



Directors and Officers Insurance

For Probud Clubs in Canada

Although Directors' and Officers' liability insurance (D&O) often is associated with large for-profit companies, they are not the only ones that need it. Many people hold the common misperception that directors (including trustees) and officers of a nonprofit organization do not have a meaningful exposure to personal liability. The reality of today's tenuous legal environment is quite the opposite. Nonprofit directors and officers may have an even more demanding job than their for-profit counterparts, because the affairs of the organization may be less familiar to the individual and may be conducted under less efficient conditions than in business corporations.

The applicable legal standards of conduct for nonprofit directors and officers are at least as high, and perhaps higher, than the standards applicable to their for-profit counterparts. A variety of corporate constituents are potential claimants against nonprofit directors and officers.

Damages recoverable from directors and officers of even a relatively small nonprofit organization can easily exceed the net worth of many individuals. There are two types of nonprofit organizations, each with differing forms of D&O exposure. The public benefit nonprofit organization exists to serve the community at large and a segment of the community defined by criteria such as need, religious affiliation or academic interest. Examples include churches, museums, libraries, hospitals, schools, civic groups and community involvement organizations.

A mutual benefit nonprofit organization is formed to serve its members. Examples include trade associations, cooperatives, social organizations, athletic clubs and credit unions. Other variables, which may affect the degree of D&O exposure, include whether the organization is operated as a corporation, trust or association, whether it is exempt from federal income tax as either a private foundation or public charity, and the number, wealth and degree of interest of the organization's constituents

A surprising number of persons unknowingly face nonprofit D&O liability exposure. It is estimated that approximately 20 percent of all corporations are nonprofit, thus indicating an extremely large number of nonprofit directors and officers. A significant percentage of these individuals are not business persons with experience as a director or officer, nor do they have knowledge of their legally recognized responsibilities and duties.

Even those with such experience and knowledge frequently abandon their business approach to decision-making when they enter the nonprofit setting. An appropriate risk management program to

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address this potential exposure is necessary, not only for the protection of these potential defendants, but also for the benefit of the organization in enhancing its ability to attract the best leadership. Regardless of organizational structure, directors and officers of all nonprofit organizations share certain common responsibilities which, if not properly discharged, may give rise to personal liability.

Function of nonprofit directors

The primary role of nonprofit directors and officers is to maintain financial stability and provide the necessary resources and environment to accomplish the goals and purposes of the organization. The unique nature of nonprofit organizations presents directors and officers with difficult challenges in performing this role.

Many for-profit corporations are subject to external forces, which tend to monitor corporate performance and dictate standards of behaviour. Reporting requirements and oversight by regulatory agencies also serve to identify and guide for-profit corporate performance and behaviour. These external forces are largely absent for nonprofit organizations. Accordingly, nonprofit directors and officers must implement their own internal information system and performance criteria in order to timely and effectively evaluate the progress of the organization and the abilities of its management. Because nonprofit directors and officers are frequently subjected to less external scrutiny than their for-profit counterparts, a greater tendency may exist to become complacent, reactive and perhaps careless in the fulfillment of their fiduciary role.

The potential for inadvertent misconduct is further heightened by the director's and officer's commitment to the nonprofit agency. For many, service as a nonprofit director or officer is a part time activity with little or no compensation.

In addition, the resources of many nonprofit organizations are insufficient to provide directors and officers with the most desirable support. As a result, decision-making may be hindered by incomplete information, insufficient time and inability to carefully investigate and document relevant factors.

The legal climate

Often there is a tendency among nonprofit directors and officers to rely too heavily upon the immunities and limitations provided by various Provincial laws, although they have exposures in spite of such statutory protections. Eventually, their defenses may prevail, but in the meantime they may run up large legal bills, which they or their organizations must pay if they do not have D&O insurance.

Furthermore, directors and officers can not be completely confident of prevailing in court either because case law does not favour directors and officers or because new laws have yet to be tested.

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In today's litigious society, nonprofit organizations and their board members commonly face lawsuits for an extended list of alleged wrongdoings: Discrimination (age, race, sex, employment, membership), Harassment, Wrongful termination of employees, Inefficient administration or supervision, Waste of assets, Misleading reports or other misrepresentations, Libel and slander, Failure to deliver services, Acts beyond the granted authority.

In addition to lawsuits and potential adverse judgments, the cost to defend an organization and its executives, employees and volunteers in the event of a lawsuit can be devastating. According to the most recent Wyatt Nonprofit Organizational Directors' and Officers' Liability Survey, the average cost to defend a lawsuit runs between \$35,000 and \$100,000.

D&O liability insurance has become a much more common item on the nonprofit agenda for the simple reason that more nonprofits are getting sued. Lawsuits are brought in response to actions and decisions made by nonprofit management, including but not exclusively the Board of Directors or Trustees.

Common areas of dispute revolve around hiring and firing decisions, employee supervision, the application of nonprofit assets and interpretation of nonprofit charters. In short, almost any day-to-day decision or action by anyone in a nonprofit organization can trigger a lawsuit that could not only hurt the organization financially, but also threaten the personal assets of those nonprofit trustees and executives.

A common misconception is that general liability insurance and umbrellas take care of D&O liability lawsuits. Typically, a nonprofit organization's general liability policy provides coverage for loss arising from bodily injury, property damage and such forms of personal injury as libel and slander. Losses arising out of suits alleging such things as discrimination or wrongful termination are often excluded by these policies. Such allegations, particularly those involving wrongful termination and other employment issues, are common in suits against nonprofit directors and officers.

D&O liability insurance indemnifies directors and officers of nonprofit organizations for damages and defense costs arising from lawsuits alleging various "wrongful acts." The policy also reimburses nonprofit corporations for any indemnification that their bylaws or Provincial laws require them to provide to the directors and officers. Many people are reluctant to serve as directors or officers of nonprofit organizations if the organization does not provide this much-needed insurance, since they otherwise could be forced to pay damages out of their personal assets.

Once thought of as expensive coverage that was often trimmed from the budget of many nonprofits, D&O liability coverage today has evolved into a very broad, much-needed coverage form for any nonprofit organization. Premiums are relatively low for the broad protections provided by this policy.

Key features of D&O liability policies may include:

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- **Broad definition of insured:** D&O liability policies cover all directors, officers, employees, including staff, volunteers and committee members. Coverage limits that are typical for nonprofit organizations range depending on the organization's asset size. Deductibles for both entity reimbursement coverage and for individual directors and officers typically are small, ranging from \$0 to \$2,500. There is generally no deductible applicable to individual directors and officers.
- **Full entity coverage:** Most policies now include coverage for claims made against the organization itself, even if no directors or officers are named in the claim.
- **Employment practices coverage:** Directors' and Officers' Liability policies help protect all insured persons of the organization against damages from claims for wrongful termination, sexual harassment, discrimination and unfair hiring/firing practices.
- **Duty to defend:** Current policies are committed to fair resolution of claims. Defense Expenses outside the limits of liability: Most policies now provide for unlimited defense expenses incurred, and these expenses will not diminish the overall limit of liability under the policy.
- **Prior acts coverage:** Policies now have no "retro dates" that would limit coverage for prior wrongful acts.
- **Zero deductibles available:** Almost all nonprofit D&O liability policies provide for no deductible for claims to directors and officers.

It should be noted that these policies are not standard in form, and, consequently, coverage does vary from one carrier to the next. The market for D&O liability coverage for non-profits is quite competitive, allowing agencies of all sizes to obtain broad coverage at reasonable premiums. With easy access to affordable D&O liability coverage, no nonprofit organization should put their board-and agency-at risk by ignoring this critical insurance product.

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