Health Law

Bulletin

A Report on Recent Developments in Corporate and Charities Law

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Charities: Some New Law

As a result of recent changes to the *Corporations Act* (Ontario) and the enactment of Regulation 04/01 made under the *Charities Accounting Act* (Ontario) on February 3, 2001 (the "**Regulation**"), charities operating in Ontario now have the corporate power to:

- indemnify directors and officers for personal liability arising from their acts or omissions in the performance of their duties;
- purchase directors and officers liability insurance ("**D&O insurance**"); and
- co-mingle multiple trust funds into a single account or investment portfolio.

Indemnification of Directors and Officers

Directors *and* officers of charities may now be indemnified out of the funds of the corporation for personal liability arising from their acts or omissions in the performance of their duties. This indemnification must be with the consent of the corporation, which can only be given by a members' resolution.

There are, however, two limitations on this new corporate power:

1. A charity may not indemnify a director or officer for liability arising from his or her own wilful neglect or default, nor for liability that relates to his or her failure to act honestly and in good faith in the performance of his or her duties.
2. A charity may not provide this indemnification unless:
   (a) it complies with the Regulation; or
   (b) it, or its director or officer, obtains a court order authorizing the indemnification.

Compliance with the second limitation is required because the indemnification of directors and officers out of the assets of a charity is a form of remuneration, and directors and officers of charities (as trustees) are precluded from directly or indirectly receiving remuneration or profiting from their office.

Purchase of D&O Insurance

The *Corporations Act* now also provides that a charity may purchase D&O insurance provided that the charity either:

(a) complies with the Regulation when purchasing D&O insurance; or

(b) obtains a court order authorizing the purchase of D&O insurance.

Compliance with the Regulation

Compliance with the Regulation involves observing certain restrictions and considering certain matters set out in the Regulation.

Restrictions

Under the Regulation, boards of directors of charities must observe the following restrictions before giving an indemnity or purchasing D&O insurance:

- the terms of the indemnity or insurance policy must not impair a person's right to bring legal action against the director or officer;
- the purchase of D&O insurance must not unduly impair the carrying out of the religious, educational, charitable or public purpose for which the charity holds property;
- no indemnity may be paid or insurance purchased if doing so would result in the amount of the debts and liabilities exceeding the value of the charitable property or render the corporation insolvent; and
- the indemnity may only be paid or the D&O insurance purchased from the charitable property to which the personal liability relates and not from any other charitable property.

The last restriction means that income from segregated funds, such as endowment funds, that do not normally attract potential liability for a director or officer should not be used to purchase D&O insurance or to make a payment pursuant to an indemnity.

Matters to Consider

Further, boards of directors of charities must consider the following matters before giving an indemnity or purchasing D&O insurance:

- the degree of risk to which the director or officer is or may be exposed;
- whether the risk can be eliminated or significantly reduced by other means;
- whether the amount or cost of the insurance is reasonable in relation to the risk;
- whether the cost of the insurance is reasonable in relation to the revenue available to the charity; and
- whether the indemnity or purchase of insurance advances the administration and management of the charitable property.

These are risk management issues that require an analysis by the board of directors of the functions and objects of the charity, as well as detailed and current information on the charity's finances.

Co-Mingling Trust Funds

Under the Regulation, a charity may now co-mingle trust funds received for a restricted or special purpose with other trust funds received for another restricted or special purpose in a single account or investment portfolio.

We note that the Regulation does not specifically allow charities to co-mingle their trust funds with their general funds.

The many restrictions and obligations imposed by the Regulation might make the option of co-mingling trust funds impractical. In this regard, a charity that intends to co-mingle trust funds held for restricted or special purposes:

- may only do so if it advances the administration and management of each of the individual funds;
- must allocate all gains, losses, income and expenses rateably, on a fair and reasonable basis, to the individual funds in accordance with generally accepted accounting principles; and
- must maintain detailed records relating to each individual fund, including:
  - the value of the individual fund immediately before it becomes part of the combined fund, and the date on which it becomes part of the combined fund;
  - the value of any portion of the individual fund that does not become part of the combined fund;
  - the source and the value of the contributed fund relating to an individual fund, and the date on which the contributed fund is received;

    "Contributed fund" means, in respect of an individual property, additional property that is added to, and forms part of, a pre-existing individual property.
  - the value of the contributed fund immediately before it becomes part of the combined fund, and the date on which it becomes part of the combined fund;

- the amount of the revenue received by the combined fund that is allocated to the individual fund, and the date of each allocation;
- the amount of the expenses paid from the combined fund that are allocated to the individual fund, and the date of each allocation; and
- the value of all distributions from the combined fund made for the purposes of the individual fund, and the purpose and date of each distribution.

In addition, the charity must maintain detailed records relating to the combined fund, including:

- the value of each individual fund that becomes part of the combined fund, and the date on which it becomes part of the combined fund;
- the value of the contributed fund that becomes part of the combined fund, the date on which it becomes part of the combined fund, and the details of the individual fund to which the contributed fund relates;
- the amount of the revenue received by the combined fund, the amount allocated to each individual fund, and the date of each allocation;
- the amount of the expenses paid from the combined fund, the amount allocated to each individual fund, and the date of each allocation; and
- the value of all distributions from the combined fund made for the purposes of an individual fund, and the purpose and date of each distribution.

We note that co-mingling trust funds in contravention of the Regulation may expose the board of directors to liability.

In light of these obligations, a charity may decide that it is simpler to maintain each restricted or special purpose fund in a separate account for investment purposes notwithstanding the likely lower rate of return for the overall portfolio investment of the charity.

What Should You Do

Given these changes in the law, the board of directors of every charity should:

- seek advice to ensure that the charity complies with the terms of the Regulation before proceeding with the provision of an indemnification or the purchase of D&O insurance;
- adopt an appropriate indemnification by-law that contemplates the restrictions contained in the Regulation;
- pass resolutions authorizing the purchase of D&O insurance, which contemplate the restrictions contained in the Regulation;
- if you passed an indemnification by-law and/or purchased D&O insurance before the enactment of the Regulation on February 3, 2001, ensure that the existing indemnification and/or insurance complies with the terms of the Regulation. This step should be taken because the Regulation is not stated to be retroactive;
- weigh the benefits to be gained from co-mingling your trust funds against the possibly significant administrative costs and efforts of keeping the required detailed records.

We would be pleased to advise you further on these matters, including assisting you in preparing the necessary resolutions and by-laws under the new Regulation.

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