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Making Sure Your Retirement Plan Has a Fidelity Bond

Why should a retirement plan sponsor follow a rule to purchase a fidelity bond when failing to follow the rule has no legal consequence?

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All qualified retirement plans are subject to Title I of the Employee Retirement Income Security Act [ERISA] of 1974, as amended. ERISA plans (plus some other employee benefit programs subject to ERISA) must purchase a fidelity bond to protect its assets from losses resulting from fraud or dishonesty.[1]

A fidelity bond is an indemnity agreement protecting a retirement plan from loss in the event that its fiduciaries cause financial damages through dishonesty.

While the plan purchases the bond, the coverage is actually extended to plan fiduciaries and anyone else who handles funds or other properties. According to the Department of Labor (DOL) in Field Assistance Bulletin (FAB) 2008-04, this "will usually include the plan administrator and those officers and employees of the plan who handle funds by virtue of their duties relating to the receipt, safekeeping and disbursement of funds."[2]

The amount of the fidelity bond must equal 10% of the plan's funds handled by the bonded individual, with the minimum bond equaling $1,000 and the maximum bond totaling $500,000[3] ($1,000,000 if the plan holds employer securities). Note that we used the phrase "bonded individual" to indicate that the coverage must be assigned per person and not as a single flat dollar amount.[4]

What constitutes handling plan funds? The FAB describes plan funds as "physical contact; power to transfer funds or other property from the plan to oneself or to a third party, or to negotiate such property for value; disbursement authority…; authority to sign check…or supervisory or other decision-making responsibility over activities…"[5]

DOES INACTION HAVE CONSEQUENCE?

Question and Answer 6 of the FAB refers to Section 412(b) of ERISA and makes it clear that it is "unlawful for any plan official to permit any other plan official to receive, handle, disperse, or otherwise exercise custody or control over plan funds or other property without first being properly bonded…"

Unlawful, yes, but what is the penalty? We could not find any specific monetary or other penalty in ERISA or within the 42 questions and answers presented in the FAB. So should a sponsor ignore the bonding requirement because there is no stick? Hardly.

ERISA outlines a series of fiduciary duties in Section 404(a)(1), which says in part:

> "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and
> (A) for the exclusive purpose of:
> (i) providing benefits to participants and their beneficiaries; and
> (ii) defraying reasonable expenses of administering the plan;
> (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."

Does a fiduciary act solely in the interests of participants and beneficiaries when said fiduciary ignores the bonding requirement and a theft of plan assets occurs? Who would then indemnify the plan? It stands to reason that if one breaches his or her fiduciary duties, with no other recourse available, the individual would be personally responsible.

NOT FDIC INSURED—NO BANK GUARANTEE—MAY LOSE VALUE

In addition, on the IRS's Website, the agency lists the top 10 compliance defects found on an audit. The number-two defect is an "inadequate or no fidelity bond."[6] If a qualified retirement plan is undergoing an IRS examination, most sponsors, it would seem to us, would not want to showcase any potential defects, especially the most common one. If you are lax in one area, is it likely you'll be found lax in another? Maybe not. But why would a sponsor want to place him- or herself in that peril?

Administratively, small plans—that is, those with fewer than 100 employees—are generally not subject to having an annual plan audit (expensive) being a part of the annual filing (Form 5500) unless more than 5% of a plan's assets are invested in "nonqualifying assets." Examples of nonqualifying plan assets could be limited partnerships or artwork. Purchasing a fidelity bond to cover the value of these nonqualifying plan assets will generally return the small plan to its desired status of not having to have an annual audit completed.

A SIMPLE SOLUTION

The purchase of a fidelity bond by a plan sponsor is not an expensive item (plus the plan can pay the expense). Premiums generally run a few hundred dollars for its three-year term. It seems a small price to pay when you consider what you could lose or what you could spend. ■

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[1] Department of Labor Regulation 2580.412-11.

[2] Department of Labor Field Assistance Bulletin No. 2008-04, Question and Answer 5, November 25, 2008.

[3] Department of Labor Regulation 2580.412-11.

[4] Department of Labor Regulation 2580.412-6.

[5] Department of Labor Field Assistance Bulletin No. 2008-04, Question and Answer 18, November 25, 2008.

[6] EP Examination Process Guide–Section 2–Compliance Monitoring Procedures, June 11, 2009.

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