Good Intentions Are Not Enough

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When you sell property coverage for condominiums, co-ops and homeowners associations, do you ask these clients if their members have directors and officers (D&O) insurance covering their volunteer board members? It's important to get answers to this question, not only for them, but also for your own protection as the insurance agent.

Agents who don't sell this product, or who don't fit the D&O coverage to the specific insured, could end up on the wrong end of an E&O suit. That's why we urge agents to treat this coverage with as much attention as they give to property or general liability.

But it's not just a matter of self-protection. It's about opportunity. Given the growing liability risk involved with board membership, more and more community associations recognize the need for protection. In the words of a California agent who has sold coverage to more than 3,500 associations, "Selling D&O coverage is a piece of cake, because no one wants to serve on a volunteer board unless they have the coverage."

Why D&O is Important

People who volunteer to serve on association boards normally do so with the best intentions. Unfortunately, in a world where lawsuits are filed at the drop of a hat, good intention are not enough and claims will be brought against association boards regardless of the care and seriousness the board members take in approaching their duties. Thus, these volunteers need the best available D&O coverage they can obtain. It is the agent's responsibility to get the appropriate coverage.

What are the Needs?

Agents dealing with community associations often find themselves in the role of an informal risk manager for the entities.

As with a commercial enterprise or any potential clients, agents need to understand what type of entity they are dealing with: condo; co-op; timeshare; or homeowners association. To fully understand and evaluate the risk, agents should familiarize themselves with the common intent of the development. They should understand what legal documents, such as Covenants, Conditions and Restrictions (CC&Rs) and bylaws, have been filed; whether the governing documents are up to date; and of course, what types of insurance coverage the association needs. For example, is the property manager covered under the D&O policy or is a separate policy required? Does the insured need EPL coverage?

The governing documents (bylaws and CC&Rs) will direct the agent as to what coverages the insured is required by its own regulations to have in place. In addition, it is the agent's job to determine, notwithstanding the formal requirements, what coverages and limits the association should carry.

Why Claims Happen

After years of insuring directors and officers of community associations, we have become all too familiar with the most common causes of claims.

Many claims are related to CC&Rs, including claims against the board regarding architectural controls or certain restrictions, e.g., putting a satellite dish on the roof of the building or parking the in-laws' motor home on the front lawn.

In addition, numerous claims result simply from the boards' failure to adhere to their own bylaws, such as election requirements and formalizing board actions. For example, a suit was filed against a co-op board alleging irregularities in conducting and election. The plaintiff was a candidate who did not receive enough votes to win a seat. The board had failed to follow

the formula set forth in its bylaws as to the number of votes each to win a seat. The board had failed to follow the formula set forth in its bylaws as to the number of votes each shareholder was to receive. Since the board's actions deviated from the requirements in the governing documents, the court ordered a new election – with all the attendant inconvenience, expense and acrimony.

Agents should be aware that the informal operating style of many community association boards often results in another common problem – the board's failure to formally memorialize changes and amendments to its bylaws and CC&Rs.

Since many associations were created and organized years ago, their governing documents may not be in compliance with changes in the law. Or, they may not reflect the way the association actually functions. In the event of a lawsuit, however, the courts will generally give full faith and credit to the governing documents, even if the board has been doing things different for years.

One Florida agent who has sold D&O coverage to community associations for more than 10 years notes that he always reads the bylaws and CC&Rs thoroughly to understand the governing rules and insurance requirements and to make sure that the D&O coverage limits meet the minimum requirements. He also looks at whether non-owners are eligible to sit on the board. Some policies cover only owners, so this is not a trivial matter. Moreover, certain board actions can be invalidated if ineligible individuals are sitting and acting on the boards.

In addition to understanding the intent and requirements of the governing documents, agents should become familiar with the entity's finances. This can provide good insight into the operation of the board and its stability. For example, if the association had $1 million in equity one year, then negative $50,000 the next year, an agent should investigate further.

Picking Policies and Coverages

Today, the number of carriers and agents offering D&O policies to community associations is limited. Notwithstanding the limited market, there are still wide differences among the available coverages. Agents need to understand these differences.

While some agents sell D&O on a stand-alone basis, many sell the coverage as part of an insurance program, which includes property, general liability, workers compensation, and boiler & machinery. In addition, the coverage also may be offered as an endorsement. It is imperative for any agent to know the differences, if any, between the package D&O coverage and the stand-alone coverage. In our experience, the differences are very often substantial, and the cost differential is often minimal in comparison. Knowledge of these differences also can easily be exploited as sales opportunities.

Another question most agents will be asked and should be prepared to answer is, "how much D&O coverage is enough?" The analysis for D&O coverage is different from other coverages. With property coverage, limits are typically based on property and/or replacement value. With general liability, the concern is the potential impact of large exposures, including large bodily injury type settlements. With D&O, the analysis surrounds the personal liability of the directors and officers and what is enough to cover the exposure.

In our experience, it is not unusual for associations to be overinsured in this area. With general liability, the concern is large bodily injury awards. Under D&O policies, however, bodily injury is excluded, so the large bodily injury payments are generally not a

concern. What is more of a concern is that limits often drive settlements. If large limits are available, they could prevent reasonable or expeditious settlements.

A large exposure for board members is defense fees and cost. Why is this important? It is expensive to defend most claims, and legal fees can push relatively small claim costs much higher. In one wrongful termination case involving a property manager, the lawsuit paid $20,000 in damages and another $15,000 in legal fees.

About the Opportunities

There is a major opportunity for agents who would like to specialize in this kind of insurance if they are willing to learn the technicalities of the risks.

The Community Associations Institute (http://www.caionline.org) offers a comprehensive D&O course for agents and brokers. In addition, it offers checklists that agents can use to familiarize themselves with the issues that confront community associations.

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