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October 26, 1999

Raymond A. Yox, Director
Legal Services for Cape Cod and Islands, Inc.
460 West Main Street
Hyannis, MA 02601-3695

Dear Mr. Yox,

This is a response to your October 20, 1999, inquiry regarding the purchase of Employee Dishonesty Insurance in lieu of a fidelity bond as required under the Legal Services Corporation ("LSC") regulations.

Part 1629 of the LSC regulations, requires each recipient of LSC funds to obtain a fidelity bond to indemnify the program against losses from fraud or dishonesty of employees or agents, who handle funds or property of the program.[1] A fidelity bond is a form of first party insurance coverage that indemnifies the insured for losses that arise from the dishonesty of an employee or agent.[2]

Part 1629 was created in 1984 when the Board of Directors of LSC sought to implement a policy to bond recipients against losses due to the dishonesty of an employee.[3] This policy was in response a number of occurrences of fraud in the field that left some programs unable to recoup their losses.[4]

The regulatory requirement of a fidelity bond is consistent with the LSC Act. The LSC Act states that the Corporation shall, "insure that grants and contracts are made so as to provide the most economical and effective delivery of legal services," and to "insure the compliance of recipients and their employees with the provisions of this title."[5] LSC believes that Part 1629 is an essential aspect of the provision of economical and effective delivery legal services.[6]

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[1] *See*, 45 C.F.R. Part 1629.1(b), 1629.2(a).
[2] Donna Ferrara, Insurance Issues In Corporate Transactions, Practicing Law Institute, 602 PLI/Lit 383 (1999).
[3] *See*, 49 FR 28717, July 16, 1984, Supplementary Information.
[4] Supplementary Information to the Proposed Rule of Part 1629 stated:

> Instances of dishonesty such as misappropriation of funds for personal use, embezzlement of funds, personal use of program credit cards, . . . involving programs in various parts of the country have been documented by the Corporation. . . . While in many cases restitution was made, in others, where the programs were not bonded, they absorbed the losses. 49 FR 28717 (July 16, 1984).

[5] 42 U.S.C. 2996f(3), 2996(e)(1)(A).
[6] *See*, 49 FR 28717 (July 16, 1984) (Supplementary Information).

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The Office of Legal Affairs will conditionally approve the substitution of Employee Dishonesty Insurance for the required fidelity bond under Part 1629. The approval is conditioned upon your program's substitution of the bond with insurance coverage that may be different in name, but not in substance. The standard fidelity contract typically covers "loss resulting directly from dishonest or fraudulent acts committed by an employee acting alone or in collusion with others."[7] By virtue of its name, "Employee Dishonesty Insurance" appears to indemnify the insured from the same losses covered by a fidelity bond.

LSC must caution a recipient that the burden falls to the program to ensure that the Employee Dishonesty Insurance provides the same protection to the program as a fidelity bond. The program is required to ensure that the insurance fulfills all the requirements of Part 1629, as if the Employee Dishonesty Insurance was a fidelity bond. For instance, §1629.1(a) describes the fiscal amount of coverage required, §1629.2(a) requires specific persons be covered, and §1629.5 describes different forms of coverage.

The purpose of Part 1629 was for recipients to avoid the losses that accompany employee fraud or dishonesty. The Employee Dishonesty Insurance should satisfy the purpose of the rule. The conditional approval for your program to obtain Employee Dishonesty Insurance is consistent with the LSC Act. Your program seeks the Employee Dishonesty Insurance because it is less costly than the fidelity bond. The purchase of less costly and economical insurance coverage for employee fraud is consistent with the LSC Act.[8]

I hope this letter answers any questions you had regarding the issue in question. Please let me know if I can provide any additional assistance in this matter.

Sincerely,

Kelline A. Carroll

Kelline A. Carroll
Attorney

[7] Robert M. Horkovich, et al, Insurance Coverage for Employee Theft Losses: A Policyholder Primer on Commonly Litigated Issues, 29 U. Mem. L. Rev. 363, Part III (1999) (citing, Financial Institution Bonds 450 (Duncan L. Clore ed., 1995) (quoting from Financial Institution Bond, Standard Form No. 24, rev. Jan. 1986)).
[8] *See*, 42 U.S.C. 2996f(3).