By and large then it seems that in spite of some Parlimentary encroachment, this area of privilege survives. It can be overridden specifically by Parliament, or, it seems, where in the Judgment of the House of Lords, the risk of actual incrimination is removed. In addition, there is a modicum of discretion in some circumstances to allow the interests of the prosecution authorities in the form of the Serious Fraud Office to be subordinated to the liquidator's interests, presumably on behalf of creditors. In both *Re Arrows Ltd. No. 4* and *Istel v Tully*, a practical device has been used to remove the danger of self-incrimination posed, rather than maintaining the right to silence.

Nonetheless, there is comparatively little in these decisions from which directors and officers can draw comfort. Parliament's readiness to abrogate this ancient privilege is manifest most noticeably in the area of corporate regulation. The director or officer is once more caught between the devil and the deep blue sea. If the House of Lords' comments in *Istel* are anything to go by, there is no enthusiasm for the privilege on the part of the senior judiciary who will not perhaps be minded to seek interpretations favourable to the individual if further in-roads are made into the privilege by Parliament. Directors and officers must take what consolation they can from Lorenzo Dow's reflections on Calvinism - you will be damned if you do - and you will be damned if you don't.

BANKERS BLANKET BOND ASSURANCE
by Andrew J. Rose, Berwin Leighton

Insurance with the perhaps somewhat curious sounding name of a "Bankers Blanket Bond" was first developed by Lloyd's, although primarily for the American Market. At the turn of the century, the only insurance available to banks was a fidelity policy for named employees, and a policy to cover losses arising from hold-ups or similar events. The second policy was split into two sections, one called "night burglary" and the other "daylight robbery", although that phrase has moved rather far away from its original meaning, unless the premium charged for that section of the policy was particularly high. At that time, Lloyd's was a growing institution and the 1911 Lloyd's Act freed it from the restriction of writing marine business alone. America was a country which then had approximately 25,000 separate financial institutions (whether banks, savings associations, or whatever) operating in states, most of which required insurance coverage as a condition of being given the appropriate license. There was clearly a potentially huge business opportunity there.

History records that the first policy called a blanket bond was issued in 1911 to the First National Bank and First National Safety Deposit Company of Boston. The word "blanket" was intended to mean that it covered all the bank's employees, without listing them individually. The first claim which was made on that policy was in July 1913, in the grand total of US$21.47 at an exchange rate of US$4.87 to the pound sterling, so times were good for English Underwriters then. To balance their books, Underwriters charged a reinstatement premium of one shilling. The Leading Underwriter at that time was one Hubert Arthur Nicholls, and the forms of policy used in America were generally known by his initials as HAN forms. Various versions were developed over the years, with the coverage widening each time.

The Market for such policies was probably rather slower to grow in the United Kingdom and Europe. There is no requirement on a bank in this county to insure, although most now do, regardless of their size. Japanese banks have recently started to purchase significant levels of cover in the London Market. Insurance was at first perhaps more attractive to smaller banks where smaller losses can have a greater effect on the balance sheets. Indeed the current coverage taken by the clearing banks (not all of whom insure) will usually only come into effect in real disaster situations, where the loss figures are in excess of £25,000,000. There are usually complex arrangements for a captive below these high levels. Most policies now tend to have a high initial excess of not less than £1,000,000, and given the increasing number of claims, Underwriters have tended to impose aggregate annual limits as well as limits on the amount of each and every claim.

A bank purchasing insurance in recent years has looked at a policy divided into three sections. The first is the bankers' blanket bond, the second the electronic and computer crime policy, and the third the professional indemnity policy. Now, some are purchasing directors and officers cover as well. The phrase bankers blanket bond is now in the process of being replaced by the phrase financial institutions bond, which is the description which has been used in America for some time.

So far as the banker's blanket bond itself is concerned, banks should appreciate what it is not. Lending money, even against what seems to be cast-iron security, is inherently risky, and all banks will make good and bad commercial decisions as to the credit-worthiness of prospective borrowers. Whilst a review of the documentation after the borrower has become insolvent, or disappeared to some untraceable jurisdiction, may well be said in retrospect to have given rise to telltale warning signs at the time, an insurance policy is not there for that purpose; it does not make the insurer a co-venturer with the bank, or make him a guarantor of the customer's bad debts. The conventional forms of bankers policy will not pay up for the likes of Polly Peck, Atlantic Computers or Olympia and York. What the policy does is to offer cover against specified losses of the type set out in the wording itself.

There are three main forms of bond available in the London Market which have, perhaps inevitably, acquired initials. The first, and oldest, of those in common use is the LPO Form 218. The second is the KFA 1981 and the third the RAGJ/ALS 1987 Form. The coverage provided by each is similar and is divided into a number of separate insuring clauses. Each of these various clauses can be purchased separately, but most banks will purchase the entire cover.

The first, and most important, clause in each of the policies relates to the honesty, or dishonesty, of the bank's employees. The LPO Form provides cover for losses "solely and directly caused by one or more dishonest or fraudulent acts of any employee of the Assured, which are committed with the manifest intent of making and which result in, improper personal financial gain for themselves. Salary, fees, commissions and other emoluments, including salary increases and promotions, shall not constitute improper personal financial gain." That phrase "improper personal financial gain" tends to be a guiding light for any coverage of this nature. One of the points which Underwriters soon learnt was that the various fields in which employees were alleged to act dishonestly were extremely widespread, and a distinction was soon drawn between loan and trading losses and other dishonesty.

The KFA 1981 Policy provides cover for the dishonest acts of employees which are committed with manifest intent to cause the bank to sustain a loss, or a gain for themselves, but provides that where the claim relates to trading or dealing in securities, commodities, futures, options, foreign exchange transactions, or relates to loans, or any other extension of credit, the policy applies only if there was an intent to make improper financial gain, and such gain is realised.

The more recent RAGJ Form requires loan and trading transactions which cause a loss to be committed with the intent of obtaining personal financial gain, but there is no requirement that it should succeed. It is perhaps worth noting that none of the standard wordings would have covered the case of Robin Hood, had he been employed by a bank in connection with a loan transaction, as he stole from the rich bank and gave to the poor, at least according to the story, without any intent to make gain for himself.

Contrary to the position in the American financial institution bonds which set a minimum gain of US$2,500, no UK policy has set a minimum financial gain for an employee. This has led some banks to assert what might easily be seen as rather tenuous allegations of improper gain on the part of their employee to justify bringing a claim under the policy for what might otherwise be treated as a credit loss. By way of example, in one case involving 8m Australian dollars the only evidence of dishonesty which the bank produced was that the customer who failed to repay that loan guaranteed a separate hire purchase agreement for the bank employee to purchase a motor vehicle, even though there was no evidence that the employee needed the guarantee to obtain the car loan, still less that the customer made any of the payments thereunder. Others, of course, are rather more obvious, such as the case where the employee used the loan proceeds to purchase two large executive homes in Hertfordshire, an up-market pub in Oxfordshire, and four adjoining villas and an adjacent plot of land in the Quinta Development in Portugal. Unfortunately, from the point of view of the bank, or perhaps the Underwriters, the employee's fraud was discovered at the same time as the property market began to turn, so substantial losses were suffered. In another case, the employee spent much of the money on koi carp, which had to be stored elsewhere following his arrest, and the storage charges ultimately outweighed the sale price.

The loss calculation is reasonably straightforward where it is a case of an employee with his hand in the till. It becomes more complex where a customer bribes an employee for a loan, and defaults on the loan. Questions of causation are relevant, as the policy covers only loss caused "solely and directly" by the employee's dishonesty. Indirect losses are not covered at all.

It is this section of the policy which is undoubtedly the most valuable to a bank. Notwithstanding the number of systems which are put in place, the number of security consultants employed, or the number of risk surveys which are undertaken, there will always be opportunities, even in the best run organisations, for employees to syphon off either the bank's or the customer's funds for their own benefit. When the fraud is discovered, it is often that of a long-serving and trusted employee, whom none of the management would have suspected. More often than not, it is just one employee who is involved-a person who has been a pillar of the bank for many years. It is also unfortunately the case that systems do not always catch the individual, and discovery of irregularities often takes place on a purely fortuitous basis, for example when a customer whose account is being manipulated visits the bank and the particular person whom he normally sees is not at his desk at the time. Underwriters are normally willing to assist banks who wish to carry out risk-management surveys, and cost-sharing arrangements can often be agreed. These surveys are particularly important where the nature of a bank's business can often change in the course of a short time, with a consequent material effect on the risk which is underwritten.

I have talked so far about "employee" as if the word has an obvious meaning. The bond extends that definition to persons whom no employment lawyer would catagorise as such. The KFA policy includes temporary staff provided by an employment contractor, ex-employees who remain as consultants, and guest students. The RAGJ definition even extends to outside solicitors, even though they would have their own professional indemnity insurance, or the Solicitors Compensation Fund may be available. That last extension has proved particularly useful to building societies, who now frequently buy at least the fidelity coverage provided by the bond. Many claims have been made concerning mortgage frauds where the underlying basis of the claim rests on that extended definition of employee. Life assurance companies have extended the definition to cover their sales associates who are treated as self-employed for any other purpose.
No policy in this country makes it a pre-condition of any claim that the matter should be reported to the police, still less that a successful prosecution should follow. If a claim is clear, Underwriters will not usually insist on delaying a final determination until after the conclusion of criminal proceedings. The approved policy for Switzerland contains a clause to the effect that the insurer is not obliged to make any payment whilst a criminal investigation is pending.

One of the roles of an investigator, where possible, is to try to meet with the particular individual who is said to have acted dishonestly. In consequence, Underwriters have heard some unlikely stories from employees. There are cases of the disappearing employee, such as the one who promised to remain present in Singapore but at the earliest available opportunity disappeared to some remote part of North-Eastern China. We have spent many hours with one individual who provided a few hints, but whose condition for giving the supposed low-down on the bank's management was a million Swiss Francs, together with a percentage of the amount which was saved on the insurance claim. It has to be said that it was rather difficult to give the employee too much credibility, and that claim resulted in one of the biggest payments made by the London Market on a fidelity claim. On the other hand, it is perhaps all too easy in these recessionary times for a bank to seek to assert that one employee has become improperly close to a customer, and therefore seek to recover the substantial loss from the insurers rather than to have to write it all off from that year's accounts. Lloyd's Underwriters over the years have a reputation for meeting valid and legitimate claims, but must always be careful not to ruin the career of a particular individual who is said to have acted dishonestly. A thorough investigation is always required into the circumstances surrounding the claim.

The LPO 218 is the only policy which includes any minimum rules for bank operations. These are listed in the policy:-

(1) The Bank is required to maintain a rule book setting out the duties of each employee.
(2) The duties of each employee must be arranged so that no one person can conduct a transaction from commencement to completion.
(3) Joint custody is to be established for all property in safes, safe keys and codes.
(4) There is to be dual control for blank forms of documentation.
(5) Each employee is required to take two weeks continuous holiday in every year.
(6) In addition to the annual external audit, an internal audit of internal controls is to be carried out once every calendar year.

These conditions have been copied into the standard form of policy which is used in Switzerland, and are obviously designed to provide certain minimum standards of care for bank operations. The rules are set out as conditions precedent, but should not cause difficulty to any well-organised bank.

Returning to the policy itself, the second insuring clause relates to loss on premises. The wording of all three of the policy forms is very similar, referring to the loss of property through "theft, larceny, burglary, robbery, false pretences, hold-ups or mysterious unexplainable disappearance", or alternatively loss of property belonging to a customer whilst on the bank's premises. The KFA Form also includes a useful extension for loss whilst on the premises of one of the Assured's correspondent banks. Given the almost identical forms which are used, it is clear that this clause has been the subject of very little dispute. It is interesting to see that "larceny" still appears, even though there has been no such offence under the criminal law since 1968. It is quite common for the phrase loss caused by "false pretences" to be excluded, by way of a separate endorsement, as that has given rise to difficulties in the past. Whilst most of the words set out in the clause require an act of violence of at least obviously criminal nature, it is questionable whether the presentation of documents which represent a shipment of goods which does not exist can amount to a "false pretence" within the wording.

The third insuring clause relates to loss in transit whilst the property is in the custody of an employee, or in the custody of what is defined as an armoured motor vehicle company. Securicor or Brinks Mat probably consider that the services which they provide extend beyond that description alone. Again, the wording of all three forms of policy is extremely similar.

The next and second most important insuring clause relates to loss through forgery. Perhaps not surprisingly, loss through forgery represents a substantial exposure for banks, and necessarily for their insurers. The conventional approach is to identify a number of documents which are covered if forged or fraudulently altered such as cheques and bills of exchange. The LPO 218 Form does not provide and cover for forged payment instructions, but loss arising from such a cause is covered in the two later policy Forms. Each version of the policy contains a specific limitation of the definition of forgery, which, although perhaps well recognised by lawyers, causes some difficulty to bankers, who tend to use the term in a wider sense. The LPO 218 states that it does not cover genuinely signed or endorsed documents which are simply false as to their contents. The KFA Form limits forgery to the signing of the name of another with intent to deceive, and specifically states that it does not include the signing of one's own name with or without authority for any purpose whatsoever.

The original LPO 218 did not include any securities cover. The securities or written instruments indorsement is now very common, and relates to losses suffered by the bank having acted upon securities which prove to be forged as to the signature of a number of possible parties, fraudulently altered, lost or stolen. The securities or written instruments are also defined, and include share certificates, warrants, letters of allotment, government stocks, promissory notes, mortgages, certificates of deposit and letters of credit. There is a specific exclusion for bills of lading, assignments of accounts receivable, and warehouse or trust receipts, and actual physical possession of the documents in question is a condition precedent to the coverage. A bank which makes payment prior to receipt of original documents will not have a claim under the wording even if these documents are in fact forged. Bills of lading losses have tended to be excluded from most policies after a series of Nigerian cement frauds some years ago. An additional clause with cover for bills of lading can be purchased in some markets, but a substantial additional premium is usually required. Losses through assignments of accounts receivable are normally covered under a separate policy applying to discounting or factoring businesses.

The KFA 1981 Form is similar, except that loss through counterfeiting is included, which is the subject of a separate insuring clause under the LPO and RAGJ policies. The RAGJ Form contains a rather different definition of securities, which includes only guarantees, carbon copies of bills of lading, and original negotiable or non-negotiable agreements in writing, having a value which is, in the ordinary course of business, transferable by delivery with any necessary indorsements or assignments. This wording has caused some difficulty in relation to the assignment of payments under equipment financing lease agreements where there has been double-financing.

The final standard insuring clause simply relates to office and contents cover (apart from computer equipment).

Each of the policies contains a lengthy list of exclusions, which include many of the standard ones utilised in Lloyd's policies such as damage caused by war or radioactivity. It is unnecessary to list all the exclusions, but the one which excludes any "loss or deprivation of potential income including but not limited to interest and dividends" is perhaps a good reflection of the policy's intention not to cover mere credit losses.

One of the more important exclusions provides a mode of computation of the loss when a claim is covered by the fidelity or forgery insuring clauses. The wording provides that the loss is deemed to be the amount of monies "paid out, advanced or withdrawn less all monies received from any source whatsoever, including payments and receipts of interest, commissions and the like". This wording can result in significant savings to insurers where some repayments have been made". In one case, the employee concerned had arranged a number of fraudulent hire purchase transactions using false names. Payments of interest and principal under the earlier transactions had been made by use of the funds obtained from the later ones. Since a high interest rate had been charged, the net effect of the computation was to reduce the claim by some 30%. Banks do not readily accept this method of calculation, but again it is simply a reflection of the fact that the policy is not intended to cover credit losses.

The only other exclusion to which I should refer is that relating to the acts of directors. The policy covers only employees, and directors only whilst acting as employees. It will not cover an organisation which is entirely riddled with fraud. The policy also includes many pages of general conditions relating to matters such as the termination of coverage and cancellation, law and jurisdiction, merger and acquisition of businesses, methods of calculation of loss in different currencies and a whole host of provisions which over the years it has been found necessary to include in order to ensure clarity and a fair balance between insurer and insured.

It is always important to remember that a blanket bond is a "discovery" policy and only applies to losses discovered during the policy period. Discovery is defined in some (but not all) of the policies simply as the time at which matters have come to light which would cause a reasonable person to believe that a loss will be incurred of a type covered by an insuring clause even though the precise amount or type of loss may not yet be known. That wording sounds quite satisfactory, but has caused difficulty, particularly when it comes to determining the policy year into which a claim should fall. Some large banks have agreed special endorsements to the effect that discovery occurs when a particular department, such as internal audit, becomes aware of the position.

The date of discovery fixes the policy year. Other provisions, such as the need to file a proof of loss, are calculated by reference to the date of discovery. The proof of loss requirement does not normally cause difficulty, although it is one which is often of concern to the banks themselves. Underwriters will normally be prepared to grant extensions of time in which to provide a proof of loss, and, provided they consider that their representatives are obtaining full co-operation from the bank in relation to production of documentation and availability of witnesses, they may be prepared to waive the requirement altogether.

I should say a few words on the other elements which comprise comprehensive insurance from the bank's point of view, even if they are not strictly part of the bond itself. The computer crime policy covers losses which arise from the deliberate or accidental loss or misuse of data. Although an important element in a bank's coverage, claims thereunder have been limited in number.

Probably rather more important in practical terms is the professional indemnity section. Litigation against banks is showing the same upward trend as against other professionals, with the merchant banks especially being in the firing line as a result of some of the 1980's takeovers not going as well as might be expected in these recessionary times. The traditional cover was limited to claims made as a result of a "negligent act, negligent error or negligent omission". Civil liability falls into many other categories and commercial pressures and requirements have meant that new endorsements are available to cover claims for misrepresentation and negligent mis-statement, breach of trust, breach of fiduciary or professional duty, or any breach of statute such as of the provisions of the Financial Services Act. Given the wide-ranging claims made against banks, many have had cause to purchase the additional cover now available, and to be grateful that they have done so. However, cover is not available for specific obligations undertaken under a contract unless that liability would otherwise have existed under the general law.

It will be obvious that the purchasers of such cover are worldwide. Even if the original insurance is placed in the country where the bank concerned is based, it will frequently be re-insured (with the benefit of a claims control clause) in London. The policy wordings I have talked about have proved accepted and adoptable in most of the English common law based countries, as well as countries as diverse as Switzerland, Scandinavia, Turkey and the Philippines. The only country where a completely different form of policy has been utilised is in France where a "globale de banque" policy is used. There is no one prescribed form of "globale de banque". French policies often refer to articles of the French Penal Code which refer in translation to "a swindle" or "an abuse of paper signed in blank", the precise meaning of which is not always easy to determine. However, I understand that increasing difficulties with claims under these wordings have led many London Underwriters recently to decline to write French business except on the more established wordings.

I think I should conclude with a few words concerning the providers of such coverage. Insurance of this nature is specialised and is not bought or sold in quite the same way as domestic or motor insurance coverage. The premiums and the policy limits are high. Amendments to the standard terms can be negotiated between banks and underwriters and some policies have over 25 endorsements affecting the insuring clauses or the other conditions, as no two banks or institutions are identical.

An American lawyer could refer to decisions on probably every significant clause of the wording. It should be acknowledged that much of the wording is the same as originally devised or amended for the American Market. However, litigation here has not yet reached US proportions and there are no English cases relating to disputes between insurer and insured on the wording of the bond. It used to be possible to say that there were no claims which had resulted in litigation, but as times become more difficult, there are proceedings in Australia, Switzerland and England. Nevertheless, the general lack of litigation is perhaps illustrative of the good commerical relationship between the banks and Lloyds. Many banks have been insured at Lloyds for many years who are justifiably proud of their record in meeting claims. The leading syndicates in this field are those headed by Rupert Villers at Spreckley, Stephen Burnhope at Merrett, Roger Field and Brian Everall at Sturge and the Alec Sharpe Syndicate. There are of course others which are too numerous to mention who lead such risks, or form part of the following market.

All syndicates recognise the common needs of banks and when faced with a claim will speedily arrange an investigation. If the claim is justified and quantum can be agreed, payment will be made of a negotiated sum. If Underwriters consider that the claim does not fall within the policy wording, then the bank will be advised of Underwriters' views and a response by the bank will be considered. Negotiations usually take place on quantum as a bank will normally include in their claim elements which are not covered under the wording. Underwriters have at times agreed not to exercise the draconian remedies available to them for non-disclosure or breach of any condition precedent. Banks do not often present claims, nor do they do so unnecessarily. With the assistance of the broker, the claims is dealt with as part of an ongoing commercial relationship.

Over the next ten years, I expect that there will be changes in the wording of the financial institutions bond. Many common banking instruments of recent origin are not really dealt with or referred to under the current wording, particularly for the forgery and securities clauses. Increasing sophistication on the part of fraudsters, whether in time of boom or recession, will lead to more claims, and in order to reduce claims incidence, underwriters will be likely to work more with banks in reducing areas of risk and proposing system improvements. Whatever the future may hold, it will be an interesting time for all those involved in this Market.