

Serving on the Board of a Nonprofit Organization?

Consider These Four Steps to Ensure You are Properly Protected



Giving back can leave you at risk. Make sure you're properly protected.

Gulfshore Insurance – Private Risk Services develops customized personal risk management programs for affluent and high-net-worth clients. Many of our clients want to ‘give back’ to their community and generously serve as board members of various nonprofit organizations. However, they may not realize that their commendable behavior increases the likelihood of being sued. Board members can be held personally liable for the actions or inactions of the charitable organization, even if the board member is unpaid.

ACE Private Risk Services, one of a few global insurance carriers catering to affluent customers, recently conducted a survey of households with at least \$5 million in investable assets. They found that 44% of those who were serving on nonprofit boards, or had served as a volunteer board member, did not have proper personal liability coverage in place.

With this in mind, our team has been raising appropriate questions to our clients in an attempt to educate them on their potential personal liability exposures as they serve in such roles.

This white paper is not intended to be an exhaustive description of all issues a nonprofit corporation and its board members should research and address. However, we hope it serves as a resource for board members as they consider board participation and take appropriate steps to ensure their personal assets and lifestyles are properly protected.

We welcome existing clients, potential clients, and their other trusted advisors to contact our Private Risk Services team to discuss D&O related questions and scenarios. We find that a collaborative discussion is the most important step in determining the best solution for each individual client. After we fully understand the potential exposures, we can discuss the available solutions to help mitigate risk and ensure proper insurance protection is in place to protect our clients' assets and lifestyles.

What Could Really Happen?

Directors of nonprofit organizations can potentially face various claims while serving in their roles, which may lead to personal lawsuits brought against them. Here are a few examples of assertions and/or claims that are commonly brought against directors.

- Due to the explosion of social media, lawsuits claiming libel, slander, invasion of privacy, plagiarism, and copyright or trademark infringement present a rapidly escalating threat.
- Employees or volunteers claiming sexual harassment, wrongful termination, or discrimination.
- Bankruptcies and those who seek to hold board members personally accountable for losses arising out of financial problems of the organization

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We recommend a four-step review process that should be reviewed and considered as part of the initial due diligence process.



- and/or the misconduct of insiders.
- The use of financing (e.g. bond offerings) that give rise to security claims similar those filed against public company directors.
- Property damage or personal injury caused by an accident/event taking place on the property owned by, or an event sponsored by, the nonprofit organization.
- Claims made by the Internal Revenue Service or attorney general alleging that a director or some other insider has inappropriately benefited from his or her relationship with the nonprofit corporation.
- Plaintiff attorneys have honed their focus on filing error and omission claims against board members of health care or educational institutions.

What Can I Do to Protect Myself?

In response to these types of liability claims, many board members and a growing number of nonprofit organizations, are seeking advice from their insurance agents and conducting legal reviews with their trusted attorneys. They want to ensure appropriate protections are in place before they agree to serve on a board of directors.

Our team at Gulfshore Insurance – Private Risk Services recommends a four-step review process of items that should be reviewed and considered as part of this initial due diligence process, these include:

1. **Best Practices to Avoid Future Claims**
2. **Commercial D&O Insurance**
3. **Independent Director Liability**
4. **Personal Liability and Umbrella Liability**

Best Practices to Avoid Future Claims

We encourage boards to assess existing policies and practices, which should demonstrate that the directors are consistently fulfilling their duties of care and loyalty. Items that might be addressed include:

- **Conflict of Interest Policy** – Does the corporation have an adequate conflict of interest policy?
- **Restricted Funds** – Do policies and practices assure that restricted funds are always used and invested as required by law?

- **Gift Acceptance Policy** – Does the corporation have and follow policies and practices that assure it accepts only gifts that do not pose undue risks?
- **Spending Policy** – Does the corporation have a spending policy assuring that endowment and trust funds are spent only as permitted by law?
- **Investment Policies** – Does the corporation have an investment policy regarding how and by whom its funds are invested? Is the policy adequate to demonstrate that the directors are exercising their fiduciary duty regarding invested assets?
- **CEO Compensation** – Who determines CEO compensation? Is the compensation reasonable? How does the board know that?
- **Employment Policies and Practices** – Does the corporation have and follow practices and policies intended to assure that its employment practices comply with law?
- **Board Information** – Do directors receive financial and other information sufficient to enable them to understand the corporation's finances and operations and make prudent decisions? Are directors readily able to secure any additional information that they require? Do directors actually review and understand the information? Do directors reach an independent conclusion based upon the information provided to them rather than "rubber-stamping" management recommendations?
- **Board Composition and Participation** – Does the board include persons with the necessary expertise? Do all directors actively participate in the work of the board? Is the board so large that some directors feel disenfranchised?
- **Governance Structure of the Board** – Does the board have an appropriate committee structure? What is the nominating process? Are appropriate meeting practices in place?
- **Audit Practices** – Does the board obtain an annual audit from an independent auditor? Does the auditor report to the board or the staff? Are adequate internal controls in place?
- **Licenses and Filing** – Does the corporation practice timely filing of its Form 990 and all required employment forms, as well as timely remittance of all employment taxes? Is the corporation appropriately registered to solicit charitable contributions?
- **Whistleblower and Document Destruction Policies** – Does the corporation have and follow satisfactory policies regarding whistleblowers and destruction of documents?

Note: The Best Practices checklist above is credited to Thompson Hine, LLP and Alan F. Berliner. It was published in their April 2013 Article, "Maximizing Legal Protections for Directors of NonProfit Corporations: A Timely Topic in Today's Dangerous World."

“Not all insurance providers can meet your unique needs, so be sure to talk to a trusted risk advisor.”

Commercial D&O Insurance

It's important for all directors to understand that the coverage provided by D&O insurance contracts are not the same. Policies can differ greatly and the associated claims responses can be meaningful. Gulfshore Insurance – Private Risk Services recommends that our clients secure a copy of the actual D&O policy that was purchased by the nonprofit organization. The policy should be reviewed by an experienced insurance agent or broker. It may require additional assistance from legal counsel, experienced in such insurance coverage matters, to review the proposed policy wording, to recommend wording improvements, and to collaborate with the broker and the nonprofit organization in securing appropriate D&O insurance protection.

A significant difference between D&O insurance and most other insurance policies is that defense fees and other costs covered by the D&O policy are charged against the policy limits. Legal expenses can, and often do, exceed policy limits, leaving the organization, and possibly the individual directors, to fund their additional defense fees and costs themselves, including any settlement costs.

The primary concern of a potential director is whether the company's D&O insurance policy provides the following coverage components.

- **“Side A”** coverage will provide each director his or her liability and also the legal defense costs if a claim is made against him or her.
- **“Side B”** coverage refers to amounts the insurance carrier would pay to the organization as reimbursement for indemnification paid by the organization to its directors and officers.
- **“Side C”** coverage protects the organization for liability the organization itself may have in the event of a claim.

Listed below are a few initial questions a prospective director should ask before agreeing to become an active board member:

- Does the organization maintain an active D&O liability insurance policy?
- Does the policy afford coverage for both reimbursement to the directors' and the company's own liability (i.e. Sides B and C coverage)?
- Does the insurance carrier advance the defense costs and expenses or only reimburse them?

- Similarly, if the corporate bylaws provide for indemnification, do they require the corporation to advance defense fees and costs to the director? Or do the bylaws only provide for reimbursement?
- Who selects the defense counsel? May the organization choose counsel or are they required to comply with the defense selected by the insurance carrier?
- What is the amount of coverage? What is the single limit for each claim and all claims in the aggregate?
- Are criminal, administrative, and regulatory proceedings covered?
- What is the self-insured retention stated in the policy? If a claim is made, will the organization pay that retention before the D&O coverage takes effect?
- Have there been claims brought against the board within the past 3 years? How did the carrier handle the claim and the defense? Were they cooperative and helpful?
- Are you covered for claims made after the policy expires, and if so, for how long?
- How are defense costs allocated among various insureds? If there is Side C coverage and the company itself is insured for direct liability to a third party, is there any methodology specified for allocation of defense costs between the company and individual insureds?
- Is the carrier financially strong and highly rated by an agency such as A.M. Best? If there is an excess carrier and the primary carrier becomes insolvent, will the excess carrier pick up coverage?
- What does the applicable state law provide for indemnification, and, if the organizations' bylaws are different, do they provide for maximum indemnification? If so, is it mandatory or discretionary?

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Note: The list of D&O questions above is credited as part of a more extensive list created by Thomas M. Reiter and Susan M. Schwartz and published in their March 2013 Article, “Questions a potential independent director should ask about directors & officers liability insurance before joining the board.”

Independent Director Liability Policies

Most reputable nonprofit organizations purchase D&O insurance, providing officers and directors with protection against claims not indemnified by the organization. But when nonprofit organizations unravel, they tend to do so in spectacular fashion. Given how a typical D&O policy is structured, directors may not be as well protected in the event of a major lawsuit as they might like.

“Independent Director Liability policies represent the most comprehensive form of ‘catastrophe insurance.’ They protect only the directors and will pay out even if all limits within a company’s D&O policy are exhausted.”

That is why D&O carriers such as ACE, Chubb Group, and XL Insurance began offering Independent Director Liability (IDL) directly to individual board members. IDL protects only the directors and would pay out even if all limits within a company’s D&O policy were exhausted. IDL policies can be written to cover for-profit and nonprofit board participation.

IDL policies do represent the most comprehensive form of ‘catastrophe insurance’ for individual directors. If directors are concerned about personal liability and protecting their personal assets, this product goes a long way toward giving them comfort.

IDL policies can be designed and purchased in two ways:

1. They can be purchased by the nonprofit organization to cover all the independent directors serving on it’s board. This would typically be secured in addition to the organizations’ primary D&O coverage.
2. Individual board members could chose to purchase an IDL policy to protect themselves from the various exposures they might face from the various boards they serve upon.

Finally, it is important to note that nationwide sales of IDL policies, to individual board members, have been limited. There are two general reasons: 1) It can be difficult to decide who should pay for an individual director’s policy, especially if the individual sits on several boards and 2) Should there be litigation, the director with extra IDL insurance could be viewed as a ‘target’ once plaintiff attorneys realize that one individual carries far more insurance coverage than other board members.

As with any insurance policy, the chief downsides to IDL are its cost and the perceived remoteness of a catastrophic event actually taking place. However, while the chances of being held personally liable as a director may be remote, you would have to defend yourself, and defending yourself in these cases can be quite expensive.

Personal Liability & Umbrella Policies

Gulfshore Insurance - Private Risk Services prioritizes **Personal Liability** protection as the foundation of our **Personal Risk Management Program**. Homeowners and Automobile insurance policies include initial limits of ‘Primary Liability’ that respond to judgments you or your family members

become legally responsible for. These primary limits are commonly limited to \$300,000 or \$500,000 and, are therefore, inadequate in today's litigious society where multi-million dollar judgments are inevitable, as they are based on **current and future earnings**.

An **Excess Liability or Umbrella** policy responds when a judgment from a lawsuit exceeds the underlying limit on your homeowner's and auto policies. We are able to secure Umbrella limits up to \$100 million. While we don't commonly sell limits at this level, we are able to provide total liability solutions that ultimately provide our clients' peace of mind, regardless of their total net worth.

As we work through our consultative process, we always point out that **most Personal Liability and Umbrella policies exclude third party damages arising out of board activity** (both for-profit and *nonprofit organizations*). That is one of the major reasons our agency prefers to work with specialty insurance carriers such as ACE, AIG, Chubb, and PURE. Each of these companies provide Umbrella policies that include foundational levels of coverage for individual liability stemming from nonprofit board activity (*it's important to note that even these comprehensive policies exclude for-profit board activity*).

It's important to note that all insurance policies are not created equal. Some policies provide coverage for the following nonprofit D&O related perils, while others chose to exclude some of them.

- **Property Damage**
- **Personal Injury/Bodily Injury**
- **Financial Loss/Wrongful Acts**

The following claims scenarios are designed to illustrate each of these perils associated with nonprofit board activity:

Claims Scenario #1: Property Damage

- Our client serves on the board of a condo association. One of the responsibilities of the Board is to maintain all common areas of the property.
- Three residents owning penthouse units in the building were awarded a total judgment of \$3 million for a lawsuit they brought against the condo association and the board for mismanaging a roof repair.

“Most Personal Liability and Umbrella policies exclude third party damages arising out of board activity.”

- The roof fell through during the repair and the contractor was found to have no license and no commercial insurance in place at the time of the project.
- The board of directors and the condo association were found negligent in the selection/hiring of this contractor.
- The \$3 million judgment was then applied to the condo association's liability policy (\$1 million available) and the commercial D&O policy (\$1 million available).
- Since there remained \$1 million of the judgment uncovered by the two commercial policies the plaintiff attorneys targeted the board members individually for negligence. They were sued individually to recover the unresolved \$1 million amount of property damage experienced.
- Our client was found legally responsible for \$170,000 (his portion of the remaining judgement spread across the six board members).

Claims Scenario #2: Personal Injury/Bodily Injury

- Our client serves on the board of a non-profit organization that provides educational and day care services for children with special needs.
- The board is responsible for maintaining all common areas of the property. One of the children's parents arrive to the facility to pick up their child.
- There was a heavy snow fall that day and the driveways and walkways were not properly cleared.
- A parent fell on her way into the facility and experienced a herniated disc and a major break to her leg. She is a physician and is not unable to walk and perform her job for 18-24 months.
- She is awarded a judgment of \$2.5 million for a lawsuit she brought against the non-profit organization and the board for mismanaging the maintenance of the property.
- The \$2.5 million judgment was then applied to the condo association's liability policy (\$1 million available) and the commercial D&O policy (\$1 million available).
- Since there is \$1 million of the judgment uncovered by the two commercial policies the third party brings suit against each of the 7 board members individually for negligence and looking to recover for the unresolved \$0.5 million amount.
- Our client is found legally responsible for \$70,000.

Claims Scenario #3: Financial Loss/Wrongful Acts

- Our client serves on the board of a non-profit organization that provides food, clothing and other welfare services for impoverished children across the U.S.
- The board is responsible for hiring the CEO and CFO who were responsible for all leadership responsibilities including managing the raised donations collected by the non-profit group.
- The CEO and CFO are a married couple and they are found guilty of embezzling \$5 million of raised donations.
- At that time the CEO and CFO can only repay \$1 million and they are tried criminally for their crimes.
- A \$4 million judgment is awarded in a suit brought against the organization and the board, as they hired the guilty parties and were found negligent in their management/accounting of the raised donations.
- The \$4 million judgment was then applied to the organization's liability policy (\$1 million available) and the commercial D&O policy (\$500,000 available).
- Since there is \$2.5million of the judgment uncovered by the two commercial policies the third party brings suit against each board member individually for negligence and looking to recover for the unresolved amount.
- Our client serves with 8 other board members and his share of the remaining judgement is \$313,000.

Again, it's very important to note that most personal liability and umbrella policies exclude for-profit and nonprofit board activities. A few high-net-worth specialty insurance carriers provide umbrella policies that will cover nonprofit board activity, but limit coverage to Property Damage and Personal Injury/Bodily Injury. Only a select few carriers offer an optional endorsement to their personal umbrella policy that would cover **Financial Loss due to Wrongful Acts** as part of nonprofit board activity.

While this is currently the best solution available in the personal umbrella market, it has its limitations.

- Coverage responds in excess of \$1,000,000 primary nonprofit D&O coverage.
- The endorsement protects only unpaid board members or trustees of charitable organizations.

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- The number of qualifying nonprofit organizations can not exceed five (5) at the inception of the policy period.

In summary, the Personal Liability and Umbrella option is our recommended first level of coverage for those clients wishing to secure individual protection for suits brought against them in their capacity as a nonprofit board member. There are only a select few carriers who offer this level of protection in their umbrella policies and some require the addition of optional endorsements. While these policies tend to offer less coverage than IDL policies, they are typically cost effective. Clients serving on nonprofit boards should absolutely consult with an independent insurance agent who can access such products and ensure proper coverage is secured for each individual case.

For additional information, please contact one of our team members.

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