Financial Benefit Requirement (Including Discussion of Employee Salary, Commissions and Fees Exclusion)

Charles M. Armentrout[1]
Jeffrey S. Price[2]

Introduction

Employee dishonesty is defined under the standard financial institution bonds and commercial crime coverages, in relevant part, as acts committed by an employee of the insured with the manifest intent to obtain ***a financial benefit for the employee or a third party***. The interpretation of this portion of the definition of employee dishonesty implicates the question: what is a "financial benefit"? Fidelity bonds and policies exclude from the definition of "financial benefit" value received by the employee in the form of ordinary compensation (i.e. salary, bonuses, company stock, etc.). The financial benefit is often presumed by the insured at the time the proof of loss is tendered to the insurer. The insured focuses on the purportedly dishonest conduct of its employee (hopefully, former employee at the time of the claim). However, it is imperative for the fidelity insurer to emphasize to the insured that its burden to establish coverage includes a showing that the conduct of the employee was motivated by an intent to receive a "financial benefit" for himself or a third party. This paper will focus on cases in which coverage has hinged upon the court's interpretation of the financial benefit requirement.[3]

The paradigm case implicating the requisite "financial benefit" is theft of property of the insured, without the insured's knowledge, by the employee, for the employee's personal benefit. Inversely, no "financial benefit" is received where the employee's dishonest conduct is merely intended to produce promotions or raises for the employee from the insured. It is those cases in

---

[1] Mr. Armentrout is the Assistant Vice President and Bond and Executive Risks Claims Manager for The Cincinnati Insurance Company, The Cincinnati Casualty Company, and The Cincinnati Indemnity Company, which are all subsidiaries of The Cincinnati Financial Corporation, located in Fairfield, Ohio. Mr. Armentrout is a member of the National Society of Professional Insurance Investigators, the National Bond Claims Association, the Surety Claims Institute, the Fidelity Law Association, Insuring the Children, and the Claims Advisory Committee of the Surety Association of America. Mr. Armentrout is responsible for the handling and supervision of all Fidelity and Surety Bond claims, as well as the supervision of Employee Dishonesty claims handled by over 600 Field Claims Representatives. The Cincinnati Insurance Companies actively market in 31 states through 966 independent agencies.

[2] Mr. Price is an associate with Manier & Herod in Nashville, Tennessee. Mr. Price received his undergraduate degree from Gardner-Webb University (Boiling Springs, N.C.), *magna cum laude*, in 1995 and his J.D. from the University of Tennessee College of Law, *summa cum laude* and Order of the Coif, in 1998. Mr. Price's practice focuses in the areas of Surety Law and Fidelity Law.

[3] The issues relating to what constitutes "manifest intent" are beyond the scope of this paper and will be addressed only peripherally as they necessarily relate to the financial benefit requirement. For a detailed analysis of the meaning of "manifest intent" and a survey of the law in this area, this writer recommends a review of the Third Circuit Court of Appeals Decision in *Resolution Trust Corporation v. Fidelity & Deposit Company of Maryland*, 205 F.3d 615, 637-45 (3rd Cir. 2000).

which the financial benefit is less clearly defined which have led to judicial interpretation of this provision.

I. *Employee Dishonesty Coverage Provisions*

Bankers Blanket Bond Standard Form No. 24, (revised to July 1980) provides coverage as follows:

> FIDELITY
>
> (A) Loss resulting directly from dishonest or fraudulent acts of an Employee committed alone or in collusion with others.
> Dishonest or fraudulent acts as used in this Insuring Agreement shall mean only dishonest or fraudulent acts committed by such Employee with the manifest intent
> (a) to cause the Insured to sustain such loss, and
> (b) **to obtain financial benefit for the Employee or for any other person or organization intended by the Employee to receive such benefit, other than salaries, commissions, fees, bonuses, promotions, awards, profit sharing, pensions or other employee benefits earned in the normal course of employment**.
> (emphasis added).

Financial Institution Bond Standard Form No. 24 (revised to January 1986) provides as follows:

> FIDELITY
>
> (A) Loss resulting directly from dishonest or fraudulent acts committed by an Employee acting alone or in collusion with others.
> Such dishonest or fraudulent must be committed by the Employee with the manifest intent.
> (a) to cause the Insured to sustain such loss, and
> (b) **to obtain 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 Loans, that portion of the loss is not covered unless the Employee was in collusion with one or more parties to the transactions and has received, in connection therewith, a financial benefit with a value of at least $2,500.**
>
> **As used throughout this Insuring Agreement, financial benefit does not include any employee benefits earned in the normal course of employment, including: salaries, commissions, fees, bonuses, promotions, awards, profit sharing or pensions.**
> (emphasis added).

Similarly, Employee Dishonesty Coverage Forms define "employee dishonesty" as:

> Only dishonest acts committed by an "employee", whether identified or not, acting alone or in collusion with other persons, except you or partner, with the manifest intent to:
>
> 1. cause you to sustain a loss; and also
> 2. **obtain financial benefit (other than salaries, commissions, fees, bonuses, promotions, awards, profit sharing, pensions or other employee benefits earned in the normal course of employment) for:**
>   **(a) the "employee"; or**
>   **(b) any person or organization intended by the "employee" to receive that benefit.**[4]
>
> (emphasis added).

All of the above-cited provisions require that the insured demonstrate that the dishonest employee act with the manifest intent to obtain a financial benefit for the employee or for another person or entity. The 1986 version of the Standard Form No. 24 Financial Institution Bond requires further that if any of the loss resulted directly or indirectly from Loans, the employee must have received a financial benefit of at least $2,500.

Few claims will turn on which particular version of employee dishonesty coverage is included in the applicable bond or policy. Most courts apply the same analysis to each variation of the employee dishonesty insuring agreement. *See Morgan, Olmstead, Kennedy & Gardner, Inc. v. Federal Ins. Co.*, 637 F. Supp. 973, 979 (S.D.N.Y. 1986). There is one major exception to this general rule. The 1986 Standard Form No. 24 Financial Institution Bond requires that, where the loss relates in any way to loans, the insured must demonstrate that the financial benefit received by the employee is valued at, at least, $2,500. This additional requirement will be discussed in detail later in this paper. One additional variation which has not been addressed directly by courts is the difference in the grammatical presentation of the employee benefit exclusion. Specifically, the 1986 Standard Form No. 24 Financial Institution Bond defines the employee benefits which are excluded from the definition of "financial benefit" as follows:

> any employee benefits earned in the normal course of employment, including: salaries, commissions, fees, bonuses, promotions, awards, profit sharing or pensions

Salaries, commissions, etc. are listed as examples of "employee benefits earned in the normal course of employment." In contrast, the 1980 Blanket Bankers Bond and the Employee Dishonesty Coverage Form present the exclusion as follows:

> salaries, commissions, fees, bonuses, promotions, awards, profit sharing, pensions or other employee benefits earned in the normal course of employment

The specific items are expanded by the general item "other employee benefits earned in the normal course of employment." At least two courts have interpreted the latter provision to

---

[4] Employee Dishonesty Coverage Form CR 00 01 01 86 (copyright, Insurance Services Office, Inc. 1984, 1989).

conclude that the phrase "earned in the normal course of employment" modified only "other employee benefits" and not the specific preceding items. *See Resolution Trust Corp. v. Fidelity & Deposit Co. of Maryland*, 205 F.3d 615, 646 (3rd Cir. 2000); *Hartford Accident & Indem. Ins. Co. v. Washington Nat'l Ins. Co.*, 638 F. Supp. 78, 83 (N.D. Ill. 1986). In the 1986 Form No. 24 Financial Institution Bond, the "earned in the normal course of employment" language modifies the specific items which follow. This distinction has not been made by courts in reported decisions and would rarely become relevant in the context of coverage. Most courts have held that "earned in the normal course of employment" simply means that the benefit received by the employee was of the kind normally earned as an employee. Courts have rejected the argument that bonuses, commissions, or other benefits received by an employee which would not have been received absent his dishonesty are not "earned in the normal course of employment." This issue will be discussed in detail later in this paper.

These coverage provisions were carefully crafted by the banking industry and the fidelity bond companies[5] to define the scope of the intended coverage. The financial benefit requirement is an essential part of these coverage provisions as it narrows coverage to loss incurred by the insured as a result of acts by an employee which are motivated by personal financial gain for the employee or an intended third party and not by an intent to benefit the employer (whether exclusive of or conjunctive with an intent for collateral benefit to the employee). The fidelity insurer, its counsel, and the insured should understand the nature and intent of this requirement.
.

II. *What is Financial Benefit?*

The type of benefit which the dishonest employee intends to receive or intends to be received by a third party can be a pivotal issue in determining coverage under a financial institution bond or employee dishonesty policy. The financial benefit requirement is the linchpin of the purpose and intent of the employee dishonesty coverage. The financial benefit requirement protects the insurer from claims where the employee's motivation is either undeterminable or intangible. The employee must, instead, have acted dishonestly with the intent or motivation to receive financial gain for himself or for some third party. It is this additional financial motivation which implicates coverage under the employee dishonesty coverage provisions. Not only does the financial benefit requirement limit coverage to that intended under the policy or bond, it also helps to focus coverage on truly dishonest conduct and not conduct which is merely improper, negligent, or incompetent. An employee that causes his employer to incur a loss without receipt of any financial benefit rarely acts with the intent or malice which is implicit in the employee dishonesty coverage. Intended coverage is tantamount to theft or taking from the employer, which necessarily requires receipt of the property or value by the employee or some third party. Courts have been, for the most part, consistent in their interpretation of the financial benefit requirement. Identifiable financial benefit has been required by the courts in order to implicate coverage under the employee dishonesty policy.

An insured will often incur a loss as a result of an employee acting in contravention of policies of the insured with the actual intent to increase the insured's business, benefit its customers, and/or increase employee's success with the insured. As the Second Circuit has acknowledged, "because the employee misguidedly hopes to benefit his employer and receives no personal gain from the transaction…the requisite manifest intent [is] not…shown." *Glusband v. Fittin Cunningham & Lauzon, Inc.*, 892 F.2d 208, 211 (2nd Cir. 1989). Even where an employee uses false promises to induce investors and conceals losses to the investors, there is no covered

---

[5] The Financial Institution Bond is a contract negotiated between the two industries and was not "drafted" by the fidelity insurers. *Federal Deposit Ins. Corp. v. Insurance Co. of North America*, 105 F.3d 778 (1st Cir. 1997).

loss where the funds were actually invested and the employee did not convert the invested funds to his own benefit or to the benefit of a third party. *Id.* at 209. An insured does not satisfy its burden to demonstrate a financial benefit by showing it incurred a significant loss and asserting, therefore, that a financial benefit was necessarily realized by some party. *Progressive Casualty Ins. Co. v. First Bank*, 828 F. Supp. 473, 475 (S.D. Tex. 1993). The court stated that the Bank's argument is unacceptable, while it "is unfortunately all too common in this era of freedom from accountability." *Id.*

Financial benefit does not, necessarily, require tangible receipt of cash by the employee. It could also involve release of the employee from personal liability on certain debts. *Estate of K. O. Jordan v. Hartford Accident & Indemnity Co.*, 844 P.2d 403 (Wash. 1993) (court held financial benefit requirement was met when the employee embezzled money from a trust account in order to cover general operating expenses of the insured for which the employee was personally liable). It has also been held that where the employee's embezzlement benefited his employer and, therefore, benefited the employee as a shareholder of the insured, the financial benefit requirement has been satisfied. *Id.* This example appears to be at the furthest end of the "financial benefit" definition. It is possible, and perhaps likely, that other courts presented with this argument would conclude that benefit received by an employee indirectly through maintenance of the value of stock owned by the employee is **not** a financial benefit. The benefit is remote and, it may be argued, is not to be included within the intent of employee dishonesty coverage.

Loans made by an employee to himself can convey the requisite financial benefit. *Hartford Accident and Indemnity Ins. Co.v. Washington Nat'l Ins. Co.*, 638 F. Supp. 78, 84 (N.D. Ill. 1986). Several courts have found that manifest intent to obtain a financial benefit was established where an employee approved loans to entities in which the employee maintained a financial stake. *Federal Deposit Ins. Corp. v. St. Paul Fire & Marine Ins. Co.*, 738 F.Supp. 1146, 1157 (M.D. Tenn. 1990); *Maryland Casualty v. American Trust Co.*, 71 F.2d 137 (5th Cir. 1934). These cases have, however, been limited to claims involving an employee with a significant interest in the borrower (i.e. officer, owner, partner). The courts have not fully defined how remote or minor the employee's interest may be before no financial benefit is found. In the borrower context under the 1986 Form No. 24 Financial Institution Bond, this issue is defined to a greater degree by the $2,500 benefit requirement. Regardless of the implication of the $2,500 benefit requirement, it is unlikely that a court would find that an employee received a financial benefit when he made an improper loan to a large company in which the employee owned a small amount of stock and had no control. If the employee owns a significant interest in the company, but receives a benefit only through the increase in the value of the stock, courts may differ on whether the requisite financial benefit was received. At this juncture, it appears the analysis would turn on how direct and definite the benefit may be. Where a loan officer is making improper loans to third parties to prevent default on obligations which the loan officer personally guaranteed, an actual direct financial benefit may be found. In contrast, if the employee is a director or officer of the borrower, but receives no benefit from profits realized by the borrower, there would not appear to be a direct financial benefit.

It is not necessary that a person covered by the fidelity bond personally profit by his acts. *Irvin Jacobs & Co. v. Fidelity & Deposit Co. of Maryland*, 202 F.2d 794, 798 (7th Cir. 1953); *Federal Deposit Corp. v. Aetna Casualty & Surety Co.*, 426 F.2d 729 (5th Cir. 1970). Some courts have indicated that the financial benefit requirement may be satisfied where the employee approved the loan to a person or entity he knew was not qualified for the loan or where the employee knew that the loans would be used for an improper purpose. *First Bank of Marietta v. Hartford Underwriters Mut. Ins. Co.*, 997 F.Supp. 934, 938-39 (S.D. Ohio 1998). In that circumstance, a court may find that the financial benefit was conveyed to the loan recipient who

was otherwise unqualified or unable to obtain the loan. However, an insured must, necessarily, demonstrate that the third party borrower would not have been able to obtain financing (from the insured or another lender) absent the dishonest employee's conduct. Without this showing, it may be argued that the borrower was not given a financial benefit. If the borrower could have obtained the same loan under the same or similar terms from another lender (or if the insured would have made the loan if it had been properly reviewed) it cannot be said that the employee gave the borrower any "value" or "benefit" to which the borrower was not otherwise entitled.[6] Moreover, it must be demonstrated that the employee's conduct was motivated by his intent to convey the benefit to the third party. If the improper financial benefit is only an ancillary product of the employee's conduct, no coverage will avail under the policy or bond. The Pennsylvania Superior Court noted that an employee's conduct cannot be judged without a proper basis of comparison with conduct which is acceptable. *Susquehanna Bancshares, Inc. v. National Union Fire Ins. Co. of Pittsburg*, 659 A.2d 991, 998 (Pa. Super. Ct. 1995). The court noted that the bank's lack of general operations and lending guidelines must be considered when evaluating the employee's conduct. *Id.*

If the employee's conduct is motivated by his success with the insured, no financial benefit will be found. However, if the employee's motivation involves employment by a third party, a court could find a financial benefit. The Sixth Circuit has held that where the employee acts in violation of the insured's policies for the purpose of saving employee's job or covering up past conduct for which the employee could be terminated, the financial benefit requirement is not satisfied. *Municipal Securities, Inc. v. Ins. Co. of North America*, 829 F.2d 7, 9 (6th Cir. 1987). The Third Circuit suggested that acting with the purpose of securing future lucrative employment opportunities with an eventual purchaser of the insured satisfied the financial benefit requirement. *Resolution Trust Corp. v. Fidelity & Deposit Company of Maryland*, 205 F.3d 615, 651 (3rd Cir. 2000). In *Resolution Trust*, the court did not find a financial benefit under the bond, but remanded the case and stated that the insured "may seek to establish coverage under the bond by proving that in engaging in the various acts of concealment and misrepresentation, [the employees] acted with the purpose of securing for themselves lucrative employment opportunities, salaries and bonuses with [the insured's] eventual purchaser." *Id.* The court did note, however, that the insured could not establish coverage by "arguing that these employees acted with the intent to secure the golden handcuff payments from [the insured], as those payments qualify as financial benefits falling within the exclusionary clause in subsection (b)." *Id.*

Although it is rarely addressed, the benefit received by the employee or third party must, in fact, be financial in nature. A desire for increased standing or recognition with the insured, a third party, or in the community does not convey the type of benefit necessary to implicate employee dishonesty coverage. These are not financial in nature. "Financial" is defined as "relating to finances." Black's Law Dictionary 630 (6th ed. 1990). The term financial benefit implies that the benefit must either be monetary or have monetary value. While it does not require direct receipt of cash, it does require a monetary benefit. As discussed above, financial benefit is received if the dishonest conduct causes a debt to be paid on which the employee was a personal guarantor. The conduct relieved a financial obligation of the employee. Receipt of property or services at a cost or rate lower than what would have otherwise been charged is a financial benefit. *First Philson Bank v. Hartford Fire Ins. Co.*, 727 A.2d 584, 590 (Pa. Super. Ct. 1999)(no financial benefit found because insured could not establish that employee received a lease on a car with an extremely low lease payment due to the employee dishonesty). In some

---

[6] This scenario also implicates the issue of whether the employee's conduct caused the loss. An employee's dishonest conduct does not implicate coverage unless the dishonesty is the actual cause of the loss.

way the benefit purportedly received by the employee or third party must be able to be valued in terms of money.

The courts have, with few exceptions, defined "financial benefit" as is intended by the plain language of the policy or bond. There is a significant body of law addressing specific examples of claims that were found to involve a financial benefit and an equal number of cases where no financial benefit was established. A survey of the cases fosters a general formula to determine whether the employee received the requisite financial benefit to implicate coverage under the policy or bond. If the employee intended to receive some direct financial gain to which he was not entitled (in some form other than increased employee benefits) or intended a third party to receive some direct financial gain which it would not have otherwise received, a financial benefit is present. Two factors which the fidelity insurer should consider when the employee's benefit is not direct receipt of property or cash are (1) the remoteness of the benefit (i.e. how many steps must be taken or assumptions made to demonstrate the benefit) and (2) whether the benefit is real (financial) or theoretical (intangible).

III. *Benefits Earned in Normal Course of Employment Exclusion*

The standard bond forms and employee dishonesty policies provide that the financial benefit requirement is not satisfied if the intended benefit to the employee is salaries, commissions, fees, bonuses, promotions, awards, profit sharing, pensions or other employee benefits earned in the normal course of employment. The drafters of the Bond recognize that it is uncommon for an employee to act intentionally to the detriment of his employer unless the employee stands to receive a potential benefit. The fact that the insured must demonstrate a financial benefit exclusive of salaries, commissions, or benefits earned in the normal course of employment, significantly focuses the intended scope of coverage under the employee dishonesty provision. Most of the case law in this area has consistently defined financial benefit which is required in order to implicate coverage under the employee dishonesty Insuring Agreement to exclude any payments or other benefit voluntarily paid by the employer to the employee, whether the voluntary payment was the result of fraud or lack of information available to the employer.

Where an employee does not intend to gain, or intend any third party to gain, any benefit other than salary and expenses from the employee's employer, there is no coverage under the employee dishonesty insuring agreement. *Benchmark Crafters, Inc. v. Northwestern National Ins. Co. of Milwaukee*, 363 N.W.2d 89 (Minn. Ct. App. 1985). No matter how great the financial gain to be received by the employee in the form of increased pay, bonuses, etc., absent additional intended financial benefit, no coverage avails. *Morgan, Olmstead, Kennedy & Gardner, Inc. v. Federal Ins. Co.*, 637 F.Supp. 973 (S.D.N.Y. 1986). In *Morgan Olmstead*, the employee improperly accepted $20 million in stock loan business which dramatically increased the employee's compensation. The new business ultimately caused the insured to incur a loss. The insured asserted that the financial benefit requirement was satisfied due to the dramatic increase in compensation received by the employee. However, the court acknowledged that the bond does not cover acts of an employee who fraudulently or dishonestly obtains salary or commissions and, therefore, no coverage was available. *Id.* at 979.

If an employee receives increased salary, bonuses, etc. as a result of his dishonest conduct, it can usually be argued that he did not "earn" the payments as his dishonest conduct caused the increase. Insureds have also argued that these payments are not earned "in the normal course of employment." However, courts have rejected these arguments. As the Third Circuit opined "courts have rejected the argument that the exclusion precludes coverage only for losses caused by an employee's desire to obtain, for example, honestly earned commissions, finding that the term 'earned' encompasses financial benefits both fraudulently obtained and honestly earned

from the employer." *Resolution Trust Corp. v. Fidelity and Deposit Company of Maryland*, 205 F.3d 615, 648 (3rd Cir. 2000). "[E]arned in the course of employment is descriptive of the character of the payment at issue rather than the frequency with which the payment is received or the timing of its receipt." *Id.* Receipt of shares of stock through an employee stock option plan or bonuses which were not legitimately earned are not sufficient financial benefit to implicate coverage under an employee dishonesty insuring agreement. *First Pilson Bank v. Hartford Fire Ins. Co.*, 727 A.2d 584 (Pa. Super. Ct. 1999); *Hartford Accident & Indemnity Ins. Co. v. Washington National Ins. Co.*, 638 F.Supp. 78 (N.D. Ill. 1986). If an employee embezzles funds from its employer and turns the funds over to a third party, the conduct would fall within coverage. *Hartford Accident & Indemnity*, 638 F. Supp. at 84. If the employee receives commissions (whether earned or unearned) and turns those commissions over to a third person, coverage would not be available. *Id*. Compensation or benefit received by the employee from the employer does not have to be "earned" in order to be excluded from the financial benefit definition under the employee dishonesty coverage. *Verex Assurance Ins. Co. v. Gate City Mortgage Co.*, 1984 WL 2918, at *1-2 (D. Utah Dec. 4, 1984). Loss resulting from the employee's manipulation of a timecard system in order to obtain extra salary from the insured has been held not to satisfy the financial benefit requirement. However, the employee benefit exclusion from the financial benefit requirement is not implicated where the financial benefit arises from benefits received by the employee as a shareholder, director, officer, or employee of a third party. *Estate of K. O. Jordan v. Hartford Accident & Indem. Co.*, 844 P.2d 403, 413 (Wash. 1993).

As alluded to above, the employee benefit exclusion applies only when the payment from the employer is voluntary. Where an employee embezzles funds from a payroll account over which the employee had control by secretly paying himself unauthorized and excessive salary, commissions and bonuses, coverage may be available under the bond or policy. *Klyn v. Travelers Indem. Co.*, 273 A.2d 931 (N.Y. App. Div. 2000). Where the insured did not knowingly make payments to dishonest employee, the employee benefit exclusion is not implicated. *Id.*

In establishing a claim for employee dishonesty, the insured must demonstrate that the dishonest employee or some third party received a financial benefit separate from any financial benefit received by the employee through voluntary compensation from the insured. Conceptually, one may characterize all of the forms of value given by an employer to its employees. To the extent the employee's dishonest conduct does not cause him or some third party to receive financial benefit in forms other than those given by the employer, the claim is not covered.

IV. $*2,500 Financial Benefit Requirement*

Of the three standard employee dishonesty discovery provisions quoted above, only the Standard Form 24 Financial Institution Bond includes the $2,500 financial benefit requirement for loss arising from loans. In addition, many insurers are changing the standard form or amending the form by rider to remove the $2,500 benefit requirement. Most large institutions who negotiate their insurance coverage will insist on removing this requirement. Therefore, this requirement has become irrelevant in many employee dishonesty claims. As briefly discussed above, the Standard Form 24 Financial Institution Bond provides as follows:

> However, if some or all of the Insured's loss results directly or indirectly from Loans, that portion of the loss is not covered unless the Employee was in collusion with one or more parties to the transactions and has received, in connection therewith, a

> ***financial benefit with a value of at least $2,500.*** (emphasis added).

The financial institution bond is not intended to guarantee against bad loans made by the insured. Therefore, certain employee dishonesty coverage provisions limit loan loss coverage to loans made as a result of a "bribe." The $2,500 minimum excludes claims where a loan officer received a small gift which is less likely to motivate the employee to make a fraudulent loan. There are several issues which arise when loss is caused by a default on credit extended by the employee on behalf of the insured to a third party borrower. First, what is a "Loan"? Second, whether the insured is required to demonstrate that the employee received an aggregate benefit of $2,500 in relation to all the loans or a separate $2,500 benefit for each extension of credit. Finally, what is the proper valuation of the benefit conveyed to the employee.

A Loan is defined under the Financial Institution Bond as "all extensions of credit by the Insured and all transactions creating a creditor relationship in favor of the Insured and all transactions by which the Insured assumes an existing creditor relationship." (Section 1(m)). Most Loans involve a clearly defined borrower/lender relationship. There are, however, certain categories of extended credit which do not, necessarily, implicate the traditional borrower/lender relationship. Some courts have held that an overdraft by a bank depositor is treated as a loan from the bank to the depositor. *Affiliated Bank/Morton Grove v. Hartford Accident and Indemn. Co.*, 1992 WL 91761, *6 (N.D. Ill. April 23, 1992)(interpreting Illinois law). In contrast, other courts have found that deficit balances in overdrawn checking accounts due to a check kiting scheme are not loans. *Oxford Bank & Trust v. Hartford Accident and Indem. Co.*, 698 N.E.2d 204, 212 (Ill. Ct. App. 1998). The two cases cited above both applied Illinois law and involved losses resulting from check kiting schemes. Under the law of most states, an overdrawn checking account creates a creditor relationship. This would appear to implicate the definition of Loan under the bond. However, the *Oxford Bank & Trust* case found that a loan necessarily involves a voluntary "meeting of the minds" on the extension of credit. A check kite is not voluntary in the sense the Bank does not consent to the overdraft. The definition of Loan is drafted broadly and should be considered any time the loss to the insured arises from the insured's inability to collect a debt owed by a customer of the insured. Where an employee makes fictitious loans to a fictitious borrower or borrower who is unaware of the loan and receives the proceeds of the loans or diverts the proceeds to a non-borrower third party, the "loan" is not a Loan as defined under the bond as no credit relationship has been created. The insured has no recourse against the named borrower, only against the defalcating employee and anyone with whom he is in collusion.

No reported case has expressly or directly addressed the application of the $2,500 benefit requirement when the loss arises from multiple transactions. Two scenarios arise where multiple "loans" or extensions of credit are involved. First, an employee may make fraudulent loans to one company in exchange for a "bribe" or financial benefit received by the employee. Second, an employee may make a series of loans to unrelated parties in relation to which he received some financial benefit. The courts have provided little guidance on this issue. One must consider the manner in which the bond treats each claim or single loss. A single loss is all the loss caused by one employee or group of employees. Therefore, the bond groups all the loans together for the purpose of the definition of a single claim or loss. Can the insurer then argue that the loans should be separated for the $2,500 requirement?

In *Federal Deposit Ins. Corp. v. Insurance Co. of North America*, 928 F. Supp 54 (D. Mass. 1996), the court addressed a claim made by the FDIC as receiver for the insured bank arising from alleged employee dishonesty of two employees of the bank. The employees were the manager of the mortgage loan department and the closing attorney employed by the bank, respectively. *Id.* at 56. The employees conspired with a group of real estate developers to cause

the insured bank to make certain loans in violation of the bank's internal lending policies. The employees made over 500 such loans with an aggregate value in excess of $30 million. *Id*. A number of the loans defaulted and the bank suffered losses in excess of $10 million. *Id*. at 57. The court did not directly address how much value the employees must receive from each loan to implicate coverage, but did address it indirectly in discussing the date on which the bank discovered the loss. The court held that when the bank knew that one of the employees' husband purchased a condominium without paying the $7,700 deposit listed in the loan documentation "the Bank had enough information for hypothetical 'reasonable persons' in their position to 'assume' that [the employee], at least, had received a benefit in excess of $2,500." *Id.* at 61. This discussion implies that the court may find that, considering all the loans were part of the same scheme, the employee would only have to receive an aggregate financial benefit in excess of $2,500 in order to implicate coverage for all the defaulted loans.

Reviewing the relevant provisions of the bond, it appears that the key phrase which will govern the insurer's determination as to how many separate $2,500 benefits are required in order to implicate coverage for loan losses is the "in connection therewith" requirement. The $2,500 must be realized by the employee in connection with the dishonest loan transaction. If an employee makes a dishonest loan to one customer and receives a $1,300 kickback and makes a second loan to an unrelated customer and receives a $1,200 kickback, it does not appear that the employee received a $2,500 benefit which caused him to decide to make either of the fraudulent loans. In contrast, where the loan is part of one scheme involving the same players as in the *FDIC v. Insurance Co. of North America* case, it could be argued that the employee received more than $2,500 in financial benefit which motivated him to make all of the loans. The linchpin is the causation between the benefit received and the loan made. If a series of loans are made in connection with one payment or group of related payments in excess of $2,500, it appears that the requirement is met. If, however, a series of completely unrelated loans are made, it cannot be said that the loans were made in connection with receipt of value in excess of $2,500 unless a separate $2,500 in value was receive in connection with each loan.

Referring back to the two categories set forth above, it appears that one $2,500 benefit is required when the loans are either to the same person or part of the same scheme, but separate $2,500 benefits must be demonstrated with respect to each loan or group of loans when the loans or group of loans are completely unrelated. It is also possible that some jurisdictions may require an insured to demonstrate a separate $2,500 benefit for each loan to an unrelated borrower. It is unlikely that a court would require an insured to demonstrate a separate $2,500 benefit for each loan to the same borrower (or even related borrowers), when the one $2,500 benefit motivated the employee to make the group of loans.

V. *Investigation and Fact Development Relating to the Issue of Financial Benefit*

As is true with all employee dishonesty claims, the fact investigation by the fidelity insurer is critical in determining whether the financial benefit requirement has been satisfied. The majority of cases on this issue turn heavily on the specific facts presented to the courts. While the discovery process will play a large role in factual development once litigation has commenced, the parties will have often developed a significant portion of the relevant facts prior to the filing of a lawsuit. More in fidelity claims than in most insurance contexts, the fact investigation and development will often determine the outcome of the litigation. The desire to fully develop the factual record must, however, be tempered by a clear understanding between the insurer and the insured that the burden of proof rests with the insured and if the insured fails to present evidence to indicate that the employee has received a financial benefit as defined under the bond or policy, the insurer is not obligated to attempt to establish the insured's claim.

Once the insured has submitted a proof of loss or other statement of its claim as may be required by the relevant bond or policy, several questions can assist the insurer in obtaining information sufficient to analyze this aspect of employee dishonesty coverage. The employee's personnel file is one key piece of information which should be made available by the insured for review. The personnel file is often used to determine whether the insured was aware of any prior dishonest conduct of the employee which may provide a defense to coverage. However, the personnel file will also often provide records of raises, benefit descriptions, and other information to allow the insurer to understand what employee benefits were received by the employee in the normal course of his employment. To the extent that the financial benefit received in relation to the alleged dishonest conduct was in the same form or similar form to those benefits previously received by the employee, no "financial benefit" can be established under the bond or policy. Other information which should be made readily available by the insured and which will provide similar information are payroll records, description of job benefits, employee handbooks, and other documents which may demonstrate the different means by which the company compensated its employees.

Interview of co-workers in the same position as the dishonest employee as well as supervisors of the dishonest employee will also provide information regarding the normal compensation received by the employee from the insured. Interviews with co-workers will also help fill in any gaps in the claim submitted by the insured.

When the alleged financial benefit is of the type contemplated under the bond or policy, it is usually most difficult to determine whether the employee or third party in fact received the benefit, whether the receipt of the benefit was directly connected with the dishonest conduct, and whether the employee engaged in the dishonest conduct with the "manifest intent" to receive the benefit. These investigations are often impeded by criminal investigations which are proceeding simultaneously. Various fact witnesses may be apprehensive or unwilling to provide information based upon the pending criminal investigation. If significant factual information is unavailable due to a pending criminal investigation, the insurer may wish to attempt to obtain an agreement with the insured to delay further investigation of the claim until the criminal investigation has been completed. If the insurer is willing to execute a tolling agreement preserving the rights of the insured, the insured will often be willing to agree to this delay as the criminal investigation will often assist the insured in developing its claim.

In many circumstances, the best investigation is an open dialogue with the insured. At the initial meeting with the insured, it is imperative that the fidelity insurer and its counsel convey to the insured the specific relevant coverage provisions and the burden of proof borne by the insured. This will provide a much easier path in the investigation as the insured will understand the basis for the continued requests by the fidelity insurer. The insured is in the best position to develop the facts to support its claim and the bond or policy clearly places that burden on the insured. It is important for the fidelity insurer to understand and convey to the insured the facts and information which is necessary to establish a claim under the bond.

VI. *Conclusion*

The financial benefit requirement under financial institution bonds and employee dishonesty coverages is essential in limiting the scope of coverage to actual intentionally dishonest conduct and helps prevent coverage for claims which arise out of employee negligence, incompetence, or recklessness. The financial benefit requirement provides a more tangible measure of the employee's dishonesty. The employee's manifest intent to cause the insured to incur a loss, necessarily, requires some assumptions and speculations. On that issue, the courts

have acknowledged that the only way to determine the manifest intent of an employee is to look at his objective conduct. With respect to the intent to receive a financial benefit, some of the same issues arise. However, requiring that a financial benefit be conveyed to the employee or third party (or at least intended to be conveyed) helps to define what is considered dishonest conduct. Intent for improper financial gain is a valid indicia of employee dishonesty.

A fidelity insurer and its counsel should consider several questions in analyzing whether the financial benefit requirement has been satisfied. First, did the employee or someone with whom the employee was in collusion receive cash or other improper **financial** value which would not have been received absent the employee's dishonest conduct? Second, has the insured established that the employee's conduct was motivated by his intent to receive a financial benefit or to convey an improper financial benefit to a third party? Third, what is the value of the benefit conveyed to the employee or a third party? Fourth, was the financial benefit received by the employee in the form of other compensation paid by the employer to the employee or other employees? Fifth, if loans were involved, did the employee receive at least $2,500 in financial benefit (assuming the Standard FIB Form 24 governs the analysis)? Finally, if loans were involved, did the employee make separate unrelated independent loans which may implicate separate $2,500 benefit requirements (assuming the Standard FIB Form 24 governs the analysis? This list is not intended to be exhaustive and will vary based upon the specific facts of the claim and the form of the bond or policy. The fidelity bond and policy clearly defines the scope of employee dishonesty coverage and these questions and the issues addressed above will assist the insurer in focusing its analysis of the financial benefit requirement. This provision has been included in bonds and policies for more than twenty years and comes with a significant body of law interpreting its application. The relative uniformity of judicial interpretation should give the insurer and the insured some comfort. However, there are many holes which will be filled and issues which are yet to be addressed. These yet undefined parameters and the evolution of employee dishonesty coverage will assure that law interpreting the financial benefit requirement will continue to evolve.