Trustees' Liability And Indemnity Insurance

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December 2000

Question
Our charity is a company limited by guarantee. Some of our directors say that they are trustees and are concerned about their liability. I have tried to reassure them by stating that their liability is limited to £1. They continue to be concerned and are keen to obtain information about trustees' indemnity insurance. Can you help?

Answer
Your question raises a number of interesting points.

Who is a trustee?

The survey carried out for the 'On Trust' report revealed that the majority of trustees did not know that they are trustees. The term trustee is defined in Section 97 of the Charities Act 1993. It includes all 'persons having the general control and management of the administration of a charity'. Therefore, directors of charitable companies are trustees as are members of the executive committee, council and such if they fall within the definition.

Companies Limited by Guarantee

I am afraid that you have a sense of false security, the £1 maximum liability you refer to is in the context of the liability of the guarantors in the event of the charity being wound up. It has little to do with the liability of the directors as trustees of the charity. Nevertheless, incorporation does give a measure of protection, albeit limited.

With incorporated charities creditors contract with the charitable company and will first seek to reclaim from it. On the other hand an unincorporated association is not a legal entity and consequently contracts with third parties are entered into by the trustees themselves. Nevertheless, it is also possible for an unincorporated charity to include in its constitution a clause entitling trustees to be indemnified against losses out of the charity's assets as long as there has been no negligence or fraud.

Statutory Protection

In certain circumstances Section 61 of the Trustee Act 1925 absolves trustees of charitable trusts from making good any loss so long as they have asked honestly and reasonably. There is also similar relief offered to Directors of charitable companies under Section 727 of the Companies Act 1985. There is much case law on what is considered reasonable and when in doubt advice should be sought.

Section 23 of the Trustee Act 1925 also gives protection from liability for the default of an agent. However, trustees are specifically required to exercise proper supervision.

In addition, trustees can seek advice from the Charity Commissioners under Section 29 of the Charities Act 1993 and statutory protection is given for breaches of trust so long as trustees act in good faith in accordance with the advice.

This relief does not apply where an action is brought by third parties and is only relevant where the action is brought by the charity.

Indemnity Insurance

In addition to the existing liabilities under law the Charities Act 1992 has increased the duties and responsibilities of trustees and the Charity Commissioners recognise the strength of the argument that people may be deterred from trusteeship by the fear that, through misjudgement rather than malicious intent, their personal assets might be at risk.

The Commissioners reviewed the question of indemnity insurance and explained that insurance is a contract of indemnity: if there is no loss, there is no payment and consequently rights arise between the parties to the contract. There are two parties who might need to be indemnified, the Charity itself and the trustees.

The matter you raised relates solely to the issue of trustees' insurance. Accordingly, I am restricting my comments to the provision of insurance for trustees to indemnify them for any liability for their acts and defaults.

The concern that trustees can be held personally liable for the financial consequence of their actions has resulted in much debate as to whether they can properly insure themselves at the charity's expense against such liability. The Commissioners now accept that there is no objection in principle to a charity insuring against loss of its funds resulting from the acts and defaults of its trustees.

There are two broad categories of action by trustees that could give rise to liability.

- those which the trustees knew to be wrong, whether criminal or not; *and*
- those which the trustees did not know to be wrong.

Trustees cannot obtain cover to protect against their own criminal acts as that would be contrary to public policy. Furthermore, insurance being a contract of the utmost good faith, it seems highly probable that the same would be true for actions which the trustee knew to be wrong, though not criminal.

However, the Commissioners did state they would not object if, in appropriate cases, a charity paid for insurance, either directly or by reimbursing the trustees for the premiums. A typical policy would cover losses incurred by trustees in the course of their duties as a result of the following:

- breach of duty
- breach of trust
- breach of warranty of authority or other act done or wrongly attempted
- negligence
- error or omission

- misleading statements

In their leaflet CC49 on Charities and Insurance, the Charity Commission have stated that the policy must include an exclusion clause along the following lines:

> *'The Insurers shall not be liable for loss arising from any act or omission which the trustee knew to be a breach of trust or breach of duty or which was committed by the trustee in reckless disregard of whether it was a breach of trust or breach of duty or not.'*

As a result of the case of Armitage v Nurse (1997 ZAER 705) which considered matters of exclusion clauses it was thought that the Charity Commission's view on "reckless disregard" might be changed but this appears not to be the case.

Essentially, the policy would cover trustees from personal liability for acts either properly undertaken in the administration of a charity or undertaken in breach of trust but under an honest mistake. Of course trustees would need to satisfy themselves that the degree of exposure to liability, and the cost of effecting insurance, justified the expenditure.

Specifically, such policies do not cover cases of third party claims against an unincorporated charity where the assets of the charity are insufficient to meet contractual obligations thus leaving the trustees as liable to do so. (see Guidance Note "Incorporation Pros and Cons). In addition, cover can not include failure to meet statutory responsibilities.

There is of course the fundamental tenet of charity law that trustees can not benefit from their trust. This was to some extent mirrored in company law which precluded a company from paying indemnity insurance premiums on behalf of their officers. This has however, been altered by virtue of section 310(3)(a) of the Companies Act 1985 as inserted by Section 137(1) of the Companies Act 1989. Companies are no longer statutorily precluded from purchasing and maintaining insurance for any officer of the company against any liability in respect of any negligence, default, breach of trust or breach of duty of which they may be guilty in relation to the company. Nevertheless, the Commissioners' views are that the withdrawal of this statutory restriction does not of itself authorise a charitable company to provide indemnity insurance for the directors (trustees) of the company.

Constitutional Powers

Provision and maintenance of indemnity insurance for charity trustees confers a personal benefit on them and the directors of a charitable company would usually be precluded from personal benefit by the company's Memorandum of Association. An amendment would, therefore normally be required to the Memorandum of Association of a charitable company to enable it to take full advantage of section 310(3)(a) of the Companies Act 1985. It is also necessary to obtain Charity Commission consent under Section 64(2) of the Charities Act 1993.

In addition to ensuring that the Memorandum of Association allows the company to have the constitutional powers to undertake such insurance, the Articles of Association may also need to be amended. The normal procedure would be to clear any such amendments with the Commissioners. Usually they would not object to such an amendment, provided that the insurance was limited to that described above. Similarly, unincorporated charities without the necessary constitutional power can apply to the Charity Commission to amend their constitution.

Disclosures

Finally, if the trustees were to take out such a policy, Paragraph 5A of Schedule 7 to the Companies Act 1985 requires that where the company has purchased or maintained insurance for its officers this fact should be disclosed in the directors' (trustees') report. The SORP also now requires a similar disclosure in the notes to the accounts.

Conclusion

Generally, the trustees will need to show clearly that such insurance is expedient, in the interest of the charity. If the activities of the charity were so simple and uncomplicated that the possibility of loss either by deliberate wrong doing or by negligence could by dealt with by proper administrative controls the necessary power may not be given. The trustees would need to demonstrate that there were special circumstances to justify the provision of such insurance. These could include the nature of the charity's activities, the degree of risk of personal liability to which its trustees were exposed, the number of trustees, the amount of indemnity required, and the cost of the charity of effecting liability insurance for them all.

All trustees must be familiar with their powers, duties and responsibilities. They must understand the objects of the charity and be familiar with its constitution. Whilst they may delegate they cannot abdicate or circumscribe their responsibilities.

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Additional Information

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This Guidance Note is based on an article written for NGO Finance. A paper on 'Incorporation pros and cons' complements the information provided in this paper.

Please do not contact the author of this document
If you require more information please contact the Charity Finance Directors' Group