

Directors and Officers Liability and Crime Insurance

(Information provided by Dick Berday, a retired Insurance Agent)

(For Kiwanis Middlesex – March 6th, 2008)

Directors and Liability Insurance

Our Directors and Officers are volunteers and serve under a non-profit basis but are subject to libel claims. If this coverage is purchased, it should include the wording “Claims are Settled on a Claims Made Basis”. This means that instead of providing liability coverage for a wrongful act that takes place during the policy period, it will provide coverage for claims made after the policy period, provided that there was an exposure during the policy period, but the claim was made after the policy expired.

The standard libel claim reported is call an “Occurrence Made Claim” and will respond only to claims made during the policy period.

Crime Insurance

Coverage:

- On-premises theft
- Off-premises theft
- Depositors Forgery
- Credit Card Fraud
- Computer Theft
- Kidnap and Ransom

(See footnotes below by Dick Berday)

Directors' and Officers' Liability Insurance

Directors and officers are quickly joining the ranks of the professional and business owner as targets for liability suits. By taking on the highly visible position of director or officer, you assume great personal risk. You could be held liable for any number of things from abuse of authority and libel to slander and financial mismanagement brought against you by shareholders, creditors, customers or employees -- to name a few.

Considering the ever increasing amounts that juries award in today's courtrooms, a liability suit could conceivably wipe out your life savings and drive you into personal bankruptcy, not to mention wreak havoc in your company. By covering the litigation costs and damages in the event you are sued, director's and officer's (D&O) insurance may save you and your company from a financial disaster.

Coverage

Designed to help protect both the assets of the company and the personal assets of the individual, D&O insurance covers those liabilities that may result from an individual or group performing their task(s) as directors or officers. Anyone acting as a director or officer for a legal entity is covered under most plans. This includes positions of chairman, deputy chairman, president or vice president of the board of directors, the managing director, general manager, comptroller, secretary or treasurer and any other person who performs the corporate functions similar to those performed by an officer.

Coverage can be expanded to encompass full-time or part-time, past, present, future or retired directors or officers. The basic form of coverage may not offer all of the normal terms and conditions that you require. Therefore, many policies include endorsements that enhance the scope of coverage.

All D&O insurance policies should include the following information:

- * Deductible that applies to each claim (retention per claim)
- * Maximum dollar amount for which the insurer is at risk under the policy, including costs of defense
- * Time period in which claims must be made in order to be covered
- * Exclusions limiting the scope of covered claims

In contrast to insurance that is written on an occurrence basis, D&O insurance is a "claims made" insurance, covering only claims made in the period stated in the policy.

Is It for You?

Whether you own a company and are considering offering D&O insurance or whether you are the individual officer or director in need of coverage, you should know the risks facing you. A recent survey determined that the average cost of defending a D&O suit is more than \$1 million. The average settlement or judgment is generally

another \$1 million-plus. Expenses like this could cripple a small company and could ruin your personal finances.

If you're sitting on a board, whether profit or non-profit, you should insist upon the presence of D&O insurance. Those involved with non-profits are more at risk, because unlike non-profits, most corporations can indemnify their directors and officers to a certain degree. Charitable organizations don't usually have the funds to provide a defense or to pay settlements that may arise from a suit.

The corporation itself gains a benefit in offering D&O insurance. Not only does it protect against suits, it is highly valued and will help a business attract and retain quality directors and officers.

Variables

Depending on deductibles and other variables, D&O insurance can cost roughly \$60 to \$100 per employee per year. A typical deductible is \$5,000. Therefore, it may be cheaper to take care of the more inexpensive problems without the insurance, and choose a higher deductible to save money in the event of a larger suit.

Other variables that factor into the cost are the limits of coverage and your claims history. If you have a history of claims, you will likely face higher premiums.

*** Article as found on www.mostchoice.com written by Karen Murphy*

This article provided by Dick Berday on April 10, 2008, and taken from an article by Karen Murphy. This article can be seen in its entirety at:

http://www.mumby.com/memos/dc_directors_and_officers_liability.php?

And the link – www.mostchoice.com.

Comments by Dick Berday:

When considering Directors and Officers Insurance, the questions we should be asking ourselves are:

1. What are the exposures facing our directors?
2. Is our operation of our Kiwanis club such that we expose ourselves to possible claims?

In today's world, when we assume a position of Director or Officer and an organization, we assume great personal risk. We could be liable for so many things.

A Primer on D&O Insurance

Why Consider D&O Insurance?

Directors & Officers can be held personally liable for misuse of funds, misappropriation of funds, knowledge of illegal or improper acts, making improper loans, fraudulent acts, transactions or decisions, which are not authorized by the bylaws of the corporation.

Directors & Officers must give undivided loyalty and are prohibited from using their position of trust for personal interests or gain. This includes secret profits from personal transactions, competition with the corporation, usurping of a corporate opportunity, conflict of interest.

Diligent attention to business is essential. Failure to attend meetings, unquestioning reliance on co-directors, inaction or being a dummy director does not lessen the duty of responsibility. A director cannot escape liability incurred by resigning. The proper care and protection of the interests of the corporation must be considered first.

Duty of skill varies with the qualifications of the Directors & Officers and the scope of the corporation's activities.

Duty of Prudence requires that Directors & Officers act carefully deliberately, and cautiously trying to foresee the probable consequences of a proposed course of action.

- *Duty of Compliance* requires every Director & Officer to comply with the business corporations act, corporate articles, corporate By-Laws, and under all other statutory law and regulations including the criminal code, the environment protection act, income tax act, labour standards act, workmen's compensation act, pay equity act, securities acts, and many others.

D&O insurance policies provide coverage for legal actions against the insured by D&O for wrongful acts committed at any time prior to the end of the policy term. The coverage applies to amounts that the D&O are legally required to pay as a result of any claim brought against them as a result of wrongful acts, and includes damages, judgments, settlements and defense costs but excludes fines, penalties, and any other charges deemed uninsurable. Penal defense coverage covers fines, penalties, regulatory costs (i.e. workers compensation fines)

FAQs about D&O Coverage

- What is the purpose of Directors & Officers Insurance coverage?

A D&O insurance policy indemnifies the corporation and its Directors & Officers for wrongful actions which cause financial harm to a third party and result in a lawsuit.

- Are the directors liable for the activities of the corporation?

Many people believe that incorporation creates some kind of legal veil of limited liability behind, which they can hide. This is not the case. Directors and officers of a corporation are responsible for their actions and the actions of the corporation and in some instances the actions of other directors. The courts have assessed damages against directors of corporations for wrongful actions and in some cases the laws carry specific legal responsibilities for directors.

- Does D&O insurance cover legal cost, defense and lawyers fees, damages awarded?

Yes it does, as they are defined in the insurance policy contract wording. The policy contract is designed so that the insurer is responsible to defend the named insured from legal action due to a wrongful act and to pay the costs and damages subject to the deductible and policy coverage limit.

In an incorporated group all members, volunteers, officers, and directors are liable. Incorporation creates a legal entity, recognized in law. Liability for activities is then based on the actions of the organization and its directors. Insurance contracts can then be put in place to defend the entity and its directors whereas an unincorporated entity does not exist in law and the individual members retain liability. It becomes more difficult to contract to indemnify each director, so many insurers refuse to offer coverage on this basis.

- Why do I need general business liability insurance if I have Directors & Officers coverage?

D&O insurance does not cover your general business activities, such as meetings, contracts, newsletters, premises, etc...as a matter of fact, not having general liability could lead to a law suit against directors for not having it when a claim occurs.

- Our association has a number of chapter/branches/members. Are we able to include all of them under one Directors & Officers policy?

Generally speaking, this should not be a problem.

The upside is:

1. For reasons of risk management controls ie you would know the quality of coverage, it would be much more desirable to have one policy
2. Your premium would be lower
3. Your chapters/branches might be very thankful not to have to deal with this issue ie 'Brownie' points for you

The downside is:

1. It may be very time and energy consuming for you to have all chapters/branches involved ie the in-fighting/control factor is quite common
 2. Most insurers will not allow you to include all chapters/branches unless they all have the same bylaws
 3. Some insurers will also not allow you to include incorporated chapters/branches because of their independent legal status.
 4. If all chapters/branches are included in one policy, you must be reminded that they all share in the one limit of the policy ie if you have 10 chapters with a limit of only \$1,000,000 and more than one claim occurs you may find yourselves with insufficient coverage and squabbling over who should be the recipient of the existing funds.
- Some organizations have found that their premiums have increased dramatically, coverage has been reduced, or their insurer will not renew their policy. What is happening?

Continued high loss ratios, disappearing investment returns and non existing profits have affected all. Associations are not an exception - as you may already have experienced - to the increased rates, reduction of coverage and/or complete cancellation or non renewal of policies.

You would be well advised to review your coverage, its limits and any activity vulnerable to loss. Ask yourself some of these questions and avoid adverse future effects to your coverage.

- Are your procedures such that they will discourage, prevent or reduce the possibility of fraud, errors and mismanagement?
- Are there limits or coverage that could be reduced or eliminated?

This article was provided by Dick Berday and taken from a Guest Article, by Wolf Leue, who is a *Director, LMS Prolink Ltd., a firm providing insurance services to associations since 1986 and now representing over 300 nonprofit organizations.* The article can be seen in its entirety at::

http://www.axi.ca/tca/Sep2003/guestarticle_2.shtml

Definitions

Directors' and Officers' Liability Insurance - Liability insurance that covers the potential liabilities of the directors and officers of an organization resulting from mistakes in administering their duties.

Directors and officers have a duty to exercise due diligence in overseeing the activities of the organization that they serve. They are required to act in good faith and in the best interest of the organization. Directors have three basic duties:

1. **Duty of Diligence (Duty of Care):** Act reasonably, in good faith, in the organization's best interest.
2. **Duty of Loyalty:** Place the interest of the organization before your own.
3. **Duty of Obedience:** Act within the scope of the organization, within applicable rules and laws.

Key Point

Directors and officers have very specific duties and obligations that must be known and practiced by all directors and officers.

Legal Liability

Directors may be liable for:

- Failure to act as stated under a statute. For example, if a statute requires directors to file a report or maintain certain records, and these reports and records are not maintained, then the director may be liable for an offence under that statute.
- Non-compliance of the organization with a statute. For example, directors may be liable for mismanagement, financial losses, wrongful dismissal, employee discrimination or failure to remediate environmental damage.

It is also important to note that:

- Directors can be held personally liable.
- Ignorance is not a defense.
- Resignation is not necessarily a defense.
- Board indemnity may not be enough.
- Directors may be liable for nonperformance.

Consult a lawyer for more information on directors' and officers' legal liability. For a comprehensive review of legal liability for directors and officers of not-for-profits, visit Industry Canada's "Primer for directors of not-for-profit corporations" at <http://strategis.ic.gc.ca/epic/internet/incilp-pdci.nsf/en/cl00689e.html>

Risk Management

1. Provide awareness training in negligence and liability to all directors and officers.
2. Ensure directors are aware of:
 - risks associated with being a director or officer of the organization;
 - statutory and civil liabilities;
 - specific directors' obligations;
 - other rules associated with the organization's business for which directors may be liable due to acts or omissions of the organization; and
 - other responsibilities (including understanding finances and knowing the organization and its charter).
3. Ensure there is no conflict between the duty owed to the organization and the director's self-interest.
 - Avoid outside employment/business that may interfere with or influence the organization's duties.
 - Handle confidential and sensitive information carefully (prevent release of information).
 - Follow guidelines on the appropriateness of public statements (i.e., what and when information can be released).
 - Do not accept gifts, favours or services relating to company duties.
4. Ensure directors are aware of the organization's operations and affairs. Maintain formalized operating policies and procedures for all activities within the organization's control.
 - a. Implement a financial management policy. Establish clear financial reporting guidelines.
 - b. Store confidential materials and sensitive information in a proper place.
 - Determine who has access.
 - Encrypt all electronic confidential materials.
 - Ensure only those with passwords have access. The system should require that passwords be changed frequently.
 - Implement firewalls to prevent hackers from accessing information.
 - c. Create a human resources policy.
 - Prepare formal job descriptions for all employees and document the experience and training required for those positions.
 - Document specific aspects of unacceptable employee performance and advise employees of it well before termination.

Key Point

Directors and officers should be given all the appropriate information that they require to perform their duties effectively.

5. Ensure all employees, visitors, customers, clients and other stakeholders are protected from harm.
6. Establish a formal information reporting system. Generally, a director is entitled to rely on information provided by officers or employees/volunteers of the organization, unless the director knows that relying on the officer/employee/volunteer is inadvisable.
7. Directors should have a clear understanding of all the activities in the organization and should question anything that is unclear. Directors should also clearly communicate their decisions.
8. Document decisions and how they were made.
9. Work closely with legal representatives in making decisions. If the director has provided full disclosure to counsel, requested counsel's advice as to the legality of the proposed action, received advice that the action would be lawful and proceeded in reliance on the advice, this may demonstrate that the director acted with due care.
10. Implement a "whistle blower" policy that is communicated to staff and volunteers, and that lets people know that they can contact a specific board member or representative to advise of any situation of which they feel the board should be aware.
11. Implement a director's indemnification policy that clearly states the rights and obligations of directors and what protection is provided to them by the organization.

Claims Handling

1. Document all information related to incidents and report the incident to your insurer. Provide them with:
 - details of the incident; and
 - information about steps that had been taken to avoid the incident.
2. There are very strict reporting requirements under Directors and Officers insurance policies. Contact your insurance representative immediately upon becoming aware of a situation that could potentially give rise to a claim.
3. Investigate and consider how future incidents may be prevented.

Key Point
Directors' and officers' claims or potential claims must be reported to your insurance representative promptly.

Directors' and Officers' Liability



Additional Resources

Government of Canada, Industry Canada, Strategis
Primer for directors of not-for-profit corporations (Rights, Duties and Practices)
<http://strategis.ic.gc.ca/epic/internet/incilp-pdci.nsf/en/cl00689e.html>

Canada Business Corporations Act
<http://laws.justice.gc.ca/en/C-44/>

Canada Labour Code
<http://laws.justice.gc.ca/en/L-2/>

Criminal Code
<http://laws.justice.gc.ca/en/C-46/>

Human Resources and Skills Development Canada
<http://www.hrsdc.gc.ca/en/home.shtml>

Priest, Margot. (1995). *Directors' duties in Canada: Managing risk*. North York, Ont.: CCH Canadian.