

NONPROFIT RISK MANAGEMENT CENTER

1001 Connecticut Avenue, NW

Suite 410

Washington, DC 20036

(202) 785-3891

INSURANCE BASICS FOR MENTORING PROGRAMS

The Role of Insurance

Generally speaking, purchasing insurance doesn't change the probability of an event materializing. For example, many nonprofits purchase directors' and officers' liability insurance due to a fear of suits against the nonprofit and individual board members alleging wrongful employment practices or breach of fiduciary duty. Yet having a policy in place and tucked neatly in a file drawer in no way changes the odds that a disgruntled former-employee will challenge the organization's employment practices at a state human relations commission or in state or federal court. And it doesn't matter whether the policy is one of the broadest available or a pared-down version of D&O protection. In rare instances and for some organizations the process of procuring insurance alters the chance that a risk may materialize. For example, an organization may find that it cannot obtain D&O insurance without having its employment policies in writing. So it develops an employee handbook in order to enable it to obtain the coverage it seeks. It has altered the probability of risk while engaging in the procurement process.

Purchasing insurance doesn't turn a potential nightmare into sweet dreams. Many nonprofit managers and board members feel relieved once they have certain insurance coverages in place. Yet even with solid insurance coverage, it's impossible to avoid the disruption and drain on resources that result when a nonprofit is sued. Even when the insurance company foots the bill for a defense, a nonprofit must spend time and human resources in the defense of a lawsuit. Time that might otherwise be spent on mission-critical activities. And there's always the possibility that the insurer will decline to cover the claim or the limits of liability will be insufficient. In some cases this is worse than never purchasing coverage in the first place — when this happens the nonprofit is caught unprepared to deal with a situation it thought was “covered.”

Insurance is a risk-financing tool. Every nonprofit must consider how it will pay for its operations, including the unintended consequences of its service delivery, such as harm suffered by a client or volunteer, or damage to property borrowed or rented by the organization. Contracting with an insurance company is one means of making certain that funds will be available to pay for these “losses.” Ironically, insurance is arguably most important for nonprofits that don't have large unrestricted reserves, yet smaller organizations are less likely to purchase coverage in the first place. But insurance doesn't affect the probability of the loss occurring or the way in which the organization will alter that probability (before) or respond if it does (after).

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Insurance for Volunteer Programs

When a volunteer program considers what types of insurance might be appropriate, the organization's leaders should be thinking about the types of losses that may occur. One place to start is the following major categories of claims:

- ❑ claims filed *against the nonprofit* that result from harm or loss *suffered by* volunteer workers while providing service for the organization or loss *caused by* volunteers while performing service for the organization; and
- ❑ claims filed *against the volunteer* alleging harm caused by the volunteer while performing service for the organization.

Each category of claims suggests different insurance products and considerations. In the following section we provide an overview of the options facing volunteer programs and a suggested approach to determining how an organization might insure these risks.

Claims Against the Nonprofit

Most nonprofits that engage volunteers in service projects are deeply concerned about the possibility that a volunteer worker will suffer an injury while performing service. In certain types of organizations, such as those sending volunteers to third world countries for emergency aid projects or U.S.-based projects where volunteers are involved in home building, outdoor activities, disaster response or work with difficult client populations, the concern about volunteer injury is a top priority. Within this category, potential claims can be further divided into two types:

- claims seeking payment of medical expenses for injuries suffered while volunteering; and
- claims seeking compensatory and/or punitive damages from the nonprofit for its negligence in supervising the activity or program in which the volunteer was injured.

Payment of Medical Expenses

The first group of claims may be insured in one of two ways. It's important to keep in mind, however, that the volunteer's existing health benefits coverage — through participation in an employer's, spouse's or self-employed program — will be primary over any coverage provided by the nonprofit. Here are the options for covering medical expenses.

- ❑ **Volunteer Accident Policy** — volunteer accident policies are relatively inexpensive policies that finance the cost of medical treatment for volunteers who are injured while delivering services for the organization. These policies usually pay the costs of emergency room services and follow-up treatment to predetermined limits based upon the kind of injury. An accident policy will not pay for an illness suffered by the volunteer, such as the flu or appendicitis, but it will respond if the illness is the result of an accident. Accident policies generally have a per accident limit ranging from \$5,000 to \$25,000 (higher limits are

available) and an aggregate limit for either any one accident or for all claims paid during the policy year. Many policies have a sublimit for accidental dismemberment, such as the loss of a limb or eyesight.

One distinctive feature of an accident and injury policy is that it will pay a claim regardless of who is at fault. These policies are often excess insurance, meaning that they pay only after other available insurance — generally the volunteer’s personal health insurance — is exhausted, doesn’t apply, or is subject to a deductible or co-payment provision. If the volunteer is uninsured, the accident and injury policy would “drop down” and become primary coverage for the injury.

Since the coverage is written on an excess basis, accident policies are relatively inexpensive. Coverage can be written on a primary basis at a much higher cost.

- ❑ **Commercial General Liability Policy** — Most commercial general liability policies include coverage for Medical Expenses. The policy has a per person limit between \$5,000 and \$10,000. The coverage is similar to the accident policy in that it will pay if the injury arises from the nonprofit’s operations or premises, even if the nonprofit is not negligent. One of the exclusions under Medical Expense coverage is that the coverage does not apply to “any insured,” including volunteers covered as “additional insureds.” If volunteers are not insureds under your policy, the Medical Expense coverage would apply to any volunteer injury, subject to the terms of the policy. Some insurance companies allow nonprofits to extend Medical Expense coverage to volunteers, even when the volunteers are listed as insureds or additional insureds on the policy.

- ❑ **Workers’ Compensation Policy** — Some states permit the inclusion of volunteers on a nonprofit’s workers’ compensation policy. A workers’ compensation policy pays for medical benefits as well as lost wages from a “work-related” injury. Therefore, if a volunteer is injured while “working” for the nonprofit, he or she might be eligible for workers’ compensation benefits. Under the workers’ compensation policy, the medical benefits are unlimited, unlike the Volunteer Accident or Medical Expense coverage under the commercial general liability policy. On the surface, this appears to be an easy answer to the dilemma of providing a source of recovery for injured volunteers. Organizations are required to carry this coverage for their employees and it may be administratively less cumbersome to simply add volunteers to an existing policy. Workers’ compensation policies may not, however, be the most effective way for a nonprofit to protect its volunteers. WC policies for employees include a number of benefits for which volunteers wouldn’t be eligible — reimbursement for lost wages, for example. In addition, WC premiums are based on position categories and total payroll, not the amount of time spent on the job. For example, the cost of insuring a patrol officer may be comparable to the cost of insuring a part-time police department volunteer who patrols a community as part of a crime deterrence effort. Another issue is how to determine the payment of lost wages if the injury results in time away from work. Will a doctor who performs home repair on a volunteer basis and suffers an injury be reimbursed for lost income as a doctor, or the average salary of a carpenter? In addition, actual losses under workers’ compensation policies can dramatically affect future premiums. If losses

paid for volunteer injuries exceed the premium paid by the nonprofit, the policy may be cancelled or a premium surcharge applied to future premiums. With a large volunteer workforce, accidents may occur and drive up the nonprofit's premium substantially.

One potential advantage of using workers' compensation coverage is that the "exclusive remedy" doctrine applies to this type of coverage, and the volunteer covered by WC may be precluded from pursuing a liability claim against the nonprofit. However, at least one state (Colorado) has ruled that a volunteer covered under workers' compensation can also file a liability claim against the nonprofit if the volunteer believes the nonprofit acted negligently.

Defense of Liability Claims Against the Nonprofit

What if an injured volunteer sues the volunteer program and alleges that his or her injuries resulted from negligence on the part of the nonprofit? Or a client of the mentoring program alleges he was harmed by a volunteer mentor? The four possible coverages that might apply are discussed below.

- ❑ **Commercial General Liability** — CGL policies protect a nonprofit and its directors, officers and employees against claims alleging property damage or bodily injury caused by the nonprofit's operations or activities. CGL policies generally offer broad coverage for damage to another's property, bodily injury, personal injury (false arrests, malicious prosecution, defamation), and advertising injury (offenses arising from the nonprofit's advertising materials). Although a CGL policy provides broad coverage, it doesn't address every possible liability exposure, such as pollution, intentional injury, liquor liability, or use of an automobile. A CGL policy will pay the cost to defend against allegations that may be covered by the policy as well as damages due to the insured's negligence. Some insurers are willing to extend the CGL policy to provide coverage for others such as volunteers, sponsors, funders and landlords.

If volunteers are additional insureds under the policy, the policy will defend both the nonprofit and the volunteer in any covered claim. There are certain instances where the policy will not protect employees or volunteers individually, even though they are additional insureds. For example, no employee or volunteer is protected for bodily injury or personal injury to the nonprofit, any fellow employee or any fellow volunteer, or the spouse, child, parent, brother or sister of the other employee or volunteer. Most CGL policies do not protect an employee or volunteer for property damage to property controlled by the nonprofit, the employee or volunteer, or any fellow employee or volunteer.

Although rare today, some CGL policies contain an exclusion for any claim filed by one insured against another insured (under the insured versus insured exclusion). Therefore, if a volunteer attempted to file a claim against the nonprofit, the insurer would deny the claim since the policy does not cover one insured filing a claim against another insured. Most general liability policies today contain a severability clause that treats each insured as a separate entity and therefore do not exclude insured versus insured claims.

Since the possibility of allegations of sexual abuse exist in a youth-mentoring program, most mentoring programs should try to purchase coverage to defend against sexual abuse claims, either as part of your CGL policy or as a separate coverage. Review the CGL policy carefully to make certain that this coverage is either explicitly provided or not excluded.

- ❑ **Directors' and Officers' Liability** — D&O policies protect against claims alleging harm attributable to the governance or management of an organization but they exclude bodily injury and property damage. Generally, D&O policies don't list specific types of covered claims, but provide coverage for any "wrongful act." A "wrongful act" may be an actual or alleged act, error or omission by the organization itself, or its directors, officers, employees and volunteers. A suit by a volunteer against a nonprofit might be precluded under the "insured versus insured" exclusion that is common on D&O policies. In most cases this exclusion is only removed with respect to employment claims. No "standard" D&O policy exists, so policy wording must be studied carefully to determine whether coverage applies in a particular instance.

Under most D&O policies, the insured parties include the nonprofit, its directors, officers, committee members, employees and volunteers working under the direction of the organization. Therefore, if volunteers are listed as insureds the policy will protect the volunteer individually for any claims for wrongful acts, subject to the terms of the insurance contract. This coverage is especially important if the volunteer is a member of the board of directors or a committee.

- ❑ **Professional Liability** — A professional liability policy will protect the nonprofit for its errors and omissions and the actions of its employees or volunteers. For example, a legal aid society's lawyers' professional liability policy may cover both the nonprofit and the volunteer lawyers in the program as "insureds." The professional liability claim would respond to allegations of malpractice by a volunteer lawyer. Most professional liability policies purchased by a nonprofit wouldn't specifically exclude volunteers as insureds, except when:
 - ✓ the policy covers specific professions, and there is no coverage for the volunteer's particular profession;
 - ✓ the policy requires that covered professionals be listed on the policy and the volunteer isn't listed;
 - ✓ the policy excludes unlicensed professionals and the particular volunteer no longer has an active license in his or her profession.
- ❑ **Automobile Liability** — A nonprofit can be held liable for an automobile accident for vehicles it owns, rents, hires, borrows or leases. The exposure also extends to vehicles owned by employees and volunteers that are used while performing service for the organization. Under an automobile liability policy, an insured includes anyone using a covered auto that the named insured owns, hires or borrows with the named insured's permission. Therefore, a volunteer is an insured when driving a vehicle owned, hired or borrowed by the nonprofit. However, insured status is not extended to the owner of any

hired or borrowed auto or an employee when using their own vehicle. Another exception is that since the extension only applies to autos owned, hired or borrowed by the nonprofit, a nonowned vehicle does not meet the insured criteria. Nonowned autos include any vehicle owned by an employee or members of the employee's household. Therefore, volunteers are not insureds under a nonprofit's auto policy when driving their own vehicles. The volunteer's personal auto insurance would respond first to any auto loss. The nonprofit's Hired and Nonowned Auto Liability coverage would respond after the volunteer's coverage has been exhausted. The volunteer's personal auto liability policy will also protect the nonprofit.

Claims Against the Volunteer

Fear of incurring personal liability for volunteer service isn't uncommon among the estimated 90 million Americans who perform volunteer service each year. Volunteer board members may be targeted in suits alleging wrongful employment practices, breach of fiduciary duty, fraud and other causes of action. Suits against volunteer service providers may allege negligence or gross negligence in caring for a client. Despite the relative infrequency of these actions, it's important to understand the legal and insurance protections available to your volunteers.

There are two major categories of protection that a volunteer can turn to if he or she faces a suit: volunteer protection laws at the state and federal levels, and insurance. The following section addresses the insurance options.

It's important to keep in mind that many nonprofits purchase broad forms of coverage that will defend a volunteer should he or she be named in a suit. And in some cases, an insurer may elect to defend a volunteer even if the coverage was intended to protect the nonprofit only. If volunteers aren't covered as insureds under the nonprofit's CGL, D&O, automobile liability or professional liability policies or the nonprofit doesn't purchase any coverage, they may look to their personal homeowners' policy or renters' policy for coverage. Other options are a volunteer liability policy purchased by the nonprofit to provide additional protection for its volunteers, and personal auto liability policies.

- ❑ **Homeowners' or Renters' Policies** — Volunteers who are homeowners may enjoy some protection under their existing homeowners' policies. In some cases coverage is provided for volunteer activities without the need for any action on the part of the homeowner. In other instances the volunteer must request an endorsement broadening coverage. Whether it's provided at no additional cost or minimal cost, this coverage is potentially valuable protection in the event the volunteer is named in a suit. Volunteers who have a renters' policy may enjoy similar protection.

It's important to keep in mind, however, that many homeowners' and renters' policies don't cover losses stemming from alleged "wrongful acts," but are limited to damages from bodily injury or property damage. Some policies include personal injury (libel, slander, defamation, invasion of privacy, etc.). Consequently, some homeowners' policies will only pay for your negligent acts that result in bodily injury or damage to the property of others — and won't

respond if you are accused of violating someone's civil rights (e.g. in an employment practices suit) or mismanaging the organization (e.g. a suit alleging fraud by the board).

Since these policies differ to a large extent, urge your nonprofit's volunteers to check their policies and discuss their board or other volunteer service with their respective homeowners' or renters' policy carrier or an insurance agent to determine the extent to which these policies provide coverage.

- ❑ **Volunteer Liability Policies** — It's likely that a significant percentage of Americans who volunteer don't have the option of relying on a homeowners' or renters' policy for coverage simply because they don't purchase such policies. Another option is available in the form of a Volunteer Liability Policy, a type of personal liability coverage. This coverage is typically packaged with a Volunteer Accident policy that is purchased by a nonprofit. For example, one provider offers up to \$1 million in personal liability insurance and up to \$500,000 in excess automobile liability insurance above the volunteer's own insurance as part of its volunteer insurance package. The personal liability coverage provides protection for a personal injury or property damage liability claim arising out of the volunteer's duties on behalf of the nonprofit. Exclusions include alleged errors or omissions in connection with the volunteer's professional services and property damage to property in the care, custody or control of the volunteer. In some cases, a state agency or state-sponsored insurance program may offer volunteer coverage at a reasonable cost.
- ❑ **Personal Auto Liability Policies** — A volunteer who will be driving his or her auto while providing service for a nonprofit should review his or her personal auto coverage. For a board member, the service might involve attending a board meeting or other nonprofit events and activities. For other volunteers the service performed could involve transporting clients or running errands. The volunteer's personal auto policy will extend protection to the nonprofit while the volunteer is driving for the nonprofit. Most states have minimum financial responsibility laws that require the owner of a motor vehicle to purchase minimum levels of liability insurance. In Wisconsin the state minimum is 25,50,10 (\$25,000 bodily injury/person, \$50,000 bodily injury/accident, and \$10,000 property damage/accident).

The Changing Insurance Marketplace

Few insurance buyers or sellers would disagree that the insurance marketplace is facing a time of unprecedented change. After a "soft market" that lasted an unprecedented 12 years, nonprofit buyers are now facing "hard market" conditions.

"Hard market" refers to the overall state of the insurance marketplace, or the condition of a particular segment of it. It is a "seller's" market. For example, there might be a hard market or hard market conditions with respect to commercial insurance in general, or with regard to a specific line of coverage, such as workers' compensation or directors' and officers' liability. Signs that a consumer is facing a hard market include:

- *Premium increases that are unrelated to loss experience.* During a hard market cycle an insured with an enviable loss ratio (total incurred losses divided by total premium paid)

may face steep increases in annual premiums, reflecting the insurer's need to generate revenue to compensate for losses and poor investment outcomes.

- *Carrier movement may be unpredictable.* During a hard market, it isn't unusual to see carriers pack up and leave certain geographical areas, or decide not to offer certain lines of coverage (e.g., medical malpractice) or not to insure certain classes of insureds (e.g., health clinics or halfway houses). In some cases companies will disappear altogether after suffering devastating losses. For example, one company that was underwriting medical malpractice coverage for a large number of nonprofits is now in receivership (Frontier Insurance).
- *New coverage restrictions, exclusions or requirements may apply.* Insurance consumers facing hard market conditions may find that coverages that were readily accessible in prior years are only available under highly restrictive terms, or not at all. Or certain conditions may be imposed on buyers before a carrier will agree to write a policy.

The events of September 11, 2001 greatly exacerbated the hard market, which was only in its formative stage at the time. The current hard market is particularly driven by the demands of reinsurers — all of whom faced enormous losses stemming from the terrorist attacks and are charging the insurance companies they insure higher rates. Because more than 50 percent of reinsurance contracts expired on January 1, 2002, these rates and terms were negotiated during the tumultuous time following September 11 and during the early stages of the U. S. military campaign in Afghanistan. While experts have been pointing to many causes of hard market conditions, one clear trigger was the investment losses suffered by insurance companies during late 2000 and much of 2001. During a “soft market” a carrier may write certain policies at a loss, recouping that loss plus enough to keep shareholders happy through its investment earnings.

When a company's investments are doing poorly, the pressure is tremendous to make an underwriting profit — collecting more in premiums than the company spends on losses, claims and administrative expenses.

By the time the hard market of the 1980s began softening in the early 1990s, many organizations in the nonprofit, public and business sectors had taken steps to protect themselves from future market fluctuations. Some banded together, pooled their insurance budgets and, depending on their state laws, functioned almost as insurance companies or operated as self-insureds. Others were simply relieved to have or be able to afford coverage once again.

There is disagreement within the insurance industry — evident in the pages of *Business Insurance*, *National Underwriter* and *Risk and Insurance* — whether or not this is a “real” hard market and how long the current upheaval will last. Some experts say that the factors extant in the mid-'80s hard market don't exist today and aren't driving the change in the marketplace. Yet few dispute that the characteristics of a hard market — higher rates, more restrictive policy terms and cutbacks in policyholder services — have arrived.

According to a recent survey of 103 brokers by the Council of Insurance Agents and Brokers (CIAB) comparing pricing in the property-casualty market on November 1, 2000, and November 1, 2001:

- There was no downward movement in premiums for any line of coverage;
- 97% of the brokers responding reported increases in workers' compensation premiums;
- 99% reported increases in umbrella and business interruption coverage;
- Average increases for other lines — auto, property, general liability, reinsurance and aviation were 10-30%;
- Medium-size and large brokers saw the largest price increases;
- Property and umbrella coverages — those most affected by the events of September 11 — have witnessed the largest increases.

In a soft market, insurance company underwriters aim to get as much premium on the books as they can. To do so, they reduce premiums to win your account and may overlook loss control issues. The buyer is in control, demanding better terms for lower rates — which will be met.

What Can You Do?

In the world of commercial insurance, there's little any individual nonprofit can do to change the ebb and flow of the insurance market cycle or influence the speed at which the cycle progresses. However, there are steps that your organization can take to make the ride a little less bumpy. These include:

- ❑ **Review Your Policies.** There's no time like the present to review the wording of your insurance policies and understand the coverage provided. And there is no substitute for reading your insurance policies. If you don't understand any aspect of your coverage, or if you have nagging questions ("what if?") after reviewing the policy wording, contact your insurance professional for assistance. Make certain you understand what your policies say about cancellation and nonrenewal. Most states have laws requiring insurers to give commercial policyholders advance notice of nonrenewal or a change in coverage terms. The notice period varies based on state law and may differ based on policy type. There is a generic summary in *IRMI Insights*, October 2000, located at www.irmi.com/insights, or check your state insurance department's Web site for additional information.
- ❑ **Review Your Partnerships.** The insurance professional, typically a broker, agent or consultant, who acts as an intermediary between your nonprofit and your insurance providers, is a key to surviving the hard market cycle. You want to know whether your insurance professional has experience with similar nonprofits, and whether your broker places a significant amount of business with the insurers for your various coverages. Generally speaking, the larger the broker's book of business with a particular company, the more clout the broker will enjoy with that carrier. This clout is important when you're negotiating terms and pricing, as well as when you're facing a claim. Finally, every nonprofit should strive to identify an insurance professional who is truly independent from the organization. Every year countless nonprofits face the double sting of an insurance-related catastrophe (such as the refusal of an insurer to pay a claim the nonprofit thought should be covered or catastrophic premium increases) that is exacerbated by the complication of working with an insider (a board member or family member of a board member or staff

member). While these “insiders” are often tapped as a small or emerging nonprofit’s first insurance advisor, as an organization matures it should make every effort to use independent advisors.

- ❑ **Understand Your Loss Experience, Risk Management Program and Appetite for Risk.** During a hard market it’s more important than ever to understand how the underwriters for commercial insurers or risk pools will regard your organization. If your losses have been substantial, you shouldn’t be surprised if a carrier looks for ways to nonrenew your account. While during a soft market underwriters may have paid little or no attention to your risk management efforts, interest in your loss prevention activities will be significant in the months and perhaps years ahead. It’s also essential that you understand your appetite for risk. It’s possible you’re willing and able to retain more risk than you’ve done in the past. For example, by taking a larger “retention” on your general liability or professional liability policy you may be able to tip the scales of inevitable premium increases.
- ❑ **Don’t Delay.** It’s vitally important during a hard market to submit *complete* new or renewal applications well before your renewal date. Work with your insurance professional well in advance of the renewal date to assemble the information needed to underwrite your account.