Germany: Corporate Governance

This country-specific Q&A provides an overview to corporate governance laws and regulations that may occur in Germany.

For a full list of jurisdictional Q&As visit here
1. What is the typical organizational structure of a company and does the structure typically differ if the company is public or private?

Companies may be organized as capital companies, like the limited liability company (Gesellschaft mit beschränkter Haftung), the stock corporation (Aktiengesellschaft, AG), the European stock corporation (Societas Europaea, SE) and the partnership limited by shares (Kommanditgesellschaft auf Aktien) or as partnerships. Only AGs, SEs and KGaAs may be listed on an EU/EEA regulated market. We will focus on the AG, the SE and the GmbH in the answers below as they are most common. As the SE in its most prevalent form is treated like an AG, we will only address it separately in case of differences.

2. Who are the key corporate actors (e.g., the governing body, management, shareholders and other key constituencies) and what are their primary roles? How are responsibilities divided between the governing body and management?

The corporate governance structure follows a two-tier system, in which the management board (Vorstand) manages the company and is supervised by the supervisory board (Aufsichtsrat). The shareholders of an AG or SE have limited influence on the management of the company and exercise their rights by voting in the general meeting. SEs may alternatively feature a one-tier corporate governance system with an administrative board (Verwaltungsrat) and managing directors (Geschäftsführende Direktoren). However, such monistic SEs are rare in Germany and will not be the focus of this contribution. A GmbH is managed by managing directors (Geschäftsführer) and only has a supervisory board in case of co-determination (Mitbestimmung). In a GmbH, shareholders have more rights, in particular the right to instruct the managing directors via shareholders’ resolution (apart from the ordinary or extra-ordinary shareholders’ meetings).

3. What are the sources of corporate governance requirements?

Primary sources for corporate governance requirements are the German Limited Liability Companies Act (Gesetz betreffend die Gesellschaften mit beschränkter Haftung, GmbHG), the German Stock Corporation Act (Aktiengesetz), the European and German acts on SEs (particularly the European SEVO and the German SEAG), the German Commercial Code (Handelsgesetzbuch) and, for certain aspects, the Reorganisation of Companies Act (Umwandlungsgesetz), the German Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz) as well as the Securities Trade Act (Wertpapierhandelsgesetz). The articles of association of the company and the rules of procedure for the management may impose further requirements.

The German Corporate Governance Code (Deutscher Corporate Governance Kodex, DCGK) is an additional, non-binding source of corporate governance rules for listed companies. The DCGK was heavily revised and is due for publication later this year.
4. **What is the purpose of a company?**

The purpose of the company may be any legally permitted activity, including non-profit purposes.

5. **Is the typical governing body a single board or comprised of more than one board?**

The typical governance system in Germany is the two-tier system with a management and a supervising body (see above 2.). It applies to an AGs, to most SEs and to GmbHs in case of co-determination. The SE, however, is the only legal form allowing for a one-tier system in Germany.

6. **How are members of the governing body appointed and removed from service?**

The supervisory board and, in case of a one-tier SE, the administrative board is responsible for appointing and dismissing the members of the management. The members of the supervisory and administrative board are appointed by the general meeting. Dismissal requires a resolution of the general meeting with a majority of in principle at least 75% of the votes cast.

However, depending on the size of the company, a certain number of members of the supervisory board must be elected by the employees of the company, *i.e.* co-determination (*Mitbestimmung*). In an AG or GmbH with generally more than 500 German employees, one-third of the supervisory board members must be employee representatives, *i.e.* the one third participation (*Drittelbeteiligung*), and with more than 2,000 German employees, the supervisory board must consist of 50% employee representatives, *i.e.* the parity co-determination (*paritätische Mitbestimmung*).

German co-determination rules do not apply to the SE. When incorporating an SE by one way of the 'numerus clausus' of incorporation, an agreement on the participation of the employees has to be negotiated with a so-called special negotiating body representing the employees. Thereby, the level of co-determination of the German company legally required prior to the implementation of the SE shall be maintained (*freeze of co-determination*).

Managing directors in a GmbH are appointed and dismissed by the shareholders’ meeting with simple majority in general.

7. **Who typically serves on the governing body and are there requirements that govern board composition or impose qualifications for directors regarding independence, diversity, tenure or succession?**

Members of the management board must fulfill basic statutory requirements regarding personal reliability, *e.g.* no criminal record. There is no minimum number of members of the management board, unless the articles of association provide otherwise. The maximum term
of office is five years (six years in a SE); a reappointment is permitted. It may not be renewed or extended until one year before the end of the term. In a listed or co-determined company, the supervisory board must determine and annually report on a target percentage for women on the management board as well as deadlines by when such percentage is to be reached.

The DCKG makes several recommendations regarding diversity of the management board and the tenure of its members.

The supervisory board has to consist of at least three members and up to 21 members, depending on the registered share capital of the corporation. In case of co-determination the number must be devisable by three. If parity co-determination is applicable, the minimum number of supervisory board members is 12 and beyond this dependents on the total number of German employees.

Supervisory boards of listed companies must have one member with finance, reporting or auditing expertise.

Regarding the representation of women, the same rules apply as with respect to the determination for the management board in listed companies. In companies that are parity co-determined and listed, the supervisory board shall be composed of at least 30% women and at least 30% men.

The DCGK makes several recommendations regarding the composition of the supervisory board as well as the qualification and independence of its members.

Similar rules apply to managing directors of a GmbH as regarding the members of the management board of non-listed AGs or SEs. The GmbHG does not limit the tenure of managing directors but limited terms of office are common practice.

8. **What are the common approaches to the leadership of the governing body?**

Applicable law does not predefine the leadership structure of the management board in an AG or among the managing directors in a GmbH. Commonly, a chairman or spokesperson is appointed. The tasks and duties of the management board are usually allocated to several functional or operational departments for which individual members of the management board are responsible. Decisions within each department are made by the responsible member of the management board, unless in case of material decision requiring a resolution of the entire board. Similar structures may be implemented among managing directors of a GmbH, however, designation of a spokesperson is less common.

The supervisory board must elect a chairman and his deputy. The supervisory board conducts its business and makes its decisions by way of resolution. The supervisory board may form committees from within itself – e.g., an audit committee and a nomination committee as
recommended by the DCGK. Committees are generally responsible for preparing supervisory board topics and consummating resolutions passed by the supervisory board.

9. **What is the typical committee structure of the governing body?**

Committees of the management board or of the managing directors of a GmbH are less common. Committees of the supervisory board have to have three members in the minimum, depending on the size of the company and of the supervisory board itself.

10. **How are members of the governing body compensated?**

The remuneration of the members of the management board is agreed upon in the service contract between the respective member and the company, represented by the supervisory board. For listed companies, the supervisory board has to develop a remuneration policy. It will typically provide for a mix of fixed remuneration and variable remuneration, the latter divided between short-term and long-term incentives with emphasis on share-based remuneration. The remuneration policy must be clear and understandable, set a maximum remuneration and include detailed information on different aspects of the remuneration. The general meeting must vote on the policy at least every four years. While non-binding, a shareholder vote rejecting the policy triggers an obligation to amend the policy and to present it again at next year’s general meeting. Further, a yearly remuneration report must be prepared and voted upon by the general meeting. Both documents must be published on the company’s website.

Members of the supervisory board receive a cash remuneration either specified in the articles of association or granted by the general meeting and taking into consideration the status as chair or deputy chair of the supervisory board. In listed companies, it must be included in the remuneration report. The DCGK suggests a fix cash remuneration.

The remuneration of managing directors of a GmbH is not subject to regulation. Nevertheless, the respective service contract between the managing director and the company (represented by the shareholders’ meeting) will commonly provide a mix of fixed and variable remuneration.

11. **Are fiduciary duties owed by members of the governing body and to whom are they owed?**

Members of the management owe a fiduciary duty to the company and must manage its affairs with the due care of a prudent and diligent businessman, particularly in accordance with the applicable laws and the articles of association. In case of entrepreneurial decisions, the aforementioned standard is met if the respective member could reasonably assume to have gained sufficient information before making the decision, is not conflicted and considers that it is acting in the company’s best interests (business judgement rule). The same applies *mutatis mutandis* to the members of the supervisory board.
While members of both boards and managing directors must act in the company’s best interests, this includes the interests of its stakeholders (e.g. creditors and employees).

12. **Do members of the governing body have potential personal liability? If so, what are the key means for protecting against such potential liability?**

The members of the management and supervisory board are personally liable for a culpable breach of duty. The members of the respective board are jointly and severally liable *vis-à-vis* the company. Thus, individual members may not alleviate themselves from liability because a certain responsibility was delegated to a different member internally. Furthermore, liability is not affected if the members of the respective board have been discharged by the general meeting. Therefore, D&O insurance for the members of both boards is common practice in order to protect them against personal liability. Premiums are generally paid by the company, however, members of the management board must bear a statutory deductible.

In case of a GmbH, the consequences of a breach of the duties of managing directors are, to great extent, comparable to an AG. However, if the shareholders’ meeting has discharged the managing director knowing the facts underlying such breach, such discharge leads to an exclusion of liability.

13. **How are managers typically compensated?**

See above 10.

14. **How are members of management typically overseen and evaluated?**

The members of the management board are overseen by the supervisory board (see above 2), primarily by way of approval rights of the supervisory board. They are evaluated by the supervisory board based on the performance indicators and targets set and agreed upon in the variable remuneration components and/or the remuneration policy. The shareholders’ meeting of a GmbH oversees the managing directors, in particular through approval rights and its right to issue instructions.

15. **Do members of management typically serve on the governing body?**

Except in a one-tier SE, no, as the supervisory board may not be involved in the management of the company beyond its supervisory role. However, former members of management may be elected as members of the supervisory board; in listed companies only after a two-year cooling-off period unless the respective person was elected upon nomination by 25% of the voting rights.

16. **What are the required corporate disclosures, and how are they communicated?**

Basic information on all capital companies is available to the public through the commercial
register (e.g. members of the management board, share capital).

All capital companies must prepare and, if applicable, publish their audited annual reports. The same applies to group financial statements. Listed companies must also prepare and publish half-yearly financial statements and management reports. Group financial statements of listed companies must be prepared in accordance with IFRS.

Listed companies must publish all notifications on voting rights and on future voting rights based on derivatives they receive from their shareholders, exceeding or falling below the thresholds of 3%, 5%, 10%, 15%, 20%, 25%, 30%, 50% or 75%. They must also publish the total number of voting rights in case of any changes.

Listed companies must announce any insider information without undue delay by way of a so-called ad hoc announcement.

In AGs and SEs, another important channel of information are the invitations to the general meeting, especially the annual general meeting.

Lastly, the company must state whether or not the recommendations of the DCGK were followed in the respective financial year and must explain any non-compliance in the report on corporate governance in the management report (‘comply or explain’).

17. **How do the governing body and the equity holders of the company communicate or otherwise engage with one another?**

Apart from the communication in the course of the company’s disclosures (see above 16.), communication primarily takes place in the course of the (annual) general meeting.

In addition, the management board may engage in communications with its investors but in doing so must tread all shareholders equally and may not disclose business secrets or insider information. For this reason, the management board will abstain from providing investors with any information that has not already been disclosed or that is not intended for disclosure to all other shareholders. The DCGK suggests that, where appropriate, the chairman of the supervisory board engages in investor relation communication on topics related to the supervisory board.

In contrast, shareholders of a GmbH may at any time demand information on company matters and access to the company records from the managing directors.

18. **Are dual or multi-class capital structures permitted and how common are they?**

Such capital structures are permitted, but the exception. If present, the most common
structure is a combination of ordinary shares and non-voting preference shares.

19. **What percentage of public equity is held by institutional investors versus retail investors?**

   A study by HIS Markit and the German Investor Relations Association of DAX companies found that institutional investors held approx. 60% of the equity in 2018.

20. **What matters are subject to approval by the shareholders and what are the typical quorum requirements and approval standards? How do shareholders approve matters (e.g., voted at a meeting, written consent)?**

    Shareholders approve matters through votes in the general meeting. Only selected decisions are reserved for the general meeting by law. Regarding the annual ordinary general meeting, such decisions include the appropriation of profits, the appointment of the auditor and the formal discharge of the members of both board. Extra-ordinary decisions include the election and removal of the supervisory board members, amendments to the articles of association and resolutions on restructuring measures as well as on corporate agreements (profit and loss pooling agreements). The general meeting usually decides with a simple majority of the votes cast, with certain items requiring approval by 75% of the votes cast. The articles of association may in some cases require greater majorities.

    The shareholders’ meeting of a GmbH is its supreme body with a broader catalogue of decisions reserved to it by law: all decisions that the ordinary general meeting of an AG has to take plus the review and determination of the financial statements and all fundamental, extraordinary decisions of the general meeting of an AG, as well as the right to instruct the managing directors.

21. **Are shareholder proposals permitted and what requirements must be met for shareholders to make a proposal?**

    Shareholders of an AG or SE whose combined share in the share capital is 5% or higher or corresponds to a nominal stake of EUR 500,000 may demand that certain additional items are put on the agenda.

    Regarding a GmbH, the respective threshold is a combined share in the share capital of 10% or higher.

22. **May shareholders call special meetings or act by written consent?**

    Shareholders whose combined share in the share capital is 5% or higher may demand the convening of a general meeting.
Regarding a GmbH, the respective threshold is a combined share in the share capital of 10% or higher to demand the convening of a shareholders’ meeting.

Decisions by way of written consent are only permissible by shareholders of a GmbH.

23. **Is shareholder activism common and what are the recent trends?**

Shareholder activism was limited through changes to the legal framework in the first decade of the century but continues to play a role in Germany. Activist shareholders are increasingly including smaller and lesser known companies in their activities. Especially small- and mid-cap companies are not yet well prepared for such interactions.

Activist shareholders today usually acquire minority stakes and will then approach the management with certain demands. If such demands are not met, they will escalate the situation, *e.g.* by launching public campaigns. They may also exercise their shareholder rights to increase pressure on the management, *e.g.* through questions in the shareholder meeting, requesting special audits in the general meeting to unearth violations of the law or placing a member on the supervisory board.

24. **What is the role of shareholders in electing the governing body?**

Shareholders elect the members of the supervisory board by simple majority of the votes cast with exception of the employee representatives, if any (see above 6.). In GmbHs, the shareholders’ meeting appoints and dismisses the managing directors.

25. **Are shareholder meetings required to be held annually or otherwise, and what information needs to be presented?**

An annual general meeting is mandatory in an AG within the first eight months of a financial year (first six months in a SE). The annual meeting has to resolve upon the ordinary topics (see above 20.) and upon extraordinary topics as they occur. The management board may convene extraordinary general meetings in urgent cases.

Apart from a customary management presentation, a report by the supervisory board and information presented in response to questions by shareholders, the Aktiengesetz requires additional information being given in certain circumstances. For example, the management board has to provide a report in case of a capital increase with the exclusion of the subscription rights of existing shareholders.

There is no legally required annual shareholders’ meeting in a GmbH.

26. **Do any organizations provide voting recommendations or otherwise advise or**
counsel shareholders on whether to approve matters?

Proxy advisors as well as shareholders’ associations for German retail investors provide voting recommendations and other advice (e.g. Institutional Shareholder Services and Glass Lewis). Implementing the Shareholder Rights Directive II the Aktiengesetz introduced several disclosure requirements for proxy advisors, e.g. an annual report with respect to the code of conduct followed by the proxy advisor in making its decision, if any.

27. What role do other stakeholders, including debt holders, employees, suppliers, customers, the government and communities, typically play in the corporate governance of a company?

Employees play a considerable role through their representation on the supervisory board in case of co-determination (see above 6.). Besides, employees can exert influence through ‘works councils’, which may be elected by the employees in companies with more than five employees or ‘economic committees’ generally established in companies with more than 100 employees. The influence of both institutions is referred to as operational co-determination giving employees various information and consultation rights mostly regarding working conditions and social issues.

Debt holders, suppliers and customers generally do not play a direct role in the corporate governance of a company. However, contractual obligations, like approval rights and financial as well as operational covenants, as well as de facto influence may have similar effects. Some companies may be subject to similar constraints vis-à-vis their customers.

28. What consideration is given to ESG (environmental, social and governance) issues, including climate change, sustainability and product safety issues, and are there any legal disclosure obligations regarding the same?

Implementing EU Directive 2014/95/EU, Germany introduced numerous reporting requirements for listed companies to improve transparency and the sustainability commitment of companies. Cornerstone is the requirement to include a declaration on non-financial aspects in the management report. It includes information on the company’s concepts regarding environmental, employee-related and social issues, human rights as well as actions against corruption and bribery and their implementation.

29. How are the interests of shareholders and other stakeholders factored into decisions of the governing body?

The German ‘stakeholder model’ requires that members of both, management and supervisory board as well as managing directors, consider the interests of shareholders and stakeholders (see above 11.).
30. **Do public companies typically provide earnings guidance on either a quarterly or annual basis?**

Companies will provide earnings guidance in their annual financial statements. In addition, larger companies will often give respective guidance in their half-year financial statements or in the course of their quarterly reporting, if applicable. If the guidance has to be changed substantially, such change may constitute an insider information requiring an ad hoc notification.

31. **May public companies engage in share buybacks and under what circumstances?**

Share buybacks are only permissible in certain circumstances, e.g. if the shareholders authorized a share buyback. The authorization may be valid of up to five years and must determine the price range and the proportion of the share capital which may be bought back (no more than 10% of the registered share capital together with own shares already held). The company must be able to cover the consideration with equity that would be distributable to the shareholders.

32. **What do you believe will be the three most significant issues influencing corporate governance trends over the next two years?**

- Increased European regulation with respect to environmental issues and sustainability
- Practical effects of the amended Aktiengesetz (implementation of the Shareholder Rights Directive II) and of the revised DCGK
- Further European regulation with respect to capital markets law, e.g. as a result of the review of the Market Abuse Regulation