CHAPTER 2

SUBMISSION OF THE INSURED'S CLAIM

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I.
Introduction

Nearly every type of organization—both profit and non-profit—finds itself victimized from time to time by fraud perpetrated by of one of its employees or by a third party. The estimated cost of employee fraud to organizations worldwide is staggering. One recent study estimated that businesses lose five percent of their revenues as a result of occupational fraud alone.[1] Electronic crime perpetrated by third parties adds significantly to that loss.[2] Fortunately for some of those organizations, the insurance industry shares the risk of that loss with them through fidelity bonds and other insurance policies. The purpose of this chapter is to review the practical considerations that an organization confronts when it is victimized by employee or third-party fraud and needs to share the burden of that loss with its fidelity bond carrier.

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1. *See* Association of Certified Fraud Examiners, *Report to the Nations: 2018 Global Study on Occupational Fraud and Abuse* 8-9, *available at* https://www.acfe.com/report-to-the-nations/2018/ (last visited May 3, 2019).
2. *See* Ponemon Institute, 2019 Cost of Cybercrime Study, *available at* https://www.accenture.com/us-en/insights/security/cost-cybercrime-study (last visited May 3, 2019).

II.
General Risk Management Considerations

Faced with the fact that fraud is prevalent, a prudent organization should pay careful attention to risk management before it suffers losses from employee and third-party dishonesty.

A. The Need for Fidelity Coverage

Organizations with more than a few employees usually need coverage that expressly protects the organization from fidelity losses.[3] Too often, an organization that incurs a fidelity loss is left to bear the financial burden of that loss itself or to try to fit the loss under an insurance policy that very arguably does not apply. If a fidelity loss is possible and could materially affect the organization's financial well-being, the decision to purchase coverage should not be a difficult one.

B. The Insured Should Explore the Market and Know What it Is Buying

A number of insurers write fidelity bonds, and many of them write coverage that varies from the standard forms, including in their fidelity and computer fraud insuring agreements. A capable broker can assist an organization explore the various coverage options.

A good example of variations in policy language can be seen in the different policy language offered in the fidelity insuring agreement of financial institution bonds. The fidelity insuring agreement—Insuring Agreement (A)—in the 2011 standard form Financial Institution Bond[4] provides:

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3. Certain regulated businesses, such as financial institutions, are required by law to have fidelity bonds. *See, e.g.*, 12 C.F.R. § 7.2013 (2017) (regulation issued by the Office of the Comptroller of the Currency [hereinafter OCC] requiring all officers and employees of a national bank to have adequate fidelity coverage).
4. FINANCIAL INSTITUTION BOND, Standard Form No. 24 (revised May 2011) [hereinafter FIB], *reprinted in* STANDARD FORMS OF THE SURETY & FIDELITY ASSOCIATION OF AMERICA (The Surety & Fidelity Association of America) [hereinafter STANDARD FORMS].

> Loss resulting directly from dishonest or fraudulent acts committed by an Employee acting alone or in collusion with others. Such dishonest or fraudulent acts must be committed by the Employee with the **manifest** intent:
>
> (1) to cause the insured to sustain such loss; **and**
>
> (2) to obtain improper financial benefit for the Employee or another person or entity.
>
> However, if some or all of the insured's loss results directly or indirectly from:
>
> (a) Loans, that portion of the loss involving any Loan is not covered unless the Employee also was in collusion with one or more parties to the Loan transactions and has received, in connection therewith, an improper financial benefit **with a value of at least $2,500; or**
>
> (b) trading, that portion of the loss is not covered unless the Employee also has received, in connection therewith, an improper financial benefit.
>
> As used in this Insuring Agreement, an improper financial benefit does not include any employee benefits earned in the normal course of employment, including but not limited to: salaries, commissions, fees, bonuses, promotions, awards, profit sharing or pensions.
>
> As used in this Insuring Agreement, loss does not include any employee benefits (including but not limited to: salaries, commissions, fees, bonuses, promotions, awards, profit sharing or pensions) intentionally paid by the insured.

(emphasis added).[5]

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5. *Id.* FIB at Insuring Agreement A. The employee dishonesty insuring agreement in one commonly used commercial crime policy form issued by the Surety Association of America is similar to the insuring agreement quoted above. CRIME PROTECTION POLICY, Standard Form (revised April 1, 2012), *reprinted in* STANDARD FORMS. The employee dishonesty insuring agreement in the commercial crime policy form issued by the Insurance Services Office, Inc. is now entitled "Employee Theft" and provides:

> We will pay for loss of or damage to "money", "securities" and "other property" resulting directly from "theft" committed by an "employee", whether identified or not, acting alone or in collusion with other persons.
>
> For the purpose of this Insuring Agreement, "theft" shall also include forgery.

In recent years, some insurers have varied that standard form language in several ways, including one or more of the following:

- Deleting the requirement that the financial benefit received by the dishonest employee have a value of at least $2,500.
- Deleting the word "manifest" before the word "intent."
- Changing the word "and" to the word "or" between parts "a." and "b." of the intent requirement.

Insuring agreements covering various types of electronic crime, including computer systems fraud, fraudulent transfer instructions, and social engineering fraud, also can vary substantially from one carrier to the next. In light of all the available variations in policy terms, the organization looking for fidelity insurance should thoroughly examine all of its options. In doing so, it should pay careful attention not only to the amount of the premium, but also to the substantive differences in policy terms. Before deciding which policy to select, the insured should review specimen forms of the competing policies and should not be satisfied with simply reviewing the terms of a quote or binder.

C. Steps to Be Taken Once Coverage Is in Place

The insured's evaluation process should not end once coverage is purchased. Often, insureds purchase fidelity coverage and, once the bond is delivered, they simply put the document in a file and never look at it until they believe they have a claim. Insureds instead should take at least three earlier steps.

First, they should compare the issued bond to the specimen form they reviewed when they purchased the policy, if one was provided, and to the binder. Insureds should be certain they know exactly what coverage they have obtained. Again, a broker can assist.

Second, some insuring agreements in a bond require that certain internal procedures be followed by the insured in order for the insured to have a path to coverage. For example, bonds frequently require that the insured have actual physical possession of an "original" document in order to pursue a claim under a forgery or securities insuring agreement.

See COMMERCIAL CRIME POLICY (Discovery Form), at A. Insuring Agreements, 1. Employee Theft (Insurance Services Office, Inc. revised 2012) [hereinafter CCP].

And many bonds require that certain verification procedures be followed to pursue coverage for electronic crime claims. The insured should take steps to identify and then implement the necessary procedures necessary for complying with the bond requirements.

Third, someone on the insured's staff, whether a risk manager, a financial officer or the like, should have responsibility—before a loss occurs—for generally knowing the terms of the fidelity bond and for educating management level employees about the insured's obligation to give notice to the insurer if a loss does occur.

III.
Discovery of Improper Conduct

Discovery can be one of the most challenging, and, at the same time, one of the most important concepts in the law of fidelity bonds. Notice of loss, proof of loss and suit deadlines are typically keyed from the date of discovery. In addition, discovery must occur prior to a financial institution bond's termination in order to trigger coverage under that bond and, under recent commercial crime policy forms, must occur within a stated period after the commercial crime policy terminates. An insured's failure to recognize that discovery has occurred, or could have occurred if suspicions were pursued, can result in a missed deadline or a lost claim.

A. The Definition of Discovery

The FIB defines "discovery" as follows:

> This bond applies to loss discovered by the insured during the Bond Period. Discovery occurs when the insured first becomes aware of facts which would cause a reasonable person to assume that a loss of the type covered by this bond has been or will be incurred, regardless of when the act or acts causing or contributing to such loss occurred, even though the exact amount or details of loss may not then be known.[6]

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6. FIB, at Conditions and Limitations, § 3. Under the FIB, "[d]iscovery also occurs when the insured receives notice of an actual or potential claim in which it is alleged that the insured is liable to a third party under circumstances which, if true, would constitute a loss under this bond." *Id.* Issues relevant to that provision are discussed below.

The CCP defines discovery in a manner similar to the FIB. The FIB requires the insured to give notice of loss to the insurer not more than thirty days after discovery of loss and to furnish proof of loss within six months after discovery.[7] The CCP requires the insured to give notice as soon as possible and proof of loss within 120 days after the insured discovers "a loss or a situation that may result in loss of or damage to 'money', 'securities' or other property' . . . ."[8]

Insureds and insurers have litigated frequently over the discovery concept in crime insurance.[9] In short, the cases have addressed such issues as whether discovery is a subjective standard or an objective standard (insurers argue it is an objective standard) and whether insureds have a duty of inquiry to pursue discovery (insurers contend that they do).

B. Applying the Discovery Concept in Real Life

Confronted with the definition of discovery in in the FIB and the CCP, insureds frequently raise the following types of questions:

- Scenario 1: I suspect Employee X of dishonest conduct, but I do not have proof. Should I file a bond claim now or wait and investigate?
- Scenario 2: I have proof that Employee X has engaged in dishonest conduct, but the business has not yet suffered any monetary loss, and I do not know whether it will. Should I file a bond claim?
- Scenario 3: I have recently learned that our senior vice president has engaged in dishonest actions that have caused us significant

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7. *Id.* § 5. Bonds issued by some insurers provide longer periods for the insured to give notice.
8. CCP, at E. Conditions, g. Duties in Event of Loss.
9. Cases addressing important issues regarding discovery can be found in Toni Scott Reed, *Discovery, in* ANNOTATED FINANCIAL INSTITUTION BOND 341-375 (Michael Keeley ed., 3d ed. 2013); Edward Etcheverry, *Discovery, Notice, Proof of Loss, and Suit Limitations, in* COMMERCIAL CRIME POLICY 12-11 (Gilbert J. Schroeder ed., 1997) [hereinafter Commercial Crime Policy]; Michael J. Weber & Ronald G. Mund, *Discovery—What Does It Do, What Is It, and Who Must Discover?, in* COMMERCIAL CRIME POLICY 333 (Randall I. Marmor & John J. Tomaine eds., 2d ed. 2005) [hereinafter Commercial Crime Policy 2d].

> losses. However, our assistant vice president who reports to the senior vice president became aware of the dishonest actions over a year ago but never reported them to me or the Board of Directors. Have I lost the bond claim?

Scenario 1: File now or wait and investigate?

The cases are clear that mere suspicion alone does not constitute discovery.[10] Indeed, one court has gone so far as to say that "discovery of loss does not occur until the insured discovers facts showing that dishonest acts occurred and appreciates the significance of those facts . . . ."[11] However, insurers often argue that discovery must be tested by a mixed objective/subjective test. That is, what a reasonable person should have concluded based upon known facts. Thus, they argue that discovery can occur even though the insured has not concluded there was dishonesty. One commentator has noted that there is a continuum of circumstances between mere suspicion and actual knowledge which may be construed as discovery.[12] Because in the authors' view insurers are constantly pushing for application of a standard that is closer to the mere suspicion end of the spectrum, the insured needs to approach Scenario 1 cautiously.

The insured confronted with this question should consider taking the following actions. First, the insured should determine the precise nature of the facts that have given rise to the suspicion, determine how and when senior management became aware of those facts and determine the amount of the loss, if known. Second, if the suspected wrongdoer is still employed by the organization, the insured should assess whether he or she can or should be relieved of his or her responsibilities or terminated. Competent employment counsel should be involved in that determination. Third, if the insured assumes that discovery occurred when the suspicion first arose, it should calculate whether there is time left on the notice "clock." If there is, the insured should investigate further. If there is not, or if investigation neither confirms nor refutes the suspicions, the insured should strongly consider submitting a notice letter

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10. *See, e.g.*, FDIC v. Fid. & Deposit Co. of Md., 45 F.3d 969, 974 (5th Cir. 1995); FDIC v. Oldenburg, 34 F.3d 1529, 1542 (10th Cir. 1994).
11. *Fid. & Deposit Co. of Md.*, 45 F.3d at 974.
12. *See* Etcheverry, *supra* note 9, at 12-11.

to the insurer. A carefully drafted notice letter usually can be withdrawn at a later date.

Scenario 2: File now or wait to see if a monetary loss materializes?

This commonly asked question raises the issue of whether discovery means (a) discovery of improper conduct plus a possible monetary loss or (b) discovery of improper conduct plus a probable or actual monetary loss. Financial institution bonds require discovery of "loss"—a term that is undefined but connotes actual economic detriment. The challenge for the insured is compounded because the discovery provision speaks of discovery of "a loss of a type covered by this bond that *has been or will be* incurred, even though the exact amount or details of loss may not then be known."[13] A layman reading that language might conclude that if he does not know if a monetary loss will occur, discovery has not happened.

An insured should not adopt the layman's approach when confronted with the issue of discovery because courts have been inconsistent in their treatment of it.[14] The insured should assume that discovery has occurred with discovery of improper conduct and the mere possibility of loss and submit a notice letter (and later, a proof of loss) to the insurer.

Scenario 3: Does a junior officer's awareness of improper conduct constitute discovery under the bond?

This question raises the issue of who can discover a loss. The discovery provision quoted above from the FIB speaks of discovery by the "insured." It does not state who at the insured can "discover"

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13. FIB, at Conditions and Limitations, § 5 (emphasis added).

14. In *FDIC v. Oldenburg,* 34 F.3d at 1542, the Tenth Circuit stated that the discovery provision "'clearly ties coverage to discovery of possible loss' and does not require actual loss." (citation omitted). However, in *California Union Insurance Co. v. American Diversified Savings Bank*, 948 F.2d 556, 564 (9th Cir. 1991), the Ninth Circuit, applying California law, stated that to have discovery there must be discovery of both the loss and the dishonesty. The court noted that in the case before it "[t]he record is devoid of any specific evidence indicating that facts supporting a conclusion that an *actual loss* occurred were brought to the attention of the non-wrongdoing employees." *Id.* (emphasis added).

dishonesty and monetary loss.[15] Cases vary by jurisdiction on whose knowledge should be imputed to the insured for purposes of discovery.[16] If the junior officer failed to apprise the organization's management about the wrongdoing and thereby allowed it to continue, there can be multiple reasons for her remaining silent, some of which might prevent imputation and some would not. If she was acting in collusion with the senior vice president, then her knowledge should not be imputed to the insured. Alternatively, if the junior officer who reported to the senior vice president had very limited authority and feared for her career if she reported what she knew, the insured might successfully argue that the junior officer did not have sufficient responsibility to justify imputing her knowledge to the insured. Faced with these circumstances, however, the insured probably should not forego submitting its claim.

C. Claims Against the Insured by a Third Party

As noted above, the insured can also discover loss under the FIB when it "receives notice of an actual or potential claim in which it is alleged that the insured is liable to a third party under circumstances which, if true, would constitute a loss under this bond."[17] This provision typically does not present the discovery issues discussed above. Discovery of a claim by a third party usually will happen when the insured receives correspondence making a demand or is served with a lawsuit. The insured's primary task is to promptly analyze the demand or suit and assess whether, if the allegations are true, it could conceivably implicate coverage under its crime policy. The insured should have a procedure in place so that a member of the organization or the organization's outside counsel knowledgeable about the bond's coverage and notice requirements promptly makes such a determination. If there are any colorable grounds for coverage, the insured or its counsel should give notice to the insurer.

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15. Some insurers now avoid this issue by writing endorsements stating that only the insured's risk manager or a certain level of officer can "discover" under the bond.
16. See for a discussion of relevant authorities Toni Scott Reed, *Discovery of Loss, in* FINANCIAL INSTITUTION BONDS 674-679 (Michael Keeley ed., 4th ed. 2016) [hereinafter FINANCIAL INSTITUTION BONDS 4th].
17. FIB, at Conditions and Limitations, § 5.

IV. Issues to Be Considered Before Notice Is Given

Once discovery occurs, sending a notice of loss to the insurer is not necessarily automatic. The insured's management should consider certain matters before giving final authorization for the sending of notice, or at least before the post-notice investigation begins.

A. Expense and Use of Resources

An insured submitting a notice of loss under a fidelity bond needs to be aware that it may be about to embark on a lengthy, and sometimes expensive, and frustrating process. If the claim is complicated, it might be necessary to retain outside counsel, and possibly investigators and consultants, to investigate and prepare a claim and interact with the insurer. Coverage for such expenditures under the fidelity bond usually is limited, if it is provided at all. The insured may also need to devote significant staff resources to assist in the investigation. The process also can consume management time. If the bond claim is not resolved amicably and results in litigation, all of these costs will continue to be incurred, probably at a faster rate. The insured might not be able to recover all of those expenditures even if it prevails in the litigation.

B. Libel Considerations

Employees or third-parties who are the subject of a fidelity bond claim will at times respond to such claims with charges of defamation, even when the claim is well grounded in fact. Management should be aware of that possibility and the insured or its counsel should draft any notice letter with that issue in mind.[18]

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18. Notice and proof of loss submitted in connection with a fidelity bond claim are subject to a qualified or conditional privilege in most jurisdictions. *See* Lull v. Wick Constr. Co., 614 P.2d 321, 324 (Alaska 1980); Farmer *ex rel.* Keomalu v. Hickam Fed. Credit Union, 224 P.3d 455, (Haw. Ct. App. 2010); Funderburk v. Johnson, 935 So. 2d 1084, 1105 (Miss. Ct. App. 2006); Gelmin v. Quiche, 638 N.Y.S. 2d 132, 135 (N.Y. App. Div. 1996); Roegelein Provision Co. v. Mayen, 566 S.W.2d

C. Effects on Coverage

An insured's submission of a claim might lead its insurer to reevaluate the risk of continuing insurance, particularly if the loss was caused by a failure to have proper safeguards in place. Thus, depending upon the circumstances leading to the loss, the insurer might offer less favorable terms for renewal, decline to renew the policy, or even terminate the policy before the end of the current policy term. Termination of coverage, however, is uncommon. Further, nonrenewal for substantial insureds that are perceived by insurers as good customers is unusual. But an insured that does not fit that profile should be aware of the possibility that its coverage could be negatively affected by its submission of a claim, but that possibility usually should not deter the insured from proceeding with the claim.

V.
Notice of Loss

All fidelity bonds require that the insured submit notice of loss to the insurer. The notice requirement in the FIB usually provides that "[a]t the earliest practicable moment, not to exceed 30 days, after discovery of loss, the insured shall give the underwriter notice thereof."[19] The notice requirement in the CCP requires the insured to give notice "as soon as possible."[20]

A. Form of Notice

A sound notice letter should identify the insured and the crime policy, briefly state that the insured has discovered facts giving rise to possible coverage, describe the area(s) of the organization's business in which the conduct occurred, describe the nature of the loss, and generally characterize, if known, the significance of the loss. The letter also should note that investigation is ongoing and that proof of loss will be forthcoming as appropriate, and should request acknowledgment of the insurer's receipt of the notice. In the case of employee dishonesty or

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1, 9 (Tex. Ct. App. 1978). *See generally* Restatement (Second) of Torts §§ 594-98 (1976).

19. FIB, at Conditions and Limitations, § 5.

20. *See, e.g.*, CCP, at E. Conditions, 1.g. Duties in the Event of Loss.

theft, the notice letter should identify the wrongdoer by name, if evidence of dishonest conduct is clear. Care should be taken in drafting the notice because of the potential libel considerations mentioned above.

Some bonds will identify on the Declarations page an address for the submission of notice. If not, notice should be sent to the insurer's general address to the attention of the claims department. If the insurer has a local office, the notice letter can be sent to that address. However, if there are no claims personnel in the local office, the forwarding of the notice letter to the appropriate claims personnel might be delayed. Notices should be submitted by e-mail and by certified or express mail or by any means specified in the bond.

B. Notice of Claim By a Third Party

As discussed above, the FIB provides that notice to the insured of an actual or potential claim by a third party constitutes discovery of loss. That type of discovery triggers the insured's obligation to give notice of loss under the FIB. Discovery of those types of circumstances also would trigger the notice requirement under the CCP. Notice should be submitted to the carrier utilizing the same procedures, though not the same content, discussed in part V.A. above.

The FIB addresses notice under these circumstances in two separate parts of the bond. First, when the insured learns of a potential or actual claim against it by a third party (short of a lawsuit being filed), the notice it is obligated to give falls under Section 5(a) of the bond's Conditions and Limitations. That section as discussed above requires notice at the earliest practicable moment, not to exceed thirty days, after the insured receives notice of the potential claim. Under Section 5(b), the insured must then file proof of loss within six months after it learns of the potential or actual claim.

Second, if the claim is first asserted in the form of a lawsuit, the notice requirement is in General Agreement F of the FIB. Under that provision, the deadline for notice is the earliest practicable moment, not to exceed thirty days, which is the same as in Section 5(a). The proof of loss requirement in that situation, however, is different than if the claim has not ripened into a lawsuit. Proof of loss is to be filed within six months of judgment or settlement rather than within six months of the insured's learning of the potential or actual claim.

The notice letter should describe in some detail the allegations made by the third party, explain why the allegations, if true, trigger coverage under the bond and, if possible and desirable, explain why it is in the insurer's interest to be involved in any settlement discussions at an early stage. If the claim is already a lawsuit, the letter should offer the insurer the opportunity to defend the lawsuit and set out a rationale why it would be in the insurer's interest to do so. The insured should transmit with that letter any demand letters and, if a lawsuit has been filed, any pleadings and discovery papers. A word of caution: the insured should count on defending the lawsuit itself because standard crime policies do not require the insurer to defend and in most cases, the insurer will decline such a defense.

C. The Predicament of Untimely Notice

The insured should always attempt to comply with the notice requirement in a timely manner. Timely notice and proof of loss typically are construed as conditions precedent to recovery under fidelity bonds. However, if the insured submits an untimely notice of loss, its claim under the fidelity bond might still be viable.

The best argument for coverage will be available to an untimely insured located in a jurisdiction requiring the insurer to demonstrate that it was prejudiced by receiving untimely notice or allowing the insured to show that the insurer was not prejudiced.[21] Despite insurers' protestations to the contrary, they are not always prejudiced by the receipt of notice that is weeks or even months late. Prejudice might be more readily proved when the insurer can show that upon the receipt of notice it would have immediately taken steps that the insured did not take, such as steps to freeze embezzled assets or their proceeds. Conversely, if the insured can show the insurer would not have begun to investigate the claim until a later date, it might be able to establish that the insurer was not prejudiced.

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21. For a discussion of relevant cases, see Joel T. Wiegert, Anthony J. Alt & Matthew J. Photis, *Notice, Proof of Loss, and Legal Proceedings Against the Insurer—The Financial Institution Bond's Procedural Conditions for Coverage, in* FINANCIAL INSTITUTION BONDS 4th, *supra* note 16 at 812-21; Etcheverry, *supra* note 9, at 12-18; and Weber & Mund, *supra* note 9, at 344-49.

Other arguments potentially available to the insured might include arguments that the notice provision is a covenant rather than a condition precedent or that the insurer waived or is estopped to rely on the notice provision. The viability of those arguments will obviously depend on the facts of the case and the law in the insured's jurisdiction.

VI.
Steps to Protect the Insured's Interests

Whether the insured has discovered fraudulent actions by an employee or third party or learned of a claim against it by a third party, the insured should focus on the fidelity bond's notice requirements. Equally important, the insured should address other steps it should take to protect its interests and comply with relevant regulations.

A. Reports to Criminal Authorities

Conduct that is covered under a crime policy frequently will constitute a federal and/or state criminal violation. If the insured has discovered fraudulent conduct by an employee or third party, it should immediately notify appropriate law enforcement agencies, possibly including the Federal Bureau of Investigation. The CCP requires that the insured do so with respect to third-party conduct that "involves a violation of law."[22] Such reports to criminal authorities are subject to a qualified privilege in most jurisdictions. National and state banks which detect any known or suspected criminal violation must submit a suspicious activity report[23] to federal regulators and law enforcement

22. CCP, at E. Conditions, 1. 9. Duties in the Event of Loss.
23. Hereinafter SAR.

authorities.[24] Federal regulation prohibits the institution from disclosing the fact that an SAR was filed, and from disclosing its contents.[25]

An immediate response from criminal authorities can be very helpful to an insured. Fast action by the FBI or other authorities can sometimes result in the wrongdoer being identified, if not already known, and possibly confessing and disclosing the whereabouts of assets. The insured should be careful to maintain copies, or other proof, of any documents or other evidence provided to the FBI or other authorities as it might be needed to prove its claim. The interplay between a bond claim and a criminal proceeding is discussed in more detail below.

B. Freezing Embezzled Assets

If the wrongdoer has embezzled or stolen assets, whether money or other property, the insured should immediately consider whether any of those assets still exist and can be frozen or seized. If there is reason to believe such assets still exist, the insured should examine the prospect of a civil suit against its former employee, any third party in collusion with the employee and any third party in possession of embezzled or stolen assets or their proceeds. Potential remedies include injunction, attachment and garnishment. The insured should not bypass such a suit if

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24. *See* 12 C.F.R. § 21.11 (2018) (OCC regulation requiring national banks to submit SAR to the Financial Crimes Enforcement Network of the Department of Treasury [hereinafter FinCEN] and encouraging them to file a copy with state and local law enforcement authorities); 12 C.F.R. § 208.62 (2018) (Federal Reserve Board regulation requiring state member banks to submit SARs); 12 C.F.R. § 353.1-353.3 (2018) (FDIC regulation requiring state nonmember banks to submit SARs). Statements made in the SAR are protected by an unqualified privilege. *See id.*; 31 U.S.C. § 5318(g); Lee v. Bankers Trust Co., 166 F.3d 540, 544 (2d Cir. 1999); *Martinez-Rodriguez v. Bank of Am.*, No. C 11-06572 CRB, 2012 WL 967030, at *12 (N.D. Cal. Mar. 21, 2012). *But cf.* Lopez v. First Union Nat'l Bank, 129 F.3d 1186, 1195 (11th Cir. 1999) (reading the safe harbor provisions of 31 U.S.C. § 5318(g) as requiring the institution to have a good faith basis).

25. *See* 12 C.F.R. §§ 21.11(k), 208.62(j), 353.3(g). In light of these restrictions, a financial institution should decline a request from an insurer for a copy of a SAR, should not disclose whether a SAR exists, and should notify its federal regulator of the request and its response.

it is economically and legally justified simply based on the thought that "we'll leave that to the fidelity bond carrier."

Care should be taken in drafting pleadings to avoid statements about the conduct that conflict with the terms of the crime policy. Also, prior to filing any such suit the insured should be aware that filing suit turns a private matter into a public matter. The adverse publicity that might result from such a suit should not be overlooked.

C. Securing Data and Documents

The insured should take immediate steps in concert with senior members of its information technology staff and third-party services to preserve all electronic data and all electronic and paper documents that might have any relationship to the wrongful activity. Emails, electronic documents in document management systems, text messages, and company-owned devices such as desktop computers, laptops and cell phones should all be secured for analysis. The insured should consider whether to retain a forensic computer specialist to assist in the preservation and analysis of electronic data.

D. Other Mitigation of Losses

Besides considering suit against the wrongdoer or third parties to freeze assets, the insured should be sensitive to other opportunities to mitigate its losses. The insurer will take the position that if it pays the insured's claim it becomes subrogated to the insured's rights against third parties and that the insured may not take any actions that harm the insurer's subrogation rights.[26] The insured should not strike a "deal" with the wrongdoer or a third party without the knowledge and approval of the insurer. If the fraudulent activity involves loan transactions, the insured should avoid releasing borrowers or collateral without the knowledge and acquiescence of the insurer. Similarly, the insured should also avoid releasing claims against professionals such as accountants, appraisers or

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26. See FIB, at Conditions and Limitations, at §§ 7(b), 7(e).

lawyers who might bear any responsibility for the loss the insured has suffered or will suffer.[27]

VII.
The Bond Claim Investigation

Either before or immediately after notice of loss is submitted, the insured typically will need to conduct an investigation of the fraudulent conduct. The nature of the investigation will vary depending on (a) the type and complexity of the conduct involved; (b) whether the bad actor is an employee who was acting alone or was acting with third parties; (c) whether the wrongdoer was a known or unknown third party; and (d) whether the wrongdoer has confessed and cooperated. Given that the type of investigation that an insured needs to conduct can vary significantly, there can be no "how to" manual explaining how such an investigation ought to be handled. However, there are certain basic principles that apply to most, if not all, bond claim investigations.

A. The Goals of Investigation

Most insureds should have four primary goals in conducting an investigation into a fidelity loss. The first goal is preparation of a solid proof of loss. While insurers disagree, in the authors' opinion, a second goal should be acting with an eye toward possible litigation if the claim is denied. As with all insurance claims, litigation is always a possibility. Therefore, the failure of an insured and its counsel to recognize this fact can lead to duplication of effort and expense if litigation does ensue and can have negative repercussions on the scope of the work product doctrine. The third goal is the assembly of material for submission to criminal authorities. The fourth goal is identification and implementation of remedial steps to try to prevent similar occurrences in the future.

B. Identifying and Confronting the Wrongdoer

In most instances, the insured will learn the identity of the wrongdoer when it learns of the improper activity. In the case of

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27. These admonitions do not apply after the Insurer has denied or refused to pay the claim and the insured eventually has to file suit to recover on the bond.