CHAPTER 8. EMPLOYEE DISHONESTY INSURANCE EXPLANATION AND REQUIREMENTS

8-1. EMPLOYEE DISHONESTY.

a. Employee dishonesty (sometimes referred to as Fidelity Bonds) should be written on a standard form approved by the Surety Association of America.

b. Fidelity, or "employee dishonesty" bonds are used to guarantee that an obligation of trust will be discharged faithfully. Examples are public official bonds and other various forms of protection for an employer against loss through dishonest acts of employees.

8-2. SURETY BONDS.

In surety bonds, the principal furnishes and pays for the bond. For example, a building contractor is obliged to furnish a completion bond to protect the HA for whom he/she is doing the construction. In fidelity bonds, the employer arranges for and pays the premium on the bond. The employees who really are the principals of the bond may have no knowledge that a bond is in effect. This is one of the key distinctions between fidelity and surety bonds.

If the principal does not fulfill the obligation, the surety or insurance company is obligated to indemnify the obligee for the actual loss or damage which directly results from the default. The maximum recovery, of course, may not exceed the bond limit.

The defaulting principal, however, becomes legally obligated to reimburse the surety or insurance company for any loss paid. This is why it is said that, in theory, underwriters do not expect any losses under a surety bond. No company would knowingly bond a principal likely to have a loss. If the company must perform the undertaking in place of the principal, the company is subrogated to the rights of the obligee against the principal with every right to enforce such rights either in the name of the obligee or of the surety itself.

8-3. BASIC COVERAGE FOR EMPLOYEE DISHONESTY.

The basic coverage provided by employee dishonesty is to cover loss of money, securities or other property which the insured may sustain due to any fraudulent or dishonest act or acts committed by any of the principals covered under the bond. Coverage is not limited to loss of money, but includes loss of merchandise or property which a principal might steal.

8-4. DEFINITION OF EMPLOYEE.

An employee is any natural person while in the regular service of the insured in the ordinary course of the insured's business during the policy period and who the insured compensates by salary, wages or commissions and has the right to govern and direct in performance of his/her service. By definition, the term "employee" does not include HA Commissioners. It is required that they be covered by special endorsement if they have been granted check signing authority, handle cash, or certify vouchers.

8-5. COMMERCIAL BLANKET BONDS.

a. There are three ways an employee dishonesty policy can be written. The first is on a commercial blanket basis. The total amount of the bond applies to any one loss regardless of the number of employees involved in the loss, there is no specific amount that applies to any single person.

b. Notice to the insurer of changes in personnel is not required. None of the employees or positions are named and any new employees are covered automatically as soon as they enter the insured's employ. Automatic coverage will not extend to a new employee if the insured knows that the employee has been guilty of previous dishonesty. No additional premium is required as new employees are added, but on an anniversary date changes in the number of employees in each rating classification are taken into consideration in determining the premium for the following year.

8-6. BLANKET POSITION:

a. The important difference between blanket position and commercial blanket is that the amount of coverage in a blanket position applies separately to each identifiable employee.

b. To illustrate, assume a $10,000 limit on a blanket position basis and the same limit for a commercial blanket basis. If two identifiable employees together perpetrated a $20,000 loss, the blanket position policy would pay $10,000 for each employee or the full amount of the loss. On the other hand, the commercial blanket would pay a total of $10,000 since that is the limit for each loss.

c. If, in this illustration, the insured was able to prove that a fidelity loss occurred, but was unable to identify the employees involved, then the blanket position policy would pay $10,000 as if only a single employee had been involved.

8-7. INDIVIDUAL AND SCHEDULE.

a. Individual policies cover a particular named person. Schedule policies may be either named or position schedules.

b. The named schedule combines several individuals. Covered persons must be listed, including the coverage amount applying to each person. New employees may be added and former employees deleted at any time, but all covered employees must be listed. The position schedule lists the positions, specifying the amount for which each position is bonded. It is unnecessary to notify the insurance company of employee turnover. No change is necessary in the bond unless the number of workers for each position category changes. The position schedule bond may include only positions that the employer wants covered. All employees in a given position category must be covered if any in that position category is covered.

8-8. ADVANTAGES OF BLANKET OVER SCHEDULE.

a. All employees are covered under blanket forms. This eliminates "surprises" if a loss is caused by an employee not thought of as in a position to steal or of "a mind" to steal.

b. Blanket forms provide automatic coverage for new employees without notice to the company.

c. Blanket forms do not require premium adjustment during the year.

d. Recovery may be made without identification of the employee(s) causing the loss provided the insured can prove that a loss actually occurred. Under schedule forms it is necessary to identify the employee.

e. The cost of blanket forms generally is no greater than (and frequently less) the cost of adequate coverage under schedule forms.

The provisions that follow are common to all of the foregoing employee dishonesty bonds:

a. Because there are many ways in which inventory shortages may occur besides employee dishonesty, inventory shortages are not covered unless the insured can prove (apart from inventory or profit and loss computations) that the shortage was sustained through fraudulent or dishonest acts of an employee(s).

b. Many policies are continuous and do not have a specific expiration date. They remain in force from the time written until they are terminated by either party. Premiums are payable each year or every three years. At the end of each 3 year period, the policy should be rebid.

c. If the amount of loss exceeds the amount of coverage under the policy, the insured is entitled to all recoveries until fully reimbursed, less the actual cost of effecting the recovery. Any remainder is applied to the reimbursement of the insurance company.

8-9. HOUSING ASSISTANCE PAYMENT PROGRAM (HAPP) - SECTION 8.

If a HA is required to have a fidelity bond because it has entered into HAPP ACC activities, then such exposures can be included under the normal HA bond coverage.

8-10. ADDITIONAL INDEMNITY RIDER.

In those instances where higher limits of coverage are needed for specific positions, a blanket policy can be issued for a lesser amount and the required higher limits can be provided for by an endorsement. This generally is not recommended because the cost of increasing the entire blanket coverage usually is more cost effective than obtaining separate and specific excess limits.

8-11 PARTIES INSURED.

The named obligee on the bond shall be the HA and the U.S. Department of Housing and Urban Development as their interests may appear.

8-12 DIRECTORS AND OFFICERS INSURANCE

This is not a type of employee dishonesty, but it is similar. There are no standardized policies for this coverage, and there are only a few insurance companies that write this line of insurance. Most of them insure against "wrongful acts" committed by directors and officers of the insured entity. A "wrongful act" is generally defined in the policy as meaning "any actual or alleged neglect, error, misleading statement, omissions, or other breach of duty." In recent years, many organizations have had difficulty getting prominent and qualified individuals to serve on the board of commissioners without some reassurance of indemnification in the event of a lawsuit. While this insurance is not mandatory, it is highly recommended.

8-13 REQUIRED MINIMUM LIMIT.

The recommended minimum limit is based on the cash flow of the PHA/IHA. The Department has developed a work sheet to measure the cash flow from which the required minimum limit is determined. The work sheet is shown on page 8-6.

COPY OF FORM HUD-5462, BOND LIMIT WORKSHEET.