Arthur J. Gallagher & Co.

Insurance Brokers of California, Inc

September 9, 2009

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, D.C. 2006-1506

Re: FINRA Rule Governing Fidelity Bonds

We are providing comments regarding the Notice to Members 09-44, relative to FINRA rules governing Fidelity Bonds. By way of introduction, our office of Arthur J. Gallagher & Co (Gallagher) has, since 1991, specialized in providing insurance and risk management services to broker dealers. We currently have over 40 broker dealer clients of varying sizes, with approximately 40,000 registered representatives covered under programs we broker and administer. During those past 18 years, we have worked with the management and staff at Marsh, Seabury & Smith. We hold them in high regard and consider them friends and colleagues.

We are writing today regarding two aspects of your proposed rules which: 1) requires that broker dealers purchase a blanket fidelity bond, if available; and 2) requires that broker dealers obtain minimum fidelity bond limits of liability relative to a their net capital.

(1) Requirement that broker dealer's purchase a blanket fidelity bond, if available

It is not accurate to assert that a blanket bond is fundamentally better than a Form 14, Financial Institution bond. The terms and riders attached to either bond will determine the adequacy or superiority of the coverage. Requiring broker dealers to purchase one form over another, could remove the potential for a broker dealer to secure superior insurance coverage at more favorable terms from an insurer which may only offer a Form 14, but with favorable riders, and thus, better coverage.

Gallagher currently has several broker dealers which have purchased robust fidelity coverage issued on a Form 14 and not a blanket bond. These Form 14 policies were obtained from alternative insurance markets (other than the FINRA sponsored program) and are endorsed to afford broader coverage than the blanket bond referenced in this Notice to Members. For instance, each of the above referenced Form 14 bonds does not have policy aggregates, the same as with blanket bonds. There are certain other standard coverages provided automatically in the blanket bond which must be endorsed onto a Form 14 in order to meet the same level of coverage. However, a properly endorsed Form 14 can meet or exceed the terms available in an unmodified blanket bond.

15 Enterprise, Suite 200
Aliso Viejo, CA 92656
(940 349-9800 - (949) 349-9900
License # 0726293
Website: www.ajg.com

(2) Requirement that broker dealers obtain minimum fidelity bond limits relative to their net capital

FINRA has proposed increasing the minimum fidelity limits from $25,000 to $100,000. As in the past, the determination of the required limits of liability is based on a percentage of a firm's net capital requirement. The Notice to Members states in part: "Historically, firms that have maintained minimum coverage of $25,000 have had claims that exceed this amount."

We find this an amazing understatement. Though theft by a registered representative is not a frequent event, it is a common occurrence. When such thefts do occur, reps rarely steal as little as $100,000. In our experience, when registered reps steal from clients, the losses frequently range from $250,000 to $5 million or more.

If fidelity bonds are intended to protect public customers, we are hard pressed to understand why FINRA has set such a low limit of coverage over the years. Even now, we believe the current proposed minimum limit does not meet the exposure. Having spoken to many executives in both the brokerage and insurance industries over the years, we have never found anyone with knowledge of this risk who believes these minimums are adequate. It should be recognized that these minimums do not meet any comparable limits of liability set for any other insurable exposure in the commercial marketplace.

It is an irony that a large broker dealer can financially withstand the repayment to customers of a theft in excess of its fidelity bond limit. However, an overwhelming majority of small firms would not have the capital to pay a large fidelity claim unless they had purchased fidelity coverage well above the minimums established by FINRA under this proposed rule change.

We are sensitive to the fact that small firms need to contain costs. However, it should be clearly understood that the economy of this purchase will confirm disaster to clients whose life fortune have been taken by a registered representative of such small firm who purchase only the minimum limits.

We believe that everyone in the broker dealer community should be concerned about protecting the reputation and public trust in this industry. Events like the catastrophic, headline grabbing Madoff and Stanford scandals may never be contained by any insurance program. But the vast majority of historically predictable acts of fraudulent conversions of client's funds can be contained with fidelity bonds with proper terms and limits.

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We also believe management of broker dealers should be concerned for their own self-interest regarding this issue. It has been very common that reps who have started stealing from clients move from one broker dealer to another. We have seen long running schemes, hidden from their supervisors, which have spanned as many as four separate broker dealers. These reps, when found out, have often admitted that they moved from the broker dealers because of fear of discovery. In such instances, whenever any of those broker dealers fail to purchase adequate limits and also have limited assets, the remaining broker dealers will be under pressure to pay restitution greater than their proportioned liability.

Medium to large broker dealers should be particularly concerned about this. We have observed a common pathology in these fraud schemes perpetrated by registered representatives. In numerous instances in which a rep, while stealing from clients, moved from a small firm to a large broker dealer. Once found out they explained, "I moved to the larger firm, so if I was caught, my clients would get their money back."

It is our experience that in such events, the larger broker dealers find themselves under intense pressure from customers and regulators to make restitution to all clients, even for theft done when the registered representative was at another firm which had inadequate fidelity bond limits.

For these reasons we recommend that FINRA reevaluate their proposed rules regarding Fidelity Bond requirements.

Sincerely,

Perry Even

Perry Even
Area Senior Vice President
Professional Liability Division
Arthur J. Gallagher & Co.

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