

Nonprofit Directors – Risk Management Items to Understand and Consider When Sitting on Outside Boards



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When asked to participate on a nonprofit board; typically; the first reaction is to be flattered that someone would want our participation and the second reaction is to agree because it meets a personal or professional goal. After agreeing to sit on the board of an organization you may find that you did not learn everything about the organization and/or board interaction prior to joining their board. There are some steps you can take in advance of joining the board that will be helpful in determining if the organization is a good fit for you and vice versa, including attending a board meeting, meeting with the Executive Director and understanding what your role will be as board member, and asking to review minutes from prior meetings as well as the organization's mission statement and strategic plan.

Board members are obligated to meet three basic duties with regards to their fiduciary duty to the organization; most people will not have problem meeting these requirements, but they will be key to affording protection for decisions down the road.

Board members have a fiduciary responsibility that includes three basic duties:

- Good Faith
- Duty of Care
- Duty of Loyalty

The fiduciary duties of a director are outlined by the State of Washington and assume that you will take your role seriously and to the best of your abilities:

“A Director shall perform the duties of a director...in good faith, in a manner such director believes to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.” RCW 24.03.127

The first duty, Good Faith, is usually understood as having an honest approach in the decision making process. A question that tests this quality is ‘what was the director's intent?’ The second duty, Duty of Care, assumes the director is staying well informed about the organization and the issues on which they are voting or making decisions. Ultimately, can they prove they did their due diligence with regards to fully investigating issues and that they showed thoughtful consideration in the decision making process? The third duty, Duty of Loyalty, is normally defined as acting in the best interest of the corporation and avoiding conflict of interest or self dealing issues. The majority of people serving on boards can say they meet these tests. However, when an incident arises adherence to these duties is one aspect of what the adjusters will be looking at for their determination of covered claims for the entity or the individual.

Assuming that everything is operating well within the organization and the board meets the fiduciary test outlined above, incidents can still occur that will give rise to a claim. The time to understand your insurance program is prior to the loss occurring, which means asking the nonprofit organization to provide a copy of their directors & officers policy and having that reviewed by your own insurance broker. Depending on the state in which the organization is incorporated the entity typically will be required to provide some level of indemnification to the individual directors. In the event the organization cannot offer this indemnification, typically in cases of fraud or bankruptcy, then the D&O policy is designed to provide coverage. As a last resort you may have access to coverage under the D&O policy in place through your own employer/company.



Things to be aware of and/or understand with regards to the nonprofit organization's D&O policy include:

- Is the policy “claims made” or “claims made and reported”, in other words are you required to report the claim or incident within the policy period?
- Are the defense costs inside or outside the limit? We are seeing many carriers agreeing to offer defense costs outside the limit for nonprofit organizations this can be a significant coverage benefit as the defense costs can significantly erode the limits of the policy.
- What is the definition of a wrongful act? When reviewing the insurance policy it is important to understand how the insurance company defines ‘wrongful act’. Every carrier has their own definition.
- What is the definition of a claim, when and how is a claim recognized by the insurance company and what is required to present a claim as far as documentation? Most policies will include a specific wording as to how they define a ‘claim’ and it is different with most companies so it is important to review and understand.
- How broad does the policy extend coverage? Everyone including volunteers within the organization or directors only? If the policy covers everyone do you have limits that are high enough to cover the organization and individuals in the event of a claim?
- How large is the deductible, can the organization accept a larger deductible, conversely is it too large?
- Can the organization choose their own defense counsel or does the insurance company require you to use someone they choose? This can be negotiated up front with many carriers and at a minimum should be part of the discussion.

These are just a few of the items you will want to understand with regards to how the D&O policy works. We recommend you have your broker review the policy and comment on the things that would not be covered.

If you are sitting on the board at the direction of your company, it is important that you let your company know about your involvement. Normally included within the company's directors & officers policy is a provision that coverage will extend to officers and sometimes employee's, serving at the direction of the company on non profit board. This coverage is not intended to be primary and should always be viewed as coverage of last resort.

You should also understand if you if your personal insurance will extend to cover a claim against you personally, or your defense costs, should the acts of the nonprofit organization result in a claim. As with most situations the key will be to make sure you are coordinating all the various policies and factors into your situation so that you know who, what and how coverage will respond in the event a claim occurs.