



DIRECTORS AND OFFICERS LIABILITY INSURANCE

PURPOSE

To explain the cover provided by D&O insurance.

Directors and Officers liability insurance (D&O insurance) covers directors and officers for claims which may be made against them alleging acts, errors, omissions, neglect or breach of their duties in their conduct or the decisions and actions taken by them on behalf of an organisation. NFPs tend to think that no one will sue them because it's unlikely any one will suffer financial loss, therefore insurance is not needed. What such a view overlooks however is that directors and officers can be the subject of claims as well as investigations, examinations and/or prosecutions by government, regulatory or statutory authorities for which cover for legal costs can be available under D&O insurance. D&O insurance options should be investigated as they are not necessarily expensive and can provide peace of mind for individuals who assume the role of directors and officers. Some potential directors may not agree to join a board unless the protection of D&O insurance is in place. Directors can also take out their own insurance to cover them across the range of board positions they undertake.

As with other types of insurance the services and advice of an insurance broker, or an independent review and assessment of insurance cover by lawyers experienced in this field, can be beneficial in achieving time and financial savings as well as ensuring the appropriate form and scope of cover is in place. There are clear distinctions between the scope of cover, cost and the calibre of the insurance companies offering D&O insurance cover in the insurance market so alternative quotations should be sought.

THERE ARE TWO BROAD FORMS OF COVER PROVIDED UNDER D&O INSURANCE

- > D&O (Directors and Officers) insurance, which provides cover for any awards of damage, compensation or settlements made against a director in the event a claim is made against them for which they or the organisation are liable; and
- > Defence costs insurance, which provides for payment of legal costs incurred in defending a claim made against the director or in attending or making submissions to an investigation, examinations and/or prosecutions by government, regulatory or statutory authorities. Legal costs are incurred immediately and can be high even if there is no finding against the director.

Other insurance-related issues which should be considered include:

- > An indemnity clause can give a false sense of security. Sometimes the constitution will provide an arbitrary indemnity, such as to the value of the organisation's assets. The benefit of D&O insurance is therefore a source of financial funding beyond the financial capacity of the organisation. Indemnities provided by a government tend not to specify if there is a limit on insurance or whether there are exclusion clauses and can often be discretionary as to whether any indemnity is in fact advanced to the director in the event of a claim
- > Some indemnities provide that if a director is found not to have been negligent, the organisation will consider whether it will repay some of the expenses incurred. Access to D&O insurance can remove this limitation as cover is provided for the defence costs incurred by the individual director or the organisation when there is an obligation on the organisation to indemnify the director. Additionally, the obligation to repay any costs incurred by the insurance company in defending a claim are typically only repaid if there is an admission by the director or finding by the courts of dishonesty

- > The necessity for a director to be indemnified by the organisation can arise in the constitution, under any agreement between the organisation and the director or under statute (e.g., Corporations Act). The source of the entitlement to indemnity does not impact on a director's access to cover under a D&O insurance policy as cover is typically available under the policy in the event that an organisation has no obligation to indemnify a director for any claims made against them that arise
- > D&O insurance is issued on a 'claims made' basis. This means that if a director becomes aware of a claim and/or facts which may give rise to a claim, a notification must be made under D&O insurance because the timing of the knowledge of a claim or potential claim and notification under the insurance policy during the same the period of insurance is critical. For example, if an organisation effects D&O insurance for a period from 30 June 2014 to 30 June 2015 and a director becomes aware of a potential claim against them on 1 June 2015 following receipt of correspondence making allegations against them in regard to their conduct as a director, it must be notified under the D&O insurance prior to expiry of the policy on 30 June 2015. If the notification is not made during the period of insurance, and legal proceedings are commenced on 1 September 2015 which relate to the 1 June 2015 correspondence, the D&O insurer may be entitled to deny cover for the claim because of the failure to notify during the policy period. It is therefore important that directors are mindful of the notification and all other obligations applicable under the D&O insurance to ensure they do not limit or disentitle themselves to cover under the policy in the event of a claim
- > As with all insurance policies, the D&O insurance policy contains exclusions which operate to deny cover under the policy. Many of the exclusions may deny cover which is more appropriately covered under other classes of insurance or relate to conduct, e.g., reckless or dishonest conduct. A director should therefore closely scrutinise the terms of any D&O insurance policy effected on their behalf
- > There are circumstances, typically prescribed by law, that deny a director access to D&O insurance, e.g., certain statutory breaches or criminal acts
- > Some D&O insurance policies are issued on the basis that cover is also provided for the organisation or association, e.g., Management or Association Liability policies. What is important to know under these policies is that there is typically no segregation between the cover available to the directors and that available for the organisation/association. Therefore, there can be 'competition' between directors and the organisation for the finite monetary limit of cover available under the policy. It is therefore recommended that an assessment of the adequacy of the limit of liability be undertaken
- > Where the D&O insurance policy provides cover for the costs of attending or making submissions to an investigation, examination and/or defending a prosecution by a government, regulatory or statutory authority, there may be an overlap in cover to that provided under any Statutory Liability insurance held by the organisation which should be reviewed together with the D&O insurance so the distinctions and triggers to cover under each policy are understood.

SOURCE

- > Prepared with the assistance of [McCullough Robertson Lawyers](http://www.mccullough.com.au) (www.mccullough.com.au)

REFERENCES

- > Australian Institute of Company Directors [What is directors and officers insurance?](#)
- > Fishel, D, The Book of the Board, Federation Press, Sydney, NSW (2003; 3rd edn. 2014)

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