risk management resource, helping design non-insurance solutions to minimize exposures.

Claim Examples

- An officer and several shipping managers for a cutlery manufacturer colluded to load trucks with merchandise for sale at flea markets and small retail shops, pocketing the proceeds.
  Loss: $1,100,000
- A job foreman used a company credit card to purchase fixtures for his personal residence.
  Loss: $47,000
- A regional sales director took on additional inventory of software for alleged seasonal sales pushes, but actually sold some of the inventory "out the back door". This 17-year employee had been named "Employee of the Year" several times.
  Loss: $345,000
- A payroll clerk at a remote office of an auto parts manufacturer had access to payroll and vacation checks. For eight years, the clerk issued duplicate vacation checks when employees requested legitimate vacation pay. The clerk converted the proceeds from the duplicate checks to her own use.
  Loss: $1,900,000
- Over a four year period, an executive secretary at an engineering firm submitted duplicate expense account requests for executives' credit card bills, and converted the duplicate payments to her own use.
  Loss: $260,000
- Four employees, working in collusion, defrauded their employer through a phony billing scheme. The employees, including a supervisor, established fictitious vendors and submitted bills for work performed by other genuine vendors.
  Loss: $167,000

Source: Travelers[7]

[7] http://www.travelers.com/iwcm/Business/BondFP/managementLiability/wrapNP/Documents/BO-192FD.pdf

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