



Directors' & Officers' Liability

What Homeowner Associations Need To Know

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With commentary from HOA insurance expert Kim Angeli

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1. Purpose

One of the most important insurance policies in any homeowner association's financial portfolio is also one of the most overlooked and misunderstood—Directors' & Officers' (D&O) Liability Insurance.

A good D&O liability insurance policy protects both past and present HOA board members, the property manager, employees, volunteers, and the community itself from lawsuits arising out of the management of the HOA. This could include any number of HOA-related issues, such as a new building project, a foreclosure against a property owner, or a complaint filed by a homeowner.

2. Are all D&O liability policies the same?

No. Depending on the insurance carrier, there can be a broad range of differences between what each D&O policy covers and what they exclude.

One quick way to tell if your HOA's D&O liability coverage is sufficient is to determine whether you have a separate "stand-alone policy" or if your D&O has simply been added to your HOA's commercial property and liability package policy.

"Boards often develop a false sense of security regarding their D&O coverage," said Kim Angeli, President of Powell, Angeli and Langford Insurance in Raleigh, NC. "They see it checked off on a box on their insurance package and think that it affords them appropriate coverage."

"The two biggest D&O claims against HOAs in the country," continues Angeli, "are non-monetary and discrimination claims." Both are specifically excluded from the vast majority of commercial package policies on the market, including those written by recognizable, brand name insurance companies.

"They're excluded for a reason," Angeli said. "The endorsement costs about \$150 to add to the package policy, so it doesn't afford much coverage. You get what you pay for. If you take out the endorsement and read it, typically the first two paragraphs are what they cover and then the next *three pages* are the exclusions."

Conversely, the stand-alone D&O liability policy underwritten by CNA Insurance Company—and recommended by Angeli—was created to protect HOAs, so it provides coverage for claims not covered by most other insurers, like discrimination and non-monetary claims.

"Something as important as D&O deserves its own policy," said Angeli.

3. How are HOAs affected by discrimination litigation?

One of the most common D&O claims facing HOAs today are lawsuits for discrimination, which in this case has nothing to do with race, gender or sexual preference.

They typically involve a property manager doing a drive-through of the community and taking note of a violation of the community bylaws—such as a home painted purple. They proceed to send the homeowner a letter asking them to put their property into compliance with the HOA's governing rules. The property owner in turn feels they are being discriminated against and files suit.

Angeli described another discrimination claim in which a board told a single family homeowner he could not build a fence. Unbeknownst to the current board, a past board had allowed another neighbor to build a similar fence three years prior. The homeowner filed a discrimination lawsuit against the board, the HOA, and the property manager.

“The HOA lost the case at trial and had to pay a \$7,000 settlement to put the homeowner's fence back up,” Angeli said. “It's really the legal fees that drain you though. In this particular case, the legal defense costs were over \$96,000.”

“The board told one owner he couldn't build a fence,” said Angeli, “and a prior board told another owner three years ago he could build the same fence. So a precedent was set. That's when boards get into trouble. When they don't know what was approved prior to them serving on the board. If they had kept their old package policy in place, this claim would have been paid out of their own account or a special assessment.”

In this case the HOA had a D&O policy written through Ian H. Graham Insurance and the claim was paid.

4. What are non-monetary claims and why is D&O coverage important?

Non-monetary claims are another example of D&O claims that are excluded from the commercial property and liability package policies endorsed for D&O coverage. Such claims are included in the stand-alone D&O liability policy like the one endorsed by HOA-USA however.

“Let's say you live in a community that has lake frontage with big, established trees,” said Kim Angeli. “The condominium in question overlooks the lake and trees, but the HOA board decides to come in and take all the trees out. The unit owner cannot put a price on what that just cost him in real estate value. He can't really put a price on it now or in the future because the aesthetic nature of the community has been ruined. That's an example of a non-monetary claim.”

“If the plaintiff in the lawsuit is not asking for a dollar amount, package policies endorsed for D&O coverage have a built-in exclusion to deny these types of claims,” said Angeli. “They're not going to defend at all. It really gives them a broad brush to deny the claim when there is non-monetary verbiage in the suit.”

This is another reason to have a stand-alone D&O liability policy like the one offered through Ian H. Graham and underwritten by CNA Insurance Company. It offers much more coverage, including protection against lawsuits brought against the HOA for non-monetary claims.

5. Is the community developer covered by D&O liability insurance?

Though it's fairly common to have a developer on the HOA board, most insurance companies will not write D&O liability coverage on an HOA if a developer is still involved with the community and serving on the board.

"Let's say the developer sits on the board with two other people. He hasn't completely transitioned the community over to the HOA," said Angeli. "And let's say the developer makes a decision about the community with the other board members that result in a lawsuit. The insurance company is going to cover everybody except the developer. They're going to exclude him, which is a huge gap when he's making decisions for the community. You can have the developer acting on the board for years."

Should the developer be named in a lawsuit and not be provided with coverage under the HOA's D&O insurance policy, he could potentially be responsible for paying his portion of the settlement out of pocket. When a developer is forced to take such a serious financial loss, it could be extremely detrimental to the community as a whole.

"Insurance companies may not write an HOA if there are a certain number of undeveloped lots. They don't want real estate activities involved, period. It is definitely a huge advantage for CNA. I don't know of any other carrier that covers the developer," said Angeli.

6. Does having the appropriate D&O liability coverage help attract board members?

Yes, it could. Having D&O liability coverage that is tailored to an HOA allows board members to make decisions without having to worry about costing the community money. They know that if they make a decision that sparks a discrimination or non-monetary lawsuit, their D&O liability policy is going to defend them.

Having the appropriate protection in place can positively impact the whole community. "It's almost like having health benefits as a small business owner. It's a retention tool to get people to volunteer," Angeli said.

7. Can your HOA afford to be without the appropriate D&O liability coverage?

Depending on the number of units in the community, the premium for a stand-alone D&O liability policy can range anywhere from \$700 to \$2,100. Compared to the roughly \$150 it costs to endorse a

commercial property and liability package policy for D&O, the CNA policy offered through Ian H. Graham is more expensive—but with good reason. It provides much more coverage.

“As I tell boards, it’s not a matter if you’re at fault,” said Angeli, “it’s when the lawsuit hits your desk or your property manager’s desk. You don’t have a choice. You have to defend yourself. If you don’t have the appropriate D&O coverage, you may be pulling out the HOA checkbook and writing a \$10,000 retainer to your attorney! And add to that another \$250 to \$300 an hour for them to defend you whether you’re in the right or the wrong.”

“You can spend that money on your attorney or you can spend it on an average D&O premium of around \$900. That’s a pretty good return on your investment, and with it comes peace of mind that you’ve got the appropriate coverage in place.”

8. What is “failure to procure insurance” and why does it matter to an HOA?

Failure to procure insurance is another example of a common D&O claim that is excluded from the commercial property and liability package policy endorsed for D&O. However, such claims are covered by the stand-alone D&O policy like the one offered through Ian H. Graham and underwritten by CNA.

This type of claim can occur when an HOA board approves an insurance policy (typically for community-owned property) and the property or risk is underinsured. Then there is a catastrophic claim such as a fire, hurricane, or flood.

“If the board failed to procure the correct insurance, they could be held liable for the difference,” said Kim Angeli. “That’s another example of a claim that’s specifically excluded on most D&O policies, but covered by the CNA policy offered through Ian H. Graham.”

9. Can your homeowners afford a special assessment due to a D&O liability claim?

One of the hidden consequences of a special assessment is that it can hurt the homeowners’ ability to sell their unit. Today, mortgage companies are asking if a special assessment has been done in the HOA before they will approve a loan.

“This is a huge deal at the moment,” said Angeli. “We have unit owners who can’t sell their units. The mortgage companies who got burned in the financial meltdown now want to know how many people rent in the community, when the last special assessment was, and how much it was. If they do not like the answers, they do not approve the loan.”

Having the appropriate D&O liability coverage should be important to everyone in the HOA, not just board members. Because it provides more coverage, it helps the community avoid special assessments, thereby protecting the entire community and its ability to buy and sell property within the HOA.

10. What is meant by fiduciary responsibility and how does it impact the board?

Because HOAs can have large numbers of homeowners, making decisions on behalf of the entire community would be unmanageable if not for its elected board members.

Many board members are unaware that the bylaws and governing documents of the HOA may assign board members a fiduciary duty to the community, and hold them personally liable for the decisions they make while on the board.

“The board members are the ones that make the decisions for the HOA, so they have a fiduciary duty to maintain the property, keep the values up, and govern the HOA based on the declarations and the covenants and bylaws,” said Angeli.

“If they aren’t meeting those responsibilities, they can be taken to court and sued because they’re not doing their job. A lot of board members don’t understand what they’re getting into when they volunteer.”

Brokers like Angeli, who have done their homework, do their best to educate board members regarding the differences in D&O liability policies on the market, and the importance to the entire HOA of having the appropriate coverage.

11. How do I know if my HOA’s D&O liability policy provides the appropriate protection?

You may want to start by contacting Ian H. Graham. IHG offers the stand-alone CNA D&O liability policy discussed in these articles and is endorsed by HOA-USA. IHG can provide you with a checklist that points out the important coverages your HOA needs to be adequately protected.

“We use Ian H. Graham’s checklist a lot,” said Angeli. “I hand out that checklist at seminars that I do across North Carolina. I challenge the board members or property managers to take that checklist to their current insurance agent and ask them what’s covered. I had a man call me from Wilmington, NC, after I did a seminar who said, ‘My agent could not answer yes to any of these. Not one of them.’ It can be enlightening. If you can’t check off five items that are included in your policy, then you need stand-alone coverage.”

Tifinni A. Tegan, CIC, is an Assistant Vice President at Ian H. Graham Insurance, a division of Aon, the world's largest insurance broker. Ian H. Graham specializes in providing Directors' & Officers' Liability and a number of other coverages to community associations.

Kim Angeli is the President of the independent agency Powell, Angeli and Langford Insurance in Raleigh, NC. Kim focuses on assisting community associations with their insurance needs. She is also a frequent speaker on such topics as Directors' & Officers' Liability.

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