Theft of Funds is Not Covered by Insurance

Resource Type: Articles

Topic: Fraud and Financial Oversight, Insurance and Risk Financing

Theft of Funds Is Not Covered by Insurance

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The employee dishonesty provisions of a standard insurance policy do not protect a charity from loss when an employee conducts an unauthorized fund raising campaign and uses the proceeds for himself, according to the First Circuit Court of Appeals. The Court has affirmed a District Court decision denying coverage for the Special Olympics International and its Massachusetts affiliate. (*Fireman's Fund Insurance Co. v. Special Olympics International, No. 03-1322, 10/10/03.*)

An area manager hired a telemarketer to begin a fund raising campaign in 1991, using the Special Olympics name but without the organization's knowledge. He deposited the money in an unauthorized bank account in the organization's name and then wrote checks to himself, with only a small portion of the $1.1 million raised being used for Special Olympics activities. When the situation was discovered, Special Olympics sought to recover under its employee fidelity policy.

Lessons Learned

Generally, ambiguity in an insurance policy is interpreted in favor of the insured and against the insurance company. This case illustrates a narrow reading of a policy by an appellate court. The case also demonstrates the importance of taking time to read and understand your nonprofit's insurance policies, and remembering that not all losses will be covered. Finally, it's never safe to assume that ambiguous policy language will be interpreted in your favor.

The policy said it covered "dishonest acts committed by an employee…with the manifest intent" to cause loss to the employer and to obtain financial benefit for the employee or a third party. It specifically excluded "indirect loss", which it defined as loss resulting from the organization's "ability to realize income that [it] would have realized had there been no loss" of, property.

The District Court found that Special Olympics was not the "owner" of the funds raised in its name and therefore had no loss under the policy. In its view, the victims were the persons who donated the money after being deceived into believing they were supporting Special Olympics. The District Court recognized that there was a loss of reputation, and perhaps future contributions, but reputation was an intangible asset not covered by the policy.

On appeal, Special Olympics argued that the funds were, in fact, owned by Special Olympics when deposited into a bank account in its name. Recognizing that the charity might be right on the ownership question, the Court of Appeals nevertheless said the issue was whether the loss came within the definitions of the policy. It

concluded that the dishonest acts were not committed “with the manifest intent” to hurt the charity.

The Court noted that the manifest intent language had been added to the standard policy about 25 years ago to narrow the scope of coverage. Here, it said, “the facts reveal a scheme that was carefully crafted to bypass the insured entirely; although [the manager] capitalized on the organization’s sympathetic charitable mission, his deception was directed at individual donors. And, unlike the classic case of embezzlement, [this] scheme generated new funds, unanticipated by [Special Olympics], specifically for his own benefit. This scenario falls outside even a broad interpretation of what it means for an employee to have a ‘manifest intent to … cause the employer to sustain loss’.”

While the Court was “sympathetic,” it said it was constrained by the policy.

[January 2004 *Community Risk Management & Insurance* newsletter]