

D&O DEDUCTIBLES REQUIRED IN GERMANY

Corporate directors in Germany may have to reach into their own pockets after passage of a law setting a Directors & Officers (D&O) deductible requirement for corporate board members. The new law sets a minimum deductible level of 10% of a loss, and a maximum of 1.5 times the fixed annual remuneration of the board member. These must be paid by the board members of German companies. Board members are expected to consider buying personal insurance to cover the deductible exposure.

The new law, the Appropriateness of Management Board Remuneration Act, *VorstAG*, updated the German Stock Corporation Act, *AktG*, effective August 5, 2009. The law affects *Aktiengesellschaft (AG)*, which are companies that issue stock, whether traded publicly or privately, i.e., listed or unlisted public companies.

The new provision raises many questions the act does not directly answer. While the details are worked out, affected German companies are advised to investigate the implications of the act as soon as possible.

WHEN DOES THE NEW PROVISION GO INTO EFFECT?

The provision applies immediately to D&O policies incepting on or after August 5, 2009, the effective date of the new law. The following transitional provisions apply:

- D&O insurance policies bound *before* the act went into effect are to be adjusted by June 30, 2010.



- If a contractual provision agreed before the enactment between a board member and the corporation substantiates entitlement to D&O insurance by that member without any deductible, that agreement shall continue to apply.

WHO IS AFFECTED?

The law focuses directly on board members of German public companies. Although the act does not directly apply to German supervisory board (*Aufsichtsrat*) members, questions have arisen about how the law might eventually be applied. The German Corporate Governance Commission has recommended a corresponding deductible for supervisory board members – at least of listed joint stock corporations.

VorstAG does not directly apply to the German equivalent of limited liability companies or closed corporations, known by the abbreviation GmbH. Some observers have

argued that from the standpoint of corporate governance the provisions of the act (especially the introduction of a deductible) may be applicable to GmbHs and perhaps foundations.

Another point of uncertainty is whether the new act applies to corporate subsidiaries or only the board members of the parent corporation that holds the D&O policy. The act does appear to apply to all board members of German joint stock corporations, regardless of whether the corporation is the policyholder or a co-insured subsidiary corporation. The same applies to board members of German joint stock corporations who are co-insured under a D&O policy of their foreign group parent.

WHAT IS THE NATURE OF THE DEDUCTIBLE?

- The 10% minimum applies to each individual loss. The upper limit, 1.5 times the board member's salary, applies to all losses in a given year.
- The rule about losses in a given year implies that losses are counted in the year of the breach of duty. However, D&O insurance in Germany is issued on a claims-made basis, meaning that the insured event is triggered by the claim and not the breach itself. The new deductible could therefore apply retroactively to breaches of duty committed before the new rule took effect.
- Given the wording of §93 of the German Stock Corporation Act, the deductible is likely to apply only to the so-called internal liabilities involving the corporation; however, this has also been questioned.
- The deductible applies only to the loss, not to the legal costs incurred in defending unjustified claims, but again, this point still needs clarification.

CAN THE DEDUCTIBLE BE INSURED?

The act addresses joint stock corporations as policyholders and not board members directly. Board members are the ones at risk, however, and can be expected to seek protection. There is no express prohibition against individual board members covering the deductible by taking out personal insurance. These individuals would pay the necessary premiums.

Individual insurance solutions for board members must be finely tuned so that the corporate D&O policy and the board member's personal D&O policy would work in a coordinated fashion.

CHECKLIST FOR YOUR CORPORATION

Here are some points to consider in responding to the changes.

- Does the new provision apply to your corporation's board members?
 - Do existing D&O contracts come under the transitional provision (meaning revisions can be made up to June 30, 2010)?
 - Does the corporation have a contractual commitment to taking out D&O insurance for board members without a deductible?

- What is the current arrangement for the deductible in your D&O policy?
- Going forward, how should your deductibles be established? Is a percentage deductible preferred or a fixed deductible meeting the law's requirements?
- Does proper corporate governance call for including a deductible provision for your supervisory board members?

For clients with D&O policies negotiated in Germany, local insurers will work with your insurance adviser to work out an immediate solution. Carriers issuing D&O policies outside of Germany are still considering how to apply the new act, but events are moving swiftly.

CONTACTS

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