THE SURETY & FIDELITY ASSOCIATION OF AMERICA
SERVING THE INDUSTRY SINCE 1908

January 21, 2019

Via Electronic Mail

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: SFAA's Comments on Notice of Proposed Rulemaking (Fidelity Bonds)

Dear Mr. Poliquin:

The Surety & Fidelity Association of America ("SFAA") is a non-profit corporation whose member companies collectively write the majority of surety and fidelity bonds in the United States. SFAA is a licensed rating or advisory organization in all states and is designated by state insurance departments as a statistical agent for the reporting of fidelity and surety experience. The vast majority of fidelity bonds provided to insure the employee dishonesty risk faced by credit unions are provided by SFAA members. We appreciate the opportunity to submit comments regarding the captioned proposed regulations. In general, certain proposed provisions might make the fidelity bonds less available or more expensive for credit unions.

In particular, 12 CFR 704.18(c)(4) and 12 CFR 713.3(a)(3) require that in the event of an involuntary liquidation, the fidelity bond must include an option for the liquidating agent to purchase coverage to extend the discovery period for at least two years after liquidation. A reason for the need to extend the discovery period cited by the National Credit Union Administration ("NCUA") is the need for a "reasonable period for discovery and filing a claim following a FICU's involuntary liquidation." 83 Fed. Reg. 59318, 59322 (November 23, 2018). The historical reason for a discovery period was that bonds previously provided coverage on an "occurrence basis". That is, the bond covered losses that occurred during the term of the bond and were discovered during the bond term. The reason for an extended period to discover a loss after the bond term was to accommodate losses that were sustained at the end of the policy term. In many cases a loss cannot be instantaneously discovered for coverage to apply and therefore a limited time was provided to give the insured the opportunity to discover the loss. In the current market, it is quite typical for a bond to provide coverage on a "discovery basis", which covers any loss that was discovered during the bond term, regardless of when the loss occurred. Thus, the entire bond term is essentially a discovery period, making an extended discovery period less necessary. While a 12-month extended discovery period might be reasonable, a 24 month discovery period is not reasonable, especially considering that the bond is already exposed to any loss, including any loss occurring well before the bond term. A 24 month discovery period significantly increases the insurer's exposure, making coverage less available or more expensive.

12 CFR 704.18(c)(5)(ii) requires the bond to include a provision requiring notification to NCUA in the event that the fidelity bond coverage is terminated as to an employee. The implementation of this requirement could be unworkable. Typically, the fidelity bond includes a provision that states that upon the discovery by the insured of a dishonest act by an employee, the bond ceases to provide coverage as to future dishonest acts by that employee. In many cases, the insurer does not know that the insured has discovered a prior dishonest act by an employee until the insured attempts to make a claim for a loss involving that employee and the insurer conducts a claims investigation. As a practical matter, an insurer may not be able to comply with the requirement under 12 CFR 704.18(c)(5)(ii). We recommend that such notice should be required by the credit union and not the insurer. Similarly, 704.18(c)(5)(iii) requires the insurer to provide notice when "a deductible is increased above permissible limits." Again, this requirement should be the credit union's obligation, as it is in the best position to know the permissible limits. These notice requirements are burdensome for the industry when the premium for the bonds does not contemplate such monitoring and oversight obligations.

Finally, the proposed regulation included provisions regarding the approval of bond forms. SFAA supports the comments submitted by the American Property Casualty Insurance Association and does not repeat them here.

Thank you for the opportunity to comment and SFAA welcomes the opportunity to answer any questions or discuss our concerns in greater detail.

Sincerely,

Robert J. Duke
General Counsel