A NONPROFIT'S GUIDE
TO
RISK MANAGEMENT
&
INSURANCE

DC BAR
PRO BONO
PROGRAM

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Risk Management

"It is an experience common to all men to find that, on any special occasion, . . . everything that can go wrong will go wrong. Whether we must attribute this to the malignity of matter or to the total depravity of inanimate things, whether the exciting cause is hurry, worry, or what not, the fact remains."
—Nevil Maskelyne

I. Introduction

Risk management does not represent the most exciting or inspiring part of a nonprofit organization's work. However, it is as crucial as any other task a nonprofit undertakes, because good risk management ensures that the nonprofit will have enough assets to carry out its mission. It also ensures that the nonprofit's actions will not harm the client population it is trying to serve, the general public, or the organization's employees and volunteers.

Nonprofit organizations without a risk management plan leave themselves vulnerable to events that could impose staggering costs or entirely shut down their operations. As unpleasant as it is, bad things, such as accidents, happen every day. No organization is immune from the possibility that its plan of action—even a well-thought-out one—could go seriously wrong. Risk management is the process by which an organization reviews its susceptibility to unexpected losses and develops strategies both to prevent them from happening and to reduce the expense when they do.

Every nonprofit organization needs to create a risk management plan and review it annually. The organization should also review it after it makes a significant change to the types of activities it engages in or when it acquires a piece of property, a new computer system, or other significant acquisition. For nonprofits with more limited funding, the responsibility for creating a risk management plan falls on the nonprofit's board of directors and management.

This manual will walk you through the risk management process. It will explain the three fundamental steps that an organization should take in order to create a risk management plan:

1. Assess the nonprofit's risks;
2. Mitigate those risks to the greatest extent practicable; and
3. Obtain insurance to help pay the costs in the event a loss occurs.

II. Case Study

Throughout this booklet, we will follow the case of the Happy Child After-School Program as it tries to develop a risk management program. Happy Child is a nonprofit incorporated in the District of Columbia and is exempt from tax under section 501(c)(3) of the Internal Revenue Code. It has been in operation for 14 years. It owns the building in which it operates and two 15-passenger vans to transport children. Its annual budget is $2.3 million, of which 40 percent comes from government grants.

Happy Child's mission is to provide childcare services for parents in the District's Anacostia neighborhood. In its service area, 33 percent of the children live in poverty and the unemployment rate has averaged 25 percent over the past several years.

Quality, affordable childcare services are critical in order to allow parents to work. In addition, the Happy Child program provides after-school tutoring, creative arts enrichment, and computer skills training for its students, many of whom are at high risk of not graduating from high school.

Happy Child serves 110 children ages five through 15. It operates from the end of the school day through 6 p.m. on weekdays, and all day during school breaks. During the program day, Happy Child supervises the children as they participate in the various activities and provides them with an afternoon snack or meals, as appropriate. It has 27 full-time and part-time employees and a nine-member board of directors. It also has 30 regular volunteers and approximately 50 occasional volunteers. The regular volunteers work one-on-one with children in need of tutors and teach classes in computer skills, art, dance, and drama. There are also volunteers who help coach sports.

Assessing Risk

The basic task of risk assessment is to imagine all the actions and relationships of a nonprofit organization that possibly could go wrong. Think of what would constitute a "Really Bad Day." Begin by considering all of the actions that your organization must perform in order to carry out its mission. Within all of your organization's actions, there exists the possibility that an unplanned event or error may occur that could put your resources and assets in jeopardy.

Liability can take many forms. The most common form of potential liability is tort liability. Under the law, a nonprofit organization may be liable for a tort if it fails in its duty of care to others, and someone is injured as a result.

This category generally includes preventable accidents, which may include "slips and falls" and car wrecks. In addition to bodily injuries, types of injury that may trigger tort claims include property damage and certain types of business injury, like slander and libel.

Now let us look at what risks Happy Child faces. The executive director, Betty Johnson, has started to develop a list of some of the risks that Happy Child faces during a typical day of operations. Here is her list:

What would a bad day look like?

1. Children get hurt playing because of:
    a. Unsafe equipment
    b. Failure to supervise.
2. Children get sick from poor sanitation practices in the kitchen.
3. A volunteer sexually molests a child.
4. A teacher or volunteer improperly disciplines a child.
5. Children are exposed to pornography while playing on the computer.
6. An employee suspects that a child is a victim of child abuse and fails to report the abuse as required by law.

7. There is a fire and there is an injury to children and staff due to lack of:
    a. Safety equipment
    b. Staff training
    c. Fire inspections.

While such a list may seem daunting, it is important to remember that there are many things an organization already does as part of its normal operation to decrease the risk of injury. The risk management plan is designed to strengthen those steps and to spot any areas where additional steps can be taken.

I. Business Risks

It is also important to remember that the risk of physical injury is not the only risk an organization faces. A nonprofit organization frequently enters into agreements with other parties for goods or services; it receives grants, it employs workers, and it has tax-exempt status. A nonprofit must comply with the terms of the grant agreements, contracts, and government regulations.

In addition, an organization must ensure that it has appropriate financial controls in place. This will help make sure that funds are handled properly and all required filings are made in a timely fashion.

Your organization should make a list of its resources and assets, such as sources of revenue, tax-exempt status, licenses, personal and real property, intellectual property, and goodwill within the community. Then, it must consider the ways in which those resources are subject to damage, revocation, or loss.

In our case, Happy Child's executive director starts to make a list of some of the financial risks the organization faces:

1. Happy Child fails to use government grants in compliance with the grant agreement.
2. Happy Child fails to keep required records of its grant expenditures.
3. An employee embezzles funds from Happy Child.
4. Happy Child uses donated funds in a manner inconsistent with the donor's designation.
5. Happy Child is sued because an employee claims that:
    a. Happy Child failed to pay the employee in accordance with the wage and hour laws.
    b. Happy Child discriminated against the employee.

Between the risk of injury and the business risks, it is important that Happy Child begin developing a risk management strategy.

Mitigating Risk

"Human beings, who are almost unique in having the ability to learn from the experience of others, are also remarkable for their apparent disinclination to do so."
―Douglas Adams

Risk mitigation is a strategy that allows an organization to focus on the actions it can take to prevent accidents from happening and to diminish the potential of future losses. A risk mitigation strategy should include both physical precautions and administrative procedures that your organization can take to reduce its exposure to risk.

Once you have identified your organization's risks, your next step is to develop a plan for addressing them individually. It is a good idea to educate yourself about the rules that regulate your organization and its activities. This will help identify areas of risk that your organization may not have known exist, as well as improve your organization's compliance with the law.

Do not worry that creating a list of your organization's risks can be used against you in a lawsuit someday. Remember that a risk assessment is a necessary component of an overall risk management plan. Organizations that manage their risks demonstrate a commitment to complying with the law, satisfying their legal obligations, and creating a safe work environment. Organizations that make no effort to identify their risks have no chance to pursue corrective action and only make those risks more likely to produce genuine liabilities.

I. Categories of Risk

As a first step, you need to decide into what category the risk falls. There are four risk categories:

Low Risk Incident Will Occur/Low Cost if Incident Does Occur	**High Risk Incident Will Occur/Low Cost if Incident Does Occur**
Low Risk Incident Will Occur/High Cost if Incident Does Occur	**High Risk Incident Will Occur/High Cost if Incident Does Occur**

In the case of Happy Child, some examples from these risk categories are:

- *Low Risk/Low Cost: The temperature in Washington, D.C., reaches 70° on January 1.*
- *High Risk/Low Cost: The administrative assistant handles a number of papers and routinely suffers paper cuts.*

- *High Risk/High Cost: The organization does not regularly inspect or maintain its 15-passenger van. An employee driving the children to an event gets into a car accident because the brakes fail.*
- *Low Risk/High Cost: D.C. is struck by a Category 3 hurricane.*

How you rate the risk of loss to your organization will determine how many resources your organization should expend trying to lessen the risk.

For example, in the case of Happy Child, while paper cuts may be momentarily painful to the assistant, it would not justify expending significant resources to prevent them. By contrast, given the risk from unsafe vehicles, and the cost to the children and the organization if the driver is involved in a serious accident, it makes sense to spend significant resources in order to minimize the risk of car accidents when driving the organization's van.

The most difficult to plan for are the low risk/high cost events. Take, for example, hurricanes and tornadoes. We know that every spring and summer there will be severe weather that will cause substantial loss of life and property damage somewhere in the United States. However, it is highly unlikely that it will strike a specific community. How much should your organization expend to mitigate the risk when your community may never experience such severe weather? This is the type of risk that concerns risk managers the most because there are no easy answers.

In the case of Happy Child, there is a remote risk of a Category 3 hurricane striking the D.C. area, but if one occurs, the risk of significant damage is substantial. We have seen from recent events—severe winter weather, an earthquake, and thunderstorms—some of the damage that can result from severe weather conditions. Therefore, it makes sense for Happy Child to take some steps to deal with the potential for a hurricane. Some of the steps that Happy Child can take to address the risk are inexpensive and easy. The executive director could determine what place in the building is safe to ride out a bad weather event, develop a plan for evacuating everyone if necessary, review the plan regularly with staff and volunteers, conduct drills as appropriate—some with staff only and others with students, develop a plan for communicating with parents, and ensure parents' contact information is up to date.

In addition, Happy Child can develop some responses that cost more money but can also help in other instances, such as providing first aid training to staff and maintaining first aid kits on site.

However, there are other steps the organization could take that may not be cost effective, such as spending large sums of money to retrofit the building so it can withstand a Category 5 hurricane or a magnitude-8.0 earthquake, given the likelihood of the risk. (Although in some places, like Florida and California, it may be necessary to undertake such renovations.)

Once you have placed all of the risks into one of the four categories, you should then figure out what your organization already does to prevent these risks from occurring.

II. Safety First!

As the first step in mitigating its risks, an organization should take the actions necessary to ensure that its facilities and program activities are safe. A thorough risk assessment will include an inspection of your organization's premises. If during the inspection you discover potential hazards, such as faulty fixtures, loose railings, or poor lighting, then arrange for the appropriate maintenance work and make certain to perform it.

Check equipment, such as playground sets, fire extinguishers, tools, ladders, etc., to be certain it is functioning properly and is in good condition. Make sure any potentially dangerous machines or chemicals are stored safely and securely. Keep in close proximity a first aid kit and medical supplies your organization may need as part of its activities. If you know of conditions that cannot readily be repaired, fence off the area or otherwise isolate the condition and put up warning signs. Obtain parental consent forms for field trips and other outside activities, and if you are serving food, make sure you ask parents whether their children have food allergies.

However, even more important than conducting the first inspection, you should schedule regular inspections, such as once a quarter or twice a year, as needed. It is good to put reminders in your calendar so that you are sure to make the inspections regularly.

III. Train Workers

Your employees and volunteers are the first line of defense when developing a risk management plan. It is essential to stress to them the importance of looking out for the safety and security of the organization's clients, customers, and workers, as well as the security of its assets.

However, a worker can only follow a rule or procedure that the organization has explained to the worker. If your organization requires workers to conduct activities that could affect someone's well-being (e.g., preparing food, treating sick individuals, supervising contact sports, handling funds, etc.), then your organization has to be certain that workers have received proper training.

Your organization should arrange for workers to attend training courses. An employee or volunteer handbook is also a good way to collect important information and to ensure that workers have ready access to it. Your organization can use these techniques to design a strategy for teaching workers to identify and prevent risks as your organization becomes aware of them.

IV. Follow Best Practices

Nonprofits that try to learn from the experience of others do a better job of avoiding situations that create potential liabilities. A nonprofit should investigate the best practices of its industry and the relevant legal requirements to set standards of behavior.

V. Set the Right Tone

A good risk management plan requires open and honest communication among the board, staff, and volunteers about the risks the organization faces. One way to encourage openness within the organization is for the officers and the board of directors to establish the right "tone at the top." The "tone at the top" refers to the ethical climate created in an organization by its leadership. A key element of any risk management plan is for the directors and officers to foster a climate whereby employees and volunteers act in a manner that upholds the highest ethical standards while carrying out their duties.

The board should make clear that, in making decisions, it is doing what it believes is in the best interests of the nonprofit organization to help carry out its mission. It is also the board's responsibility to ensure that the nonprofit fully complies with all applicable federal, state, and local laws and regulations.

VI. Put It in Writing

Ultimately, management and oversight by a nonprofit's officers and directors determine how closely risk mitigation strategies are followed. To assist leadership in monitoring your organization's risk mitigation strategies, your organization should document the actions taken to mitigate risks. Having a written record will inform managers on what actions the organization has and has not performed. Documentation will also help the organization prove that it undertook precautionary and corrective measures.

Make Someone Responsible

As part of your organization's risk mitigation policies, you should clearly identify the persons within your organization to which workers must report in the event of a serious accident or emergency. Your management, staff, and volunteers should know to call 911, to seek help from a nearby staff member who is qualified to provide the necessary first aid, and to report the event to at least one senior employee or board member designated by the organization. This individual can then contact any parties who should be informed and begin the process for making a claim with the organization's insurance provider.

Similarly, your organization should have a whistleblower policy in place, so employees and volunteers can report violations of the law or organizational policies without fear of reprisal. It is important that people feel comfortable delivering "bad news" to the organization.

VII. Risk Management and Insurance

Many people think that risk mitigation just means buying insurance. However, risk mitigation strategies are more than that. The goal of risk mitigation is to prevent accidents and other losses from happening. While insurance may pay for the out-of-pocket costs if your organization is sued or otherwise incurs a loss, it does not pay for the staff time and program momentum your organization will lose if there is an accident. It cannot compensate for the loss to your organization's reputation. Insurance also does not heal the pain that everyone feels when someone, such as a child or volunteer, is seriously injured. It is also important to remember that not all risks are insurable or insurable at an affordable cost. For example, almost every liability policy excludes from coverage an organization's potential liability from lead paint.

In our example, suppose that Happy Child discovers that its facility has lead paint. The organization could face liability if the children were exposed to the lead paint. Since general liability insurance policies now typically exclude from coverage injuries caused by lead paint, the only way to protect the organization is to mitigate the risk of lead paint exposure by either using a building with no lead paint or having properly licensed professionals remove any lead paint in the facility.

VIII. **Waivers of Liability**

In addition to pursuing other risk mitigation strategies, organizations can seek waivers and releases of liability from volunteers who work for the organization. By signing a waiver, the volunteer agrees to absolve an organization of responsibility for any harm that the individual sustains through volunteering and relinquishes the right to bring a claim based on the organization's negligence.

Before seeking waivers, your organization should keep in mind a few things. First, states have different rules regarding the effectiveness of liability waivers. In the District of Columbia and Maryland, courts will generally uphold the validity of liability waivers. In Virginia, courts reject prospective (i.e., pre-injury) waivers of liability that prevent a person from being held liable for injuries he or she causes another.

Second, potential volunteers may have apprehension over signing away their legal rights in the event they suffer injury due to the organization's fault. Nonprofits should have sensitivity to such apprehension and demonstrate how liability waivers fit into an overall risk management plan. By pursuing the other components of risk management, a risk-conscious nonprofit makes its programs and activities as safe as possible and obtains waivers as precautions due to the overwhelming expense that unmitigated risks present. As part of presenting a volunteer with a liability waiver, it is important that the nonprofit conduct a safety orientation that introduces the nonprofit's programs, instructs volunteers on how to keep safe, and thanks the volunteers for their service. The nonprofit should also keep a list of volunteers who attended the orientation.

Third, courts across jurisdictions will not uphold waivers that remove liability for conduct that exceeds negligence, such as intentional misconduct and a lack of care that is so egregious that it constitutes "gross negligence." Courts take the opinion that waivers cannot release a party of culpability without restriction.

Therefore, your organization is well advised to obtain assistance from an attorney to review and draft waiver agreements to ensure that they actually create the agreed-upon protections.

IX. **Charitable Immunity**

"Charitable immunity" is a centuries-old legal doctrine that provides that a charity could not be held financially liable even if it was responsible for an injury to another. Because the old rules caused hardship to anyone injured due to the charity's negligence, and because of the easy availability of insurance, the doctrine of charitable immunity has been significantly modified.

In the District of Columbia, a nonprofit volunteer is immune from civil liability if the nonprofit maintains liability insurance at least equal to $200,000 per individual claim and $500,000 per total claims arising from the same occurrence. The immunity does not apply if the injury was the result of:

- The willful misconduct of the volunteer;
- A crime, unless the volunteer had reasonable cause to believe that the act was lawful;
- A transaction that resulted in an improper personal benefit of money, property, or service to the volunteer; or
- An act or omission that is not in good faith and is beyond the scope of the nonprofit's authority.

Organizations exempt under section 501(c)(3) of the Internal Revenue Code do not have to maintain insurance in order for its volunteers to qualify for immunity from liability if the organization has annual total functional expenses, exclusive of grants and allocations, of less than $100,000.

In D.C., a nonprofit employee is similarly exempt from liability for his or her negligent acts, except to the extent of one year's salary. However, this limitation does not apply to any licensed professional employee, such as a lawyer or nurse, operating in his or her professional capacity.

The limitation on an employee or volunteer's liability does not exempt a nonprofit corporation from liability, but the nonprofit is liable only to the extent of the applicable limit of insurance coverage it maintains.

Some states, such as Maryland, have similar provisions in their laws. However, the laws in other states, such as Virginia, do not provide the same level of immunity. An organization must take into account that it could be held liable if the organization is sued in that state.

In our example, Happy Child is taking its middle school students on a field trip to President Washington's home in Mount Vernon, Virginia. While traveling in Virginia, the group gets into an accident involving a resident of Virginia. Happy Child may be held liable under the rules in Virginia because that is where the accident occurred and where the other driver lives.

X. **Indemnification**

Another way to mitigate risk is to ask another person to indemnify you. Indemnification means that one person agrees to pay for the losses of another. For example, when a nonprofit rents a space to hold a special event, the person renting the space may ask the nonprofit to indemnify him or her from any accident that occurs to a person attending the special event. Sometimes the other person only asks your nonprofit to indemnify them for liability caused by the organization's negligence. Other times, the organization may be asked to indemnify the other person for liability caused by everyone, including the person asking for the indemnification! In such case, you may ask the other person to be responsible for his or her own acts, instead of passing the legal responsibility to you. In fact, it may be appropriate to ask the other person for a mutual indemnification.

One of the most important indemnification contracts your organization may have is the provisions in your governing documents stating that you will indemnify your officers and directors in the event they are sued because of their service to your organization. It is important that your organization be in a position to honor such a commitment, either through insurance or otherwise.

In our example, Happy Child rents an event space at The Local Hotel in order to hold its annual fundraising dinner. Happy Child agrees to indemnify The Local Hotel if someone is injured because of Happy Child's negligence, and The Local Hotel agrees to indemnify Happy Child if the injury is caused by The Local Hotel's negligence.

Now let us look at Happy Child's "Really Bad Day" list and see what it can do to mitigate the risk:

What would a really bad day look like?

1. Children get hurt playing because of:
   a. Unsafe equipment – Perform regular inspections; repair and replace as needed.
   b. Failure to supervise – Ensure proper number of workers assigned to play ground; train workers about how to supervise the children properly.
2. Children get sick from poor sanitation practices in the kitchen – Perform regular inspections; train workers on proper sanitary procedures; ensure food is properly stored; buy food from known sources; be on the alert for safety recalls and food allergies.
3. A volunteer sexually molests a child – Perform background checks on volunteers that have contact with children; put procedures in place so that volunteers are not left alone with children; ensure meeting places are open and visible by others; properly staff facilities; restrict contact between volunteers and children outside the program; train workers on how to spot signs that someone is inappropriately interacting with children; train children on how to avoid inappropriate contact by adults; set up procedure so that people can report incidents.
4. A teacher or volunteer improperly disciplines a child – Develop clear rules for disciplining children and communicate them to staff; monitor compliance; discipline staff who do not follow rules.
5. Children are exposed to pornography while playing on the computer – Install child controls on computers; monitor children's use of computers; train staff on proper computer use.

6. An employee suspects that a child is a victim of child abuse and fails to report the abuse as required by law – Develop protocol for handling cases of suspected abuse; train staff and volunteers about the protocol and the need to report immediately suspected child abuse; develop disciplinary procedures for workers who fail to follow protocol and report suspected cases immediately; follow policy.
7. Children and staff are injured in a fire due to lack of:
    a. Safety equipment - Ensure proper equipment is available and inspect regularly.
    b. Staff training – Train staff in accordance with best practices.
    c. Fire inspections – Ensure that the fire department inspects premises; hold regular fire drills.
8. Happy Child fails to keep required records of its grant expenditures – Develop record retention and expense policies; train staff on maintaining proper records; follow up with staff who do not submit proper records.
9. An employee embezzles funds from Happy Child – Develop appropriate financial controls for the intake and disbursement of funds; regularly review bank records; review expense records for any anomalies; enable software features that allow organization to track changes to financial records; ensure that employee who handles funds takes vacations so someone else performs the work regularly.
10. Happy Child uses donated funds in a manner inconsistent with the donor's designation – Develop procedures for properly accounting for and reporting on funds restricted by a donor's designation, including allocating staff time and overhead expenses to restricted funds when appropriate; properly track operational expenses; ensure that all monthly reports to senior management and the board clearly state what funds are restricted and what funds are available for the general operating expenses.
11. Happy Child is sued because an employee claims that:
    a. Happy Child failed to pay the employee in accordance with the wage and hour laws – Develop job descriptions for each position

based on the actual duties performed by the employees; with the assistance of counsel, properly categorize employees as either subject to overtime laws or exempt; keep accurate records of the number of hours non-exempt employees work; develop policy that requires non-exempt employees receive permission prior to working overtime hours; ensure that all non-exempt employees are paid for overtime hours worked.

b. Happy Child discriminated against the employee – Develop policy that prohibits discrimination and unlawful harassment; put policy in employee and volunteer handbooks and develop procedures on reporting discrimination; train employees on topic and discipline employees who fail to follow policy; train employees and volunteers with respect to the policy.

Once it has done everything practicable to mitigate the risk, Happy Child must decide how much insurance and what types of coverage it will need to protect the organization.

Insuring Against Risk

Authors and actors and artists and such
Never know nothing, and never know much.
Sculptors and singers and those of their kidney
Tell their affairs from Seattle to Sydney. . . .
Diarists, critics, and similar roe
Never say nothing, and never say no.
People Who Do Things exceed my endurance;
[Oh] . . . for a man that solicits insurance!
—Dorothy Parker

Risks can be mitigated, but never eliminated. Despite the best efforts of an organization to prevent them, accidents will happen. For this reason, an organization should obtain insurance to transfer its risk of loss to the insurance carrier.

However, not all risks can be insured, and all insurance policies will have some gaps. Accordingly, understanding the terms of your insurance coverage is important. Your organization should always read its insurance policies in light of its risks and obtain the insurance that adequately and efficiently and economically addresses its risks. This section will help your organization better understand the issues it should consider when obtaining insurance.

I. **The Broker**

The first step in purchasing insurance is to find the right broker. An insurance broker is a professional insurance advisor that will help your organization obtain coverage from insurance carriers. A broker does not work for an insurance company. Instead, a broker operates independently and must represent the best interests of the nonprofit. A broker analyzes your organization's need for insurance, compares policies of multiple insurers, and helps select the best policy for obtaining the necessary coverage within your price range. In that way a broker is different from an insurance agent, who works on behalf of a specific insurance company. Unlike a broker, an agent does not owe a duty to examine an organization's operations or to ensure the organization has the right coverage. The responsibility of an agent to a customer is strictly administrative—an agent is only required to process paperwork, claims, and premiums in an accurate and timely manner.

Finding the right broker means finding a broker that understands the needs of your nonprofit; can help you access the right insurance carriers; and provides your organization with good service. It is good to remember that some brokers specialize in working with nonprofit organizations. They may have a better feel for a nonprofit's insurance needs, such as protecting volunteers, and should be able to find an insurance carrier that meets those needs.

Other brokers specialize in working with small businesses, and these brokers may be better suited to your organization than a broker that may work with nonprofits, but only very large ones, such as museums and universities. Other brokers specialize in particular types of businesses, such as medical facilities, and understand the special insurance markets for coverage like malpractice insurance. If you are operating a health care clinic, such a broker may be better suited to your organization's needs. Therefore, you should speak to several brokers before retaining one to determine which broker is right for your organization.

In order to fulfill its role as an advisor, a broker needs to fully understand your organization's operations and help your organization fully understand its insurance coverage. A broker should meet regularly with a client to learn about the client's activities and to assist with the client's risk assessment. In addition, a nonprofit should alert the broker about any new activities or changes in its business practices that could create a new exposure, and should confirm with the broker that the proper insurance is in place for the change in activities. A broker's experience with risk management can help an organization foresee new risks and analyze trends in an organization's losses.

In addition, a broker should review any existing coverage and explain the key terms and conditions of the coverage to the client. This will help the broker identify any gaps in coverage, or coverage that exceeds an organization's needs. The broker should help the client determine the appropriate coverage, shop for policies, and reach an agreement with an insurance provider. Once an organization purchases a policy, a broker can manage the organization's claims under the policy. For all of these services, a broker is paid a portion of the premium on the policy.

II. **Types of Insurance**

Generally, insurance can be classified as either third-party insurance or first-party insurance. Third-party insurance protects an organization from claims made by a third party and makes payment to a third party for liabilities arising from a claim as well as the legal cost of defending the claim. It is "lawsuit insurance." First-party insurance covers an organization's losses caused by itself, another party, or a natural occurrence. For example, property insurance is first-party insurance that protects an organization from loss if the loss is caused by an act of nature, by another person, or by the negligence of the property owner. Both categories include several types of policies that cover specific conduct, circumstances, and property.

III. Insurance Policies Most Important for a Nonprofit Organization

A. General Liability. General liability insurance is a form of third-party insurance that covers bodily injury claims by a third person, damage to the property of a third person, and personal and advertising injury suffered by a third person. It covers any successful claim in court unless it is excluded under the terms of the policy, any payments made to settle a case, and the cost of paying a lawyer to represent the organization.

"Bodily injury" refers to physical injury sustained by a third person while on your premises or because of your organization's conduct. For example, if someone is visiting your offices and is injured in a fall, that person may sue your organization, alleging that the organization failed to maintain a safe office space. The organization's general liability insurance would cover the cost of a lawyer to defend the organization and the cost of any settlement of claim against the organization. Similarly, if the claim alleges that your organization's negligence resulted in damage to a person's property, the general liability insurance would also cover the claim.

General liability insurance also covers lawsuits brought as a result of "personal injury" that do not result in physical injury, such as invasion of privacy, false imprisonment (inappropriately holding someone against his or her will, such as a store owner inappropriately holding a customer), or "advertising injury," such as libel and slander.

A general liability policy tailored for nonprofits usually insures not only the nonprofit organization, but also anyone else listed as a "named insured," such as a director, officer, employee, or volunteer at the nonprofit.

B. Directors and Officers Insurance (D&O). D&O insurance is another form of third-party insurance. A D&O policy covers liability arising from certain kinds of "wrongful acts" potentially committed by a nonprofit or by its directors or officers. Nonprofits typically acquire a D&O policy in order to insulate directors and officers from personal liability arising from their participation on the board or management of the nonprofit.

The wrongful acts covered by a D&O policy typically include claims that an officer or director breached a fiduciary duty when carrying out his or her responsibilities. It also covers any claim that an officer or director discriminated against someone applying for benefits from the nonprofit. For example, if an individual applies for housing from a housing nonprofit and is turned down, the individual may claim that the nonprofit denied his or her application because it engaged in illegal discrimination. The D&O policy is designed to cover such claims.

In addition, many nonprofit D&O policies also cover employment discrimination claims. You should check with your broker to see if your organization's D&O policy covers such claims or if you need to purchase additional insurance to protect your organization.

You should also check to see if the D&O policy covers not just the officers and directors, but also the organization and its employees and volunteers. Many nonprofit D&O policies have what are called "association liability" policies that cover the nonprofit organization and the persons associated with it. If your policy does not extend such coverage to your organization and its employees and volunteers, you may want to consider changing your organization's coverage.

C. Workers' Compensation. Every jurisdiction requires businesses, including nonprofits, to have workers' compensation insurance (workers' comp) once the business hires a specific number of employees. In D.C. and Maryland, one employee triggers the requirement. In Virginia, two employees trigger the requirement. The amount of your organization's payroll and the type of work performed by employees will determine the cost of your organization's premium. For example, an organization will generally have to pay a higher premium for an employee engaged in manual labor because the manual worker faces a greater risk of serious injury.

Nonprofits should consider workers' comp a benefit and not just a requirement. It limits an organization's liability. In the event an employee is injured while on the job, workers' comp will cover all medical costs, lost wages, and other losses suffered by the employee. Moreover, workers' comp is a "no-fault" policy, meaning that the employee is covered for his or her injuries, regardless of who is responsible—even if it is the employee.

In exchange for this no-fault coverage, the law provides that the employee cannot sue the nonprofit for negligence in causing the injury. Therefore, it is in the employer's interest to have an injured worker covered by a workers' comp policy.

It is important to keep in mind that, because workers' comp is designed to compensate an employee injured on the job, work-related injuries are not covered under health insurance plans. Sometimes small employers do not include employees on their workers' comp policies in order to reduce the cost of coverage, expecting that any claims would be covered by the employee's spouse's health insurance or some other policy. However, because work-related injuries are not covered under health insurance plans, the employee could be at risk of having no coverage at all.

In addition, you should obtain a certificate of insurance from every contractor with whom you do business. If you do not, the workers' comp carrier has the right to charge your organization a premium for the period the worker was working for you, unless you can demonstrate that the worker was covered under another workers' comp policy.

D. Property Insurance. Property insurance is a type of first-person insurance that protects a nonprofit from theft, loss, or damage to its property, such as any buildings it owns or its business property, including computers, furniture, etc. This insurance for nonprofits is similar to homeowners' insurance for individuals. It does not include protection for automobiles. A nonprofit needs to purchase a separate auto insurance policy to cover loss or damage to automobiles, as well as coverage for liability for accidents.

An “all risk” property policy protects your property in the event of loss from most kinds of “peril,” including fire, hurricane, tornado, and theft. However, property insurance policies commonly do not cover loss caused by mold, flood, pollution, asbestos, lead, terrorism, and earthquake. A nonprofit can obtain policies that cover these events, though doing so can be cost prohibitive.

Many property policies for nonprofits also include “fidelity bond” coverage, which covers any loss incurred by the nonprofit because of employee dishonesty, such as by embezzlement. You should ask your broker if your organization’s policy provides such coverage.

E. Volunteer Accidental Medical Insurance. Accidental medical insurance helps compensate volunteers who are injured while performing volunteer services for a nonprofit. This insurance will reimburse the volunteer for any uninsured medical expenses, up to the limits of the policy. If the volunteer has no insurance, this type of insurance will pay for all the costs of medical treatment. The policy is a “no-fault” policy, meaning that the volunteer will be covered even if the injury was caused by his or her own negligence, and the volunteer does not have to sue the nonprofit in order to receive coverage.

The policy is beneficial not only to the volunteer but also to the nonprofit. First, by providing immediate benefit to the volunteer, the volunteer is not forced to sue the nonprofit in order to have his or her costs covered. Second, if the volunteer signed a waiver of liability for the benefit of the nonprofit, providing this coverage serves as a return benefit in consideration for the waiver. As a result, it is more likely that a court will uphold the validity of the waiver.

F. Automobile Insurance. If your organization owns one or more automobiles, it is required to obtain insurance. Vehicles specifically used for work purposes should be placed on a commercial auto policy. While commercial policies cover the same types of liability as a personal auto policy, many of the requirements for obtaining the insurance are different, and an organization risks being denied coverage in the event of a claim if it does not obtain the proper policy and comply with its provisions. For example, a personal auto policy will cover anyone who borrows your car for a day, but a commercial auto policy may require you to list the people eligible to drive the vehicle.

Your organization should make sure that it has “non-owned and hired” coverage, even if it does not own a vehicle. If your organization does not have an auto policy, it can be included as part of the organization’s general liability insurance. This will provide insurance coverage in the event an organization is sued if one of its employees or volunteers is involved in an accident while driving his or her own vehicle or a rented vehicle on company business.

For example, suppose Happy Child is planning a fundraising event, and the executive director sends a volunteer to the local Costco to buy supplies. The volunteer uses her own vehicle. On the way back from the store, the volunteer gets into an auto accident that is her fault and the other driver is seriously injured. The volunteer’s own auto policy would cover the damages suffered by *the other driver. However, suppose the volunteer only has a $100,000/$300,000 policy and the other driver's damages, including medical bills, lost wages, and pain and suffering, exceed $450,000. The other driver could sue the nonprofit organization as well as the volunteer, claiming that it was negligent for the executive director to send a volunteer to the store on behalf of the organization. A non-owned and hired policy would protect the nonprofit by providing coverage in such circumstances.*

IV. **Terms of Insurance**

An insurance policy is a contract and, like any contract, requires careful reading. An understanding of the coverage provided by an organization's insurance begins with a review of the organization's policies. Insurance policies typically include the following parts:

A. Declarations Page. An insurance policy will usually begin with a Declarations Page. The Declarations Page identifies the name of the insured, the policy number, the risks or property covered by the policy, the premium, any deductible, the total dollar limits on the amount the insurer will pay, and the policy period (time the policy is in force).

B. Definitions. Each insurance policy has definitions that are key to understanding the meaning of the policy. Parties might interpret an "occurrence" or "accident" differently, so the precise language of definitions deserves diligent scrutiny.

C. Insuring Agreement. The insuring agreement summarizes the major promises of the insurance company and describes what claims the policy will pay. In this section, an insurer agrees to certain obligations. For example, the insuring agreement in third-party insurance policies will include the insurer's duty to defend and its duty to indemnify. It may include wording such as: "This policy covers any bodily injury up to the limits of the policy."

D. Conditions. An insurance policy will also include the "conditions" upon which an insurer would not have to perform its obligations. Conditions typically require the person buying the insurance to take a particular action. For example, the insurer's promise to pay for a loss typically is conditioned upon the insured person notifying the insurance company of the loss in a timely manner. Some policies will even impose a deadline, requiring you to report the claim within a specified period of time, like 60 days after the incident occurs.

E. Exclusions. Exclusions are provisions that take away coverage provided in the insuring agreement. Because exclusions narrow coverage, a nonprofit should focus on understanding any exclusion in its policy. Typically, policy exclusions will follow industry standards.

Many standard exclusions are designed to prevent overlapping coverage provided by other policies. For example, general liability insurance does not cover injuries sustained by workers in the course of their employment or damages resulting from an officer's conflict of interest, as those injuries would be covered by workers' comp and D&O insurance, respectively. Property insurance policies typically exclude coverage for automobiles and boats. Other exclusions may not be covered in another policy but will remain excluded nonetheless because an insurer either will not accept the risk or defend a particular conduct, or will do so only for an additional premium. For example, general liability policies commonly exclude liability from pollution, asbestos, lead, and mold. They also exclude coverage for intentional bad acts, such as intentionally striking another person or intentionally destroying property.

F. Endorsements. Insurance contracts often contain standard language, and most of the terms will not vary from one insurance company to another. However, if your organization needs special coverage, your broker can negotiate that coverage on your behalf, and the insurance company will change the terms of the standard policy by adding an endorsement to your policy. Endorsements are provisions that either change or add to the terms or sections of a policy. Endorsements can make changes as significant as entirely replacing the language of the policy. For this reason, an individual reviewing an insurance policy is well advised to look at any endorsements first to identify if they make wholesale changes to the policy. For example, normally a general liability policy would not cover non-owned and hired autos. If your organization wants this coverage, it would be added to your policy by endorsement.

V. **Limits on Coverage**

All policies will have limits on coverage. An insurer will limit an amount paid per "occurrence" or per "claim," as well as limit the "aggregate," which is the total amount that an insurer will pay during the entire policy period or for a particular type of loss regardless of the number of claims.

For example, Happy Child has an auto policy that pays up to $250,000 per injured person, and up to $500,000 in total for all people injured in an accident. One of its vehicles is in an auto accident, and three people are injured. Person A has $300,000 in injuries, Person B has $200,000 in injuries, and Person C has $125,000 in injuries. Person A's payment will be limited to $250,000 because, under the terms of the policy, that is the maximum amount that will be paid to any one person. Moreover, all three will have their payments reduced because their total claims exceed $500,000 ($250,000 + $200,000 + $125,000 = $575,000). Each person will only receive 87 percent of what he or she would otherwise receive ($500,000 ÷ $575,000 = 87 percent). In this case, Person A would receive $217,250; Person B, $174,000; and Person C, $108,750.

Some policies apply "sublimits," which set the cap for claims for specific losses that may be less than the total policy limit. For example, a general liability policy may have a sublimit for certain types of claims, such as sexual injury to a minor. Using a more specific example, a policy with an overall limit of $1 million per claim may have a sublimit stating that the policy would only cover $250,000 in claims for sexual molestation. The higher the limits on a policy, the more a nonprofit will pay for the coverage.

A. Umbrella Coverage. An umbrella policy is so named because, like an umbrella, it is designed to cover your organization for anything that might fall on it. It "sits" over your other insurance policies and supplements the amount of coverage your organization has.

There are two types of umbrella policies. The first is really just an “excess limits” policy. This policy provides additional protection to the organization by increasing the limits of the organization’s existing policies.

In our example, Happy Child has a $500,000 auto policy and a $2 million excess limit policy. The excess limit policy covers any type of claim covered by Happy Child’s auto policy, but it provides an additional $2 million in coverage once the insurance company has paid the maximum amount allowed under the auto policy. In our example, all the people hurt in the accident will receive full coverage because the excess limit policy would pay any amounts not covered by the auto policy.

The second type of umbrella policy is what is called a “true umbrella” policy. This policy not only provides additional coverage that augments your existing policies, it also covers losses that are not covered by your other policies because there is a gap in your organization’s coverage. Like all insurance policies, there are exclusions from umbrella policies, so it may not protect your organization from all types of losses, but it does provide an extra layer of protection for your organization.

VI. **How Much You Should Spend on Insurance**

The amount of money that a nonprofit will spend on insurance varies for each organization. It will depend on factors such as the size of the organization, including the size of the organization’s payroll; the extent of its risk exposure; how much risk the organization wants to take; and what it can afford. Another factor will be the amount of assets an organization needs to protect. If a nonprofit owns a building, not only will it need property insurance, but it may also need additional general liability insurance because a plaintiff could try to seize the building in order to settle a legal claim. A broker should advise your organization on the types and amount of coverage that best suits the needs and resources of your organization.

It is important to keep in mind that many insurance policies are “auditable.” This means that the premium is based on an estimate of certain things, such as the size of the payroll and the types of activities in which the organization engages. Under the policy, the insurance company has the right to audit your organization’s activities after the end of the policy year to see if what actually happened varied from the assumptions used in calculating the premium. If the size of your organization’s payroll was higher than expected or if the nature of your operations changed, your insurance carrier may have the right to charge your organization an additional premium to reflect what actually occurred.

The policy most frequently audited is the workers’ compensation policy, since the premium is estimated based on your organization’s expected payroll in various job classifications. If you end up adding or reducing staff during the year, the amount of your final premium may be adjusted. In addition, if you added a janitor but an office worker resigned, the premium may be adjusted because the type of work being performed changed. Generally, an employer will have to pay a higher premium for employees who perform manual work because the risk of injury is higher.

Finally, most policies are experience rated, meaning the more losses your organization experiences, the higher the risk of loss to the insurance company, and the higher the premium your organization must pay for coverage. In some cases, such as workers' comp, the experience rating is directly added to the premium calculation. In other cases, the insurance company may have some discretion as to what extent it will take such losses into account, but the fact remains: the more effective your organization is in reducing its losses, the more savings it will realize when purchasing insurance.

VII. Other Insurance Issues

A. Additional Insureds. You also have the option of having another person or entity named as an additional insured. For example, if you rent a facility for your annual fundraising dinner, the owner may ask to be named as an additional insured under the organization's general liability policy. Generally, the insurance company will not charge your organization any additional premium for doing so. You should contact your broker, and he or she will have the other person added, but only for the period involved (in our example, only for the time your organization is occupying the facility).

B. Duty to Defend. It is important to make sure that your organization's insurance coverage–especially your organization's D&O policy—has what is called a "duty to defend." This means that, under the terms of the policy, the insurance company is obligated to hire and pay a lawyer to represent you in the litigation. This is in contrast with some of the types of insurance that for-profit companies purchase, where the for-profit company must pay the attorney directly and receive reimbursement from the insurance carrier. Many nonprofit organizations do not have the funds to wait until they are reimbursed for attorneys' fees. Therefore, it is important to ensure that your organization's policies have the duty to defend.

C. Claims-Made Versus Claims-Incurred. Insurance policies fall into one of two categories: claims-made or claims-incurred policy. Under a claims-made policy, the insurance carrier should protect your organization against any claims made during the policy year. Under a claims-incurred policy, the insurance carrier should protect your organization against any claims that result from injuries caused by any act or failure to act during the policy year, even if the lawsuit is brought against your organization years later. D&O insurance is typically a claims-made policy and liability insurance is typically a claims-incurred policy.

The difference between these two types of policy is illustrated in the following example.

Suppose Happy Child's insurance policies run from January 1 to December 31 of each year. On March 5, 2012, one of the children is hurt while playing and suffers a compound fracture of his leg. Then, on August 17, 2012, Happy Child terminates the employment of one of its workers, and then terminates the employment of another worker on October 18. On September 15, the first employee files a claim with the D.C. government alleging that she was terminated because of her race, and on January 27, 2013, the second employee files a claim for discrimination on account of his gender. On May 8, 2013, the child sues Happy Child alleging that the injury he suffered was the result of the organization's negligence.

Happy Child has a D&O policy that covers employment discrimination, and a general liability policy that covers claims for personal injury. The D&O policy is a claims-made policy and the general liability policy is claim-incurred policy.

The child's claim for personal injury is covered by the 2012 general liability policy, even though the claim was not filed until 2013. This is because the event that resulted in the claim—the broken leg—occurred in 2012.

The first employee's claim is covered under the 2012 D&O policy because the claim was filed in 2012. For the same reason, the second employee's claim is covered under the 2013 policy because the claim was filed in 2013.

This distinction is important for a couple of reasons. First, your organization may change insurance carriers, and it is important to file the claim with the right carrier. Moreover, if someone asserts a claim against your organization, you must report it in a timely manner to the insurance company. Knowing which carrier and which policy applies is important so that your organization files its notice of claim correctly. Finally, every policy has a limit on the amount of claims it will cover. In our example, because the employment claims were filed in two separate years and covered by two separate policies, there is less of a risk that the claims will exceed the dollar amount of coverage Happy Child has.

D. Co-Insurance. Certain forms of insurance, such as property insurance, require that the insured entity disclose to the insurance carrier the value of the property it is seeking to insure. Using this value, the insurance carrier calculates the amount of premium the entity must pay. The more valuable the property, the higher the premium. Sometimes insured parties are tempted to understate the value of their property in order to keep the premium as low as possible. Other times the insured party fails to update its policy to reflect increases in the value of the property.

The insurance carrier is entitled to a fair premium for its coverage. Therefore, in order to ensure that the insured party is accurately reporting the value of the property, most property policies have what is called a co-insurance penalty. What this means is that if the reported value of the property is less than a specified percentage (typically 80 percent), then the amount that the insurance company will pay on claims will be reduced by the same percentage.

For example, suppose Happy Child owned a building worth $500,000, but on its insurance policy the building was valued at $300,000. As a result, the reported value is only 60 percent of the actual value of the property. Happy Child has an 80 percent co-insurance penalty in its property insurance. If a fire occurs and Happy Child suffers $50,000 in damages, the amount the insurance carrier would have to pay on the claim would be $37,500 ($300,000 ÷ (.80 x $500,000) x $50,000 = $37,500).

Therefore, it is vital that you accurately report and update the values of property you declare to the insurance carrier to reflect inflation and other increases in value.

VIII. **Serious Losses and Filing a Claim**

If your organization experiences a serious loss, there are some important steps that it should take in the immediate aftermath of the loss. First, your organization can and should offer sympathy to anyone impacted by the incident, but it should not admit liability or commit to make any payments without getting the insurance company's consent. Offer medical attention as warranted, and if appropriate under the circumstances, have the injured party complete an "incident report." You should also inspect the area or condition where the loss occurred and note any defects or contributing factors. Take photos or videos of the area or condition as soon as possible; document the date, time, and name of the person taking photos or videos; and retain documentation for your records. Retain any evidence relevant to the incident by immediately tagging and storing them in a protected place until you speak to your insurance adjuster. Identify witnesses and, if possible, have them give a statement of the facts as they know them, even if they did not see the incident occur.

Keep in mind that if your organization is sued following an incident, you will have to turn over to the other side any e-mails or other written communications about the incident. You should not offer opinions about what occurred, but limit your communications to factual statements.

Every insurance policy requires that you file a claim promptly; some will even specify an exact time deadline by which the claim must be filed. There are several reasons for this. First, and most important, the longer you wait to file the claim, the harder it will be for the insurance company to investigate the facts. Memories fade, we lose track of witnesses, and evidence gets lost. Therefore, you should contact your broker every time there is a serious incident involving your organization. It may not always be necessary to alert the carrier, but you should discuss the incident with your broker. **You should always alert your insurance carrier as soon as possible if your organization's vehicles are involved in an auto accident; if there is a loss of property due to a fire, theft, natural disaster, or accident; or if your organization is sued.**

If you fail to give timely notice, it may jeopardize your coverage under the policy. You should pay special attention to these deadlines in the case of a claims-made policy, since claims made after the deadline are not covered by the policy.

Your broker should be in communication with your carrier to determine the status of any claim so that you are aware of how the claim is being handled on your behalf. If there is litigation, your organization will be expected to assist in the litigation, and if it fails to do so, your organization may forfeit coverage under the insurance policy.

IX. **Obtaining and Retaining Copies of Your Policies**

It is important that you obtain from your broker copies of your organization's policies and keep them in a secure place. The claims-made policies, such as your property insurance, should be kept for a minimum of three years. The claims-incurred policies, such as your general liability, auto and umbrella policies, should be kept permanently. This is because you may find out years later that something happened during that policy period giving rise to the claim, and the insurance company will have to provide you with a legal defense and pay any claims even if many years have passed.

X. **Summary**

Now let us go back to Happy Child's list of potential risks and see where it has insurance to protect against those risks:

What would a really bad day look like?

1. Children get hurt playing because of:
   a. Unsafe equipment
   b. Failure to supervise.

   General liability and umbrella insurance.
2. Children get sick from poor sanitation practices in the kitchen.

   General liability and umbrella insurance.
3. A volunteer sexually molests a child.

   General liability insurance, but often excluded from umbrella insurance.
4. A teacher or volunteer improperly disciplines a child.

   General liability and umbrella insurance. Organization is covered; however, if an employee is sued, he or she may not be covered by the organization's policy because the conduct may be considered an intentional act.
5. Children are exposed to pornography while playing on the computer.

   General liability and umbrella insurance.
6. An employee suspects that a child is a victim of child abuse and fails to report the abuse as required by law.

   Errors and omissions insurance and general liability insurance.
7. There is a fire. Building is damaged and children and staff are injured due to lack of:
   a. Safety equipment
   b. Staff training
   c. Fire inspections.

   Property insurance for damage to building. General liability insurance to covers any liability because of injury to children. Workers' compensation covers injuries to staff.
8. Happy Child fails to use government grants in compliance with the grant agreement.

   No insurance available. Happy Child must comply with grant requirements.
9. An employee embezzles funds from Happy Child.

Employee dishonesty coverage. Usually included as part of property insurance.

10. Happy Child uses donated funds in a manner inconsistent with the donor's designation.

No insurance coverage available. Happy Child must comply with donor's request.

11. Happy Child is sued because:

a. An employee claims that Happy Child failed to pay the employee in accordance with wage and hour laws.

Insurance coverage generally not available. Happy Child must comply with the law. However, the cost of hiring an attorney to defend the claim may be covered.

b. Happy Child discriminated against the employee.

Employment practices coverage. Usually included as part of D&O insurance.

As you can see, Happy Child has a wide range of insurance coverage. However, even with a comprehensive insurance program, it still has some uninsured risks. In addition, since the premiums for most insurance coverage are experience rated, if your organization has a large claim, or even a number of small claims, they will increase the amount you pay for insurance for more than one year. Therefore, it is important to have a strong risk mitigation program.

It is also important to remember that risk management is not an all-or-nothing proposition. Even if you can only take some risk mitigation steps now—like sending only some of your staff to trainings—you will still reduce the overall risk to the organization. If you cannot afford an umbrella policy now, it is still worthwhile to make sure that your organization has a non-owned and hired auto coverage in place. Then, in later years, if your organization can afford it, it can provide more training or purchase more insurance. Risk management is a step-by-step process, but like all journeys, it begins with the first step.

Additional Resources

In addition to this manual, you may also want to consult the following resources:

Nonprofit Risk Management Center: www.nonprofitrisk.org
Nonprofit Insurance Advisors: www.nonprofitinsuranceadvisors.org
Risk and Insurance Management Society: www.rims.org
The Institute of Risk Management: www.theirm.org
National Association of Insurance Commissioners: www.naic.org

Please note: This manual can only discuss risk management in the broadest terms. It is intended to provide general information and not specific risk management or legal advice to your organization. You should discuss your risk management plans with an insurance professional and your attorney. Moreover, laws and market conditions change. You should verify that the information in this manual is still timely.