



# DON'T BE CAUGHT SWIMMING NAKED! USING INSURANCE FOR FINANCIAL RECOVERY

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# Agenda

- Part I - Fidelity Insurance
- Part II - Tips to a successful claim outcome
- Part III - Current Insurance Outlook

With you today



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# Part I - Fidelity Insurance

# Defining Fidelity Insurance

A **fidelity bond** is a form of **insurance** protection that covers policyholders for losses that they incur as a result of fraudulent acts by specified individuals. It usually insures a business for losses caused by the dishonest acts of its employees.

Otherwise referred to as Commercial Crime or Employee dishonesty insurance policies.

First party versus third party policies.



## Recent News Articles

1. **June 3, 2020 - Former President of the United Auto Workers Union accused of embezzling \$1 million**
2. **January 14, 2020 - Archivist and bookseller plead guilty to pilfering \$8M in rare texts from Carnegie Library**
3. **October 3, 2018 - Fort Worth woman charged in \$30 million healthcare fraud scheme at area clinics**
4. **September 11, 2018 - Brownwood bank missing \$2 million, ex-employee arrested for theft**



# Overview of Fidelity Insurance

## Types of Coverages

- ▶ Employee Theft
- ▶ Forgery or Alteration
- ▶ Inside of Premises - Theft of Money and Securities
- ▶ Inside the Premises - Robbery or Safe Burglary of other Property
- ▶ Outside the Premises
- ▶ In Transit
- ▶ Computer Fraud
- ▶ Funds Transfer Fraud
- ▶ Money Orders and Counterfeit Money
- ▶ Claims Expense





# Valuation

**Loss of “money”** but only up to and including its face value.

**Loss of “securities”** but only up to and including their value at the close of business on the day the loss was discovered.

**Loss of or damage to “other property”** or loss from damage to the “premises” or its exterior for the replacement cost of the property without deduction for depreciation. However, we will not pay more than the least of the following:

- ▶ The cost to replace the lost or damaged property with property of comparable material and quality and used for the same purpose
- ▶ The amount you actually spend that is necessary to repair or replace the lost or damaged property
- ▶ The limit of insurance



# The Challenges

Money and/or securities can be relatively straightforward but...

- *What if your procurement person has been awarding contracts to a related party without going to bid?*
- *What if your salesperson is engaging in transactions below market value?*
- *What if an Executive or Officer of the company is purchasing personal real estate with company funds?*



# Case Studies

- Small town Georgia scrap theft
- CFO misappropriation of corporate funds
- Commodity trader selling product below market cost

# Part II - Tips to a successful claim outcome

# Where It All Begins - The Application Process

- A critical part of fidelity/employee dishonesty
- Top factor in denials of claims

**B. Internal Controls:**

1. Are background checks performed on all new hires?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
2. Are bank accounts reconciled monthly?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
3. Are bank accounts reconciled by someone not authorized to deposit or withdraw?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
4. Is countersignature of checks required? If "Yes", above what amount? \$ _____	Yes <input type="checkbox"/>	No <input type="checkbox"/>
5. Do vouchers or other supporting records accompany all checks to be signed?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
6. Are internal controls designed so that no employee can control any process from beginning to end?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
7. Are all incoming checks stamped "For Deposit Only" upon receipt?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
8. Are disbursement functions separated from those who have cash receipt or cash refund duties?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
9. Do expense reimbursements require original receipts for expenses?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
10. Do expense reimbursements require management approval at the next level?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
11. Are at least 20% of accounts receivable periodically verified by contact with the customer?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
12. If you handle securities, are they subject to joint control? If "Yes", what is the value of securities held? \$ _____	Yes <input type="checkbox"/>	No <input type="checkbox"/>
13. How often is an inventory made including a physical check of stock and equipment? _____		
14. Are all controls and informational systems consistent among all locations?	Yes <input type="checkbox"/>	No <input type="checkbox"/>



# Steps to Take When You Have a Claim

- Ensure that risk management or the individual at your Company that maintains the relationship with the insurance broker is notified as soon as possible.
- Company notifies the insurance broker of a potential claim who then, in turn, notifies the insurance company of a potential claim.
- Insurance company opens a file and a claim number is assigned.
- An insurance adjuster will be assigned - sometimes an internal employee of the insurance company or sometimes a 3<sup>rd</sup> party adjuster.



# Fidelity Insurance - The Investigation

- Standard investigation but a focus on quantum
- Determining who takes the lead on the investigation
- Coverage for the investigation costs
- Written report (otherwise known as a proof of loss) addressing the facts of the case and establishing the quantum and evidence. Appendices to the report should include the financial analyses performed.
- Typically, insurance coverage is not addressed in the written report

# Fidelity Insurance - Documenting the Claim

- Always establishing the who, what, why, where and when
- A section of the report should be on the discovery:
  - How discovered?
  - When was the insurance company notified?
  - When was law enforcement notified?
- Are there any third parties involved? This provides the opportunity for subrogation.
- The goal is to deliver a report that hits all of the key areas of concern for the insurance carrier to limit the time of the carrier's post-proof of loss submission.





# Important Coverage Considerations

- Personnel file and existence of a background check
- Knowledge of prior dishonest acts
- Cost of the investigation
- Other tangible benefits of the investigation that may be irrelevant from the insurance company's perspective.



## Fidelity Insurance - Settlement Negotiations

- The Carrier will review the Proof of Loss and make request additional documentation, the opportunity to interview subjects, discuss with law enforcement, etc.
- Having a reputable 3<sup>rd</sup> party who has performed the investigation and is knowledgeable of the fidelity insurance process is important.
- Based on potential coverage issues, there may be some negotiation in the final settlement.

# Part III - Current Insurance Outlook

# Current Outlook from Our Perspective

- Impact of COVID-19
- Deregulation is going to increase the frequency of fraud; allows people to rationalize and provides the opportunity
- Aggregate household debt has increased to \$14.3 trillion in Q1 2020
- Pressure is increasing

*Crime is a part of a bigger insurance risk universe.  
When was the last time you reviewed the insurance program?*



# Broader Insurance Program

All organizations have an insurance risk universe:

- Risk identification and measurement
- Risk framework and strategy
- Risk transfer (insurance)
- Claims management
- Vendor management

## *Why does your organization purchase commercial insurance?*

Establishing an insurance purchasing framework helps answer this question

- Insurance is typically used as a risk transfer tool for the following reasons:
  - Liquidity
  - Regulatory
  - Contractual
  - Special services
  - Insurance market efficiency

## *Alternates to the traditional commercial insurance market?*

- A captive is an insurance subsidiary of a non-insurance parent
- Exists to serve the risk management needs of the parent and/or to support the core business goals of the parent, rather than for its own profitability
- Risk financing vehicle for retaining corporate insurance risks



## Hot Topic

# Net Operating Losses and the CARES Act

Following the 2017 tax reform legislation, net operating losses (NOLs) generated in tax years beginning in 2018 and later years could not be carried back and can only offset up to 80% of taxable income in carryover years.

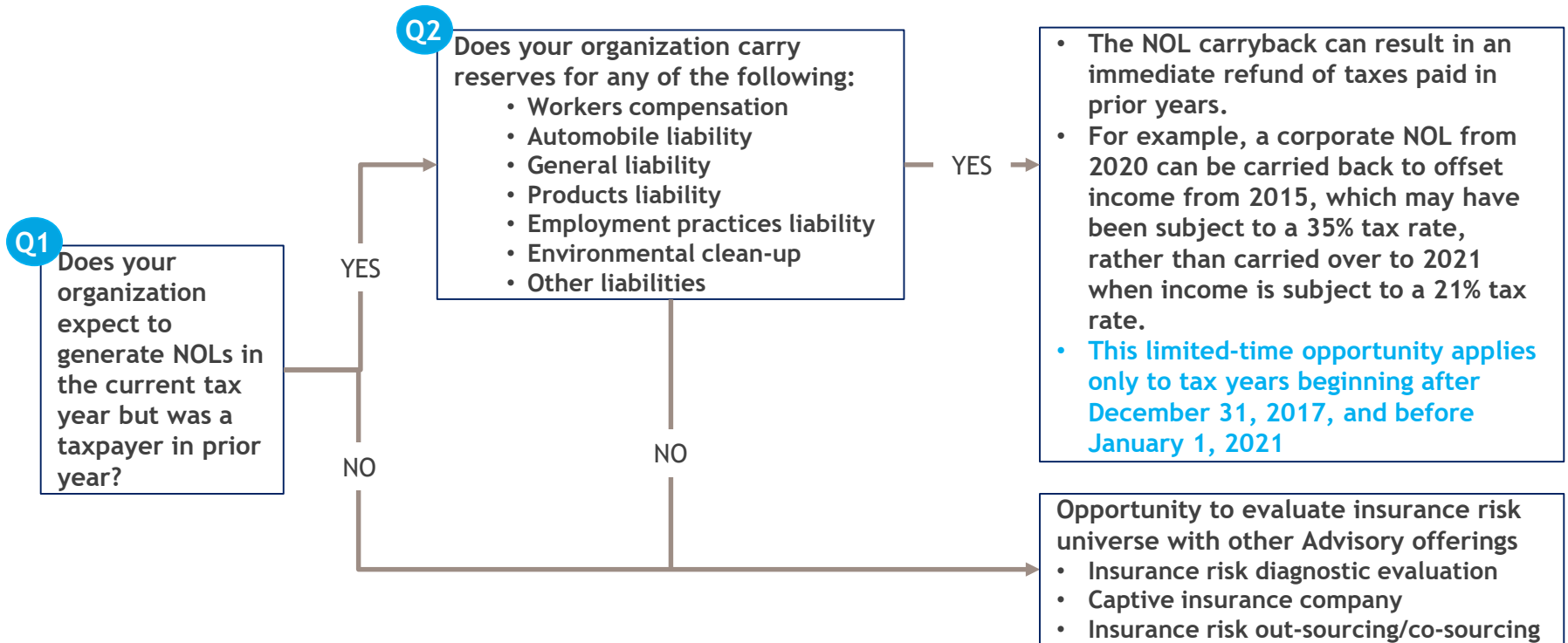
**HOWEVER: Now, the CARES Act allows a five-year carryback of any NOL generated in a taxable year beginning after December 31, 2017, and before January 1, 2021.**

The NOL carryback can result in an immediate refund of taxes paid in prior years. For example, a corporate NOL from 2020 can be carried back to offset income from 2015, which may have been subject to a 35% tax rate, rather than carried over to 2021 when corporate income is subject to a 21% tax rate.

Organizations retaining insurable risks may have an opportunity to secure immediate and permanent tax savings by using these loss reserves to offset income generated prior to tax reform, when the income tax rates were higher, using a captive insurance company.

# Through the use of insurable risk to reclaim liquidity

There are two key questions to ask when using the Net Operating Loss (NOL) strategy. Does your organization meet the following criteria?





## In Closing

- Understand your company's fidelity exposure, as part of the insurance risk universe.
- Fidelity insurance is a great tool in recuperating corporate funds that have been misappropriated as well as cover the costs of an investigation.
- It is an emerging insurance product growing in popularity in today's companies spanning virtually all industries.
- There are intricacies in the fidelity claim process that should be understood to avoid delays in claim payments and the risk of denial.



# Questions?



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