Not-for-Profit Indemnification and Directors and Officers Liability policies are complex technical documents that are not well understood and too often only considered when problems arise. Legislation concerning corporate governance and disclosure and a dramatic increase in litigation, is causing more boards to ask questions about the scope of protection afforded under the corporate indemnity and insurance polices which are designed to protect them.

The insurance industry has developed a language of insurance jargon and acronyms to deal with the intricacies of the coverage and codify the various policy extensions and endorsements. This has often left management and boards with a faint understanding, at best, of the complexities of the insurance policy and the scope of the protection it provides. This issue is further complicated by the fact that there is no standard D&O policy wording.

This paper puts into layman's terms the language of insurance in a way that will assist Directors and Officers of Not-for-Profit boards to understand the coverage nuances. The board and management should understand the protection with which they are provided and what options are available to them before a problem occurs. By then it might be too late to ensure adequate protection is in place.

Directors Liability

Directors are faced with a wide range of legal exposures arising from their duties to the corporation. They are required to act with competence and skill and in the best interests of the corporation. This is a fiduciary duty because the obligation to act in the best interests of the corporation is an obligation of loyalty and good faith. Director’s fiduciary duties can be divided into two main areas, the duty of care and the duty of loyalty.

- **Duty of Care:** Directors must execute their obligations with competence and at all times act with an appropriate degree of skill and care.
- **Duty of Loyalty:** Duty to act honestly and in good faith and in the best interest of the corporation.

D&Os deserve to be protected. Being on the receiving end of a lawsuit can put a director’s or officer’s reputation and finances on the line and also threaten your organization’s ability to continue serving the community. Without D&O insurance protection in place it can be extremely difficult to attract and retain the leading talent to the board.

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1. We recommend reading: 20 Questions Directors of Not-for-Profit Organizations Should Ask About Fiduciary Duty by Jane Burke-Robertson
3 Levels of Protection Available to D&Os

Step 1 - Risk Management
Every D&O should be aware of his responsibility to the corporation, the role he fulfills on the board, or in his management capacity and the expertise he is expected to bring to the position. The first line of defense for the D&Os is to execute their responsibility to the corporation with the required level of care and skill and using sound judgment. Diligence in attending board meetings, reviewing board materials, understanding and questioning management and matters put before the board, will greatly reduce the risks of litigation and enhance the Directors' defense in responding to any claims. Axis Insurance, upon request, can provide general material relating to Risk Management guidance for D&Os of Not-for-Profit entities. However, Directors are urged to consult their own legal counsel for specific advice concerning their own corporate duties, responsibilities and exposures.

Step 2 - Corporate Indemnification By Laws and Contractual Indemnity
Most corporate by-laws state that the company will advance defense costs and settle claims made against D&Os acting in that capacity. It is recommended that Directors also have this indemnification specified in their contracts. This prevents any by-law changes from affecting Directors' rights to indemnification. A Delaware court has even ruled that a corporation can change by-laws after a D&O has left the corporation and the new by-laws will apply to that D&O, rather than those that were in place at the time he/she served as a D&O. This makes the contractual indemnification that much more important.

Step 3 - Insurance
The Directors' and Officers’ Liability policy for Not-for-Profit entities protects the non-profit entity against a wide array of claims. In addition to the coverage provided to the insured organization the policy also protects the Directors, Officers, Trustees, Committee Members, Employees and Volunteers. Coverage enhancements offer protection against emerging risks but no two policies are the same the scope of coverage needs to be carefully analyzed.

Insurers - Who provides insurance coverage?
A large number of insurance companies offer D&O insurance for Canadian Not-for-Profit organizations. Most of these insurers underwrite the coverage as a specialty class of business employing highly trained underwriting and claims personnel. Other companies offer the Insurance as part of a package or suite of polices where the coverage tends to be more standardized and limited in its scope.

Most participants in the Canadian Not-for-Profit D&O market are insurance companies of considerable financial strength and sound reputations for service, knowledge and claims settling ability. Clients should look for companies rated by S&P or A.M. Best with a minimum rating of ‘A-’ or higher.
The Not-for-Profit D&O Policy

**What is the coverage ‘trigger’ - is it a ‘claims made’ policy?**
The “trigger” refers to the event that will give rise to a claim under the policy, hence, trigger the coverage. The D&O policy is almost universally a “claims made” policy.
This means the trigger that will give rise to a claim is the date a claim is made against the insured. The date when the wrongful act occurred (such as a misstatement in a prospectus) that is the underlying cause of the allegation will not determine coverage under the policy; the claim must be made against the Insured during the policy period and not after the policy has been allowed to lapse.

**What is the limit of liability?**
The limit of liability under the D&O policy is an aggregate limit, meaning it is the most the underwriters will pay for all claims combined during the policy year. Some policies include defense costs and expenses within the limit while broader policies provide unlimited defense costs coverage in addition to the policy limit. The limit of liability usually applies in addition to the retention which is the amount of each claim assumed by the insured.

The limit on the policy is a shared limit and the policy covers multiple insureds, including all the Directors, Officers, Trustees, Committee Members, Employees and Volunteers and the Insured Organization.

**What is the retention? - When does it apply?**
Retention is the term for a deductible on the D&O policy. This retention applies to the insured Organization but not to the individual Directors. Some policies specify that the retention does not apply to defense costs and some will even contribute equally to damages along with the insured until the retention has been paid.

D&O policies typically contain a retention that the corporation needs to pay in the event that they reimburse a Director for a claim. To ensure that companies do not try and avoid paying the retention by not reimbursing the D&O, many policies contain “presumptive indemnification” language. This forces the corporation to reimburse the insured, or at least pay the deductible, unless the corporation is prevented by law from indemnifying the insured.

**Do I control my own defense and appoint legal counsel?**
Typically Not-for-Profit D&O policies follow a “Duty to Defend” format. A duty to defend policy means that the insurer conducts the defense on your behalf; appointing lawyers and paying legal costs as they are incurred. The duty to defend option has a cash flow advantage as legal costs are paid directly by the insurance company. In addition some duty to defend policies do not apply the retention to defense costs enhancing the cash flow advantage.

Less common for the Not-for-Profit organizations is a reimbursement format. With a reimbursement policy you would appoint legal counsel (after consulting the insurer) and conduct your own defense, paying legal costs as they fall due. The insurer reimburses costs when you provide documentation to support them. Directors who are comfortable having more control in dealing with lawyers and conducting and overseeing the defense of the claim, and to whom the cash flow advantage of the duty to defend policy is not essential, often prefer the greater level of involvement allowed by the reimbursement policy, especially where serious allegations and personal reputations may be in question.
Why is the application important? Who should sign the application?
The application forms part of the policy. In addition to providing basic information about your organization which underwriters rely on to assess the risk, the application contains “warranty statements”, declarations you make relating to any circumstances that could give rise to a claim as well as any prior litigation or notice of claims that occurred. Misstatements in the application have resulted in insurers rescinding coverage ab initio. It is therefore exceptionally important that the questions on the application are carefully considered and that the application is signed by the chairman of the board or the CEO.

Do we have a responsibility to provide information after the coverage is bound?
Certain events can be impacted by clauses in the policy where a denial of coverage could result if information is not provided to and accepted by insurers. Key areas where any changes should be reported to your insurance broker immediately to avoid loss of coverage or denial of claims:

- A formal claim is made against D&Os or the corporation
- You become aware of circumstances that could result in a claim
- You are changing the Not-for-Profit status or your organization
- Creation or acquisition of new subsidiary organizations

Reading the Policy

The policy is difficult to read - how does it work?
The typical policy is divided into 6 sections:

1. Declarations - This section specifies what is unique to each insured. It includes the name and address of the insured, coverage period, limits and deductibles purchased and the premium.

2. Insuring Agreements - This clearly spells out the coverage grant in broad terms. The broad scope is then limited and shaped by the exclusions, definitions and conditions as well as certain endorsements that are added to the policy.

3. Definitions - Many terms are defined in the policy, usually in such a way to put a narrow interpretation to the term and often operate to exclude certain aspects of coverage.

4. Exclusions - They typically fall into two categories: Coverage that is provided by other policies, such as the General Liability policy; and situations that are beyond the scope of insurance such as conduct exclusions relating to criminal acts and fraud.

5. Conditions - How the policy is managed and the rights and responsibilities of both the insurer and the insured are specified in this section of the policy. This section would explain the procedure for reporting a claim and what happens in the event of a merger or sale of the corporation amongst other things.

6. Endorsements - The endorsements of the policy can make changes to any of the sections noted above. This is the insurer’s avenue for making changes to their base or standard wording.
FAQ

Who is the Insurance Company?

Q - Does the insurer have a satisfactory financial standing and credit rating?

The knowledge, experience, integrity and financial capacity of the insurer are of paramount importance. It is easy for an insurance company to write business when everything is going well for the client. However, the insurer will be needed most when things are going wrong, you may be experiencing difficulties with your funding or you are involved in litigation or potential litigation. In these challenging times you will appreciate the comfort of dealing with a knowledgeable and competent insurer should a claim occur. Issues can arise with renewal of coverage and acceptance of notice of claim. While not always avoidable, it is wise to deal with insurers that have sound underwriting and claims personnel with experience in writing insurance policies for the Not-for-Profit sector.

How are Defense Costs Covered?

Duty to Defend or Reimbursement

Q - Does the policy offer clear guidance on how defense costs may be advanced and reimbursed?

Most policies impose a duty to defend on the insurer. Where the insured has the duty to defend the policy will spell out clear guidelines as to how the insured must conduct the defense. In most cases the insured is required to allow the insurer to associate in the defense of a claim and approve the selection of counsel. The policy should also clearly state how the insured will be reimbursed for defense costs as well as settlement amounts.

Limit of Liability

Q – Are defense costs paid in addition to the policy limit
Q – is there a separate limit for defense costs

Allocation

Q - Is there a per-determined allocation provision in the policy?
Q - Does it apply to defense cost only or settlements as well?
Q - Is the percentage a minimum or a set amount?
Q - Where a pre-determined percentage does not apply is allocation based on best efforts or relative legal exposure?
Hammer Clause
Q - Is there a “Hammer Clause” in the policy?
Q. – If the policy contains a Hammer Clause what is the percentage?

This clause states that if a settlement offer is declined by the insured and the final damages are higher than that settlement opportunity, then that difference is not covered, or only a portion is covered. Allegations can be highly personal and a D&O may want to prove their innocence without the threat of coverage being withdrawn. Some policies limit the hammer clause to a set percentage, which means the insured participation in any increase settlement amount is limited to that percentage.

Retention (Deductible)
Q - Does the policy retention apply to all claims including defense costs?

What are the Exclusions in the Policy?
Conduct Exclusions
Q - Does final adjudication apply to all conduct exclusions?

These exclusions deal with fraud and disgorgement of profits or remuneration or financial advantage to which the insured is not legally entitled. An important aspect to these exclusions is when the coverage for defense of allegations stops. Some policies refer to a “finding in fact”, language that is considered to be limiting and may cut short the continuation of defense costs for an innocent director who may subsequently be exonerated. The broader approach is “final adjudication” language where coverage continues until there is final settlement in the courts which means defense costs will continue through the entire settlement process.

Prior Notice
Q - Has notice been given under a prior policy?

The policy will exclude prior notice of any facts or circumstances given as notice of a claim or potential claim under any other policy. The scope of this exclusion may apply to new allegations that arise from the same or similar facts or circumstances or which in any way may be related to those facts or circumstances reported under another policy.

Prior or Pending Litigation
Q - Are you aware of any litigation or circumstances that could arise out of the same or essentially the same facts?
Q - If you have changed from one insurer to another, was the prior and pending litigation date from the original policy used?

The policy excludes claims that were commenced or pending prior to the “prior and pending litigation” date specified on the policy declarations.
**Insured v/s Insured**

Q - Is there an exception for Trustees in Bankruptcy, whistle blowers and derivative actions?

The policy excludes claims brought by any insured against another insured. A number of special exceptions may apply to this exclusion.

**Pollution**

Q - Does my policy provide the broadest pollution coverage available?

Pollution or Environmental Impairment liability coverage can be purchased as a separate policy. Many insurers will now include a level limited coverage which is written back into the policy as an exception to the pollution exclusion. Each policy should be carefully reviewed carefully as the scope of coverage can vary significantly between policies.

**Bodily Injury and Property Damage**

Almost all D&O policies contain broad BI/PD exclusions since it is the intention of the D&O policy to provide coverage for financial loss. BI/PD exposures are better addressed via the General Liability policy.

**What Policy Terms have Specific Definitions?**

**Definition of Claim**

Q - Does the definition of claim include oral demands?
Q - Is there coverage for non-monetary and injunctive relief?
Q - Does the definition cover criminal allegations?
Q - Are extradition proceedings explicitly covered?

There can be considerable difference in the scope of this important definition between various policies, as many insurers have substantially broadened the definition.

**Definition of Loss**

Q - Does the definition of loss specifically exclude taxes?
Q - Are punitive damages excluded?
Q - Is the coverage broad offering ‘most favourable jurisdiction’ language or is coverage limited to Canadian suits only?

**Insured**

Q - Does the definition include:

- Past, present and future Directors and Officers
- Trustees
- Committee Members
- Employees?
- Volunteers

Some policies include employees only with respect to an employment practices liability (EPL) claim; if named as a codefendant with another insured person. Some policies also clearly state that in-house legal counsel and risk managers are added as covered persons.
Insured
Q - Does the definition include spouses, domestic partners or heirs in the event they are named as parties to a suit solely due to their relationship to an insured person?

There are subtle differences between definitions that can have a significant coverage impact.

Subsidiary Coverage
Q - Do you control subsidiary companies that are not covered by the policy?
Q - Do your Directors sit on boards or provide management consulting services for companies that you have a minority interest in?
Q - Do you have foreign subsidiaries that require locally admitted and licensed insurance?
Q - Do you own or control any LLCs, ULCs or LPs as they may not fall within the definition of Subsidiary under the policy?

Most policies automatically cover all subsidiaries if more than 50% of the outstanding voting shares are controlled by the insured organization.

Policy Conditions
Change in Control
Q - Are you aware of the policy terms regarding a change in control?
In the event of a change in control, usually the acquisition of more than 50% of the outstanding voting shares of the company, the policy will go into automatic run-off. That is, from the date of the change in control the policy will continue to expiry but only with respect to wrongful acts that occurred prior to the change in control. Options are available for the board to purchase a multi-year run off policy, typically for a six year term, the cost of which will vary depending on the risk.

Discovery
Q - What is the automatic extended reporting period in the policy?
Q - Does the policy offer a one year bi-lateral extended reporting period (ERP), not requiring the consent of the insurer?
Q - What is the cost for the ERP as a percentage of the annual premium?

If the policy is not renewed or is allowed to lapse an automatic period of time (usually 30 days) is allowed for the insured to report claims or notice of circumstances that could give rise to a claim. Most policies give the insured an option to purchase an extended reporting for one year. This allows the insured to maintain coverage for wrongful acts that took place prior to the expiry of the policy. As the insurer may fail to offer competitive renewal terms or even refuse to renew the policy this can be an important clause allowing the insured valuable time to prepare proper notice of claim or to be covered for events that subsequently come to light after the expiration date.

Cancellation
Most policies are non cancellable by the insurer, except with respect to non-payment of premium.
Coverage Territory
Most policies provide coverage worldwide and suits are covered whether they are brought in North America or overseas. It is important to note that the policy will not comply with admitted (local licensing requirements) insurance regulations of many foreign countries. If required, admitted coverage can be arranged in many foreign jurisdictions.

Severability
Broad policies will contain severability clauses applicable to the application and the exclusions. A misstatement by one insured will not be imputed to another insured.

Priority of Payments
Q - Does the policy include a priority of payment provision?
This wording places individual D&Os ahead of the corporation when claim payments are due to both parties and the policy limits are in danger of being exhausted. This clause is designed to protect individual D&Os in the event that the corporation is using up the policy limits.

Recession
Q - Is there a non-rescindable endorsement applicable to the coverage for Directors?
Misstatements by the chairman or CEO can lead to coverage being rescinded.

To find out more about our products and service for the Not-for-Profit Organizations or to discuss your existing insurance policies, please give one of Axis insurance Not-for-Profit professionals and experienced team members a call at 604.731.5328 or email: info@axisinsurance.ca.