

CEO, Director and Officer Liabilities and the Risks of Being Sued

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Kaufman & Canoles, P.C.

Basic Roles and Responsibilities

- Decision making
- Oversight
- Duty of loyalty
- Duty of care

General Standards

- Standards of Conduct
 - Good faith
 - Reasonable belief
 - Best interests of credit union

- Standards of Liability
 - Lack of good faith
 - Unreasonable belief
 - Lack of information
 - Lack of objectivity

Always put the interest of the credit union first!

- Business Judgment Rule (std. defense)
 - Business decision
 - Good faith
 - Disinterested parties
 - Informed judgment
 - Reasonable belief
 - Best interests of credit union

Influences on Standards of Conduct

- Consumer perceptions and expectations
- Litigation
- Legislative
- Regulatory
- Insurance

Sarbanes - Oxley

- Corporate disclosure and governance
- Insider Accountability and disclosure obligations
- Auditor independence
- Sanctions for criminal and civil wrongdoing

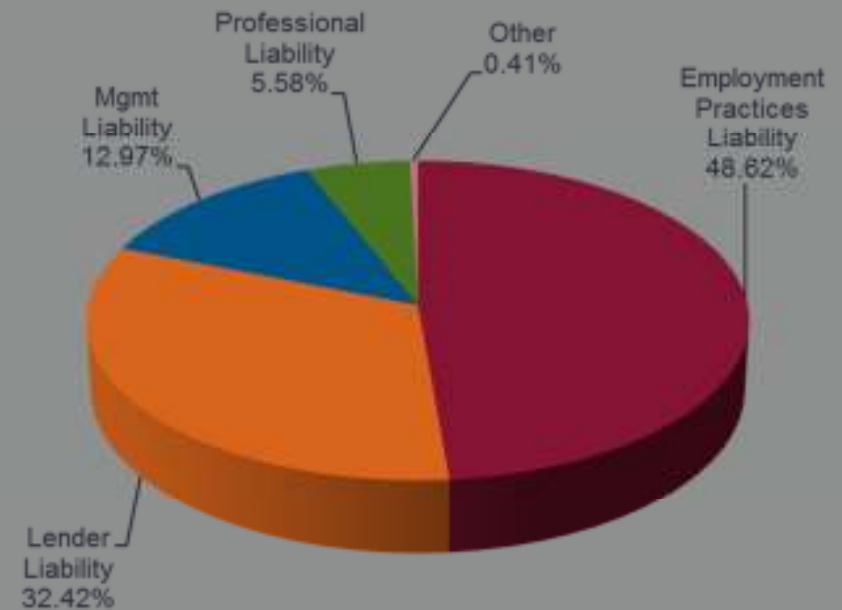
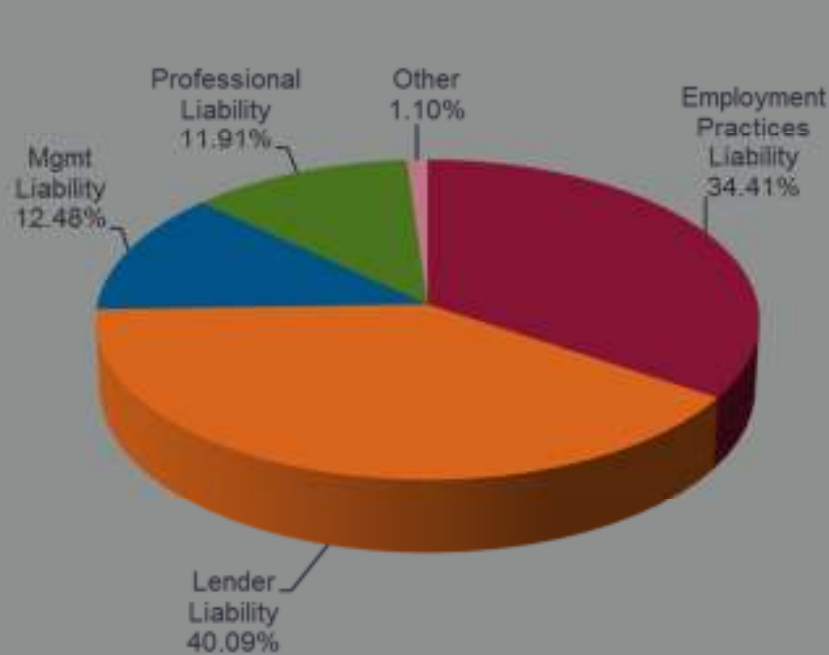
Selected Provisions

- Safety and soundness
- Corporate governance practices
- Corporate responsibility
- Enhanced financial disclosures
- Board financial literacy

Management & Professional Liability: Trend Losses

MPL Claim Count
(frequency)

MPL Claim Dollars
(severity)



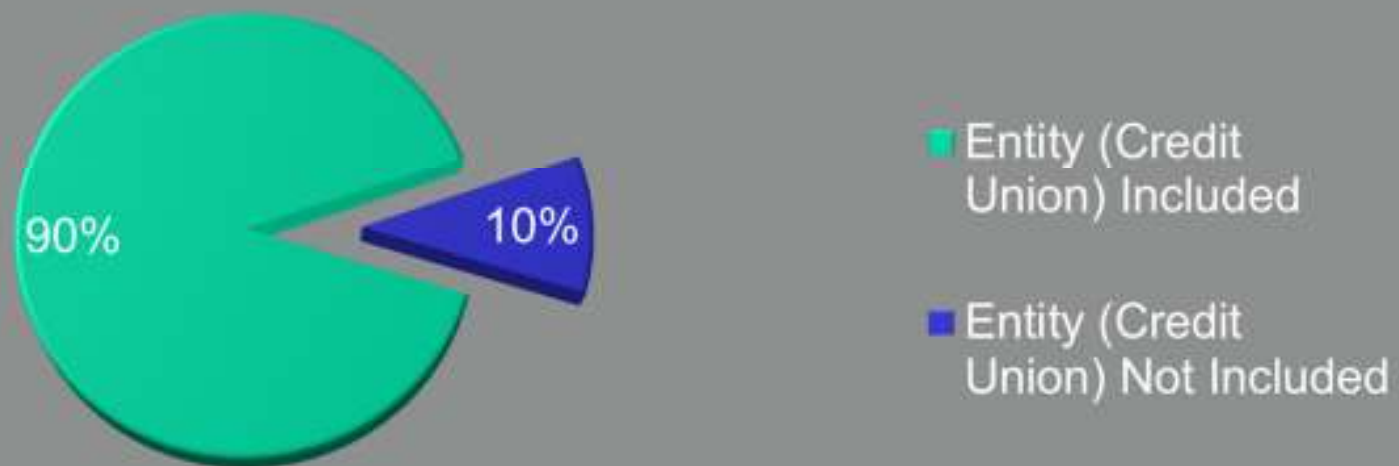
Point of Emphasis: Always consider both frequency and severity

Source: 2011-2015 CUNA Mutual Group internal claims data 10

Management Liability (D&O) Coverage Drill Down



Percentage Of CUs That Include The Entity Option
As An Insured Person In The D&O Coverage



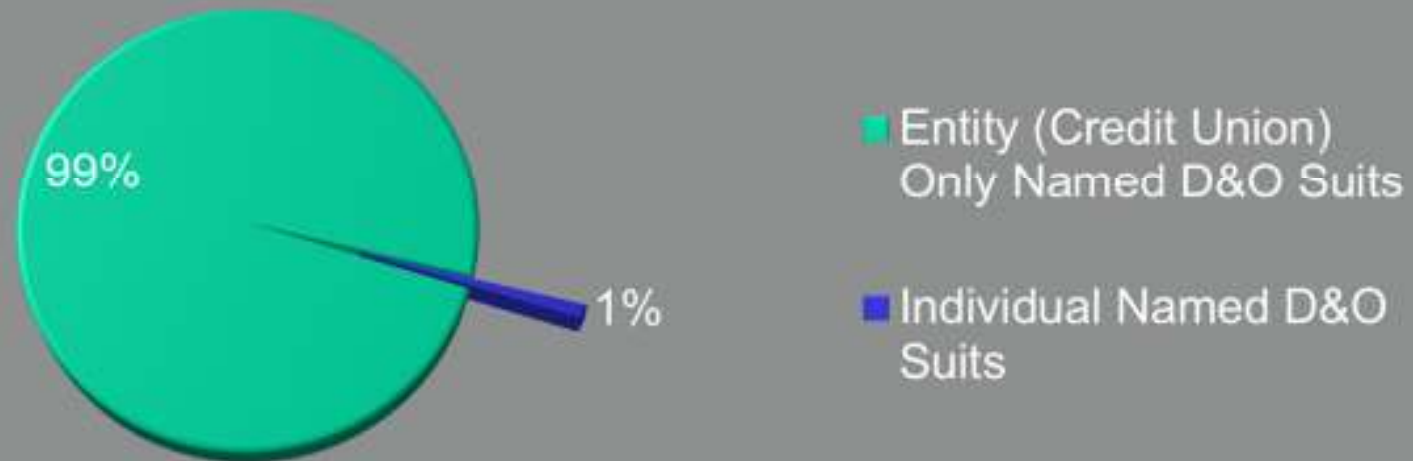
- The above charts references natural person credit unions only (No Corporate Credit Unions)



Management Liability (D&O) Losses Drill Down



Percentage of Entity vs Individual Suits Within The D&O Coverage



- The above charts references natural person credit unions only (No Corporate Credit Unions)



New Environment for Directors and Officers

- What's Happening Out There?
 - New regulations from various agencies
 - Increased risk of cyber breaches
 - Increased pressure to grow revenue

Source: CUNA Mutual Group

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Management Liability Coverage Options

- Personal assets are exposed
- CUNA Mutual Group offers Management Liability options tailored to fit the needs of any credit union
 - Traditional Management Liability
 - D&O Umbrella

Source: CUNA Mutual Group

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Management Liability Coverage Options (cont.)

- Personal Excess Liability – new option from CUNA Mutual Group
 - Dedicated limit for each named director or officer
 - Non-rescindable
 - If a regulator cancels or nonrenews the policy and does not purchase ERP, coverage remains in force for 36 months for acts occurring prior to the cancellation or nonrenewal
- Optional Outside Director Liability Coverage available if you are directed by the credit union to sit on the Board of a 501(c)(3), 501(c)(4) or 501(c)(10)

Source: CUNA Mutual Group

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Management Professional Liability Policy Awareness



- Prior to roughly 1998 including the Entity (Credit Union) as an insured “person” under the D&O coverage was not an available option in the credit union industry.
- Due to this change you need to be aware of how your current D&O coverage is structured within your Management Professional Liability policy from a limit/policy aggregate standpoint as the Entity coverage may potentially impair the limit that the individuals think they have available in their contract.
- Shared limits or lower policy aggregate limits could potentially water down the limit available to the individual D&Os if Entity suits are paid out under this coverage.
- If the Entity is included it should prompt a question or thought about whether your current D&O limit should be increased. Again how your limits are currently structured will play a role in that decision.
- If the Entity is not included than the limit of protection available is entirely allotted to the individual D&Os.

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Benefits That Allied Has Contributed To The Management Professional Liability Contract

- Through its underwriting partners Allied Solutions introduced **Entity Protection** in the D&O coverage part in 1998. This was a significant benefit as most of the claims paid under the D&O are triggered from having Entity protection. This coverage was not available prior to 1998.
- Through its underwriting partners Allied Solutions introduced **Credit Union Professional Liability** coverage in 1998. Prior to that time the only coverage available was Supplemental Litigation, which was a scaled down version of Credit Union Professional Liability as we know it today.
- Through its underwriting partners Allied Solutions introduced **Lender Liability** coverage in 1998. Prior to that time the only coverage available was Supplemental Litigation, which was a scaled down version of Lender Liability as we know it today.

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We do whatever it takes.

Whatever "it" is.

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Due Diligence Checklist Items

1	Defense Costs	The separate Defense Costs coverage pays defense costs when suit allegations could result in a covered bond loss in excess of the coverage deductible. Coverage is provided for all reasonable defense costs and will not be prorated. Some specified coverages are not subject to Defense Costs.
2	Reward Payment	In the event a credit union is robbed, burglarized or subjected to extortion, kidnap or ransom demand, the credit union may offer a reward for information leading to the arrest of the criminals.
3	Payments for Injury or Death	The coverage reimburses the credit union for a death benefit to the victim's heirs and for costs the credit union decides to cover relating to the victim's (or victims') medical or surgical treatment.
4	Post-Robbery Trauma Counseling	Reimbursement for payments made for counseling expenses resulting from mental trauma injury inflicted upon a director, employee or credit union's member.
5	Extortion, Kidnap and Ransom	Covers losses resulting from the surrender of covered property due to threat to either harm someone or damage property.
6	Extortion, Kidnap Investigation Expense	Pays the credit union for investigative expenses incurred and paid by the credit union, an employee or director in connection with a computer extortion, or an extortion, kidnap or ransom. Includes reasonable fees and expenses
7	Counterfeit Currency	Covers losses resulting from acceptance of counterfeit currency from anywhere in the world.
8	Audit Expense	Covers audit expense incurred to prove an employee caused loss.
9	Cash Letter	Covers losses caused by loss of a cash letter, which was being transported for the purpose of deposit.
10	Electronic Crime	Covers theft that results from, unauthorized access to the Credit Union's computer systems and fraudulent communication through electronic means, fax or telephone. It also covers damage or destruction of data done by the introduction of a computer virus or other form of malicious code into the systems.

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11	Electronic Crime – Loan	The use of a fraudulent digital signature to create or alter the terms or the amount of a loan. The withdrawal or transfer of the proceeds of a member’s existing loan by a person other than the member who has obtained unauthorized access to the member’s electronic account information A breach of computer security through which results in a loan being created, or the amount of credit extended in connection with an existing loan to a member is increased.
12	Computer Crisis Management	Pays for crisis control expenses incurred as a direct result of any malicious attacks against any computer system for which the credit union is primarily and directly responsible.
13	Business Credit Cards / Travel Advances	Covers up to \$10,000 for loss due to a lost, altered, stolen or counterfeited credit card issued to the Credit Union for business or travel expenses. Covers travel advances for Credit Union directors and employees.
14	Employees’/Members’ Property	Covers employees’ and members’ property stolen or damaged during robbery or burglary.
15	Fraudulent Deposit & Forgery or Alteration	Covers losses resulting from forgery or alteration of any instrument or share draft. Also covers losses caused by uncollected funds, including check kiting.
16	Faithful Performance Enhanced	Focuses coverage on major exposure areas of lending, shares and deposit policies. The amount of the covered loan loss is not reduced by the amount of the earnings realized by the Credit Union, including interest received on that loan. This coverage uses a “conscious disregard” standard.
17	Stop Payment and Wrongful Dishonor	Stop Payment covers loss resulting directly from the credit union’s failure to comply with a proper notice from a member to stop payment on a share draft or check payable by the credit union and made or drawn by the member. Wrongful Dishonor covers loss resulting directly from the credit union’s wrongful refusal to pay a share draft or check drawn by a member.
18	Unauthorized Signature	Covers loss resulting directly from the credit union honoring a share draft, check or withdrawal order of a member in reliance upon an unauthorized signature.
19	Counterfeit Share Draft and Securities	Pays for loss from a counterfeit share draft or check paid against a member account or the credit union’s own corporate account.
20	Mortgage Defective Signature	A mortgage instrument which proves to be defective by reason of a signature obtained by trick, artifice, fraud or false pretenses.

21	IRA/EDCP Plans	Pays for credit union loss from any negligent act, error or omission by an employee or director in carrying out his/her duties as an administrator or trustee of an IRA, or as an administrator or sponsor of the credit union's EDCP. IRA/EDCP provides coverage to the credit union alone.
22	ATM Off Premises	Covers loss resulting directly from burglary, robbery, damage or destruction of covered property, including deposits, money and other items dispensed by an ATM owned, operated and maintained by the credit union.
23	Consumer Legislation	<p>Pays for covered loss resulting directly from the credit union's failure to comply with the following consumer legislation acts:</p> <ul style="list-style-type: none"> • Truth-In-Lending Act • Fair Credit Billing Act • Consumer Leasing Act • Fair Credit Reporting Act • Equal Credit Opportunity Act • Real Estate Settlement Procedures Act • Federal Trade Commission Holder in Due Course Rule • Electronic Fund Transfers Act • Expedited Funds Availability Act (subparts A and B only) • Truth-In-Savings Act <p>Defense costs are included within the limit.</p>
24	Plastic Card/PIN	Provides protection from losses resulting from unauthorized use of a lost, altered, stolen or counterfeit plastic card.



Due Diligence Summary Checklist (Fidelity Bond, Plastic Card Fraud, Management Professional Liability, Cyber Liability, and P&C Package)

NCUA regulations require that the board of directors exercise looking at other programs that are available in the market.

- A. When was the last time you looked at other bids?
- B. Are you partnering with an insurance agency that has demonstrated a high level of expertise in respect to underwriting knowledge, claims knowledge, and risk management knowledge specific to these coverages and this industry?
- C. How many credit union clients does the insurance agency you are looking to partner with handle pertaining to these coverages?
- D. Does their risk management unit provide educational and training programs such as scam/risk alerts, on-site risk reviews, webinars, and white papers etc.?
- E. How much experience does your current insurance agency have in the claims area. What is the number and volume of claims being handled?
- F. Because of the current number of insurance carriers that are offering these coverages are you certain that you have the best coverages available at the most competitive premiums. (There are currently eight insurance carriers in the market. Do not assume that your incumbent insurance carrier has the best program, no matter how long they have been in the market.)



Due Diligence Summary Checklist (Fidelity Bond, Plastic Card Fraud, Management Professional Liability, Cyber Liability, and P&C Package)

- G. Are you aware that there are insurance agents that have exclusive programs available to the industry. These would be programs only that insurance agent has the ability to access. If so, have you asked for bids from the insurance agent.
- H. Were you aware that the NCUA guidelines only mandate that you carry employee dishonesty coverage at a limit based on your asset size. All other coverages within the Fidelity Bond are optional and have no mandated limit. As a result are you over-insured in areas that you thought you needed to carrier certain limit for in order to be within NCUA compliance.
- I. From a basic insurance protection perspective do you currently carry a Fidelity Bond, Management Professional Liability, Cyber Liability, Property, Business Auto, Workers Compensation (if required), and Excess/Umbrella coverages?
- J. As a result of the continued evolution and changing landscape of this market over the last 18 years do you feel that you are receiving a fair representation from your current partner of the options that are available in the market?
- K. What is the financial strength of the insurance agency and insurance carrier that you currently do business with in these product lines?

What if you breach?

- Breach of duty + damages = potential liability
- Indemnification, insurance
- Who would sue?
 - NCUA, members with uninsured shares, disgruntled ex employees, those not elected to the Board
 - Many “members” threaten a lawsuit
- Current trend

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Indemnification

- FCU Bylaws
- FCUs may not indemnify officials or employees for personal liability
 - Where decision giving rise to claim is determined by a court to have constituted
 - Gross negligence
 - Recklessness
 - Willful misconduct
- Resolution by Board of Directors

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Indemnification 12 CFR 701.33

- Exception will allow advance of funds (for defense) if, before final disposition,
 - Disinterested board members/supervisory committee deem officials acted in good faith
 - Disinterested individuals determine that payment will not harm safety and soundness
 - Corporate governance/Board resolution

Directors are Responsible for General Direction and Control of the Credit Union

- Duty of good faith
- Best interests of membership
- Fairly, impartially and without discrimination in favor of any particular member
- New regulation/financial literacy
- Be prepared

Potential Trend

- Breach of duty
- Shift in application of business judgment rule
- Suggests personal liability may be imposed where directors fail to adopt and implement a compliance plan

Federal Credit Union Context

- NCUA
- State corporate law
 - Bylaws
 - Model Business Corporation Act
- Other federal laws
- Sarbanes - Oxley

Areas of Interest Now or in the Future

- Risk Management – Risk Assessment & Planning
- Compliance and ethics training
- Internal control standards
- Written documentation
- Effective due diligence

Principles of Corporate Governance

- Board Structure
 - Size of board
 - Director qualifications
 - Selection of new directors
 - Term limits

- Board meetings
 - Agenda
 - Advance distribution of materials
 - Access to employees
 - Executive sessions
 - Regular attendance

- Performance evaluation
 - Board effectiveness
 - Director evaluation
 - Director orientation and continuing education
 - CEO evaluation

NCUA's Fiduciary Duties Regulation

- Creation of federal duties
- Indemnification changes
- Financial literacy

Fiduciary Duties

- Fiduciary duties portion applies to federal credit union directors
- Financial literacy rules only apply to federal credit unions

Fiduciary Duties Thumbnail Sketch

- Clarification that directors are responsible for general direction and control
- Four specific FCU director duties
 1. Director must carry out duty in good faith, in best interests of membership
 2. Administer affairs fairly, impartially and without discrimination in favor or against any particular member
 3. Financial literacy
 4. Ensure management's operation comply with all applicable "rules"

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Fiduciary Duties 12 CFR 701.4

- General direction and control
 - Board is ultimately responsible
 - Delegation of execution? Yes.
 - Delegation of responsibility? No.
- Carry out duties
 - In good faith
 - Reasonably believe that actions are in best interests of membership as a whole
 - Use same care as “ordinary prudent person” in similar situation

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Fiduciary Duties 12 CFR 701.4

Outside Staff and Consultants

- Boards are empowered to retain staff and outside consultants as needed
- Boards may rely on staff, officers, committees or outside consultants if directors “reasonably believe” the person is reliable and competent in that area
- Higher standard for legal counsel, public accountants and others retained for their skills or expertise?

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Director and Staff Involvement

- “Federal credit union's staff providing services to the board of directors or any committee of the board under this regulation may be required to report directly to the board or such committee as appropriate.”
 - There is no mention of director in this paragraph
 - There is discussion of the board's right to require staff to report to the board or committee of the board, *as appropriate*
 - A director, by himself or herself, has little or no power. It is the board and their vote that matters

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NCUA Discussion

- "Some commenters object to any provision requiring federal credit union employees (staff) to report directly to the board of directors or committees of the board, stating this would undermine management's authority over the employees of the credit union."
- "The NCUA Board disagrees."
- "While the board of directors should not attempt to bypass the CEO in giving direction to management and employees, the board is free to ask any manager, employee, or independent contractor to provide the board and its committees information directly and not through the filter of the CEO."

Summary

- Federal credit union's board has the right to gain direct access to information from credit union employees
- NCUA notes that boards should not bypass the CEO to direct or manage the credit union's employees

Fiduciary Duties

- Clarification that directors are responsible for general direction and control
- Four specific FCU director duties
 1. Director must carry out duty in good faith, in best interests of membership
 2. Administer affairs fairly, impartially and without discrimination in favor or against any particular member
 3. Financial literacy
 4. Ensure management's operation comply with all applicable "rules"

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