CLIENT BRIEFING

THE ERISA BONDING REQUIREMENT:

Plan Sponsor Information to Ensure Compliance

Introduction

The Employee Retirement Income Security Act (ERISA) of 1974 was initially enacted to protect employees from being defrauded of their pension funds. While instances of fraud have been rare, the Department of Labor has moved to monitor small company pension plans more closely, requiring ERISA bonds for all retirement plans with very few exceptions.

This *Client Briefing* will provide answers to frequently asked questions (FAQs) to help you understand what is necessary for you to be in compliance with ERISA's bonding requirement.

ERISA Bonding FAQs

What are the Department of Labor requirements for a Fidelity Bond?

A Fidelity Bond is required by Department of Labor (DOL) regulations under the Employee ERISA to protect the assets in a retirement plan from misuse or misappropriation by the plan fiduciaries. In other words, intentional acts of fraud or dishonesty by a fiduciary who is defined to a trustee and any person who has:

- Physical contact with cash, checks or other Plan property;
- Power to transfer or negotiate Plan property for a price;
- Power to disburse funds, sign checks or produce negotiable instruments from the Plan assets; or
- Decision making authority over any individual described above.

How much does the ERISA Fidelity Bond have to be?

The ERISA Fidelity Bond must be at no less than 10% of plan assets with a minimum of $1,000 and a maximum of $500,000.

Are there any exceptions to the requirements stated above?

Yes. Here are two important exceptions.

1. Maximum Amount. The new Pension Protection Act of 2006 increases the maximum bond amount to $1 million for retirement plans that hold employer stock or other employer securities.

   A retirement plan would not generally be considered to hold employer stock or other employer securities if these assets are part of a broadly diversified group of assets such as mutual funds.

   The new bonding provision is effective for plan years beginning on and after January 1, 2007.

2. Non-Qualifying Assets. The DOL defines "non-qualifying assets as investments in limited partnerships, artwork, collectibles, mortgages, real estate or securities of "closely-held" companies that are held outside of regulated institutions.

Such institutions include a bank;
an insurance company; a
registered broker-dealer or other
organization
authorized to act as trustee for individual retirement accounts under Internal Revenue Code Section 408.

If more than 5% of plan assets are non-qualifying, then a plan sponsor needs to do one of two things:

a) make certain that the bond amount is equal to 100% of the value of these "non-qualified" assets or

b) arrange for an annual full-scope audit, where the CPA physically confirms the existence of the assets at the start and end of the plan year.

What are the consequences for not maintaining the ERISA Fidelity Bond?

There can be serious consequences for not purchasing and maintaining a sufficient ERISA Fidelity Bond.

1. It can be a red flag to the Department of Labor that they need to take a closer look at the plan.
2. A fiduciary can be held personally liable if a loss results to the plan.
3. In cases where a retirement plan has more than 5% in non-qualified assets, a serious underwriting risk may arise if the non-qualified assets are not properly listed on the bond application.

This is because non-qualifying assets carry a higher level of risk for loss.

If the non-qualified assets are not listed on the bond, the underwriter would have cause to deny coverage if there was a loss due to misuse or misappropriation by a plan fiduciary. Under those circumstances, the loss could be denied and the trustees could be liable for the losses to the plan.

Do you meet ERISA requirements if you already have a employee dishonest bond or a fiduciary bond?

No. The bond must be an ERISA Fidelity Bond, and NOT an employee dishonesty bond nor a general fiduciary bond. These other bonds do not fulfill the Department of Labor requirements for ERISA compliance.

About National Benefit Services, Inc.

Founded in 1978, National Benefit Services, Inc. provides retirement plan consulting and administrative services for a wide range of privately held and publicly traded employers.

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