

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

CUES Directors Conference
December 11, 2017

Kaufman & Canoles, P.C.



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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
 - Statutory and Regulatory Liability

Always put the interests of the credit union first!

- Business Judgment Rule
 - Business decision
 - Good faith
 - Disinterested parties
 - Informed judgment
 - Reasonable belief
 - Best interests of the credit union

Influences on Standards of Conduct

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

Selected Provisions from Sarbanes/Oxley

– Dodd/Frank

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

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
 - Increased work
 - Increased liability
 - Director's Insurance

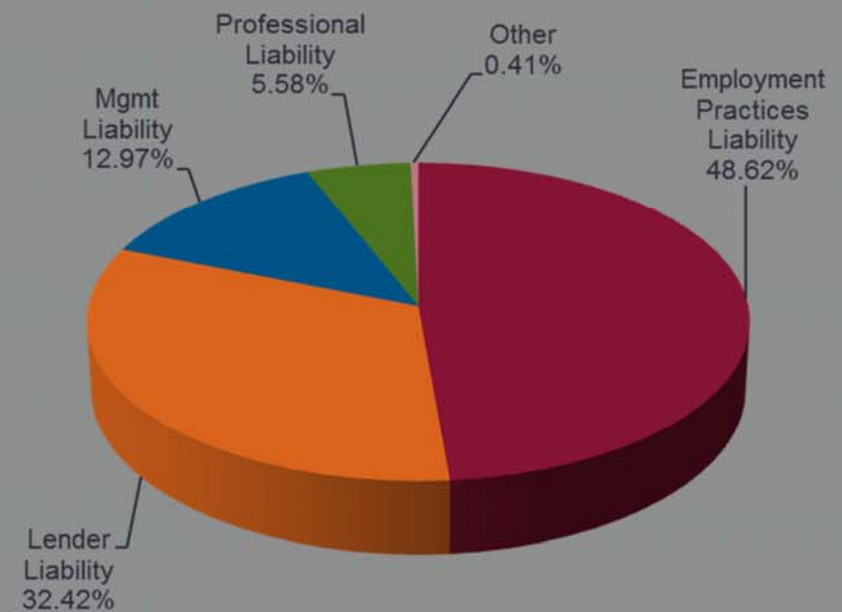
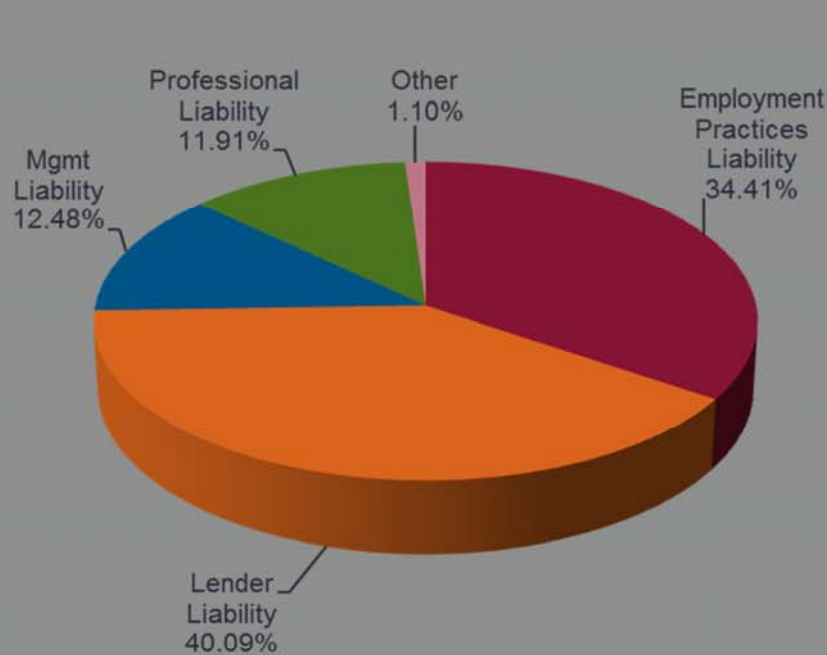
Source: CUNA Mutual Group

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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 11

Management Liability (D&O) Coverage Drill Down



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

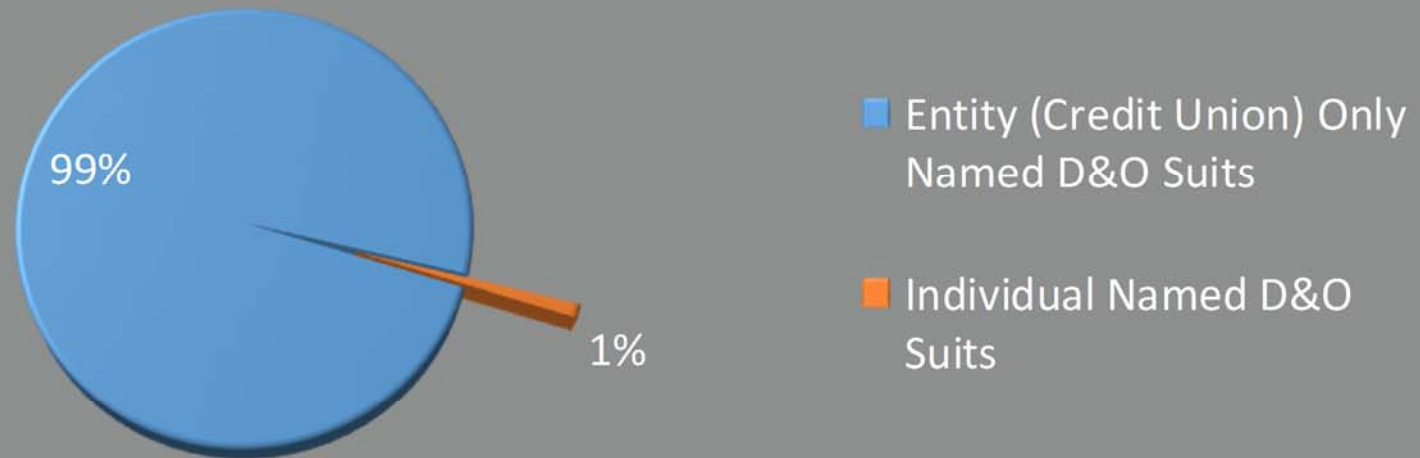


- The above charts references natural person credit unions only (No Corporate Credit Unions)

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)

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 –from CUNA Mutual Group
 - Dedicated limit for each named director or officer
 - Non-rescindable
 - If a regulator cancels or non-renews 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)

Source: CUNA Mutual Group

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- Jayne Campbell, CPCU, RPLU, AU, AIM
- Staff Underwriting Specialist | Business Protection
- CUNA Mutual Group
- 800.637.2676, Ext. 665.8607
- Jayne.Campbell@cunamutual.com



We do whatever it takes.

Whatever "it" is.

Contact Information

Patrick Touhey, SVP

Email: patrick.touhey@alliedsolutions.net

Phone #: 800-785-5527 ext. 29152



Due Diligence Insurance Checklist Items

1. Defense Costs
2. Reward Payment
3. Payments for Injury or Death
4. Post-Robbery Trauma Counseling
5. Extortion, Kidnap and Ransom
6. Extortion, Kidnap Investigation Expense
7. Counterfeit Currency
8. Audit Expense

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Due Diligence Checklist Items

9. Cash Letter
10. Electronic Crime
11. Electronic Crime – Loan
12. Computer Crisis Management
13. Business Credit Cards / Travel Advances
14. Employees'/Members' Property
15. Fraudulent Deposit & Forgery or Alteration
16. Faithful Performance Enhanced

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Due Diligence Checklist Items

- 17. Stop Payment and Wrongful Dishonor
- 18. Unauthorized Signature
- 19. Counterfeit Share Draft and Securities
- 20. Mortgage Defective Signature
- 21. IRA/EDCP Plans
- 22. ATM Off Premises
- 23. Consumer Legislation
- 24. Plastic Card/PIN

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What if you breach?

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

- 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](#)
- Protection from Litigation Exposures

Current Trend

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

All help to reduce potential liability

Current Trend

- Performance evaluation to limit liability
 - Board effectiveness
 - Director evaluation
 - Director orientation and continuing education
 - CEO evaluation
- Code of Ethics

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 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 actions are in best interests of credit union
 - Use same care as “ordinary prudent person”
- Policies

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Fiduciary Duties of 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."
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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 (NCUA Updates)

- 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

Thumbnail Sketch/NCUA

- 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
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Takeaways

- Fiduciary Duties
- Insurance
- NCUA Updates
- Indemnification

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KAUFMAN & CANOLES
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**CERTIFICATION OF RESOLUTION OF BOARD OF DIRECTORS ADOPTING
INDEMNIFICATION PROVISION**

We, the undersigned, Chairperson and Secretary of _____, Federal Credit Union, Charter No. _____, hereby certify that by affirmative vote of two-thirds of the members of the board at a duly noticed and held meeting thereof on _____, 2017, the following resolution was adopted:

BE IT RESOLVED: That the following indemnification shall be approved and be effective immediately.

_____ Federal Credit Union shall, to the maximum extent permitted by state law, as amended, indemnify and allow payments or reimbursement for the reasonable expenses such as, but not limited to defense costs, insurance and bond deductibles and travel costs, of any person who was or is a party or threatened to be made a party to any legal proceeding, by reason of the fact that he or she is or was a director, officer, employee or agent of the credit union or volunteers services to the credit union; or is or was serving at the request of the credit union as a member of any committee or a director or officer of any other corporation or enterprise, except liability for:

- (A) receipt of a financial benefit to which he or she is not entitled;
- (B) an intentional infliction of harm on the corporation or its shareholders;
- (C) an intentional violation of criminal law.

Such right of indemnification shall transfer to the benefit of the estate and personal representative of such a person.

BE IT FURTHER RESOLVED: As of this date, the persons holding the position of President/CEO; Vice President Lending; Vice President Organizational Development; _____; _____; and Electronic Services Manager are the named officials of _____ Federal Credit Union.

The forgoing resolution, together with the names of Directors voting for and or against the resolution, and those absent from the meeting have been entered in full in the minutes of the Board of Director's meeting.

_____, Chairperson

_____, Secretary

Date