ERISA Bond: What Is It and Do I Need One?

Legacy Retirement Solutions, LLC

700 Turner Industrial Way
Suite 110
Aston, PA 19014

Phone: 484-483-1044
Fax: 484-361-4800

E-mail: marketing@legacyrsllc.com

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Almost every sponsor of every tax-qualified retirement plan must obtain a fidelity bond in accordance with section 412 of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Despite the broad application of this requirement, a surprising number of plan sponsors are unaware of this requirement and, in fact, do not have a bond at all or do not have a bond in the proper amount. Consequently, this article is written in order to help explain the requirement in order to attempt to ensure that those who are subject to this requirement satisfy it.

Obviously, in order to reasonably expect to satisfy this "ERISA bond" ("ERISA Bond") requirement, it is necessary to understand exactly what it is. In this regard, an ERISA Bond is a type of insurance that protects a plan against losses caused by acts of fraud or dishonesty. Fraud or dishonesty includes, but is not limited to, larceny, theft, embezzlement, forgery, misappropriation, wrongful abstraction, wrongful conversion, willful misapplication, and other acts.

It is important to understand that the ERISA Bond is different from fiduciary insurance. The ERISA Bond protects plan participants from the acts of fraud or dishonesty described above. However, fiduciary insurance protects a plan fiduciary from claims relating to a fiduciary breach under ERISA. Thus, the ERISA Bond protects plan participants while fiduciary insurance protects plan fiduciaries. In addition, the ERISA Bond is a mandatory requirement under ERISA for most retirement plans while fiduciary insurance is not required.

As mentioned above, *most* retirement plans are required to have an ERISA Bond. This raises the question of exactly which plans must obtain the ERISA Bond. Although the bonding requirements generally apply to most ERISA retirement plans (and many funded welfare benefit plans), the ERISA bonding requirements do not apply to plans that are not subject to Title I of ERISA; the most notable of which are owner only, "solo k", plans or to employee benefit plans that are completely unfunded (i.e., the benefits are paid directly out of an employer's or union's general assets).

Now that we understand which plans must have ERISA Bond coverage, we also need to understand exactly which persons must be covered by the ERISA Bond. Under ERISA, every person who "handles funds or other property" of an employee benefit plan is required to be bonded unless covered by an ERISA exemption. ERISA makes it an unlawful act for any person to "receive, handle, disburse, or otherwise exercise custody or control of plan funds or property" without being properly bonded.

In application, the "handles funds or other property" qualification generally encompasses the ERISA plan administrator and those officers and employees of the plan or plan sponsor (employer, joint board, or employee organization) who handle plan funds by virtue of their duties relating to the receipt, safekeeping and disbursement of funds.

"Funds or other property" generally refers to all funds or property that the plan uses or may use to pay benefits to plan participants or beneficiaries. Plan "funds or other property" includes all plan investments such as land and buildings, mortgages, and securities in closely-held corporations. It also includes contributions from any source (such as employers, employees, and employee organizations) that are received by the plan, and cash, checks and other property held for the purpose of making distributions to plan participants or beneficiaries.

A person is deemed to be "handling" funds or other property of a plan whenever his or her duties or activities could cause a loss of plan funds or property due to fraud or dishonesty, whether acting alone or in collusion with others. The general criteria for "handling" includes but is not limited to: 1) physical contact with cash, checks or similar property; 2) power to transfer funds from the plan to oneself or to a third party; 3) power to negotiate plan property (e.g., mortgages, title to land and buildings or securities); 4) disbursement authority or authority to direct disbursement; 5) authority to sign checks or other negotiable instruments; or 6) supervisory or decision-making responsibility over activities that require bonding.

Generally, the amount of the ERISA Bond must be equal to at least 10% of the amount of funds "handled" in the preceding year. The bond amount cannot, however, be less than $1,000, and the Department cannot require a plan official to be bonded for more than $500,000, or $1,000,000 for plans that hold employer securities. These amounts apply for each plan named on a bond.

For example, assume a company's plan has total assets of $1,000,000. The plan trustee, named fiduciary and administrator are three different company employees that each have access to the full $1 million, and each has the power to transfer plan funds, approve distributions, and sign checks. Under ERISA, each person must be bonded for at least 10% of the $1 million or $100,000. (Note: Bonds covering more than one plan may be required to be over $500,000 to meet the ERISA requirement because persons covered by the bond may handle funds or other property for more than one plan.)

Finally, it is permissible under ERISA to pay for the ERISA Bond with plan assets. The purpose of the ERISA Bond requirements is to protect the plan. The ERISA Bond does not protect the person handling plan funds or other property or relieve them from their obligations to the plan. As a result, there is no conflict created if the plan pays for the ERISA Bond.

As much as we hope this article helped you to better understand this topic, it is not to be construed as financial, tax or legal advice. Therefore, if you believe that the issues discussed herein may apply to your (or your client's) company, be sure to further discuss it with a qualified retirement plan professional. For more information about this topic, please contact our marketing department at 484-483-1044 or your administrator at Legacy.

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