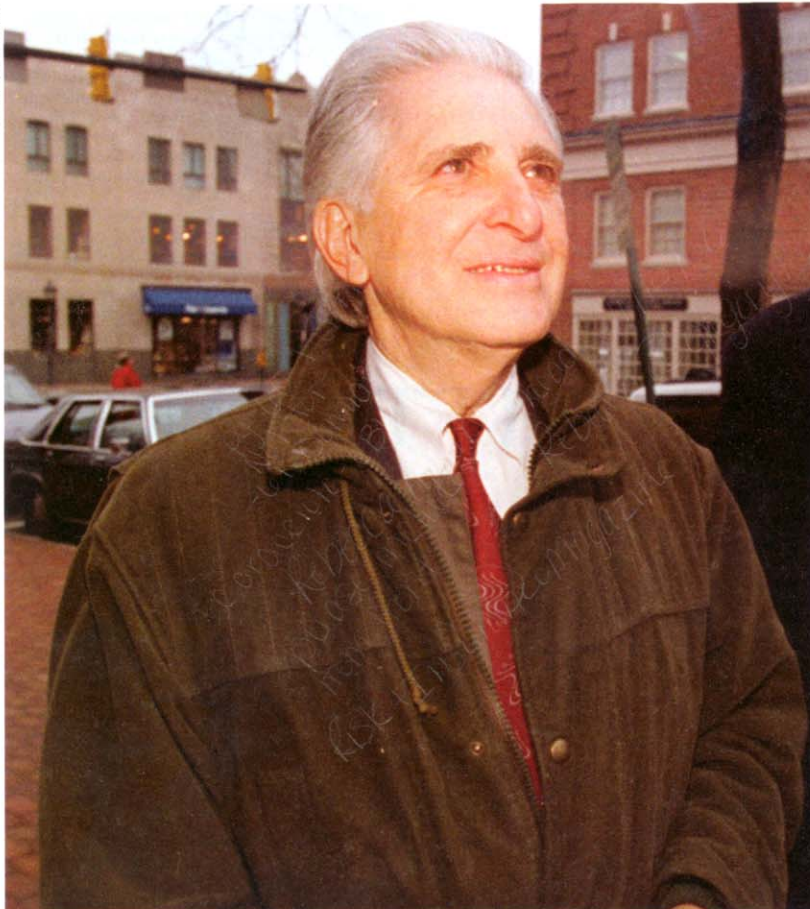


# RISK & INSURANCE®

Emerging Strategies for Risk

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AP PHOTO, MARK WILSON



**WILLIAM J. ARAMONY**, former United Way of America president, was found guilty in 1995 of stealing more than \$600,000 from the charity. The case was an embarrassment both to the independent United Way organizations and to the nonprofit sector generally.

• **D&O**

## Not-for-Profit, Not for Nothing

**Volunteer your time, not your financial security. Here's what executives should know about D&O if they're contemplating volunteering for a nonprofit organization. BY DAMIAN C. CARACCILO**

In today's litigious society, even not-for-profit organizations run the risk of being sued for alleged wrongdoings. Follow the logic, and it's obvious that these organizations' directors and officers also run the risk too.

These suits can include anything that a for-profit company would face, from discrimination on age, race, sex, employment or membership; harassment; wrongful employment termination; inefficient administration or supervision; Family Medical Leave Act claims; to waste of assets.

That's far from all. Other alleged wrongdoings might include conflicts of interest, misleading reports or other misrepresentations, defamation, libel and slander, breach of fiduciary duty, failure to

deliver services, acts beyond granted authority and derivative action claims, which are more common with trade associations.

Many nonprofits are targets simply by virtue of their nonexempt status or the defined objective in the charter. In many cases, an issue can arise because a nonprofit's budget is lean, and it doesn't have the personnel or expertise needed to monitor the organization's day-to-day operation. That can lead to an array of problems, including employment-practice claims or errors in financial reporting. Many nonprofits rely on completion of a form to satisfy governmental financial-reporting requirements but do not engage a certified public accountant to perform an annual audit.

Nonprofit director and officer responsibilities go well beyond attendance at monthly meetings. Some of the responsibilities include developing the organization's policies and procedures, monitoring budgets, maintaining financial reporting and disclosure requirements, human resource functions, and compliance with all applicable federal, state and local laws, as well as the organization's bylaws and articles of incorporation.

So if established and well-meaning businesspeople are looking to give their time and energy to serve on the board of a not-for-profit organization, they must recognize these risks and these responsibilities and make certain they aren't risking their personal financial security.

### **NOT FOR SURE ON NONPROFITS**

To limit the liability of volunteer board members, many states have enacted volunteer protection statutes. However, each statute needs to be examined carefully before relying on the provision. In certain instances, the statutes are deficient in that they typically don't protect the organization or apply only to volunteers, leaving other employees exposed to personal liability.

Other times, statutes limit damages but do not reduce defense costs, or they don't apply to violations of federal statutes, such as discrimination. And rarely do statutes apply to allegations of gross negligence or willful misconduct, which are common.

Most not-for-profit organizations assume a general liability policy will provide coverage for various allegations. Most, if not all, general liability policies, though, specifically exclude employment-related claims. Even when employment-related claims aren't excluded, the general liability policy is only triggered by a reported claim based on an occurrence of property damage or bodily injury.

That leaves a lot of questions when it comes to who will foot the bill to defend against these allegations. Consider the following: Could the organization find the funds to mount a defense against allegations? Or does the group expect directors and officers to pay for their own defense against frivolous allegations? Are there adequate indemnification provisions in place to protect directors and officers?

Keep going to the logical and potential conclusion: Can the organization pay if directors and officers are found liable? If so, is this how donors want the organization's funds spent?

### **VOLUNTEER FOR PROTECTION**

A wrongful act can be defined as any actual or alleged act, error, omission, misstatement or breach of duty, including any wrongful employment practice or any matter asserted against an insured person solely by reason of his or her status as a nonprofit director or officer.

So anyone serving on or considering service on a nonprofit board should review the organization's directors' and officers' policy to ensure they have adequate coverage and limits to protect past, present and future directors of the organization, using the following steps:

**Agent/Broker:** Whether or not the organization has or is contemplating the purchase of nonprofit D&O coverage, it should have an agent or broker who specializes in management liability products—nonprofit D&O, D&O, EPL, fiduciary and E&O. The broker or agent should also have extensive underwriting and placement experience. This may or may not be the organization's current P/C broker because the products available aren't "boilerplate policies," and typically coverage is specifically tailored to meet the needs of each individual insured. An experienced broker will have a game plan for the placement of a group's program.

**Underwriting:** The chosen agent or broker ought to then educate the insured about the underwriting process, including which markets will be approached and why, the completion of the various

applications, the representations made in the process (to avoid possible coverage rescissions down the road), the insurers' informational needs, the awareness and reporting of claims, and how and when proposals and recommendations will be made. The goal is to place the coverage before the need arises—then hope the need never arises.

**Carrier:** When the nonprofit organization pulls the trigger on a carrier, it should take into account its experience, philosophy, underwriting expertise, capacity, contract terms and conditions, claims handling and risk management services, market

## Building a Board 101

In many cases, the standard of care for public and private entities is applied to directors and officers of nonprofit organizations. Therefore, selection of individuals to serve on the board is critical at any stage of the organization's existence. Here's advice for nonprofits on how they can pick their board members:

**Size:** More is not necessarily better. Nonprofits should seek management and financial experts who can help achieve goals and objectives with a balance of diversity, business expertise and independence.

**Independence:** Nonprofits should seek individuals who will provide independent advice, have no conflicts of interest, and will make decisions that are in the best interests of the organization and its members. Ideally, the majority of the directors should be from outside the organization.

**Education:** Each board member must have an understanding of the environment in which the entity operates, as well as the laws and regulations that apply to operations. The education of board members should be an ongoing process, along with a review of the laws governing the activities of directors. That review should include anti-trust activities, intellectual-property protection, employment practices, pollution, fraud and governmental contracts.

**Bylaws and Procedures:** Review the corporate charter and bylaws so they adequately define the purpose and scope of the organization. Particular attention should be paid to the indemnification provisions—they are one measure to protect the directors and officers personally and attract quality members to the board.

**Guidance and Advice:** Guidance in developing or revising the bylaws should be sought ideally from outside counsel, along with advice on sound risk management practices, to ensure the most protection for those serving on boards.

—Damian C. Caracciolo

niche and creditworthiness. These are all critical factors when making a purchasing decision.

**Limits/Retentions:** The limits of the ultimate policy should be adequate and based on the indemnification obligations set forth in the nonprofit's bylaws. Decisions on limits and retentions should also take into account the construction of the policy, inclusion of EPL in the policy, the size of the nonprofit, its particular industry, the number and reputation of its individual directors and officer, and its number of employees.

**Terms/Conditions:** Of course, the ultimate goal in securing coverage for a nonprofit organization is to get the best possible terms and conditions with a quality carrier at a reasonable price. An understating of the contract and the mechanics are critical in terms of the coverage provided. Each carrier's policy is similar, but not the same. Coverage enhancements may be built into one policy and need to be endorsed onto another.

Some coverage enhancements are more critical than others. Each policy should be tailored to meet the specific needs of the nonprofit to ensure adequate coverage in the event of a claim or potential claim. Many brokers who specialize in this type of coverage systematically request and receive superior terms and conditions for the benefit of their clients.

**Presentation:** Lastly, all of these findings should be put together in a clear and concise format with a meaningful recommendation at the end. The presentation is invaluable in providing a not-for-profit organization and its volunteer board members with the information they need to make an informed decision on how to protect the organization and themselves.

A volunteer board member should review the coverage, limits and retention options, optional coverage, key definitions (such as claim, insured, damages and loss), reporting provisions, severability and exclusions. The client should understand what is covered—as well as what is not covered.

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