

D&O Insurance

How D&O insurance discourages the management

D&O insurance cases are often long and unedifying for the managers concerned. Executives therefore secure their decisions more and more to avoid uncomfortable situations. Unfortunately, this also hinders innovations.

On the basis of the information available, executives have to make the right decisions. The company's shareholders know that "to err is human". The D&O insurance is making various contributions to avoid such mistakes. It offers protection for the manager and the company against the financial consequences of negligent mistakes which lead to a loss for the company (the so-called internal recourse as the usual case in Germany). At least, that is how it should be.

In international comparison, the strict liability provisions for managers in Germany do not make it easy for decision makers to take risks. An added factor is the dynamic of particular situations which requires fast decisions. Nowadays, the D&O insurance is needed if damage occurs due to a mistake. That is not always easy.

The management believes in the all-round carefree package. The company is convinced that the damage will be compensated by the insurance. The insurer starts to examine the claim. Different effects occur:

The insured event requires that a claim is being made. Companies which were up to now satisfied with their management do not want to lose or burden their managers even if they have made a mistake. For this, the legislator allows the managers to assign their claim for indemnification against the insurer to the company. Insurers are never happy about this because they assume that collaboration between the management and the company could be a disadvantage for them.

If it comes to a settlement of the case, the insurer re-examines the case on the basis of the requested information from the company. He defends the manager (in case of assignment himself) against the claim of the company. The information simultaneously serves to discuss the possible subsequent insurance coverage. A settlement in a mutual agreement with the company and the management only occurs in exceptional cases. This leads to the effect that a D&O claim settlement extends over several years and the manager is constantly worried.

The conflict arises between the fully comprehensive insurance mentality of the management or of the company and the intent to prevent of the abuse of the D&O insurance. The pressure on the manager rises. Should he still be working with the company it is probable that internal conflicts are taking place because his misconduct is discussed in detail. In case he has already left the company, he faces insurmountable obstacles when searching for a new job. Employers are never happy about pending liability claims and see a risk in the possible new manager which is to be avoided.

Defense costs increase in the escalation stage of the conflict which, in turn, reduce the sum insured. The more board members a company claims against, the more drastically the defense costs increase. The individual executive faces the increasing risk of his personal ruin.

Nowadays, more and more managers are familiar with the process of an insurance case, either because they experienced it themselves or know a colleague who experienced it. One effect is that managers secure their decisions by third parties and not any more by their original management skills. They rely on consultants. Nowadays, lawyers, accountants and auditors are instructed to secure management decisions through reviews to give a disclaimer of liability. Consultants themselves are obliged by strict statutory liability provisions to inform about all possible risks. In the end of such process, the managers usually make the most riskless decisions.

Management decision then might be faultless. But innovation inevitable suffers. The scopes of decision-making become smaller.

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