

**SUPREME COURT OF FLORIDA**

**No. 96,413**

**KPMG PEAT MARWICK, etc.,**

**Petitioner,**

**vs.**

**NATIONAL UNION FIRE  
INSURANCE COMPANY OF  
PITTSBURGH, PENNSYLVANIA,  
etc.,**

**Respondent.**

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**BRIEF OF AMICUS CURIAE  
THE SURETY ASSOCIATION OF AMERICA**

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**On Review of a Decision of the District  
Court of Appeal of Florida, Third District**

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## **CERTIFICATE OF TYPE STYLE**

We certify that we have used 14-point proportionally spaced CG Times type in this brief.

## INTRODUCTION

For sixty-five years it has been the law of this State that an "insurer has the right to be subrogated pro tanto to any right of action which the insured may have had against [its accountants], whose alleged wrongful act or negligence caused the loss . . . ." *Dantzler Lumber and Export Co. v. Columbia Cas. Co.*, 115 Fla. 541, 556, 156 So. 116, 121 (1934). And, although the obvious concomitant was not then stated, the district court of appeal did so below with the straightforward declaration: "If a subrogation claim may proceed, we take this as persuasive that an assignment claim may likewise proceed." *National Union Fire Ins. Co. v. KPMG Peat Marwick*, No. 98-3051, slip op. 7, 24 Fla. L. Weekly D1756, D1757 (Fla. July 28, 1999). And with this same reliance on *Dantzler*, the district court concluded that National Union, the fidelity bond insurer of BankAtlantic, having paid BankAtlantic \$18 million for losses incurred, could as BankAtlantic's subrogee and assignee sue the bank's independent auditor, KPMG Peat Marwick, for professional malpractice allegedly causing the loss. Having so concluded, the district court certified to this Court the question whether *Dantzler*, undisturbed and relied on all these years, "is still good law." *National Union*, slip op. at 7.

## SUMMARY OF ARGUMENT

As an amicus curiae in this matter,<sup>1</sup> The Surety Association of America ("SAA") will address three points. We will explain, first, that fidelity insurers inquire about and rely on audited financial statements of their prospective insureds in underwriting the risk to be assumed under their insurance policies; second, that the statistics on which premiums for such coverages are ultimately based are computed from historical net losses, that is, losses paid less recoveries received; and third, that the position advocated by KPMG would adversely affect the public interest in that it would increase the cost of required fidelity insurance, and therefore the cost of operating a bank, and it would shift the loss caused by the negligence of a bank's accountant from the party in a position to have prevented it, in this case KPMG, onto a party that could not have prevented it, National Union. If KPMG can shift the loss caused by its negligence onto someone else's insurance, it has no financial incentive to incur the costs necessary to help reduce the incidence of fraud. This Court's decision in *Dantzler* prevents that shift, and should be adhered to as being as much in step with modern-day tort law as it was when it was first decided.

### STATEMENT OF THE ROLE OF THE AMICUS CURIAE, THE SURETY ASSOCIATION OF AMERICA

Commercial banks are required to have insurance coverage under a financial institution bond. The standard form of this bond is Standard Form No. 24 of The Surety Association of America (SAA), which is filed with the insurance department of each

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<sup>1</sup> The Surety Association of America has simultaneously filed its motion for leave to appear as amicus curiae with the written consents of the petitioner and respondent. Although, because consented-to, the motion for leave may be unnecessary under Florida Rule of Appellate Procedure 9.370, we believed it to be the safer practice to file it.

state, including Florida.<sup>2</sup> SAA also prepares and files Form SA 5874f (revised to December 1993), the Application for Standard Form No. 24, the bond.<sup>3</sup>

Pertinent here is Section 11 of that application, which asks the applicant bank for the following information concerning its audit procedures:

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<sup>2</sup> The decision in this case will impact all banks and fidelity insurers in Florida, and our amicus brief addresses the standard forms approved by the Florida Department of Insurance. SAA member companies, including the petitioner, National Union, are free to file their own forms and applications, and often do. These specific company forms are usually based on the appropriate SAA Standard Form with relatively minor variations.

<sup>3</sup> Form SA 5874f was approved by the Florida Department of Insurance on January 10, 1994. For the Court's convenience we have attached a copy of this application (Appendix, A1-A4).

11. AUDIT PROCEDURES:

- (a) Is there an annual audit by an independent CPA?.....Yes No
- (b) If "Yes", is it a complete audit made in accordance with generally accepted auditing standards and so certified?  
.....Yes No
- (c) If the answer to (b) is "No", explain the scope of the CPA's examination \_\_\_\_\_
- (d) Is the audit report rendered directly to the Board of Directors?  
.....Yes No
- (e) Name and location of CPA \_\_\_\_\_
- (f) Date of completion of the last audit by CPA \_\_\_\_\_
- (g) Is there a continuous internal audit by an Internal Audit Department?.....Yes No
- (h) If "Yes", are monthly reports rendered directly to the Board of Directors?.....Yes No
- (i) If (a) and (d) or (g) and (h) are answered affirmatively, is there direct verification of at least 20% of all deposit accounts and direct verification of at least 20% of all loan accounts?.....Yes No

The information about audit procedures obtained in the Application is used to compute an increase or decrease in the premium — to be offered to the prospective insured — of as much as plus or minus 15%.<sup>4</sup> The insurer relies on the existence and competence of the auditor in setting the premium to be charged for its Bond. Since an audit by a certified public accountant following generally acceptable auditing standards

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<sup>4</sup> SAA also files with each insurance department a Manual of Rules, Procedures and Classifications for Fidelity, Forgery and Surety Bonds. The manual guides the underwriting process of the member companies who use it. A part of the manual is Fidelity Rating Plans. The particular plan applicable to Financial Institution Bonds – Loss Cost Rating Plan One (LCRP-1) – provides for a premium credit or debit of up to 15% for Audit Procedures. LCRP-1 was approved by the Florida Department of Insurance on November 1, 1994. For the Court's convenience, LCRP-1 is attached (Appendix, A5-A12). Again, the SAA forms and manual are available for use by its member companies which can, however, choose to file their own variations with the insurance departments. The SAA filings are the industry standard, but their use is not required.



will help reduce the type of fraud losses covered by Financial Institution Bonds,<sup>5</sup> banks that have such audits are charged lower premiums.

Another major factor in setting premiums is, of course, loss experience. SAA compiles, and provides to its member companies and state insurance departments, rating factors based on loss experience for numerous categories of insureds. These factors, called loss costs, are computed from net losses, that is, paid losses less recoveries obtained. The ability of a fidelity insurer, through subrogation or assignment, to recover from negligent third parties who caused the loss, directly impacts the premium charged for fidelity bonds.

### **ARGUMENT**

In the present case, National Union was paid to assume the risks of certain losses suffered by BankAtlantic; it was not paid to assume the risk of losses caused by the negligence of KPMG. KPMG presumably has its own insurance and pays premiums based on losses resulting from the negligence of KPMG and other accounting firms. If the Court were to depart from *Dantzler* and make the bank's insurer bear a loss caused by the accountant's negligence, it would adversely affect the public. Plainly, because the net losses for Financial Institution Bonds would increase insurance premiums, these higher premiums to the bank would mean higher costs to the bank's customers.

But neither BankAtlantic nor National Union is in a position to prevent KPMG's employees from failing to perform their audit obligations, or, in other words, in a position to prevent these increased costs. KPMG is in such a position, however. Through careful hiring, training and supervision, it can reduce such losses.

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<sup>5</sup> See Bradford R. Carver and D.M. Studler, *The Auditor's Responsibility to Detect Fraud*, 4 Fidelity Law Association J. 89 (1998) for a discussion of the auditor's responsibilities and their potential effect on insurers.

One objective of the law is to reduce the incidence of loss by placing it on the party in the best position to efficiently avoid it. The "basic function of tort law is to shift the burden of loss from the injured plaintiff to one who is at fault ... or to one who is better able to bear the loss and prevent its occurrence." *Casa Clara Condominium v. Charley Toppino and Sons, Inc.*, 620 So. 2d 1244, 1246 (Fla. 1993) (citation and internal quotation marks omitted). KPMG would have little financial incentive to make expenditures in hiring, training and supervising if losses were not paid by it directly or indirectly through insurance premiums.

Further, "[i]t is a traditional function of tort law not only to provide compensation for losses, but also to ensure that careless conduct be deterred." *Sunshine Jr. Stores, Inc. v. Department of Env'tl. Regulation*, 556 So. 2d 1177, 1186 (Fla. 1st DCA 1990) (Ervin, J., dissenting). The law carries out this function in many ways. *See, e.g., White Constr. Co., Inc. v. DuPont*, 455 So. 2d 1026, 1029 (Fla. 1984) (rule making evidence of subsequent remedial measures inadmissible to prove negligence prevents defendant from being penalized for preventing injury to others); *Seaboard Air Line Ry. Co. v. Parks*, 89 Fla. 405, 411, 104 So. 587, 589 (1925) (same); *Owens-Corning Fiberglas Corp. v. Ballard*, No. 92,963, 1999 WL 669026, at \*3 (Fla. Aug. 26, 1999) (purpose of punitive damages is not to further compensate, but to deter similar misconduct by defendant and others in future); *Porter v. Rosenberg*, 650 So. 2d 79, 81 (Fla. 4th DCA 1995) (purpose of doctrine of strict liability is to further public safety in use of consumer goods). Thus, this Court's decision in *Dantzler* and the district court's decision under review are entirely consistent with the aspirational goals of the tort law of this State. As the brief of National Union convincingly argues, there is no compelling reason based on the accountant-client relationship to depart from *Dantzler* and the body of tort law that places loss on the party in the best position to prevent it, and by doing so, encourages the elimination of loss, and

in this case, fraud. In the present case, only KPMG was in a position to prevent loss caused by its negligence in the three audits of BankAtlantic. National Union, having compensated BankAtlantic, should be allowed to go forward with its case and recover any such losses so that KPMG, and other accountants, will have an incentive to try to prevent such losses in the future.

### **CONCLUSION**

For the reasons stated, it is in the public interest to leave the well-established rule of *Dantzler* undisturbed and affirm the well-reasoned opinion of the Third District Court of Appeal.

Respectfully submitted,

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Daniel S. Pearson  
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## CERTIFICATE OF SERVICE

We certify that on October \_\_\_\_\_, 1999 we mailed a copy of this Brief of Amicus Curiae The Surety Association of America to Lewis N. Brown, Esq. and Dyanne E. Feinberg, Esq., Gilbride, Heller & Brown, P.A., Attorneys for Petitioner, One Biscayne Tower, Suite 1570, Two South Biscayne Boulevard, Miami, Florida 33131; David Wagner, Esq., Associate General Counsel for Petitioner, 280 Park Avenue, New York, New York 10017; Russell Yagel, Esq. and James F. Crowder, Jr., Esq. Kimbrell & Hamann, P.A., Attorneys for Respondent, Suite 900, Brickell Centre, 799 Brickell Plaza, Miami, Florida 33131-2805.

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Daniel S. Pearson

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## APPLICATION FOR A FINANCIAL INSTITUTION BOND, STANDARD FORM NO. 24 FOR COMMERCIAL BANKS, SAVINGS BANKS AND SAVINGS AND LOAN ASSOCIATIONS

Application is hereby made by \_\_\_\_\_

(List all insureds, including Employee Benefit Plans)

Principal Address \_\_\_\_\_ (herein called Insured)

(No.) (Street) (City) (State) (Zip Code)

for a \_\_\_\_\_ Financial Institution Bond, Standard Form No. 24, to become effective as of

(primary, excess, concurrent, co-surety, endorsed)

12:01 a. m. on \_\_\_\_\_ to 12:01 a. m. on \_\_\_\_\_ in the Aggregate Limit of Liability of \$ \_\_\_\_\_

Date insured was established \_\_\_\_\_ Name of prior carrier \_\_\_\_\_

1. Insured is a (check the appropriate box). Commercial Bank , Savings Bank , Savings and Loan Association , Other

2. For all insureds, show the total number of:
- |  | <u>No. of</u> |
|--|---------------|
| (a) Salaried officers, employees, retained attorneys and persons provided by employment contractors.....   | _____         |
| (b) Banking locations (other than the Home Office or the first Named Insured) in the U.S., Canada, Puerto Rico and Virgin Islands.....               | _____         |
| (c) Limited banking facilities in the U.S., Canada, Puerto Rico and Virgin Islands.....  | _____         |
| (d) Non-banking locations in the U.S., Canada, Puerto Rico and Virgin Islands.....   | _____         |
| (e) Banking locations, limited banking facilities and non-banking locations outside of the U.S., Canada, Puerto Rico and Virgin Islands, list below: |               |

<u>Location</u>	<u>Location</u>

3. Complete the following.

	<u>Total Assets</u>	<u>Total Deposits</u>	<u>Commercial Banks only</u> <u>Total Loans &amp; Discounts</u>
(a) As of latest Dec 31 .....	\$ _____	\$ _____	\$ _____
(b) As of latest June 30 .....	\$ _____	\$ _____	\$ _____

4. Complete the following for optional coverages desired.
- | <u>Form of Coverage</u>   | <u>Single Loss Limit</u> |
|---|--------------------------|
| (a) Is Insuring Agreement (D)—Forgery or Alteration Coverage desired?..... Yes <input type="checkbox"/> No <input type="checkbox"/>                             | \$ _____                 |
| If "Yes", are checking accounts permitted? (Savings Banks and Savings and Loan Associations only)..... Yes <input type="checkbox"/> No <input type="checkbox"/> |                          |
| (b) Is Insuring Agreement (E)—Securities Coverage desired?..... Yes <input type="checkbox"/> No <input type="checkbox"/>  | \$ _____                 |
| If "Yes", is Loan Participation Coverage desired?..... Yes <input type="checkbox"/> No <input type="checkbox"/>   |                          |
| (c) Is Trading Loss Coverage desired?..... Yes <input type="checkbox"/> No <input type="checkbox"/>   | \$ _____                 |
| (d) Is Extortion—Threats to Persons Coverage desired?..... Yes <input type="checkbox"/> No <input type="checkbox"/>   | \$ _____                 |

If "Yes", list below locations to be excluded:

<u>Location</u>	<u>Location</u>

4. Complete the following for optional coverages desired (cont'd):

(e) Is Extortion—Threats to Property Coverage desired? ..... Yes  No  ..... \$                      Single Loss Limit  
 If "Yes", list below locations to be excluded:

<u>Location</u>	<u>Location</u>

(f) Is Fraudulent Real Property Mortgages Coverage desired?..... Yes  No  ..... \$                      Single Loss Limit  
 (g) Is Audit Expense Coverage desired? (Savings and Loan Associations only)..... Yes  No  ..... \$                       
 (h) Is Unattended Automated Teller Machine Coverage desired?..... Yes  No  ..... \$                     

If "Yes", complete the following:

- (1) Number of locations to be covered.....                       
 (2) List below locations to be excluded:

<u>Location</u>	<u>Location</u>

(i) Is Computer Systems Fraud Coverage desired?..... Yes  No  ..... \$                      Single Loss Limit  
 If "Yes", complete the following:

(1) Insured's Computer System(s)

For the Computer System(s) you operate, whether owned or leased, complete the following:

- a) Number of independent software contractors authorized to design, implement or service programs for your System(s)                       
 b) Is access to your System(s) by customers, or other outside parties, other than by Automated Teller Machines, permitted (e.g. by computer, terminal or touchtone telephone key pad, etc.)?..... Yes  No   
 c) Number of Automated Teller Machines

(2) Other Computer Systems

- a) Check if coverage is desired for:  
 Automated Clearing Houses using Federal Reserve Computer facilities , Fed Wire , CHIPS , SWIFT   
 b) List below other Computer System(s) for which coverage is desired: (For Automated Teller Machine Systems, complete item c) below.)

<u>Computer System(s)</u>

- c) List below shared or other participatory Automated Teller Machine Systems for which coverage is desired:

<u>ATM System(s)</u>

(3) Is coverage desired for Tested telex or other similar means of Tested communication?... Yes  No

(j) Is Voice Initiated Transfer Fraud Coverage desired? (NOTE: Computer Systems Fraud Coverage must be purchased in conjunction with this Coverage.)..... Yes  No  ..... \$                      Single Loss Limit  
 If "Yes", what is the dollar amount of the call-back threshold to the originator of an instruction?... \$                     

(k) Is Telefacsimile Transfer Fraud Coverage desired? (NOTE: Computer Systems Fraud Coverage must be purchased in conjunction with this Coverage.)..... Yes  No  ..... \$                      Single Loss Limit  
 If "Yes", what is the dollar amount of the call-back threshold to the originator of an instruction?... \$                     

(l) Is coverage desired on businesses engaged in the data processing of your checks or other accounting records? Yes  No   
 If "Yes", list below the name and location of each data processor.

<u>Name &amp; Location</u>	<u>Name &amp; Location</u>

Complete the following for optional coverages desired (cont'd)

Single Loss Limit

(m) Is Servicing Contractors Coverage desired? Yes  No  \$ \_\_\_\_\_

If "Yes", complete the following. (NOTE: Servicing Contractors service your real estate mortgages or home modernization loans or manage your real property.)

(1) List below the name and location of each Servicing Contractor to be covered:

<u>Name &amp; Location</u>	<u>Name &amp; Location</u>
_____	_____
_____	_____

(2) List below the name and location of each Servicing Contractor to be excluded: (NOTE: Commercial Banks, Savings Banks, Savings and Loan Associations, or industry service organizations formed by any of them, may be excluded.)

<u>Name &amp; Location</u>	<u>Name &amp; Location</u>
_____	_____
_____	_____

Single Loss Limit

(n) Is coverage desired on issuers of Register Checks or Personal Money Orders? (Commercial Banks only) Yes  No  \$ \_\_\_\_\_

If "Yes", list below the name and location of each issuer:

<u>Name &amp; Location</u>	<u>Name &amp; Location</u>
_____	_____
_____	_____

(o) Is coverage desired on your appointed or elected agents, whether they be persons, partnerships or corporations (other than servicing contractors or data processors) performing any act or service in connection with the ordinary conduct of your business? (Savings Banks and Savings and Loan Associations only) Yes  No

If "Yes", list below the name, location and single loss limit of liability on each agent:

<u>Name &amp; Location</u>	<u>Single Loss Limit</u>	<u>Name &amp; Location</u>	<u>Single Loss Limit</u>
_____	\$ _____	_____	\$ _____
_____	_____	_____	_____

5. Are you a direct participant in a depository for the central handling of securities? ... Yes  No   
If "Yes", list below the name and location of each depository.

<u>Name &amp; Location</u>	<u>Name &amp; Location</u>
_____	_____
_____	_____

6. Check the appropriate box(es) if you are a seller or servicer of secondary market mortgages of: Freddie Mac , Fannie Mae , Ginnie Mae , Other agencies

7. For deductibles, complete the following: (NOTE: Deductibles on Insuring Agreements (D) and (E) must be at least equal to that carried on the Basic Bond Coverage. Deductibles on Extortion Coverage and Unattended Automated Teller Machine Coverage may be written in any amount.)

<u>Coverage</u>	<u>Single Loss Deductible</u>
(a) All coverages except Insuring Agreements (D), (E), Extortion and Unattended Automated Teller Machines	\$ _____
(b) Insuring Agreement (D) — Forgery or Alteration	\$ _____
(c) Insuring Agreement (E) — Securities	\$ _____
(d) Extortion — Threats to Persons	\$ _____
(e) Extortion — Threats to Property	\$ _____
(f) Unattended Automated Teller Machines	\$ _____

8. If coverage is being written on an excess, concurrent or co-surety basis, show the names of the other carriers and bond limits. In the case of co-surety also show percentage participations: \_\_\_\_\_

9. If coverage is being written on a coinsurance basis, show your percentage participation \_\_\_\_\_ % (Note: Insured may assume a participation of between 5% and 25%.)

10. Are deposits insured by the Federal Deposit Insurance Corporation? Yes  No



11. AUDIT PROCEDURES.

- (a) Is there an annual audit by an independent CPA?..... Yes  No
- (b) If "Yes", is it a complete audit made in accordance with generally accepted auditing standards and so certified?..... Yes  No
- (c) If the answer to (b) is "No", explain the scope of the CPA's examination \_\_\_\_\_
- (d) Is the audit report rendered directly to the Board of Directors?..... Yes  No
- (e) Name and location of CPA \_\_\_\_\_
- (f) Date of completion of the last audit by CPA \_\_\_\_\_
- (g) Is there a continuous internal audit by an Internal Audit Department?..... Yes  No
- (h) If "Yes", are monthly reports rendered directly to the Board of Directors? ..... Yes  No
- (i) If (a) and (d) or (g) and (h) are answered affirmatively, is there direct verification of at least 20% of all deposit accounts and direct verification of at least 20% of all loan accounts?..... Yes  No

12. INTERNAL CONTROLS (OTHER THAN AUDIT PROCEDURES):

- (a) Do you require annual vacations of at least two consecutive weeks for all officers and employees?..... Yes  No   
If "No", explain: \_\_\_\_\_
- (b) Is there a formal, planned program requiring the rotation of duties of key personnel without prior notice thereof? ... Yes  No   
If "No", explain: \_\_\_\_\_
- (c) Is there a formal, planned program requiring segregation of duties so that no single transaction can be fully controlled from origination to posting by one person?.....Yes  No   
If "No", explain: \_\_\_\_\_

13. Date of last examination by State authorities \_\_\_\_\_

Date of last examination by Federal authorities \_\_\_\_\_

Was there any criticism of your operations in either the last State or Federal examination?..... Yes  No

If "Yes", explain: \_\_\_\_\_

14. Has there been any change in ownership or management within the past three years?..... Yes  No

If "Yes", explain: \_\_\_\_\_

15. Has any insurance been declined or canceled during the past three years?..... Yes  No

If "Yes", explain: \_\_\_\_\_

16. List all losses sustained during the past three years, whether reimbursed or not, from \_\_\_\_\_ (month, day, year) to \_\_\_\_\_ (month, day, year)  
Check if none

Date of Loss	Type of Loss	Amount of Loss	Amount Recovered from Insurance	Amount Recovered from other than Insurance	Amount of Loss Pending	If Loss occurred at other than Main Office, state location
		\$	\$	\$	\$	

The Insured represents that the information furnished in this application is complete, true and correct. Any misrepresentation, omission, concealment or incorrect statement of a material fact, in this application or otherwise, shall be grounds for the rescission of any bond issued in reliance upon such information.

Dated at \_\_\_\_\_ this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_\_

By \_\_\_\_\_ (Name and Title)

(Insured)

# **INDIVIDUAL RISK MODIFICATION RATING PLAN FOR FINANCIAL INSTITUTIONS**

This Rating Plan is designed for use in conjunction with the Surety Association Manual of Rules, Procedures and Classifications, and the Fidelity and Forgery Loss Cost Addendum.

## **I. RULES OF PROCEDURE**

The following Rules of Procedure shall govern the use of this Individual Risk Modification Rating Plan.

### **A. DEFINITIONS**

#### **1. Insured**

The term "insured" shall mean all classes of financial institutions including: banks, stockbrokers, savings and loan associations, credit unions, investment bankers and trusts, safe deposit companies, stock exchanges and trust companies, dealers in mortgages and commercial paper, finance companies, insurance companies, life insurance companies, small loan companies, Federal Reserve Banks, Federal Land Banks, Federal Home Loan Banks, Financial Institution Clearing Houses, etc.

#### **2. Joint Insured**

The term "joint insured" shall mean those separate insureds which are included as joint insureds under the same bond subject to compliance with the eligibility requirements of the manual rules regarding joint insureds.

#### **3. Risk**

The term "risk" shall mean all covered perils in the standard bond forms issuable to an insured.

#### **4. Company Manual Premium**

The term "company manual premium" means the manual premium produced in accordance with the Manual of Rules, Procedures and Classifications prior to the application of any individual risk modification. Package modification factors, if any, are included in the company manual premium.

### **B. ELIGIBILITY**

Any risk that is covered under a Bond (or Policy), the company manual premiums for which the Manual of Rules, Procedures and Classifications specifies being subject to this Plan, shall be eligible for and shall be rated by the application of this Plan.

## INDIVIDUAL RISK MODIFICATION RATING PLAN FOR FINANCIAL INSTITUTIONS

### I. RULES OF PROCEDURE (Continued)

#### C. ESTABLISHMENT OF THE RATING FOR THE RISK

##### 1. Applicability

The risk modification as hereinafter determined shall be applicable to the company manual premiums at the effective date of such risk modification.

##### 2. Term and Amount of Coverage

Each risk modification including excess risk modification, if any, shall be understood to be established for the premium period for which the primary coverage is to be written and, unless otherwise provided for in the Manual of Rules, Procedures and Classifications, to be applicable to the company manual premiums for the total amount of each of the various forms of eligible coverages to be carried by the risk except to the extent that there occurs during said premium period:

- a. additions or deletions of optional coverages;
- b. additions, deletions or changes in deductible(s); or
- c. a request by the insured, in writing, for a new premium period in order to conform the anniversary date with that of other coverages.

In the event of a. or b. above, a revised risk modification shall be established based upon last used rates, rating factors and experience for the unexpired portion of the original premium period. In the event of c. above, a revised risk modification shall be established, based upon last used rates, current rating factors and current experience for the extended period only.

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##### 3. Multi-Bond Risks

In the event a risk involves two or more bonds with different effective dates, the risk modification for the primary coverage shall apply to such bonds during the premium period for which the primary coverage is to be written. That portion of the premium for coverages written beyond the premium period of the primary bond shall be calculated on the basis of the current risk modification or unity, whichever is higher, subject to adjustment when the next risk modification applicable to the primary bond is calculated.

## INDIVIDUAL RISK MODIFICATION RATING PLAN FOR FINANCIAL INSTITUTIONS

### II. DETERMINATION OF RISK MODIFICATION

#### A. RATING PROCEDURE

With respect to any risk to be rated by the application of this Plan, the determination of the "rating for the risk" (i.e. the risk modification) shall be made in accordance with the procedure described herein.

An experience credit or debit resulting from the experience modification shall be applied in the "rating for the risk" and credits or debits reflecting specified characteristics of the risk may be applied in accordance with the Underwriting Table which is a part of this Plan to the extent that such characteristics are not reflected in the past loss experience of the risk. The combined credit or debit constitutes the "rating for the risk" (i.e. the risk modification).

#### B. EXPERIENCE PERIOD

For the determination of the experience modification, a full "3-year" experience period ending three months prior to the bond rating date shall be used.

Experience incurred by other companies or self-insured experience may be used subject to the period specified above. If the risk has been self-insured or insured with a company from which the experience is not obtainable, the experience may be used if submitted to the company in the form of a statement signed by the insured. Experience in such form shall be given credence in accordance with its apparent credibility. Newly created risks shall be treated the same as risks having completed a loss-free "3-year" experience period.

#### C. EXPERIENCE MODIFICATION

The experience modification shall be determined by application of the following procedure:

##### 1. Determination of Company Manual Premium

Based on current rating factors compute the 3-year company manual premium in accordance with the Manual of Rules, Procedures and Classifications for the form(s) and the amount(s) of coverage to be rated, subject to a maximum of \$500,000 of coverage. See Section II. C. 8. on page 6, for deductible computation procedure. (Disregard any coinsurance carried.)

**Note:** If the experience modification is to apply to coverages to be rated in conjunction with a Multi-Line package policy, the company manual premium shall reflect any package discount which may be applicable.

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## INDIVIDUAL RISK MODIFICATION RATING PLAN FOR FINANCIAL INSTITUTIONS

### II. DETERMINATION OF RISK MODIFICATION (Continued)

#### C. EXPERIENCE MODIFICATION (Continued)

##### 2. Determination of Company Subject Loss Cost

Multiply the 3-year company manual premium produced in Section II. C. 1. on page 3 by the company Expected Loss Ratio (ELR) divided by a factor of 1.197 to reflect the removal of loss adjustment expenses, i.e.:

$$3\text{-year company manual premium} \times (\text{company ELR} \div 1.197)$$

The result is the "Company Subject Loss Cost." (The company ELR is used in the development of the Company Loss Cost Multiplier.)

##### 3. Premium Modifier, Adjusted Loss Multiplier, and Maximum Single Loss

From the "Table of Values" on page 8, determine the "Premium Modifier", "Adjusted Loss Multiplier", and the "Maximum Single Loss" according to the "Company Subject Loss Cost".

##### 4. Determination of "Adjusted Losses Incurred" and "Adjusted Loss Ratio"

In determining "Adjusted Losses Incurred" for the experience period, the amount of any one "net direct loss incurred" to be included in the rating shall not exceed the maximum single loss specified in the "Table of Values" on page 8.

**Exception:** The Maximum Single Loss may be increased by 100% for each "net direct loss incurred" which exceeds \$500,000.

"Net direct loss incurred" shall include paid and outstanding amounts of direct losses (exclusive of loss adjustment expenses) which have been incurred during the experience period less any net salvage (i.e. less salvage expense) from such loss payments which are received during the experience period.

Outstanding losses shall be valued in light of all information available at the time of evaluation, which shall be not more than four (4) months nor less than two (2) months prior to the effective date of the rating.

Full coverage experience on risks which are to be written on a deductible basis shall be adjusted to the deductible basis and vice versa, any deductible experience on risks which are to be written on a full-coverage basis shall be built up to a full-coverage basis before using the rating calculation, see Section II. C. 8. on page 6.

If the risk is written on a coinsurance basis, the loss must be adjusted to its full amount.

The "Adjusted Loss Ratio" is determined by dividing "Adjusted Losses Incurred" by the 3-year company manual premium developed in accordance with Section II. C. 1. on page 3.

## INDIVIDUAL RISK MODIFICATION RATING PLAN FOR FINANCIAL INSTITUTIONS

### II. DETERMINATION OF RISK MODIFICATION (Continued)

#### C. EXPERIENCE MODIFICATION (Continued)

##### 5. Calculation of Experience Modification

The experience modification for the experience period shall be calculated by adding the "Premium Modifier" to the product of the "Adjusted Loss Multiplier" times the "Adjusted Loss Ratio" (calculate to the nearest one percent) i.e.:  
 $EM = PM + (ALM \times ALR)$ .

##### 6. Experience Credits or Debits

The experience modification if less than 100% may be expressed as an experience credit by deducting said modification from 100%. The experience modification if more than 100% may be expressed as an experience debit by deducting 100% from said modification.

##### 7. Excess Experience Modification

An "excess experience modification" of unity (i.e. 1.00) may be applied to the company manual premium for coverage in excess of the appropriate Basic Unit as set forth below, in lieu of the "experience modification" applicable to the company manual premium for coverage within the Basic Unit.

**TABLE OF BASIC UNITS**  
(For all insureds subject to this Plan)

Asset Group	Asset Size (average amount*)	Basic Unit of Coverage
1	less than \$ 10,000,000	\$ 500,000
2	\$ 10,000,000 to 24,999,999	750,000
3	25,000,000 to 49,999,999	1,000,000
4	50,000,000 to 99,999,999	1,500,000
5	100,000,000 to 249,999,999	2,000,000
6	250,000,000 to 499,999,999	3,000,000
7	500,000,000 to 999,999,999	4,000,000
8	1,000,000,000 to 1,999,999,999	5,000,000
9	2,000,000,000 to 4,999,999,999	7,500,000
10	5,000,000,000 and over	10,000,000

\*The average amount of assets is based on the latest June 30 and December 31 financial statements.

## INDIVIDUAL RISK MODIFICATION RATING PLAN FOR FINANCIAL INSTITUTIONS

### II. DETERMINATION OF RISK MODIFICATION (Continued)

#### C. EXPERIENCE MODIFICATION (Continued)

##### 8. Deductible Coverage

If coverage is to be written on a deductible basis:

The 3-year company manual premium shall be computed for the first \$500,000 (or less) of coverage excess over the actual deductible amount or excess over \$25,000, whichever is lower.

**Exception:** For insureds with more than 250 employees use the first \$500,000 (or less) of coverage excess over the actual deductible amount or excess over \$50,000, whichever is lower.

Each actual loss experienced shall be reduced by an amount equivalent to the deductible amount, applicable to the 3-year company manual premium.

When varying amounts of deductibles apply to joint insured risks, proceed as above for each separate deductible amount. The 3-year company manual premium for each such separate amount shall be computed using the total of all rating factors covered under the bond. The experience modification for each such separate amount shall be developed by including the total of all "net direct losses incurred" under the bond.

The risk modifications thus developed shall be applied to the appropriate premiums, i.e. to the company manual premiums computed in accordance with procedures set forth in the Manual of Rules, Procedures and Classifications under the Section entitled "Deductibles in Varying Amounts — Joint Insured Risks".

#### D. UNDERWRITING TABLE

To reflect such characteristics of the risk as are not reflected in its past loss experience the risk modification applicable to the company manual premium for the risk may reflect a modification in accordance with the following Underwriting Table, subject to a maximum additional change equal to 25 percentage points.

	Range of Modification Percentage Points		
	Decrease		Increase
1. Audit Procedures	-15	to	+15
2. Internal Controls	-15	to	+15
3. Management & Personnel (Qualifications & Procedures)	-10	to	+10
4. Classification Peculiarities (unique or unusual conditions of exposure or hazard)	-10	to	+10

# INDIVIDUAL RISK MODIFICATION RATING PLAN FOR FINANCIAL INSTITUTIONS

## II. DETERMINATION OF RISK MODIFICATION (Continued)

### D. UNDERWRITING TABLE (Continued)

In addition to the schedule rating elements considered on page 6, if the Expected Loss Ratio (ELR) underlying the company manual premium for the class of insured is different than the actual ELR for the risk, multiply the otherwise chargeable premium (after experience modification) by the following expense variation factor:

$$\text{Expense Variation Factor} = \frac{\text{ELR underlying the company manual premium for the class}}{\text{Actual ELR for the risk}}$$

## III. SUPPLEMENTARY RATING RULES

### A. SPECIAL RULES FOR RATING UNIQUE OR UNUSUAL CONDITIONS

If it can be clearly demonstrated that a risk described by specific classifications, presents unique or unusual conditions of exposure or hazard such that the application of the normal rating procedure does not produce a reasonable and equitable company premium for the risk, such risk may be treated on an (a) rate basis.

If for reasons beyond the control of the issuing company it is impractical or impossible to apply the regular underwriting basis to a risk, it shall be permissible to establish special underwriting for such risk as an (a) rate.

### B. RATING SIZABLE RISKS

Risks developing \$100,000 or more 3-year company manual premium may be (a) rated.



# INDIVIDUAL RISK MODIFICATION RATING PLAN FOR FINANCIAL INSTITUTIONS

## TABLE OF VALUES

Subject Loss Cost (Company Expected Losses)	Premium Modifier	Adjusted Loss Multiplier	Maximum Single Loss
Up to	\$ 15,423	0.95	0.09
\$ 15,424 —	18,422	0.94	0.11
18,423 —	21,486	0.93	0.13
21,487 —	24,617	0.92	0.15
24,618 —	27,818	0.91	0.17
27,819 —	31,089	0.90	0.19
31,090 —	34,435	0.89	0.21
34,436 —	37,857	0.88	0.23
37,858 —	41,358	0.87	0.25
41,359 —	44,941	0.86	0.26
44,942 —	48,609	0.85	0.28
48,610 —	52,365	0.84	0.30
52,366 —	56,212	0.83	0.32
56,213 —	60,153	0.82	0.34
60,154 —	64,193	0.81	0.36
64,194 —	68,333	0.80	0.38
68,334 —	72,579	0.79	0.40
72,580 —	76,935	0.78	0.42
76,936 —	81,405	0.77	0.43
81,406 —	85,993	0.76	0.45
85,994 —	90,704	0.75	0.47
90,705 —	95,544	0.74	0.49
95,545 —	100,517	0.73	0.51
100,518 —	105,629	0.72	0.53
105,630 —	110,886	0.71	0.55
110,887 —	116,295	0.70	0.57
116,296 —	121,861	0.69	0.58
121,862 —	127,592	0.68	0.60
127,593 —	133,496	0.67	0.62
133,497 —	139,580	0.66	0.64
139,581 —	145,852	0.65	0.66
145,853 —	152,323	0.64	0.68
152,324 —	159,000	0.63	0.70
159,001 —	165,894	0.62	0.72
165,895 —	173,016	0.61	0.74
173,017 —	180,378	0.60	0.75
180,379 —	187,991	0.59	0.77
187,992 —	195,869	0.58	0.79
195,870 —	204,026	0.57	0.81
204,027 —	212,477	0.56	0.83
212,478 —	221,238	0.55	0.85
221,239 —	230,327	0.54	0.87
230,328 —	239,761	0.53	0.89
239,762 —	249,563	0.52	0.91
249,564 —	259,752	0.51	0.92
259,753 or more		0.50	0.94
			3.18 x Prem \$ 84,574
			85,484
			86,413
			87,363
			88,333
			89,326
			90,341
			91,379
			92,442
			93,529
			94,643
			95,783
			96,951
			98,148
			99,375
			100,633
			101,923
			103,247
			104,605
			106,000
			107,432
			108,904
			110,417
			111,972
			113,571
			115,217
			116,912
			118,657
			120,455
			122,308
			124,219
			126,190
			128,226
			130,328
			132,500
			134,746
			137,069
			139,474
			141,964
			144,545
			147,222
			150,000
			152,885
			155,882
			318 x Prem (max 500,000)