Executive Risks

Willis

June 2007 – Issue 25

Crime (Coverage) Does Not Pay – A Crime/Fidelity Myth

We are often surprised at the questions we're asked about Crime, *aka* Fidelity insurance or Crime bonds. Misconceptions are perhaps understandable – it's not the largest segment of the Executive Risks insurance world, and it comes with a healthy share of quirks and complexities. The coverage is important, though, especially given the fact that Crime/Fidelity exposures usually grow as companies grow. There is in most cases a direct correlation between company size and Crime/Fidelity loss size, mostly because the larger an organization, the more difficult it is to keep an eye on everything. If your company has growth plans, take note: You, too, may be laboring under some common misconceptions. Below we put to rest what is perhaps the most common.

The Indirect Loss Question

Risk managers often express frustration over the fact that Crime policies don't always cover losses that appear to be the result of some criminal activity – hence the reputation that the policies don't pay. Not true. The top 50 Crime/Fidelity underwriters took in $1.2 billion in premium and paid out/reserved $521 million in losses in 2005. (Quick math minds will calculate a loss ratio of 43.4; marketplace observers will see – correctly in our opinion – softening pressures in the marketplace, but that is a different discussion.)

This misconception stems from the fact that most policies cover direct losses but not indirect losses. Segregating the two is not always easy. Some policies explicitly exclude indirect losses, but most simply offer coverage for losses that result "directly from" the criminal activity of employees. So what is the difference between a direct and an indirect loss? Some examples may be helpful.

- You discover that your warehouse manager has been stealing inventory items you were holding on consignment for a client. You are ultimately responsible. However, the losses are not yours directly – they are the client's. Those losses may not be covered. The ownership provision in most policies may appear to cover client property, but the provision maybe be narrowly interpreted by carriers – and the courts. An answer to this problem is an endorsement that specifically covers client property.

- An employee in your accounting firm steals money received from clients that was earmarked for the IRS. Soon enough, the IRS comes not only for their money, but for penalties they've assessed as well. In many cases, the loss of the funds will be covered, but not the penalties, which are considered an indirect loss.

- An employee steals credit card information through your retail payment system. In some states, retailers may be held liable for costs that others may incur for information that was stolen following transactions through their systems. The actual losses are incurred by others.

- Perhaps the most common indirect loss resulting from a crime is the loss of the use of funds, also known as opportunity costs. If your CFO steals company money, you can recover the amount stolen. If, however, the theft prevents you from making an important investment, that lost opportunity is an indirect loss and not covered.

Some may look at the list above and argue that we have reinforced the misconception instead of debunking it. We point again to the half billion dollars paid out in claims by the top carriers. More

Alert

importantly, there are steps that can be taken to address many of these circumstances. For example, one common endorsement to a typical Crime policy, as mentioned above, covers the loss of client property.

As always, the key in effective risk management is to work with your risk management advisor to first understand your exposures, and then understand your policy. If there are gaps in coverage, you should craft an appropriate strategy.

The chief contributor to this article was Stephen Leggett from the Willis Executive Risks Practice in New York. Steve has been focusing on Crime/Fidelity coverage for more than 25 years.

Executive Risks Regional Contacts

For further information, please contact any of the following:

Boston, MA
David Goldstein
P- 617 351 7498
F- 617 351 7430
david.goldstein@willis.com

Chicago, IL
Brian Gauen
P- 312 621 4855
F- 312 621 6870
brian.gauen@willis.com

Denver, CO
Jim Iacino
P- 303 218 4039
F- 303 218 4058
jim.iacino@willis.com

Los Angeles, CA
Chris Crawford
P- 213 607 6294
F- 213 607 6301
chris.crawford@willis.com

New York, NY
Steve Pincus
P- 212 915 7940
F- 212 519 5460
steve.pincus@willis.com

Radnor, PA
Matt Schott
P- 610 254 5642
F- 610 254 5600
matt.schott@willis.com

San Francisco, CA
Michael Mahoney
P- 415 291 1535
F- 415 982 7978
mike.mahoney@willis.com

Toronto, ON
Jonathan Ashall
P- 416 646 8351
F- 416 869 1649
jonathan.ashall@willis.com

Executive Risks *Alerts* and *Newsletters* provide a general overview and discussion on a wide range of topics. They are not intended, and should not be used, as a substitute for legal advice in any specific situation.