

Non-Profit D&O Liability Insurance

What you don't know...can hurt you and your organization

A non-profit board may be subject to the same management liability exposures that are found in a private for-profit organization. Unfortunately, non-profits do not purchase insurance coverage at the same rate as their for-profit counterparts. Directors and Officers Liability Insurance was created to protect individual directors and officers, employees and an organization from the allegations of a covered wrongful act. These policies protect the assets of the organization as well as the personal assets of the directors and officers on those non-profit boards by paying defense costs, damages, settlements and judgments of any covered claims. The assets of spouses, domestic partners, heirs and estates may also be exposed and these policies protect these parties as well. A claim brought against a non-profit firm and/or its board can be financially devastating. Effective risk transfer to a Directors and Officers Liability/Employment Practices Liability Policy (Management Liability Policy) may help alleviate that potential financial impact.

Directors and officers of a not-for-profit organization have historically been sued by employees, volunteers, customers, creditors as well as contributors (donors) to their organization. The most common type of management liability claim against a non-profit organization typically comes from an employee or volunteer as an employment practices complaint, however, below is a more complete listing of typical allegations.

TYPICAL ALLEGATIONS INCLUDING THE FOLLOWING:

- Wrongful termination
- Harassment
- Discrimination
- Civil rights violations
- Conflict of interest
- Violation of a statute
- Fraudulent conduct
- Violation of the article/by-laws
- Breach of contract
- Breach of fiduciary duty
- Financial mismanagement/bankruptcy
- Personal financial gain
- Negligence
- Mistakes/judgment errors

WHAT ARE THE FIDUCIARY DUTIES OF DIRECTORS AND OFFICERS TO THE ORGANIZATION?

Duty of Care: Directors and officers are expected to perform their duties in good faith and at a level of professionalism they reasonably believe to be in the interest of the corporation and with the care that a reasonably prudent person in a similar situation would use under similar circumstances..

Duty of Loyalty: The duty of loyalty prohibits directors and officers from using their positions to further or enhance their private interests and requires them to refrain from engaging in personal activities which might injure the corporation. It requires an unselfish and undivided loyalty to the corporation and demands that there be no conflict between one's self interest and that owed to the entity.

Duty of Obedience: Directors and officers are required to perform their duties in accordance with applicable statutes and the terms of the by-laws of their non-profit organization. Directors and officers are not excused from their duties if they are unfamiliar with the laws governing their conduct.

The exposures that affect a non-profit board include financial constraints, corporate governance, indemnification concerns, immunity misconceptions and others.

CHARACTERISTICS AND FINANCIAL CONSTRAINTS

Non-profit organizations were created to provide a service or support an issue (and gain tax advantages). The issues that a non-profit organization support are commonly formed for educational, religious, charitable or even scientific purposes. The typical non-profit organization operates with fewer employees to keep expenses down and they normally have relatively small budgets. They are less likely to have formalized employment practices procedures which may lead to increased claims exposure. Additionally, non-profit organizations may be more prone to possible errors and oversight based upon their small budgets which may ultimately lead to a negative impact on their financial statements. A full-time CPA is traditionally not on staff due to these budget constraints which also adds to the possibility of mistakes, miscalculations and inaccuracies. Generally, the assets held within a non-profit organization are restricted, and may not be available for use, especially, if the operational cash flow comes from government grants or directed funds. Non-profit organizations also rely heavily on the services of volunteers which may open the door to more errors and unforeseen lawsuits.

Corporate governance is also a factor to consider. Sarbanes-Oxley and other similar legislation have provisions that apply to non-profit organizations, such as, whistleblower protection and document preservation. A developing exposure which traditionally hasn't had many controls, is the protection of personally identifiable information of its employees, customers, etc. Forty five states now have some type of law governing the actions required in the event of a breach of personally identifiable information. Additionally, the Red Flag Rules (financial sector compliance) and HITECH (health care information compliance) are two examples of new compliance acts that have surfaced in 2009. USI recommends that non-profit organizations develop and implement a formal process to acknowledge and appropriately handle these types of governance issues. The potential cost of these exposures may be offset with a comprehensive Management Liability Policy.

INDEMNIFICATION CONCERNS

Most non-profit organizations are willing to indemnify their employees and board members, however, high legal expenses may ultimately exceed the organizations financial capacity. Directors and officers of non-profit organizations that depend specifically on indemnification provisions may still be exposed to this potential financial shortfall. Many times the indemnification provisions haven't been updated or even reviewed for acceptable language. It is possible that the bylaws may not be available to a particular non-profit chapter for a variety of reasons or the bylaws themselves may have become a forgotten topic after years of board turnover. Relying solely on indemnification and/or charitable immunity (discussed next) has become a common practice for non-profits due to exceptionally tight annual budgets. Fortunately, the cost of a D&O policy is much less than you might expect which may help ease the burden and costs associated with unforeseen litigation.

Although indemnity may be stated in the articles/bylaws of the organization or identified in an employment contract, by and large, non-profit organizations may not have the funds to pay the expenses associated

with protecting their directors and officers. It is important to review and update the articles/bylaws of your organization on a regular basis. Understanding the issues and updating the areas that need to be addressed in your organization will help you attract more experienced and talented board members.

CHARTABLE IMMUNITY MISCONCEPTION

There are state and federal laws that limit the liability of non-profit volunteers, more commonly referred to as the Charitable Immunity Doctrine. Many courts have abolished charitable immunity altogether while others are more likely to require those involved to take financial responsibility. The organization itself is rarely included within the immunity language and there may be applicability concerns for compensated directors, officers and employees. Beyond state laws, there is a federal immunity law (i.e. Federal Volunteer Protection Act), which provides protection to individual volunteers but not the organization. Ultimately, if a lawsuit is filed, those named will be required to defend themselves with proper counsel. It is important to research and understand your state statutes and protections as relates to immunity.

OTHER COMMENTS

As mentioned above, the majority of claims stem from employment related acts and the protections available under charitable immunity laws might not extend to these types of allegations. Depending on case specific allegations and policy language, defense cost and settlement options for an employment practices claim will most likely be covered under an Employment Practices Liability Policy. The average cost to defend and settle an employment practices claim may easily exceed \$100,000. Can your balance sheet absorb this type of expense? If not, you may want to consider purchasing insurance to transfer this exposure..

Another misconception is that personal umbrella coverage may cover liability arising out of ones work at a non-profit. To some degree, this is true, however, in order for coverage to apply under a personal umbrella policy there usually must be property damage or bodily injury. Personal umbrella policies provide important coverage for unexpected liability associated with property damage or bodily injury, but is not the answer to non-profit board liability.

SUMMARY

Adequate financial protection is critical for the directors and officers of a non-profit management team as they can be held to the same high level standards of a for-profit company. Risk transfer is available under a combined comprehensive Management Liability Policy and this coverage can provide effective protection in today's business climate. The coverage we obtain at USI comes from our pre-selected carriers, all with AM Best ratings of A (or better), and coverage terms will be tailored to your specific exposures. Call on your USI representative for more details.

SUMMARY POINTS

- Non-profit organizations are subject to many of the same management liability exposures as for-profit organizations.
- Most non-profit claims involve employment related issues (full-time, part-time, third party vendors and/or volunteers) which are also covered by a Management Liability Policy.
- Claims have been brought by a variety of sources, including customers, creditors, donors, regulatory bodies and other non-profit organizations.
- Non-profits are faced with less resources including a small number of employees and limited budgets.
- Indemnification may be available, although not always adequate.
- Charitable immunity doctrines should not be relied upon exclusively as the solution to your individual exposure.
- Personal umbrella (homeowner) coverage may only apply to claim alleging bodily injury or property damage claims.
- Management Liability Insurance can offset most, if not all, of these exposures.

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