

# The Surety & Fidelity Association of America

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September 14, 2009

## Via Electronic Mail

Ms. Marcia E. Asquith  
Office of Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

**Re: Regulatory Notice 09-44 (“Notice”)  
Proposed Consolidated FINRA Rule Governing Fidelity Bonds**

Dear Ms. Asquith:

The Surety & Fidelity Association of America (“SFAA”) is a trade association of companies that are licensed to provide surety and fidelity bonds. The vast majority of fidelity bonds that are obtained by financial institutions such as securities dealers are provided by SFAA members. SFAA also develops various standard fidelity forms and riders that are available for use by our members. The Financial Institution Bond, Standard Form No. 14 (“Form 14”), developed by SFAA, is intended to insure against fidelity, forgery and theft risks for broker dealer and securities firms. Thus, we have a significant interest in FINRA’s proposed rule regarding fidelity bonds as set forth in proposed rule 4360 (the successor to NASD rule 3020).

### Prescription of a particular product

Under the proposal, rule 4360(a) is amended to stipulate the Securities Dealer Blanket Bond as the preferred form. We have two concerns regarding this revision. First, insurers can only offer and use insurance forms that have been filed and approved by state insurance departments. This filing process can be laborious and limits an insurer’s ability to introduce new products to the market quickly. Therefore, by prescribing a particular product, the rule significantly limits competition among insurers and restricts broker dealers’ options only to those insurers that have the particular product filed and approved with the state insurance departments. Second, the discussion in the Notice states that the Securities Dealer Blanket Bond is preferred because such form provides coverage on a “per event” basis and the Form 14 provides coverage on a “per year” basis. This is not accurate. The Form

14's Single Loss Limit is on a per occurrence basis similar to "per event" coverage. A "Single Loss" is defined as all covered loss resulting from any one act or series of related acts. A payment for loss attributed to an act or related acts does not reduce the Single Loss Limit of Liability for losses attributed to other acts. The Form 14 is subject to an Aggregate Limit of Liability, which limits the insurer's aggregate loss. However, if a loss reduces the remaining aggregate limit, the insured is able to purchase a restoration of the aggregate. Thus, with the restoration of the aggregate, the Form 14 effectively provides "per event." coverage. Finally, we question whether it is appropriate that the rules prescribe the use of a particular product developed by a for-profit entity with which FINRA has an apparent business relationship. (See Endnote 5 of the Notice.) If FINRA desires certain parameters of coverage, it should prescribe those parameters in the rules, rather than prescribing a particular product by name.

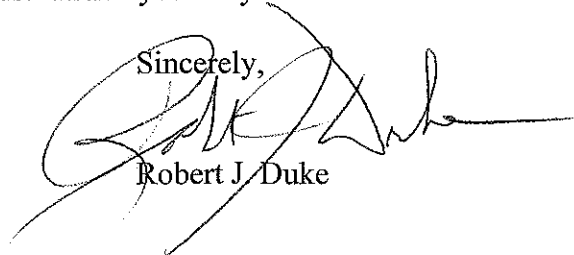
Scope of employee dishonesty coverage

The Notice states that rule 4360 no longer maintains the exception in NASD Rule 3020 for a one-person firm. The Notice states that such firms "can and often do acquire fidelity bond coverage." We agree that a broker dealer should have fidelity coverage for its employees if it is owned by one individual. Such a bond, however, will not and should not insure the owner against his or her own dishonesty. Although burglary, theft and forgery coverages may be available and necessary, we do not know of a fidelity bond that currently provides coverage for losses caused by the dishonesty of the owner of a one-person firm. In fact, the form of a Securities Dealer Blanket Bond that we have seen covers loss resulting directly from the dishonest acts of an "Employee," and sole owners are not included within the definition of "Employee." There are sound underwriting reasons that the dishonest acts of the sole owner do not come within the scope of fidelity coverage. The underwriting of a fidelity bond is based, in part, on the strength of the internal controls of the insured. An owner of a business usually is not subject to the internal controls applicable to the business' employees. In addition, the owner is the alter ego of the insured, and one cannot insure against one's own intentional acts.

The changes proposed by FINRA indicate that it may be requiring coverage that may not be available in the market. Section 4360 deletes the requirements for coverage of "officers and employees" and replaces it with a broader requirement of coverage "for any person associated with the member . . . ." The proposal also deletes the definition of "employee," which explicitly did not include sole proprietors and sole stockholders in the definition. Does FINRA expect coverage of loss caused by the dishonesty of persons in addition to those that are covered under current forms: employees, officers and registered representatives?

We would be happy to work with FINRA to develop parameters of fidelity bond coverage that protect the interests of FINRA and the public, would be available in the market and provide for the greatest competition among insurers. Thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert J. Duke", is written over the typed name. The signature is fluid and cursive.

Robert J. Duke