FIDELITY BOND / FIDELITY GUARANTEE INSURANCE

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1 INTRODUCTION

> **"*Pay me now or pay me later*" says Jones silently as he walks away from what he believes was yet another unsuccessful interaction with his boss over disputed overtime hours. Jones wastes no time and during his late night shift that evening, when he knows the security guard does his rounds, he quickly runs a couple of boxes of stock items out to his vehicle. He will be selling these items to friends and family, pocketing exactly as much as he would have earned for the overtime he believes he wasn't paid for.**

Jones' behavior is typical of a disgruntled, unhappy and demotivated employee who feels that the company "owes him."

There is often a direct correlation between a decline in the general economy / lack of employment and an increase in the number of Fidelity Bond /Guarantee (FB/G) claims. As a hypothetical example, the spouse of a trusted bookkeeper with many years of loyal service becomes unemployed. That bookkeeper then uses her intimate knowledge of checks & balances (or lack thereof) to defraud her employer. The fraud proceeds are used to fund college tuition and so although she feels bad about the act, the end is justified since she didn't just squander the money, she used it to further her daughter's education…

FB/G claims are not limited to financial transactions and/or finance staff and could involve any staff member with access to cash and goods. With human nature being unpredictable, FB/G policies are often critical to the longevity of businesses since theft of cash and/or goods by an employee is excluded under most property policies.

2 WHAT IS FIDELITY BOND / GUARANTEE INSURANCE?

Very simply put, it is a policy available for purchase by employers designed to indemnify their business against a pecuniary loss suffered as a result of forgery, embezzlement (diverting money for personal use), fraudulent conversion, or defalcation (misappropriation of money) by an insured employee with manifest intent during the course of their employment. Hollinger and Clark defined employee theft as "*the unauthorized taking, control, or transfer of money/or property of the formal work organization perpetrated by an employee during the course of occupational activity which related to his or her employment.*"

Since companies differ in their needs, the market offers several types of policies such as: Individual Policies – issued to cover a specific individual; Collective Policies – issued to cover a specific group of employees; Floater Policies – issued to usually cover groups of more than five employees but with a specified sum insured; and Blanket Policies – issued to cover the event rather than a specific group and usually to businesses with well-established audit practices.

Proving a loss under this type of policy is quite an arduous task. Several unique factors apply to an FB/G policy due to the varying nature of events. Some of these considerations are (including but not limited to):

- Losses have to be pecuniary, i.e. direct and not consequential
- The act must have resulted during the employee's normal execution of duties as specified
- Losses occurring as a result of poor accounting / lack of audit is not covered
- Losses must involve monies and or goods belonging to the insured, or for which the insured has liability

3 TYPICAL LOSSES

Desperation results in incredibly creative behavior and FB/G claims are often excellent evidence in support of this statement. As with other types of crime, the immediate effect of FB/G losses often goes further than simply those affected directly. First, stolen property must be replaced and so results in lost money and lost production / time. This of course affects profit, bonuses etc. Secondly, these events create uncertainty and disruptions that can, in some circumstances, result in business failure.

Typical losses commonly include variations of the following:

- "Rolling" of creditors
- Creation of "ghost" or fictitious employees
- Stock theft
- Setting up of a parallel competitor business to the insured
- Electronic Funds Transfer (EFT) fraud where account numbers are altered

So why do employees steal? Identifying the root cause is almost an impossible task since there is no single factor or theory that can be used to explain each occurrence. Rather, social scientists have concluded that it is a variety of factors that contribute to a staff member making that decision (Rational Choice theory). We have to assume that most employed individuals are conventionally socialized individuals, law-abiding citizens who are able to distinguish between right and wrong. So for an individual to come to a point where they believe the act is justified, two sets of factors come in to play.

The first set is internal to the organization and relates to factors such as job satisfaction, organizational culture, rationalization and opportunity. The second set is external and refers to factors like domestic financial pressure, peer pressure and seasonal consumer economic pressure.

4 Statistics

- The US Commerce Department estimates the annual cost of employee theft to be $40 billion (ten times as much as street crime)
- Employee theft causes 20% of all business failures, according to The American Management Association
- A national survey reported one third of all retail, health care and manufacturing employees admitted stealing from employers last year
- Forbes Magazine reports that 34.5% or $15 billion of annual shrinkage in 2014 occurred as a result of employee theft

5 How EMA can help

- EMA employs qualified and experienced Executive General Adjusters within its Specialty Loss Group (SLG) that have experience in investigating and adjusting FB/G losses.
- Loss adjusting is only one small part of successfully concluding a FB/G loss. It is critical to engage specialists in both the evidence preparation and preservation space as well as legal resources. EMA has established and reliable partnerships in these areas to ensure successful outcomes.

Sources

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