FIDELITY GUARANTEE INSURANCE
WHY, WHAT AND HOW MUCH?

Legislation requires funds to have insurance against dishonesty or fraud, and trustees have a duty to carefully consider the terms and amount of cover.

This note gives details about the terms of the insurance policies and outlines some of the challenges faced by trustees in meeting their duties.

WHY DOES THE FUND NEED FIDELITY GUARANTEE INSURANCE?

Regulation 30(2)(u) of the Pension Funds Act 1956 stipulates that a fund must have a policy of insurance to indemnify the fund against losses due to dishonesty or fraud by any of its officials.

The fund's auditor will check on an annual basis that this policy is in place.

WHAT IS COVERED UNDER A FIDELITY GUARANTEE INSURANCE POLICY?

Broadly speaking this type of policy covers a retirement fund and its officers (i.e. trustees and third party service providers other than investment managers and investment administrators) for three main events:

- The first area of coverage is fidelity guarantee. This would arise if the fund suffers a loss as a result of theft, fraud or dishonesty by a person acting in their fiduciary capacity for the fund. Strictly speaking, this is the only cover stipulated as being required by legislation.
- The next event is errors and omissions, or as some may call it, "negligence". Simply put, this covers the fund and its officers in the event that, as a result of an error, neglect or omission (among many other examples), on the part of the officers of the fund, a loss occurs to the fund and therefore its members.
- The third aspect is that of computer crime. This is generally a loss caused by the fraudulent or dishonest entry of data into the fund's computer systems.

This note only gives a brief summary of what is covered by the policy. For full details on cover, exclusions and the claim process please refer to your full policy and speak to your fund consultant if any further clarity is required.

HOW MUCH COVER IS NEEDED?

After releasing a draft guideline in 1996 based on the American "Honesty Index", which received much criticism about its relevance in the South African context, the Financial Services Board has provided no further guidance on the Regulator's view about the limits of indemnity – the sufficiency of cover remains the trustees' decision.

There are however some other suggestions that have developed in the industry with regard to the quantum of cover, which include:

- Two times the largest potential death benefit; or
- A percentage of assets (2% plus 10% of annual contributions); or
- A number of months' contributions; or
- A minimum of R1,000,000.

Whilst there may be no particular scientific justification for any of these approaches, the first three at least try to ask a question along the lines of "if something were to go wrong, what might be the financial impact?" In truth, however, none of them are particularly convincing and trustees would be ill-advised to determine the amount of cover without further reflection on the risks involved.

When considering the amount of cover, trustees should also consider the following:

- The level of expertise and experience of the trustees
- The professionalism and experience of the fund's service providers and the service level agreements that are in place
- The fund's risk management policies and procedures, and the effectiveness thereof
- The fund's level of compliance with the Registrar of Pension Funds' governance circular PF130
- Any other controls that are in place regarding the handling of contributions, investments, benefits and data

An interesting exercise for trustees is to carry out a "thought experiment" by trying to describe a set of circumstances that would lead to their fund making a claim. The greater the degree of good risk management, the harder it should be to come up with a plausible scenario.

OTHER CONSIDERATIONS

For most funds most of the time, the chances of making a claim are extremely small. This explains why this type of insurance is so inexpensive: millions of rand of cover are frequently available for a premium of a few thousand rand per annum.

On the other hand, if a loss did occur and it exceeded the indemnity limit, the trustees could be held personally liable for any excess amount.

Given the duty that rests on the trustees to ensure that sufficient cover is in place, a practical approach is to err on the side of safety and, even at the risk of being over-insured, accept a slightly higher premium in return for the comfort of being sure that more than sufficient cover is in place. What this amount is will of course vary from fund to fund.

WHAT DOES THIS MEAN FOR YOU?

Actions to be taken by boards of funds:

> *Trustee boards need to ensure that they have a current policy of insurance in place and that they have sufficient cover.*
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> *Trustees should request a disclosure of conflicts from their service providers especially if acting on any recommendations by the service provider.*
>
> *Trustees should ensure that their service providers have adequate professional indemnity cover in place.*
>
> *The fund's investment policy statement should be reviewed annually or when there is a significant change in the membership profile.*
>
> *If trustees are concerned about a service provider's standards they should address this sooner rather than later.*
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> *If you are aware of any claim or even just a circumstance which may give rise to a claim the policy requires that you must notify your insurer, either directly or through your fund consultant, as soon as is reasonably possible.*

Your Robson Savage consultant will be glad to provide any further input you might require, and will ensure the matter is raised for discussion at the appropriate time.

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