

The Changing German Landscape *by Thierry Daucourt*

For companies with operations in Germany, it is important to understand that corporate governance is now in the public spotlight and the risk outlook for directors and officers (D&O) is changing for the worse.

In response to growing public pressure spurred by the worldwide economic crisis, the German government is considering new measures aimed at strengthening corporate governance and holding senior managers of public companies accountable for their wrongdoing. The country is also expected to grow increasingly litigious as efforts to strengthen shareholder rights gain momentum.

U.S. companies have a significant stake in what is happening in Germany. Known for its stable government, educated workforce and outstanding infrastructure, Germany is the world's third-largest economy and the fifth-largest trading partner for the United States. The unraveling of Germany's economy has shaken the country at its roots, however, causing widespread anger and calls for change. Hit by a decline in exports, the country's gross domestic product fell 2.1% in the fourth quarter of 2008—its largest contraction since reunification in 1990—and the International Monetary Fund has predicted a 2.5% decline in GDP in 2009.

Trade unions and globalization critics have been staging demonstrations in Germany to protest government bailouts, which are viewed as putting a heavy burden on taxpayers. The bailouts are fueling taxpayer resentment over what is perceived as a lack of accountability by executives who were richly compensated and yet led their companies to ruin. Political parties and interest groups, as well the member states of the Federal Republic, are demanding various measures that would impose tougher standards on senior managers of public companies.

German Minister of Justice Brigitte Zyprie has said she believes existing laws are sufficient, but has called for a "cultural change" in the way they are applied. Her views, coupled with the groundswell of public discontent, are among the factors forcing the government to rethink its approach to corporate governance.

The German approach to corporate governance has differed from the U.S. approach. In addition to laws that protect shareholders and hold business leaders accountable—even for the slightest negligence—Germany has established the "Corporate Governance Codex," a set of standards all public companies are expected to uphold. While Codex compliance is widespread, it is not absolute. For example, many companies do not include a deductible in their D&O insurance policies (a Codex recommendation). There is a growing belief, however, that Germany's Codex approach may be too passive and further changes are needed.

The risk of litigation in Germany has been relatively low compared with the United States, yet over the past several years high-profile cases have gained attention. These cases include Siemens, which failed to prevent or detect bribery; Volkswagen, which failed to prevent or detect embezzlement and bribery; and Deutsche Bank, in which an alleged statement by the CEO damaged the creditworthiness of a client.

Recent government action points toward tougher rules concerning the liability of managers of private limited corporations in insolvency. Additional measures to influence executive behavior and empower the government with more authority to intervene in struggling companies are likely. Proposals are still in the early stages and few details are available. But companies should expect tougher measures to be enacted in the matter of months, not years.

In this fluid and volatile environment, it is crucial that U.S. companies with large operations in Germany pay close attention and ensure their compliance with changing regulations in order to uphold high corporate governance standards. Companies also need to obtain D&O liability insurance coverage that is underwritten locally since a U.S. policy that provides insurance for international exposures may not provide the scope of insurance needed in light of the rapidly changing environment in Germany.

With such dynamic change in mind, companies should work with an insurer that has a global network, is on the ground locally and has expertise in the local market. With the deterioration of the German and global economies, D&O liability risks in Germany are on the rise. Companies with operations in Germany need to prepare for a possible increase in litigation, as well as the imposition of new rules and standards as the country responds to growing social unrest. ■

