Four Insurance Products that Help You Sleep Better at night

By Eric Johnson

Don't let a lawsuit crush your organization. Protect yourself with the right insurance.

You sit in the courtroom, the defendant in a lawsuit. A donor that has made generous contributions to your nonprofit for years has filed a suit against you and your fellow board members for "misuse of funds." In the papers served by the county sheriff, the donor is also alleging the board "failed to fulfill its mission."

You're nervous and rightfully so. Though you believe you're innocent, your greatest fear is whether or not your insurance will cover the claim. At $500 an hour, the legal fees alone have the potential to destroy your organization. You can't help but wish you had paid more attention to your insurance program.

This article explains some of the basics about insuring a nonprofit. Having this knowledge will avoid a great deal of stress when a claim occurs.

Management Liability Insurance 101

In today's economic environment, managers are charged with navigating a sometimes precarious maze of difficult decisions. With the tightening of purse strings, nonprofits depend on the aptitude, effectiveness, and integrity of their staff. It's essential to prepare for the risks inherent in day-to-day operations.

To properly equip yourself, you should be aware of the coverage available and understand how the following four products provide protection to your organization, your board, and your staff.

1 DIRECTORS' & OFFICERS' (D&O) LIABILITY INSURANCE

Directors and officers are held to a high standard and can be held personally responsible for the decisions made by their board. Your directors and officers are obligated to practice the three duties required for effective board leadership: loyalty, care, and obedience.

The duty of loyalty demands that directors and officers must act in the best interest of the organization. They cannot use their position for their own personal gain and should avoid conflicts of interest.

The duty of care necessitates acting in a prudent manner. This means making informed decisions and exercising due diligence in performing their board obligations.

The duty of obedience requires that directors and officers act within, and obey the bylaws of, the organization. This means working to fulfill the organization's mission.

Sixty-three percent of U.S. nonprofits have experienced a D&O claim over the past 10 years.[1] D&O insurance protects directors and officers from such claims and from the legal liability arising from their actions or inactions. It responds to allegations of mismanagement, including alleged errors in judgment and breach of duty.

Examples of common D&O claims include:

- self-dealing
- conflicts of interest
- defamation of character
- libel and slander
- copyright infringement
- third-party harassment
- discrimination
- mismanagement of funds.

[1] Trefry, John, "Nonprofit Management Faces Liability Risks," *Risk Management*, September 1, 2014.

Unwilling to risk their personal assets, many people refuse to serve on boards that lack D&O insurance coverage. A D&O policy not only protects your organization, it can help attract talent to your board.

What to Look For

One way to determine if your D&O policy is sufficient is to see if it provides protection for the organization itself. This coverage feature, known as "entity" coverage, is an important aspect of nonprofit D&O policies.

2 EMPLOYMENT PRACTICES LIABILITY INSURANCE (EPLI)

Don't think employees sue their employers? Think again. The need to insure yourself and your organization against potential employment suits has never been greater.

Due to the Equal Employment Opportunity Commission's (EEOC) rigorous enforcement of federal laws such as the Civil Rights Act of 1964, and Fair Employment Practice Agency prosecution of state and local employment laws, employment practices liability continues to be a serious exposure for all U.S. businesses, including nonprofits.

- **88,778 discrimination claims** were filed with the EEOC in 2014.[2]
- **When employment practice lawsuits go to trial,** the employee wins 51% of the time.[3]
- **The median award of an employment practices claim** is $325,000.[4]
- **The average length of time** to resolve employment litigation is 18-24 months.[3]
- **The legal fees** associated with defending an employee suit typically range from $75,000 - $125,000.[4]

EPLI protects an organization against allegations or claims made by its employees, former employees, and potential employees. Examples of common EPLI claims include:

- discrimination
- wrongful termination
- failure to hire or promote
- sexual harassment
- retaliation
- violations of the Family & Medical Leave Act
- infliction of emotional distress
- defamation.

EPLI Buying Tip

EPLI is needed as soon as you start to hire employees. An easy, affordable way for a nonprofit to pick up this important coverage is through its D&O insurance. Review your D&O policy to determine whether EPLI is included.

3 FIDUCIARY LIABILITY INSURANCE

To understand fiduciary liability insurance, it's important to understand the Employee Retirement Income Security Act of 1974, commonly referred to as ERISA.

ERISA is a federal law that sets minimum standards for most voluntarily established pension and health plans in private industry. ERISA does not require any employer to establish a pension or employee benefit plan. However, ERISA was enacted to protect the interests of employee benefit plan participants and their beneficiaries. ERISA does the following:[5]

- **Requires plans to provide participants with information** about the plan, including funding.
- **Sets minimum standards** for participation, vesting, benefit accrual, and funding.
- **Requires fiduciary accountability** regarding the plan.
- **Gives plan participants the right to sue** for benefits and breaches of fiduciary duty.

Fiduciary status is based on functions performed, not just a person's title. A key to determining whether an individual is a fiduciary is whether or not they are exercising control of the benefit plan.

Fiduciary liability insurance pays for claims arising out of the plan fiduciaries' alleged failure to prudently act within the scope of

[2] U.S. Equal Employment Opportunity Commission, "EEOC Releases Fiscal Year 2014 Enforcement and Litigation Data," *Newsroom*, February 4, 2015.

[3] Jury Verdict Research, "Employment Practice Liability: Jury Award Trends and Statistics, 2013 Edition," *Westlaw*, 2014.

[4] Hyman, Jon, "How Much Does It Cost to Defend an Employment Lawsuit?" *LexisNexis*, May 14, 2013.

[5] United States Department of Labor, "Health Plans & Benefits, Employee Retirement Income Security Act," www.dol.gov.

D&O CLAIM SCENARIO

Type of Insured	Nonprofit professional trade association.
Cause of Action	Several association members filed a lawsuit seeking a temporary restraining order, plus attorney fees, to prevent the association's board from meeting and amending the bylaws.
Situation	After a contentious dispute between the board members about the future of the organization, the bylaws were amended at the annual meeting to prevent the organization's dissolution. The claimants, who were in favor of dissolving the organization, alleged that there was a lack of proper notice provided about the meeting where the changes took place.
Resolution	Though the claim was dismissed at court, the association's legal expenses to defend the case amounted to more than $140,000.

EPLI CLAIM SCENARIO

Type of Insured	Nonprofit social service organization.
Allegations	Breach of contract, misrepresentation, defamation, age discrimination.
Situation	An employee in her 60s was terminated for poor performance, after which she filed suit against her long-term employer, who she alleged had guaranteed her lifetime employment for staying with the organization through a merger. Five years' future pay of approximately $360,000 was sought, in addition to damages for emotional distress and attorney fees.
Resolution	The claim was settled for one year's salary of $65,000 with legal expenses amounting to approximately $18,000.

FIDUCIARY CLAIMS SCENARIO

Type of Insured	Museum.
Allegations	Failure to properly monitor investments; failure to monitor investment manager.
Situation	Employees of the museum alleged the wrongful elimination of a very profitable 401(k) investment option by the plan investment manager and the improper selection of a replacement option.
Resolution	The court awarded $430,000 in damages. In addition, the museum had to pay defense costs of $67,000.

CRIME INSURANCE CLAIMS SCENARIO

Type of Insured	Nonprofit foundation.
Situation	The foundation's controller manipulated the bank records to hide that he'd been accessing account funds for personal use.
Resolution	The organization was able to recoup more than $270,000 in funds.

ERISA. Fiduciary liability claims typically fall into two categories, allegations of:

- breach of fiduciary duty
- errors or omissions in the administration of the plan.

What to Be Aware of

It's important to understand that a fiduciary may be considered liable for the actions of persons or entities providing services to a plan, including law firms and investment firms. You should consider fiduciary liability insurance if your organization provides employee benefit plans, including health, life, pension, 401(k), and 403(b) plans.

4 CRIME INSURANCE

Employee theft continues to grow as a concern for nonprofits and their managers. The Association of Certified Fraud Examiners found the following:[6]

- **The typical organization loses 5% of its revenues** each year to employee theft.
- **The median loss is $145,000,** while 22% of reported cases involve losses of $1 million.
- **Smaller organizations tend to suffer** disproportionately larger losses.
- **The average length of time from commencement to detection** is 18 months.

Crime insurance, sometimes referred to as fidelity insurance, protects organizations from the loss of money, securities, or inventory resulting from crime. Crime insurance coverage includes options for:

- employee theft
- forgery or alteration
- money and securities inside the premises
- money and securities outside the premises
- computer and funds transfer fraud
- money order & counterfeit currency fraud.

What to Consider

If your organization uses paid staff or volunteers, you should be aware of the devastating effects of an employee theft. If you handle cash or securities, you have burglary and robbery exposure. Crime insurance is a cost-effective method for transferring your risk.

Compare Wisely

Some insurance carriers offer all four management liability insurance plans on a single insurance policy form. While pricing is an important factor in choosing insurance coverage, be aware that not all insurance policies are created equal. Depending on the carrier's level of specialization, the type of coverage can vary wildly.

Be wary of one-size-fits-all insurance policies. When talking to your insurance advisor, ask if the insurance company's policies offer coverage customized to the nonprofit sector. Their response should help guide your decision-making.

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The scenarios summarized herein are offered only as examples. Coverage depends on the actual facts of each case and the terms, conditions, and exclusions of the issued policy. Please refer to the issued policy to determine all terms, conditions, and exclusions of coverage.

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Protect Your Organization from Risk

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Conflict of Interest in the Board Room (Vol. 17, No. 2)

Fraud: Discovery and Action (Vol. 25, No. 5)

Get the Best Protection for Your Insurance Dollar (Vol. 24, No. 4)

How to Avoid Retaliation Claims (Vol. 21, No. 6)

Six Ways to Reduce Risk & Comply with the Law (Vol. 25, No. 6)

Do Your Board Members Know Their Fiduciary Responsibilities? (Vol. 33, No. 1)

Don't Be Sued for Negligent Hiring (Vol. 21, No. 3)

The Most Likely Lawsuits—and How to Protect Yourself (Vol. 19, No. 1)

How to Hire the Best People without Breaking the Law (Vol. 20, No. 5)

[6] Association of Certified Fraud Examiners, "2014 Report to the Nation on Occupational Fraud and Abuse."