

What Board Members Need To Know About Credit Union Directors' and Officers' Insurance

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Introduction

In my insurance consulting work, I'm often asked about directors' and officers' insurance, a.k.a. D&O. In many ways there is an air of mystery around this kind of policy. Let's get rid of that!

First, your credit union buys D&O insurance as protection against a breach of "duty" by the directors and officers. D&O pays for actual or alleged wrong decisions, what the policy calls "wrongful acts."

Directors' and officers' insurance protects the directors, the officers, the credit union, and, in some coverage sections, employees. It's a liability policy, providing protection from lawsuits against the insureds (directors, officers, the credit union) by others.

Although each insurer defines coverage in its own way, D&O insurance generally includes: "any actual or alleged act or omission, error, misstatement, misleading statement, neglect, or breach of duty by an Insured Person in the discharge of his/her duties."

Some examples of claims under D&O:

- An officer in the credit union is fired. You are sued, as a board member, for age discrimination.
- Your credit union forecloses on a mortgage. The customer sues the credit union and you, a director, alleging that you failed in your process of foreclosure, resulting in money damages and mental distress.
- Customer information is hacked and posted on a public website. You are sued as a board member for not providing adequate safeguards.

What D&O Does Not Cover

The policy does not pay for bodily injury or property damage, auto accidents, injuries to employees, allegations of pollution, employee dishonesty, or loss to the credit union's property.

Other policies like auto insurance, workers' compensation, crime insurance, bonds, property insurance, and general liability should be purchased for such claims.

Who Should Read This

This special report is designed for directors serving credit unions. I have included hints, tips, and strategies that will help you understand the coverage generally included in the directors' and officers' insurance purchased by credit unions.

I come at this subject from a different perspective from most insurance people you'll run into. I don't sell insurance. I never accept fees or commissions from insurance agents or companies. I don't even let them buy me lunch. I have been in the insurance business since 1979 and have been involved in all aspects of the business. My whole career has been spent helping business people find the right insurance. I have built a specialty practice of helping credit unions and other financial institutions with insurance issues.

I'm confident that this guide will help you.

Unbiased Insurance Coverage Review For Your Credit Union

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Thumbnail Sketch of the Coverage

The policy is designed to address liabilities that come out of management decisions - decisions in the operation of the credit union, including loans. Employment practices liability coverage can also be a part of D&O; such claims as harassment, discrimination, wrongful discharge, failure to hire, and failure to promote.

The cost to defend lawsuits (groundless and justified) is included in the protection.

Most D&O policies have a deductible provision. The credit union must spend the deductible amount before the insurance company steps in. Defense costs are usually included in the deductible.

Bodily injury, property damage, workers' compensation, employee theft, issues involving unemployment insurance, and ERISA are excluded from D&O policy protection.

D&O Insurance and Your Personal Insurance

Any time I meet with board members I get someone asking about using a homeowners' policy or umbrella liability policy for protection against issues involving the board.

Personal liability insurance—either homeowners' or the personal umbrella—covers bodily injury and property damage for which the insured—you—are liable.

Business endeavors are excluded. Volunteer activities (such as voluntary service on a credit union board) may be covered by your personal liability insurance, but only for bodily injury and property damage.

D&O insurance covers damage resulting from wrongful decisions.

A lawsuit alleging wrongful termination or discrimination in a loan is not bodily injury. Present these claims to your home insurance company and they will be declined.

Don't depend on personal liability to protect you from your actions on a board of directors.

Indemnification

Most credit union bylaws include an indemnification agreement that puts the CU on the hook for your liabilities as a board member. Your court costs, legal bills, and other expenses are to be reimbursed by the credit union.

In most cases it is the assets of the credit union that actually protect you from a lawsuit. The credit union's directors' and officers' insurance reimburses the credit union.

In rare cases, you only have the D&O insurance protecting you as indemnification may not be allowed or may not be possible.

Laws may prevent indemnification when the allegation involves breaches of loyalty, bad faith, fraud, or personal gain. Derivative lawsuits (when it is the credit union suing you) are also not indemnifiable. Then there is the possibility that the assets of the CU have been depleted. No assets means no possible indemnification.

No Standard Coverage

As there are no standard D&O policies, each insurer, policy, and proposal must be evaluated on its own merits. Every insurer uses his or her own policy forms, terms, and conditions.

Claims-Made Coverage

Most liability insurance policies (general liability, automobile, workers' compensation) pay for events that occur during the policy period. For example, an auto insurance policy will pay for an accident that occurs while the policy is in force.

D&O policies, however, pay for lawsuits filed during the policy period; the wrongful act could have occurred years before. Claims-made policies respond only when a suit is filed, or when a strong threat of a suit exists.

Claims-made policy: Pays based on the date of the lawsuit.

Occurrence policy: Pays based on the date of the accident or occurrence.

The downside of a claims-made policy comes if the policy is canceled.

Example: A D&O policy is put in force January 1, 2008, and is renewed in 2009 and 2010.

In 2011 the organization decides to end the coverage, as the premium has increased. Six months later, a letter from an attorney arrives announcing a lawsuit for discrimination in hiring that occurred in 2010.

No coverage. Although the policy was in force at the time of the alleged discrimination, the policy was not in force when the suit was filed. The solution to this problem is the extended reporting period found in most policies (see the next paragraph).

Extended Reporting Period/Tail Issues

Most directors' and officers' policies only provide protection for lawsuits and actions brought during the policy period. In the event that coverage is replaced or cancelled, protection may be desired for events that took place prior to expiration/cancellation but for which no claim has yet been filed. This coverage is called a "tail" or "extended reporting period" (ERP). Your insurance agent can help with the issues presented if you ever decide to cancel your insurance.

Policy Limit

What amount of coverage is provided by your policy? What's the total amount of protection offered for all claims during the covered time frame (also known as an "aggregate limit")? Multiple claims can, in effect, use up the limit of coverage.

I often use the analogy of insurance coverage on a shelf. As claims are paid the insurance is removed, leaving some to pay future claims. Claims payed now reduce coverage available for future claims.

Defense Within The Policy Limit

Most D&O policies include the cost of defending a claim (attorneys' fees, etc.) within the policy limit of liability. That means that the amount of coverage purchased must be enough to cover the awards and the defense costs of all claims. This can be an issue when considering the amount of coverage (aggregate limit) you buy.

Retroactive Date

As I've said, claims-made policies respond to claims brought during the policy period. Many policies include a date after which a claim must occur in order for the policy to respond—a retroactive date. When changing insurance companies, it is vital to understand the new policy retroactive date. The use of a "Tail" may be necessary if the retroactive date is not sufficiently in the past.

Employment-Related Practices Coverage

Many D&O policies include coverage for employment-related practices—wrongful discharge, harassment, discrimination, etc. Check the policy's definition of "wrongful employment act." Does it include only certain acts, such as sexual harassment? Or is the coverage broad, including workplace harassment, for example? Are discrimination suits brought by third parties covered? Remember that including employment practices claims in your organization's D&O policy could affect the limit of liability available for other claims.

Fiduciary Liability Coverage

The federal law ERISA makes administrators of employee benefit plans liable for mistakes and errors in the administration of those plans. Fiduciary liability insurance provides coverage for such events in the administration of the entity's own employee benefit plan. This also may be a part of your D&O insurance or a separate policy.

Guaranteed Coverage For Directors

Traditionally, there are three parts to D&O insurance:

Side A Coverage within a directors' and officers' insurance policy that pays for claims against individual directors or officers when corporate reimbursement isn't allowed.

Side B Coverage within a directors' and officers' insurance policy that pays for claims against individual directors or officers when corporate reimbursement is allowed.

Side C Coverage within a directors' and officers' insurance policy that pays for claims against the credit union. Also referred to as entity coverage.

Side A and B deal with the issue of corporate indemnification (discussed in a previous section). In real life, most claims against a board member are indemnified by the credit union, meaning that the assets of the credit union protect you. There are rare instances when your credit union is unable legally to indemnify you. Perhaps the credit union is unable to indemnify you due to insolvency.

Your protection is the coverage in Side A - where the insurer pays you when the CU cannot.

What if other claims have used up the insurance available?

Many CU D&O policies hold an amount of coverage in reserve, just for directors, just for when the rest of the coverage has been used up. Consider it a reserve parachute. It's often called excess D&O or excess Side A coverage.

Policy Exclusions

All insurance policies have exclusions. Review each exclusion carefully. Look both at the section of your policy called "exclusions," and endorsements attached to the back of the policy.

There is often an exclusion for actions brought by one insured against another. Some policies exclude bankruptcy or insolvency issues. Some exclude suits brought against directors by governmental regulators.

Other common exclusions:

- Pollution
- Bodily Injury & Property Damage
- Violation Of Intellectual Property Rights
- Violation Of Privacy
- Employee Theft
- Workers' Compensation, Unemployment, or Similar Laws

Review your exclusions with your insurance advisor.

Civil Money Penalties

The definition of “loss” in your D&O policy excludes fines and penalties. The nice people at NCUA do not care.

Civil Money Penalties insurance is a part of many D&O policies. It provides coverage for penalties or fines assessed by regulatory agencies against directors’ and officers’. Your credit union itself is not eligible for coverage.

Not every insurer will offer this coverage. For example, CUNA Mutual is does not offer civil money penalties insurance now.

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Regularly Review Coverage with Your Agent

Obviously, the management of your credit union should be reviewing the insurance coverage each year. Here are the questions management should be asking:

- How much coverage do we have – what are the limits of liability?
- Are defense costs included in the limit of liability?
- Do we have coverage for employment practices?
- Do we have coverage for ERISA imposed liabilities?
- Do we have coverage for lender liability issues?
- Do we have coverage for prior acts?
- Is there excess Side A coverage?
- What professional services are excluded?
- Is there an exclusion for securities or insurance sales?
- Is there an exclusion for suits brought by regulators?
- What are the policy exclusions?
- Is there an insolvency or bankruptcy exclusion?
- Are the directors and officers covered for civil money penalties assessed by regulators?
- Can the insurance company cancel our policy during the policy term?
- Does the insurance company have to renew our insurance at the end of the policy term?

I also think that the management of a credit union should review the coverage with the board at least once a year. The above questions are pertinent for that conversation too.

Independent Director's Liability Insurance

Several insurance companies are now selling coverage directly to independent board members to provide coverage when the corporate D&O doesn't respond due to government intervention, bankruptcy, or insolvency. Hartford Financial Services Group, Inc. offers a policy called *Priority Protection-IDL*. Chubb Specialty Insurance calls their product *Personal Director's Liability Insurance*.

Here are the issues to consider if you are going to buy your own D&O insurance:

- What are the policy limits?
- Is there a retention/deductible?
- In what circumstances will the policy pay? Must the corporate directors' and officers' policy respond first?
- Who selects the defense team - you or the insurer?
- Is coverage included for actions brought against a non-director spouse?
- Assuming the policy is a claims-made, what are the extended reporting provisions available?

Unbiased Insurance Coverage Reviews

Part of the risk management process for any financial institution should be a review of insurance coverage by someone other than your insurance provider. It's simply good practice to perform due diligence. Have all of your exposures been reviewed? Have you sought other opinions of managing risk? Have you considered the wide range of insurance coverages available?

For information on an unbiased coverage review please contact Scott Simmonds at Scott@ScottSimmonds.com or 207-284-0085.

About Scott Simmonds

Scott Simmonds, CPCU, ARM, CMC is The Unbiased Insurance Guy™

He started his insurance career in 1979. He has provided insurance advice and counsel to hundreds of companies, large and small, throughout the U.S.

Simmonds is a graduate of Babson College, Wellesley, Massachusetts. In 1987 he received the Certified Insurance Counselor designation from the Society of CIC. In 1995, Simmonds completed his studies to qualify for the Chartered Property and Casualty Underwriter designation conferred by the American Institute for CPCU. He completed the requirements for the Insurance Institute of America's Associate in Risk Management designation in 2005.

Scott's insurance work has involved companies of all sizes, in a wide range of industries including many with international operations. He is licensed in property, casualty, life, and health insurance consulting.

Scott is a member of the Society for Advancement of Consulting, an organization accepting only the top 1% of consultants nationwide. He is the first and only insurance consultant granted membership in this prestigious organization.

Scott has been inducted into the Million Dollar Consultant Hall of Fame, which was founded in 2006 by Dr. Alan Weiss to recognize world class consulting achievement. Dr. Weiss is a consultant and prolific author. He is recognized world wide as the Dean of Consultants.

Scott's writing and comments have appeared in the Wall Street Journal, Forbes, Portland Press Herald, MaineBiz, Fortune, Money, Inc. Magazine, the New York Times, Boston Globe, Investors Business Daily, Kiplinger's, the Los Angeles Times, and countless trade publications.

Simmonds lives in Saco, Maine, with his family. He is a past president of the trade association, Maine Association of Professional Consultants, and of the Biddeford Saco Rotary Club.

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