Chapter 310

BOND AND INSURANCE COVERAGE

Introduction

Obtaining insurance coverage for every insurable risk has been replaced by the risk management concept. Risk management, which includes insurance coverage, is intended to minimize the cost associated with assuming certain types of risk and providing prudent protection. It deals with pure risks that are characterized by chance occurrence and may only result in a financial loss.

Categories of Risk

Insurable risk can be separated into three major categories: property, liability, and personnel. First, the most commonly known property risk relates to loss of real property from natural events (such as flood, fire, or hurricane) or intentional causes (such as vandalism or arson). This category also includes the loss of any corporate credit union (corporate) asset, including currency, securities, electronic data, or records. Property risk also includes indirect expenses that result from property losses, such as relocating to temporary facilities or loss of business while replacing facilities. Secondly, liability risk includes suits resulting from injury or death of employees and the public, suits alleging official misconduct, and individual or class action suits alleging mistreatment or violations of law, regulation, or contractual obligations. All phases of the corporate's operations are susceptible to liability risk. Finally, personnel risk relates to the risks associated with the loss of key personnel. This risk is more pronounced in small and medium-size corporates that lack management succession plans.

Stages in Risk Management

There are three stages in risk management: risk identification and analysis, risk control, and risk treatment. Through its risk assessment process, each corporate should document its rationale and decision-making process for each of the three stages typically used for insurance risk management.

The importance of risk control is readily apparent when an uninsurable risk is involved. However, the significance of minimizing premium cost through risk controls cannot be overlooked. A corporate's primary defenses against loss are its policies, procedures, and internal controls. These systems and guidelines are integral parts of the risk and insurance management program. They must be communicated to and understood by all corporate personnel. Also, the corporate should provide audit coverage to ensure those controls are followed.

Once risks have been identified and risk controls implemented, management must decide the most appropriate method of treating a particular risk. A corporate has various options of treating a particular risk. It can implement additional controls to minimize that risk, yet still retain it. It may also transfer the risk to another party through insurance or contractual transfer, or a combination of these options. A basic concept of risk management is those risks that carry the potential for catastrophic or significant losses should not be retained.

Board Responsibility

Section 704.18 of the NCUA Rules and Regulation requires fidelity bond coverage to be obtained for all employees and officials in corporates. Also, the bond must provide coverage for the fraud and dishonesty of all employees, directors, officers, and committee members. Additionally, the bond may also provide coverage for lack of faithful performance, but coverage is not required by regulation.

The board of directors must determine and document the maximum loss a corporate is willing and able to assume. Additionally, Section 704.18(b) of the NCUA Rules and Regulations requires the board to (at least annually) carefully review the bond insurance coverage in force to determine its adequacy in relation to risk exposure and the minimum fidelity bond requirements disclosed in 704.18(d).

Fidelity Bond Insurance

Typically, fidelity bond insurance includes reimbursement for loss, not only from employee dishonesty, but also from robbery, burglary, theft, forgery, mysterious disappearance, and in specific instances, damage to offices or fixtures of the corporate. Fidelity bond coverage applies to all corporate locations. However, automated teller machines (which are not prevalent at corporates) are not covered, but can be specifically added under a rider.

It is the standard procedure for insurance companies to write fidelity bonds on a "discovery basis." Under this method, the insurance company is liable up to the full amount of the policy for losses covered under the terms of the bond and discovered while the bond is in force, regardless of the date, which the loss was actually sustained by the corporate. This applies even though lower coverage amounts or more restrictive terms might be in effect on the date the loss was sustained.

All fidelity bonds require a loss be reported to the bonding company within a specified time after a reportable item comes to the attention of management. Therefore, management must diligently report all potential claims to the corporate's insurance company. Failure to do so may jeopardize coverage for the loss.

Most corporates obtain excess coverage, as Section 704.18 (d)(2) of the NCUA Rules and Regulations states "it is the duty of the board of directors of each corporate to provide adequate protection to meet its unique circumstances by obtaining, when necessary, bond insurance coverage in excess of the minimum requirement."

Other Types of Insurance

Corporates may also need other specialized forms of insurance for which the fidelity bond, along with the related policies, endorsements and specific coverage previously mentioned, provide insufficient protection. The following list depicts some of those coverages:

1. Automobile - public and property damage;
2. Extra expense;
3. Fire;
4. General liability;
5. Key person;
6. Umbrella liability;
7. Excess Electronic Crime Policy or E-commerce;
8. Valuable papers and destruction of records; and
9. Compliance.

Recordkeeping

The breadth of available insurance policies and differences in the coverages, emphasize the importance of maintaining a concise, easily referenced schedule of insurance coverage. These records should include, at a minimum the:

1. Coverage provided, detailing major exclusions;
2. Underwriter;
3. Deductible amounts;
4. Upper limits;
5. Term of the policy;
6. Date premium(s) are due; and
7. Premium amount.

Records of losses must also be maintained, regardless of whether or not the corporate was reimbursed. This information indicates areas where internal controls may need to be improved and is useful in measuring the level of risk exposure in a particular area.

Bidding Process for Insurance/Bonding

The bidding process for insurance/bonding coverage is the responsibility of the corporate's board. Insurance must be obtained from an NCUA approved carrier. The extent of an examiner's involvement will be to ensure the bidding process is completed in accordance with the board's polices regarding contracts. More detailed information on contracts is contained in Chapter 301, Management.

Examination Objectives

The objectives of the bond and insurance review are to:

1. Determine if the corporate's bond and insurance polices, procedures, practices, and internal controls are adequate to address risk, in relationship with capital. The procedures must, at a minimum, require annual review of the corporate's bond and insurance coverage in relationship to identified risks;

2. Determine the corporate's risk management process adequately identifies, controls, and address insurance risks;

3. Determine if bonding coverage meets the minimum coverage amounts in Section 704.18(d) of the NCUA Rules and Regulations;

4. Determine if the board of directors have established reasonable guidelines and mitigating controls for non-insured risk;

5. Determine if insurance coverage adequately protects against significant or catastrophic loss;

6. Determine if recordkeeping practices are sufficient to enable effective risk and insurance management;

7. Initiate corrective action when policies, practices, procedures or internal controls are deficient or when violations of law, regulations, and rulings are noted; and

8. Determine if potential losses are reported to bonding or insurance companies pursuant to policy provisions.

Examination Procedures

See Corporate Examination Procedures - Bond and Insurance Coverage (OCCU 310P).

Examination Questionnaire

See Corporate Examination Questionnaire (OCCU 310Q).

References

1. NCUA Rules and Regulations (Section 704.18); and

2. Comptroller's Handbook for National Bank Examiners - Risk Management and Insurance (Section 406).