

Information Alert

August 2011

Insights on Developments and Issues for Associations and
Not-for-Profits



Crime Doesn't Pay...But Crime Insurance Does

In the process of leading their associations and not-for-profits, senior managers typically deal with a myriad of member and constituent issues on a daily basis. While leadership appropriately focuses most of its attention on these strategic issues, such as understanding and responding to member concerns or constituent needs and staying on mission and remaining relevant in an ever-changing world, they cannot afford to overlook the very real need to manage risk and protect the association/not-for-profit's assets. This often involves a two-pronged approach of appropriate policies and procedures, back-stopped by insurance protection.

One such area of risk that needs ongoing vigilance is potential losses due to criminal activity and employee dishonesty. Be it a dishonest act by one of your employees or a computer hacker from the outside who captures your banking Personal Identification Number (PIN) and drains your accounts, it is important to be protected.

Think it can't happen to you? Here are a couple of recent situations affecting organizations like yours:

- **Fraudulent Transfer of Funds:** In checking its online bank statement, one organization found an unauthorized \$86,000 withdrawal. Upon further investigation, it discovered that someone had misappropriated their bank PIN and account information and made the withdrawal without anyone's knowledge or consent.
- **Fake Invoices:** During the year-end financial closing at a for-profit client of ours, it was discovered that there had been a significant increase in "Consulting Charges" on the firm's financial statements. Research into the matter showed that an employee (since terminated) had been submitting false invoices for subconsultant services in the amount of \$124,000.

There are literally dozens of examples like these across the country every week. The risk is real, but the good news is that some simple precautions and readily available insurance can help protect your association or not-for-profit organization from these types of potential financial consequences or possibly even financial ruin.

What Should an Association or Not-for-Profit Do To Reduce The Likelihood of Loss?

Developing and enforcing effective policies and procedures can dramatically reduce the potential

for loss from employee dishonesty, computer fraud and related criminal activity. Best practices that are typically implemented include:

- Not allowing the same person who approves items for payment to issue checks. Separate the roles.
- Requiring supervisor review and approval of all expense accounts. Allow employees to use credit cards and seek reimbursement rather than keeping a petty cash fund.
- Reconciling bank statements and accounting records of receipts and payables on a monthly basis.
- Keeping passwords and account information secure. Computers should be turned off or locked nightly. Consider encrypting sensitive information.
- Having a second set of eyes review and approve any wiring of funds or unusually large payments.
- Continually monitoring and enforcing internal controls. It does no good to have appropriate protections if no one uses them.

Crime Insurance Provides Critical Protection

In addition to the risk management steps outlined above, associations and not-for-profits can also protect themselves by purchasing insurance coverage known alternately as Crime, Fidelity, or Employee Dishonesty Insurance. There are typically two ways to secure this coverage:

1. **Policy extension.** Organizations can arrange to extend their existing Commercial Property/Business Owners Policy (BOP) by having their insurer include a sub-limited crime extension. Typically, this approach provides \$25,000 to \$250,000 of coverage per covered loss. Coverage is usually extended for Employee Dishonesty, Forgery or Alteration, or Computer Fraud (see definitions below).
2. **Purchase a stand-alone Crime policy.** Limits on such policies usually range from \$1 million to as much as \$5 million or more. Crime policies can be extended to

include additional coverages for Credit Card Fraud, Employee Theft of Clients' Property, and Funds Transfer Fraud. In many cases, these coverage extensions aren't available under the BOP crime coverage described in the first approach above.

Small associations and not-for-profits (generally, those with less than \$2 million of annual revenue/contributions or less than \$3 million in net assets) often choose option #1 above—relying on the crime coverage extension within their so-called Business Owners Policy.

Larger organizations often recognize the potentially more significant risks these issues represent, and consequently seek the higher limits and broader coverages provided by a stand-alone policy (option #2 above).

These Crime Insurance policies are offered by a variety of insurers including: Chubb, CNA, Hanover, Hartford, Lexington (Chartis), Travelers, Zurich and others.

What is Covered by a Crime Policy?

The crime policy can be structured to provide “basic” coverage or extended to cover an array of related and evolving risks. Among the coverages available (many of which have to be specifically requested) are:

- **Employee Theft or Dishonesty**—This is the core coverage provided by practically all policies and pays for “direct loss of money, securities, and other property resulting from dishonest acts committed by an employee while acting alone or in collusion with others with the intent of obtaining financial benefit.”
- **Forgery or Alteration**—Pays for loss directly caused by forgery or alteration of any check, draft, promissory note, bill of exchange or similar written promise, order or direction to pay made or drawn by or drawn upon the insured organization's account or made or drawn by one acting

as your agent or that are purported to have been so made or drawn.

This coverage may also reimburse reasonable legal expenses incurred in defending against a lawsuit refusing to pay any written covered instrument on the basis it has been forged or altered.

- **Premises**—Pays for direct loss of money and securities located inside your premises or banking premises (e.g. night deposit chute) caused by theft, disappearance or destruction. The insurer will also pay for direct loss to other property located in the premises directly caused by an actual or attempted robbery or safe burglary.
- **Off Premises/In Transit**—Pays for direct loss of your money and securities directly caused by theft, disappearance or destruction while outside the premises (in transit) whether being transported by an Insured (not always provided) or in the care, custody, or control of a messenger or armored motor vehicle company.
- **Computer Fraud and Funds Transfer Fraud**—Pays for direct loss caused by the unlawful taking of money, securities or other property resulting from a fraudulent computer act or fraudulent written, electronic, telegraphic, cable, facsimile or telephone instructions issued to a financial institution directing them to transfer, pay or deliver money or securities from the insured's account at such institution without the Insured's knowledge or consent.
- **Money Orders and Counterfeit Currency Fraud** —Pays for direct loss resulting from good faith acceptance of any original money orders or counterfeit money received in the regular course of business and issued by any post office, express company, or bank that is not paid upon presentation.
- **Employee Theft of Member or Constituent Property (known as Third Party Coverage)**—Pays for direct loss of

money, securities, and other property sustained by one of your constituents or members as a result of theft or forgery committed by your employee while performing duties for your constituents/members.

Exclusions, Deductibles, and ERISA Fidelity Bond Requirements

While the outline above provides general information on the types of coverages available, it is important to note that all Crime policies contain various exclusions that limit or prevent coverage for certain claims; and that not all of the coverages described above are included in every Crime policy for reasons of cost and insurer practice. Among some common exclusions are:

- Accounting errors;
- Acts by certain Managers, Partners and Directors;
- Loss of trade secrets or intellectual property;
- Loss discovered and reported more than 60 days after policy expiration;
- Any loss caused by someone who had previously stolen from you, if you were aware of the previous theft.

Most Crime policies can be extended to meet the ERISA requirement for employee dishonesty coverage applicable to ERISA Welfare and Pension Plans. For most organizations, the requirement to carry \$500,000 in coverage is standard.

Crime policies also contain a deductible that must be paid by the Insured. Deductibles can range from \$1,000 to \$25,000 per occurrence.

How are Claims Reported and Losses Adjusted?

Claims must be reported as soon as possible, but in any event this must typically be either during the

policy period or within 60 days after the end of the policy period. Once a claim is reported, the insurer will settle a claim based on the following valuation approaches:

1. **Money (also referred to on occasion as currency or cash)**—pays up to and including face value for U.S. dollars. For other countries, the rate is determined by the exchange rate published in *The Wall Street Journal* on the day the loss was discovered.
2. **Securities**—pays up to and including their value at the close of business on the day the loss was discovered or, at the insurer's option, replaces them in kind or pays the cost of a Lost Securities Bond in connection with issuing duplicates of the securities.
3. **Other Property**—pays, at insurer option, no more than the actual replacement cost or repair costs up to the limit of the policy.

Crime Insurance Pays

Crime-related risks are both preventable and insurable. Associations and not-for-profits should evaluate their policies and procedures, and implement best practices to reduce the likelihood of loss.

They should also review their insurance program to determine if they carry sufficient Crime Insurance coverage. If not, they should discuss alternatives with their broker.

Indeed, as the title of this publication asserts: "Crime doesn't pay ... but Crime Insurance does!"

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