



Risk Management Considerations for Directors' and Officers' Liability

A private boarding school tailored to students with learning disabilities and behavioural issues closed their doors in November of 2013. Parents of the students were notified of the immediate school closure by an email which provided less than 24 hours' notice that they were to have their children removed from the premises. The principle and CEO of the school informed parents that the sudden and immediate closure was due to low enrollment. Parents were left wondering why controls were not in place to prevent this from happening and whether they would receive a refund on the annual tuition that had already been paid.

According to Ontario Auditor General Bonnie Lysyk, "private schools are not required to demonstrate that they will be financially viable operations." And while private schools do undergo inspections from the Ministry of Education, these inspections focus on curriculum and teaching compliance rather than financial solvency.

The directors of an organization can be held personally liable for matters including mismanagement of funds, financial losses and breach of fiduciary duty. A Directors' and Officers' (D&O) liability insurance policy offers protection to directors against claims which may arise from the decisions and actions they take within the scope of their regular duties.

It's important to note that a D&O policy is not designed to protect an individual from their fraudulent or intentional

non-compliant acts. However, innocent directors remain covered in the event they are named as a co-defendant as a result of their colleagues fraudulent or intentional acts. Consider the D&O claim example below:

- A group of parents sued the organization which had been providing housing for their disabled children, alleging breach of fiduciary duty.
- Investigations showed that the children were receiving substandard care due to lack of funding and that some of the directors and officers had been embezzling from the organization as well as mismanaging funds.
- Court of appeal awarded the plaintiffs a judgement in excess of \$3,000,000.
- The innocent directors were able to enjoy the protection of the D&O policy, rather than being held personally responsible for both legal costs and the judgement award.

These scenarios also serve to illustrate why a thorough review of an organization's financial statements and accounting practices is such a critical component to the underwriting of D&O coverage. An underwriter needs to be sure that the organization has sufficient cash available to fund its operations and manage any outstanding debt throughout the policy term. Organizations which are in poor financial condition can face the risk of insolvency and present a higher likelihood that claims will be brought against the organization and its directors and officers.

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