

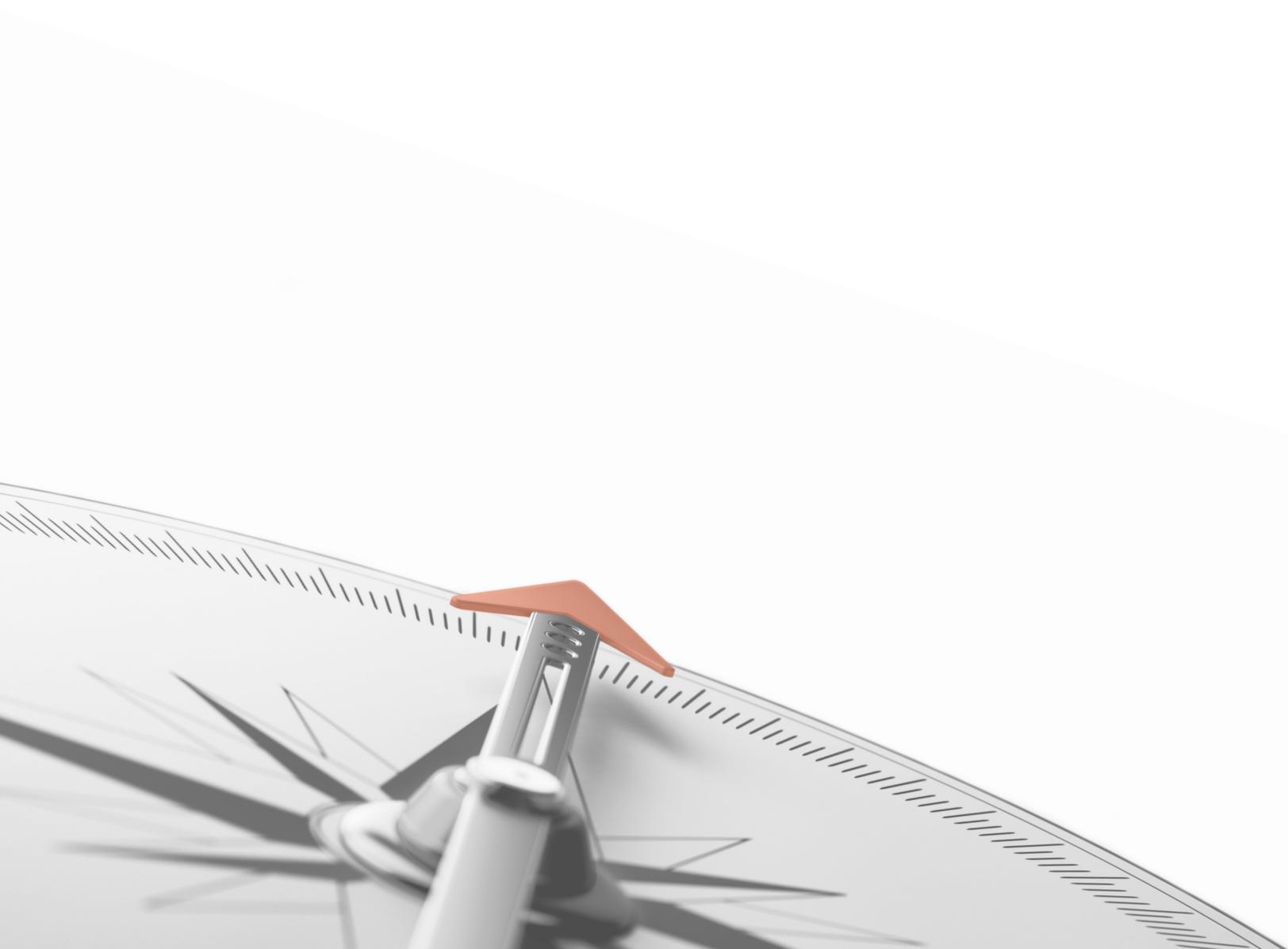
**2019**

PROXY PAPER™

# GUIDELINES

AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE

# GERMANY



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# Guidelines Introduction

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These guidelines are intended to supplement Glass Lewis' Continental Europe Policy Guidelines by highlighting the key policies that we apply specifically to companies listed in Germany and the relevant regulatory background to which German companies are subject, where they differ from Europe as a whole. The Continental Europe Policy Guidelines describe the underlying principles, definitions and global policies that Glass Lewis uses when analysing German companies in accordance with best practice standards for Germany.

Where a topic is not addressed in these guidelines, but is addressed in the Continental Europe Policy Guidelines, we consider our policy approach and the relevant regulations and recommendations to be substantially the same in Germany as in continental Europe. Wherever our policy deviates from the Continental Europe Policy Guidelines, we will clearly state this.

## CORPORATE GOVERNANCE BACKGROUND

The German Stock Corporations Act (Aktiengesetz) provides the primary legislative framework for German corporate governance. Best practices are centered on the recommendations contained in the German Corporate Governance Code ("Kodex") that operates on a comply or explain basis, whereby the management and supervisory boards of all publicly-listed companies are required to make annual statements detailing their adherence to the Kodex.

Corporate governance principles in Germany are generally less prescriptive than in many other European countries, with a strong emphasis on corporate flexibility. The Kodex contains very general provisions, which are much less specific in nature than the recommendations contained in corporate governance codes of most other European markets. The government commission responsible for the Kodex states that the aim of the country's distinct governance code is increased transparency and comprehensibility for stakeholders in order to strengthen their confidence in management and supervision of German listed companies. The Kodex, initially adopted on February 26, 2002, was most recently amended on February 7, 2017.

## BEST PRACTICE RECOMMENDATIONS; REGULATORY UPDATES

Amendments to the European Shareholder Rights Directive ("SRD II") approved in 2017 will be transposed into German law prior to the implementation deadline of June 10, 2019. As a consequence, revised versions of both the German Stock Corporations Act and the Kodex will be implemented in the coming year. A draft bill of amendments to the German Stock Corporations Act was released by the German Federal Ministry for Justice and Consumer Protection (BMJV) in October 2018. Public consultations are currently ongoing, with a government draft expected in early 2019. On November 6, 2018 the government commission responsible for the Kodex published a draft of proposed revisions, with a consultation period running until January 31, 2019. The proposed amendments foresee a substantial increase in clarity, as well as strengthened recommendations, particularly with regard to management board remuneration and supervisory board independence. An updated version of the Kodex is not expected to be published until SRD II has been transposed into national law.

Furthermore, in 2018, a working group of German corporate governance experts issued new "Guidelines for Sustainable Management Board Remuneration Systems" (*Leitlinien für eine nachhaltige Vorstandsvergütung*; the "LnVv Guidelines"), promoting the implementation of the principles contained in the SRD and anticipating many of the regulatory changes expected in 2019.

In particular, the LnVv Guidelines emphasise the focus on long-term remuneration, as well as the use of sustainability indicators alongside strategic and financial objectives, under long-term incentive plans. In addition, the LnVv Guidelines recommend the establishment of share ownership guidance for management board members, who should hold company shares amounting to at least one year of base salary by the fourth year of employment.

Furthermore, the LnVv Guidelines promote transparency through disclosure improvements and the simplification of the remuneration report and structure. In particular, readability is championed through the recommended use of charts, tables and “clear and concise” explanations. Moreover, the remuneration system should be based on no more than three components (i.e., fixed, short-term, long-term). At the same time, the remuneration report should include an explanation of the driving principles followed by the supervisory board while formulating the remuneration system, as well as an explanation of the link between pay and performance and ex-post disclosure of performance targets and achievement levels. The exercise of any upward or downward discretion and the allocation of extraordinary awards should be justified and disclosed in detail by the board.

With regard to quantum, the LnVv Guidelines call for clear disclosure of absolute caps on total and individual remuneration, which should also include possible effects of share price performance. Remuneration levels should be appropriate in relation to national and international peers and the justification for any pay increase should include the disclosure of the peer group considered by the company.

Finally, the LnVv Guidelines recommend the implementation of malus and clawback provisions and maintain the cap on severance and change in control payments currently prescribed by the Kodex, i.e., two years and three years of total pay, respectively, or the remainder of the contract in both cases.

We believe that the best practice recommendations contained in the LnVv Guidelines will lead to a number of German companies reconsidering the incentive plans for management board members. Without materially amending our guidelines at this time, Glass Lewis will continue to monitor evolving best practice in Germany and consider say-on-pay proposals in Germany in the context of new best practice recommendations.

## **SUMMARY OF CHANGES FOR THE 2019 GERMANY POLICY GUIDELINES**

Glass Lewis evaluates these guidelines on an ongoing basis and formally updates them on an annual basis. This year we’ve made noteworthy revisions in the following areas, which are summarized below but discussed in greater detail in the relevant sections of this document:

### **MANAGEMENT BOARD REMUNERATION**

We have updated our guidelines to clarify our expectation that shareholders are provided a vote on a company’s executive remuneration policy each time that material amendments are made or when the remuneration policy was rejected or received substantial opposition of free-float shareholders. Further, we have highlighted that our analysis of executive remuneration proposals focuses on the overall effect of structural and disclosure changes in the context of a company’s historical practices and will be considered in the context of new best practice recommendations and impending changes to the regulatory environment.

### **SUPERVISORY BOARD DIVERSITY**

Due to substantial market practice improvements, we are increasing our scrutiny of all-male supervisory boards. Where a company with an all-male supervisory board consisting of six directors or more has elections at a general meeting and has not nominated a female director, we may recommend voting against the reelection of the nominating committee chair unless a target to increase female representation has been set and the board provides a compelling reason for why no female candidates are being proposed at this time.

## SUPERVISORY BOARD COMPOSITION AND CANDIDATE DISCLOSURE

Due to substantial market practice improvements, we will generally consider recommending against the reelection of the nominating committee chair of DAX, MDAX, and SDAX companies with board elections where shareholders have not been provided with meaningful information on the supervisory board's skills and expertise profile (*Kompetenzprofil*) and an independence classification of incumbent supervisory board members.

## SUPERVISORY BOARD COMMITTEE COMPOSITION AND INDEPENDENCE

We have clarified that where companies clearly disclose their intentions with regard to post-AGM supervisory board committee composition, we will take this into consideration in our analysis of the supervisory board.

Further, while we generally believe that shareholders are best served when the majority of shareholder representatives on key supervisory board committees are independent, we have clarified that in cases where there are an even number of shareholder representatives on the audit and remuneration committees, we will accept 50% independence where the committee chair is an independent shareholder representative.

# A Supervisory Board that Serves the Interests of Shareholders

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## ELECTION OF SUPERVISORY BOARD MEMBERS

Under German law, companies are governed by a two-tier board system, with the supervisory board presiding over the management board. The supervisory board<sup>1</sup> consists entirely of non-executive directors, while the management board<sup>2</sup> is composed entirely of executive directors. The management board is responsible for the day-to-day operation of the business,<sup>3</sup> whereas the supervisory board is responsible for appointing and monitoring the management board.<sup>4</sup> Alternatively, German companies may elect to incorporate under European Company (Societas Europaea, or “S.E.”) law and such companies may be governed by either a single-tier or two-tier board system.<sup>5</sup>

Unless otherwise provided by these guidelines, provisions will apply to companies with a two-tiered board.<sup>6</sup>

## INDEPENDENCE

In Germany, we put supervisory board members into four categories based on an examination of the type of relationship they have with the company:

1. **Independent Supervisory Board Member** — An independent supervisory board member has no material<sup>7</sup> financial, familial<sup>8</sup> or other current relationships with the company,<sup>9</sup> its executives, or other board members, except for board service and standard fees paid for that service. An individual who has been employed by the company within the past five years<sup>10</sup> is not considered to be independent. We use a three-year look back for all other relationships.

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1 Article 105(1) of the German Stock Corporations Act (Aktengesetz, or “AktG”), a legally-binding document introduced September 6, 1965.

2 Article 76 of the German Stock Corporations Act (“AktG”).

3 Article 76(1) of the German Stock Corporations Act (“AktG”) and Article 4.1.1 of the German Corporate Governance Code (“Kodex”).

4 Article 111 of the German Stock Corporations Act (“AktG”) and Article 5.1 of the Kodex.

5 Council Regulation (EC) 2157/2001 of 8 October 2001, on the Statute for a European Company and Foreword of the Kodex.

6 Though more German companies make use of the European Company form than in any other country, the one-tier board option has not been widely utilised by German companies incorporated under European Company law.

7 “Material” as used herein means a relationship in which the value exceeds: (i) €50,000, or the equivalent (or 50% of the total compensation paid to a board member, or where no amount is disclosed) for board members who personally receive compensation for a professional or other service they have agreed to perform for the company, outside of their service as board members. This limit would also apply to cases in which a consulting firm that is owned by or appears to be owned by a board member receives fees directly; (ii) €100,000, or where no amount is disclosed, for those board members employed by a professional services firm such as a law firm, investment bank or large consulting firm where the firm is paid for services but the individual is not directly compensated. This limit would also apply to charitable contributions to schools where a board member is a professor, or charities where a board member serves on the board or is an executive, or any other commercial dealings between the company and the director or the director’s firm; (iii) 1% of either company’s consolidated gross revenue for other business relationships (e.g., where the supervisory board member is an executive officer of a company that provides services or products to or receives services or products from the company); (iv) 10% of shareholders’ equity and 5% of total assets for financing transactions; or (v) the total annual fees paid to a supervisory board member for a personal loan not granted on normal market terms, or where no information regarding the terms of a loan have been provided.

8 Per Glass Lewis’ Continental Europe Policy Guidelines, familial relationships include a person’s spouse, parents, children, siblings, grandparents, uncles, aunts, cousins, nieces, nephews, in-laws, and anyone (other than domestic employees) who shares such person’s home. A director is an affiliate if the director has a family member who is employed by the company.

9 A company includes any parent or subsidiary in a group with the company or any entity that merged with, was acquired by, or acquired the company.

10 In our view, a five-year standard is appropriate because we believe that the unwinding of conflicting relationships between former management and supervisory board members is more likely to be complete and final after five years. However, Glass Lewis generally applies an exception for supervisory board members who have previously served as executives of the company on an interim basis for less than one year. Article 100(2.4) of the German Stock Corporations Act (“AktG”) prohibits a member of the management board from serving on the supervisory board within two years of the end of the employment mandate, unless requested by a shareholder owning more than 25% of a company’s total voting rights.

2. **Affiliated Supervisory Board Member** — An affiliated supervisory board member has a material financial, familial or other relationship with the company or its executives, but is not an employee of the company. We will normally consider supervisory board members affiliated if they:
  - Have been employed by the company within the past five years;
  - Have — or have had within the past three years — a material business relationship with the company;
  - Own or control 10% or more of the company’s share capital or voting rights;<sup>11</sup>
  - Have served on the supervisory board<sup>12</sup> for more than 15 years or more than three terms, whichever is longer;<sup>13</sup> or
  - Have close family ties with any of the company’s advisers, board members or employees.
  
3. **Inside Supervisory Board Member** — An inside supervisory board member is a shareholder representative that simultaneously serves as a supervisory board member and as an employee of the company. This category may include a board chair who acts as an employee of the company or is paid as an employee of the company. In Germany, supervisory board members may not legally serve simultaneously as members of the management board, representatives of management and/or officers of the company.<sup>14</sup> As a result, insiders are very rare on German supervisory boards. However, the law allows a member of the supervisory board to serve on the management board for a transitional period, not to exceed one year, under exceptional circumstances.<sup>15</sup>
  
4. **Employee Representatives** — Due to German co-determination laws, employees are entitled to have representation on the supervisory board of all public companies with at least 500 employees<sup>16</sup> and may constitute up to half of the seats on a company’s supervisory board. Glass Lewis does not take employee representatives into account when analysing the independence of German supervisory boards given that these individuals are neither elected by, nor intended to directly represent, the company’s shareholders.

## Voting Recommendations on the Basis of Supervisory Board Independence

Glass Lewis believes a supervisory board will be most effective in protecting shareholders’ interests when at least a majority<sup>17</sup> of the shareholder-elected members are independent. Where 50% or more of the supervisory board members are either affiliated or inside members, we typically<sup>18</sup> recommend voting against some of

11 Article 5.4.1 of the Kodex recommends that companies disclose the personal and business relationships of supervisory board nominees with shareholders who directly or indirectly hold in excess of 10% of the company’s voting rights.

12 In certain cases, we will also consider supervisory board members to be affiliates when they have served fewer than 15 years or three terms on the supervisory board if they previously served on the management board and did not have a material break in service between their resignation from the management board and their election to the supervisory board.

13 EU Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board. Annex II. Article 1(h). While Glass Lewis makes every effort to obtain relevant information regarding supervisory board members’ terms of office, this information is often not provided by smallcap German companies. As such, we will only affiliate supervisory board members for this reason when the information is provided. Otherwise, we will note that the company has not provided the relevant information. Additionally, while we will classify board members as affiliates in accordance with this standard, we will evaluate voting recommendations based on this issue on a case-by-case basis. When a board or committee does not meet the independence standards set forth in these guidelines solely as a result of a nominee’s length of service on the board, we may refrain from recommending a vote against the nominee if the board or relevant committee is otherwise sufficiently independent.

14 Article 105(1) of the German Stock Corporations Act (“AktG”).

15 Article 105(2) of the German Stock Corporations Act (“AktG”).

16 Companies that regularly have between 500 and 1,999 employees are subject to the German Law on One-Third Participation (Gesetz über die Drittelbeteiligung der Arbeitnehmer im Aufsichtsrat, or “DrittelbG”), Article 4(1) of which requires one-third of the supervisory board to be composed of employee representatives. Companies regularly employing 2,000 or more individuals are subject to the German Co-Determination Act (Mitbestimmungsgesetz or “MitbestG”), which requires equal representation of employees and shareholders on the supervisory board.

17 We note that the Kodex states only that the supervisory board should have “an appropriate number of” independent members.

18 With a staggered board, if the affiliates who we believe should not be on the board are not up for election, we will express our concern regarding those board members, but we will not necessarily recommend voting against the affiliates who are up for election just to achieve the majority independence threshold.

the inside and/or affiliated members in order to satisfy the majority threshold. However, we generally accept the presence of representatives of significant shareholders in proportion to their equity or voting stake in the company.

We refrain from recommending to vote against any supervisory board members on the basis of lengthy tenure alone. However, we may recommend voting against certain long-tenured directors when lack of board refreshment may have contributed to poor financial performance, lax risk oversight, misaligned remuneration practices, lack of shareholder responsiveness, diminution of shareholder rights or other concerns. In conducting such analysis, we will consider lengthy average board tenure (e.g. more than 12 years), evidence of planned or recent board refreshment, and other concerns with the board's independence or structure.

### **Voting Recommendations on the Basis of Committee Independence**

We generally believe that the majority of shareholder-elected supervisory board members serving on a company's audit and remuneration committees should be independent of the company and its significant shareholders.<sup>19</sup> However, given that the audit and remuneration committees of companies subject to co-determination laws often consist of an even number of shareholder representatives, we will generally accept 50% independence of the audit and remuneration committees as long as the committee chair is an independent shareholder representative.

Further, we believe that at least 50% of a company's audit committee should be comprised of shareholder-elected supervisory board members.<sup>20</sup> Given the amount and importance of the work of the audit committee, shareholders' interests should be at least equally represented in proportion to employees. We will recommend voting against any audit committee chair who: (i) is also the supervisory board chair, unless a cogent reason is given;<sup>21</sup> (ii) is not independent of the company;<sup>22</sup> or (iii) is a recent former member of the company's management board.<sup>23</sup>

With respect to the composition of a company's nominating committee, the Kodex recommends that such a committee be comprised solely of shareholder-elected members.<sup>24</sup> Glass Lewis believes that a majority of these members should be independent of company management and other related parties. However, we accept the presence of representatives of significant shareholders on this committee in proportion to their equity or voting stake in the company.

## **OTHER CONSIDERATIONS FOR INDIVIDUAL BOARD MEMBERS**

Our policies with regard to performance, experience and conflict-of-interest issues are not materially different from our Continental Europe Policy Guidelines. The following are clarifications regarding best practice recommendations in Germany.

### **EXTERNAL COMMITMENTS**

We believe that supervisory board members should have the necessary time to fulfill their duties to shareholders. In our view, an overcommitted board member can pose a material risk to a company's shareholders, particularly

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<sup>19</sup> EU Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board. Annex I. Articles 3.1 and 4.1. We believe a majority of remuneration committee members should be independent of the company and shareholders owning at least 50% of the share capital or voting rights. Given the importance of the audit committee's work, we believe that a higher level of independence from major shareholders is necessary. As such, we believe a majority of audit committee members should always be independent of the company and shareholders holding more than 20% or more of the company's share capital or voting rights. While we generally believe that a majority of the members of the audit and remuneration committees should also be independent of shareholders owning 10% or more of the company's share capital or voting rights, we will take into account the company's ownership structure when evaluating the composition of these committees.

<sup>20</sup> We will recommend voting against the board chair when 75% or more of the audit committee is composed of employee representatives. When employee representatives comprise 50 to 75% of the audit committee, we will note our concern.

<sup>21</sup> Recommended by Article 5.3.2 of the Kodex.

<sup>22</sup> *Ibid.*

<sup>23</sup> While the Kodex only recommends that a two-year look-back period be applied to this situation, Glass Lewis believes that a five-year look-back period is more appropriate in order to protect the interests of all shareholders.

<sup>24</sup> Article 5.3.3 of the Kodex.

during periods of crisis. In addition, recent research indicates that the time commitment associated with being a director has been on a significant upward trend in the past decade.

As a result, a supervisory board member who serves as an executive officer or management board member of any public company while serving on more than two<sup>25</sup> public company boards and any other supervisory board member who serves on more than five public company boards typically receives an against recommendation from Glass Lewis.<sup>26</sup> As stated in our Continental Europe Policy Guidelines, we count board chairships as double given the increased time commitment and we may consider relevant factors such as the size and location of the other companies where the individual serves on the board, as well as attendance records, when making recommendations based on this issue.

## BOARD STRUCTURE AND COMPOSITION

Our policies with regard to board-level risk management, oversight and board diversity are not materially different from our Continental Europe Policy Guidelines. In deviation from our Continental Europe Policy Guidelines, we apply different standards for the election of former management board chairs to the supervisory board and board size.

## SEPARATION OF THE ROLES OF MANAGEMENT AND SUPERVISORY BOARDS

Glass Lewis believes that fully separating the roles of the management and supervisory boards creates a better governance structure. By law, members of the supervisory board cannot simultaneously serve as management board members, authorised representatives of the management board or company, or officers of the company,<sup>27</sup> except for a one-year transitional period under extraordinary circumstances.<sup>28</sup> Moreover, German law stipulates that former members of the management board may only serve as members of the supervisory board within two years after the end of their appointment if they are appointed by a motion presented by shareholders holding more than 25% of the voting rights in the company.<sup>29</sup> Lastly, in accordance with best practice standards in Germany, no more than two former members of a company's management board should serve on the supervisory board.<sup>30</sup>

Despite statements in German law and the Kodex cautioning against crossover between the management and supervisory boards, it was common practice until recently for German companies to appoint former management board members or executives to the role of supervisory board chair. Given that the purpose of the supervisory board is to provide independent oversight of the management board,<sup>31</sup> we strongly believe that an independent chair can better oversee executives and set a pro-shareholder agenda without the management conflicts that a former CEO, executive, or management board member often faces. Such oversight allows for a more proactive and effective supervisory board that is better able to protect the interests of shareholders.

We do not recommend that shareholders vote against former CEOs, executives or management board members who serve on or chair the supervisory board, unless the board is not sufficiently independent. However, we typically apply extra scrutiny to former executives who are proposed as candidates for election to the supervisory board. In line with best practice standards in Germany, we will generally recommend voting against the election of a current or recent<sup>32</sup> member of the management board to the supervisory board unless one of the following criteria are fulfilled: (i) the company states that the nominee will not serve as chair; or (ii) the company provides a compelling rationale for why the nominee's service as supervisory board chair will support shareholder value creation, and the board is otherwise sufficiently independent. We generally encourage our clients to support the appointment of an independent chair whenever that question is posed in a proxy.

25 Article 5.4.5 of the Kodex recommends a limit of three.

26 Article 100(2) of the German Stock Corporations Act ("AktG") prohibits supervisory board members from serving on more than ten supervisory boards of any incorporated companies that are legally required to have a supervisory board, although up to five additional directorships are allowable for group companies. The law further specifies that the supervisory board chair may not serve on more than five incorporated company boards. We generally consider only public company boards when making voting recommendations based on this issue.

27 Article 105(1) of the German Stock Corporations Act ("AktG").

28 Article 105(2) of the German Stock Corporations Act ("AktG"). During such a transitional period, individuals may not engage in supervisory board duties.

29 Article 100(2.4) of the German Stock Corporations Act ("AktG").

30 Article 5.4.2 of the Kodex.

31 Article 5.1.1 of the Kodex.

32 We will consider any individual serving on the management board within the past two years as "recent."

## SIZE OF THE SUPERVISORY BOARD

While we do not believe there is a universally applicable optimum board size, we do believe boards should have at least six supervisory board members (or three supervisory board members in the event of small-cap companies) to ensure sufficient diversity in decision-making and to enable the formation of key board committees with independent supervisory board members. Under German law, the maximum supervisory board size is 21 members,<sup>33</sup> which we believe to be reasonable.

## BOARD DIVERSITY

### Supervisory Board Gender Quota

Since January 1, 2016, German publicly-listed companies with 2,000 or more employees have been required to ensure that at least 30% of supervisory board seats are held by directors of each gender.<sup>34</sup> Companies subject to this legislation are not required to immediately adapt the composition of their supervisory boards; rather they are required to work toward the quota when the terms of current board members expire. Pursuant to the so-called “empty seat” provision, elections or appointments to the supervisory board that are not in compliance with this legislation will be legally invalid and the positions will remain vacant.<sup>35</sup>

In principle, this quota is intended to apply to the composition of the supervisory board as a whole. However, the shareholder representatives and the employee representatives on a company’s supervisory board are permitted to lodge an objection to this overall compliance provision in advance of an election, subsequent to a resolution adopted by the majority of either group.<sup>36</sup> Should this occur, the shareholder representatives and employee representatives will be required to each meet the quota separately. When companies subject to this legislation are proposing elections to the supervisory board, they are required to disclose in the notice of meeting the minimum number of supervisory board seats that must be filled by directors of each gender in order to comply with the legislation as well as whether an objection has been lodged to meet separate quotas for shareholder and employee representatives.<sup>37</sup>

Given the consequences of board seats initially remaining empty if companies subject to the 30% quota fail to comply with the legislation, Glass Lewis may recommend voting against the nominating committee chair if forthcoming elections appear to contravene the gender quota provisions and no compelling justification is provided.

### Board Diversity Targets

As a result of the aforementioned legislative developments, the supervisory boards of all German publicly-listed companies - regardless of size or employee headcount - are required to set target levels for the participation of women in both the supervisory board and management board.<sup>38</sup> While companies are afforded a large degree of flexibility in setting these targets, they are prohibited from setting targets for the proportion of women on each board or management level which are lower than the current composition unless women already account for at least 30% of the members of the respective board or management level.<sup>39</sup> Companies will be required to

<sup>33</sup> Article 95 of the German Stock Corporations Act (“AktG”) stipulates that supervisory boards consist of between three and 21 supervisory board members, including employee representatives. The law further specifies the maximum number of supervisory board members allowable as follows: (i) a maximum of nine supervisory board members for a company with a nominal share capital of up to €1,500,000, (ii) a maximum of 15 supervisory board members for a company with a nominal share capital of up to €10,000,000, and (iii) a maximum of 21 supervisory board members for a company with a nominal share capital of more than €10,000,000.

<sup>34</sup> Article 96(2) of the German Stock Corporations Act (“AktG”).

<sup>35</sup> *Ibid.* “Fragen und Antworten zu dem Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst.” Bundesministerium für Familie, Senioren, Frauen und Jugend. Empty seats due to non-compliance with the legislation are to be filled through a by-election or through an appointment by way of court order.

<sup>36</sup> Article 96(2) of the German Stock Corporations Act (“AktG”).

<sup>37</sup> Article 124(2) of the German Stock Corporations Act (“AktG”).

<sup>38</sup> Article 111(5) of the German Stock Corporations Act (“AktG”). Furthermore, pursuant to Article 76(4), the management boards of all German publicly-listed companies will be required to set target levels for the participation of women in the two tiers of management directly below the management board.

<sup>39</sup> Articles 76(4) and 111(5) of the German Stock Corporations Act (“AktG”). “Fragen und Antworten zu dem Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst.” Bundesministerium für Familie, Senioren, Frauen und Jugend. Companies are required to set these targets by September 30, 2015. The deadlines that are to be set for reaching these targets may not exceed five years, with the initial deadline to be no later than June 30, 2017.

report on the targets set on an annual basis as well as to disclose whether targets were met. While there will be no penalties for companies that do not meet the predefined targets, the supervisory board will be required to explain the steps that have been taken and why the targets were not reached.<sup>40</sup>

While Glass Lewis typically refrains from evaluating the appropriateness of targets for board diversity, we expect companies to provide sufficient information and a meaningful discussion relating to specific diversity targets and the company's progress against such targets, in line with emerging best practice in Germany. We believe clear disclosure on this topic to be in the best interests of all shareholders wishing to evaluate the board's composition. As such, we will evaluate the sufficiency of a company's disclosure on a case-by-case basis and, in the event that we find the disclosure to be particularly lacking, especially in cases where targets have not been met, may recommend shareholders vote against the chair of the accountable committee or, in the absence of clear disclosure of accountability for setting these targets, the supervisory board chair on this basis.

In line with our Continental Europe Guidelines, we will closely scrutinise the diversity policies of companies with all-male supervisory boards. Where a company with an all-male supervisory board has elections and has not nominated a female director, we may recommend voting against the reelection of the nominating committee chair unless a target to increase female representation has been set and the board provides a compelling reason for why no female candidates are being proposed at this meeting.<sup>41</sup>

## SUPERVISORY BOARD COMMITTEES

German public companies are recommended to have at least an audit committee and a nominating committee.<sup>42</sup> In the absence of an audit committee, we will generally recommend voting against the supervisory board chair on this basis; provided, however, that this will generally not apply to small-cap companies with a sufficient number of independent supervisory board members.<sup>43</sup>

In Germany, planned amendments to the composition of key board committees are often not disclosed until after the supervisory board's initial meeting following the general meeting. Where the board has clearly disclosed its intentions with regard to post-AGM committee composition, we will take this into consideration in our analysis of the supervisory board.

Our policies with regard to committee performance are not materially different from our Continental Europe Policy Guidelines. In deviation from our Continental Europe Policy Guidelines, we make an exception in Germany for boards that do not form remuneration committees.

## AUDIT COMMITTEE

The Kodex recommends that the audit committee chair should not also chair the supervisory board and should have "specialist knowledge and experience" of accounting principles and the internal control process.<sup>44</sup> Further, we believe that at least one shareholder representative on the audit committee should possess sufficient knowledge of the sector in which the company operates.<sup>45</sup>

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40 "Fragen und Antworten zu dem Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst." Bundesministerium für Familie, Senioren, Frauen und Jugend.

41 This policy will generally be applied to supervisory boards with six or more members only.

42 Articles 5.3.2 and 5.3.3 of the Kodex.

43 While article 324(1) of the German Commercial Code (Handelsgesetzbuch or "HGB") requires all German corporate entities to establish an audit committee, this requirement does not apply to public companies with a supervisory board or board of directors as these bodies are already required to contain at least one member who can be classified as a financial expert in line with article 100(5) of the German Stock Corporations Act ("AktG"). However, the establishment of an audit committee is recommended by article 5.3.2 of the Kodex. When the supervisory board is small and sufficiently independent, and when a company explicitly states that the entire supervisory board carries out the function of the audit committee, we will generally refrain from recommending against the reelection of the board chair.

44 Article 5.3.2 of the Kodex.

45 Article 100(5) AktG stipulates that the supervisory board and audit committee as a whole must be familiar with the sector in which the company operates. We believe that companies should address how this requirement is fulfilled in line with emerging best practice in Germany.

## REMUNERATION COMMITTEE

In Germany, remuneration committees are less common than in other European countries. The Kodex does not recommend that supervisory boards form remuneration committees.<sup>46</sup> Instead, the supervisory board as a whole fulfills the aforementioned responsibilities. As such, when assessing the performance of the supervisory board with regard to remuneration policy oversight, a vote against the supervisory board chair may be merited due to failure to comply with best practice in Germany (please see “Management Board Remuneration” section). If, however, a company forms a remuneration committee that bears more responsibility for remuneration oversight than the supervisory board as a whole, we believe that a higher level of accountability for remuneration issues should be attributed to the remuneration committee chair.<sup>47</sup>

## ELECTION PROCEDURES

Our policies with regard to election procedures are not materially different from our Continental Europe Policy Guidelines. The following are clarifications regarding best practice recommendations in Germany.

## CLASSIFIED SUPERVISORY BOARDS AND TERM LENGTHS

German law requires that supervisory board members either resign or stand for re-election at least every five years.<sup>48</sup> As a result, most German companies appoint supervisory board members for the full five-year term allowable by law. Until June 6, 2008, the Kodex recommended that supervisory board elections be staggered so that some supervisory board members would stand for election at regular intervals. As a result, several companies continue to maintain staggered supervisory boards. However, a majority of companies propose all shareholder-elected supervisory board members to be appointed for equal and concurrent terms.

Given that it is common practice in Germany for companies to nominate supervisory board members for five-year terms, we do not normally recommend voting against candidates who are nominated for five-year terms.

## ELECTION OF SUPERVISORY BOARD MEMBERS AS A SLATE

German companies are recommended to elect supervisory board members individually.<sup>49</sup> Given that most companies comply with this best practice, we recommend voting against any election that is clearly proposed as a slate.

## PARTNERSHIP LIMITED BY SHARES (KOMMANDITGESELLSCHAFT AUF AKTIEN, OR “KGaA”)

Under German law, a publicly-traded company may be both a limited partnership and a stock corporation. This unique hybrid company structure, the *Kommanditgesellschaft auf Aktien*, or “KGaA,” is utilised infrequently in comparison with the more common German public stock corporation (Aktiengesellschaft, or “AG”) structure. In general, Glass Lewis believes that the KGaA company form is not conducive to promoting accountability to shareholders or best practices for corporate governance. The structure of a KGaA creates the possibility for management, through the limited partnership, to exercise disproportionate control over a company’s governance structure. Specifically, the supervisory board of a KGaA does not have the power to hire or fire management, in contrast with the supervisory board of an AG. The supervisory board’s role at a KGaA is to consult with management on issues related to shareholders’ interests. Given the substantially reduced supervisory board authority under the KGaA company form, Glass Lewis generally does not support proposals to transform a company from an AG, or other comparable legal form, to a KGaA.

<sup>46</sup> Articles 4.2.2 and 5.1.2 of the Kodex allow for supervisory boards to establish a committee to deal with management board contracts and remuneration; however, its proposals must be approved by the full board in a plenary session. Article 87 of the German Stock Corporations Act (“AktG”) sets a legal precedent for the entire supervisory board to review and approve management board remuneration. In fact, all supervisory board members may be held personally liable if management board remuneration is deemed inappropriate.

<sup>47</sup> Where the recommendation is to vote against the supervisory board or remuneration committee chair and the individual is not up for election, we do not recommend voting against any members of the supervisory board or remuneration committee who are up for election; rather, we will express our concern regarding the individual.

<sup>48</sup> Article 102(1) of the German Stock Corporations Act (“AktG”).

<sup>49</sup> Article 5.4.3 of the Kodex.

Notwithstanding our unfavourable view of the KGaA from a shareholder rights' perspective, we believe that most shareholders of a KGaA both understand and accept that the structure's legal form of company differs from that of an AG, or any comparable legal form. As such, we will not apply the same independence standards to the supervisory board or committees of a KGaA that we apply to companies incorporated in a more typical stock corporation form, such as an AG. Given the varying capital structure possibilities of a KGaA, we approach each KGaA on a case-by-case basis. However, we generally believe that the supervisory board of a KGaA should reflect the company's shareholder structure. In addition, we note that the supervisory board of a KGaA is not responsible for oversight of the company's financial reporting,<sup>50</sup> thereby rendering the formation of an audit committee less relevant. As such, we will exempt companies incorporated in the form of a KGaA from the requirement that they form an audit committee of the supervisory board if the company has an adequately independent committee responsible for overseeing the audit of the company's financial statements within another governing body of the company. If a KGaA chooses to form an audit committee of the supervisory board, we will evaluate its composition based on the responsibilities assigned to the committee.

## SUPERVISORY BOARD COMPOSITION AND CANDIDATE DISCLOSURE

Historically, the disclosure of information regarding the composition of the supervisory board and the background of its members and nominees has been less thorough in Germany than in other major European markets.

However, several amendments to the Kodex in February 2017 sought to address this situation. In particular, recommendations were introduced that shareholders be provided with current and detailed curriculum vitae for all incumbent and proposed supervisory board members as well as information on which supervisory board members are deemed to be independent.<sup>51</sup> Furthermore, the supervisory board is now recommended to prepare a profile of skills and expertise (*Kompetenzprofil*) for the entire board, which should be taken into account in board election proposals.<sup>52</sup>

Given the substantial improvements to the information provided around supervisory board elections in Germany in the past year, we may consider recommending against the reelection of the nominating committee chair in cases where there are supervisory board elections and shareholders have not been provided with meaningful information on the supervisory board's skills and expertise profile and an independence classification of incumbent supervisory board members.<sup>53</sup>

We may also recommend that shareholders vote against the reelection of the nominating committee chair if disclosure of the backgrounds and relevant qualifications of incumbent and proposed supervisory board members is substantially below best practice. This shall apply in particular in cases where the board fails to maintain current and detailed curriculum vitae of its incumbent and proposed members, or fails to disclose personal and business relationships between board candidates and a company's corporate bodies and/or shareholders with a material interest.<sup>54</sup>

We will provide an explicit assessment of skills and experience of shareholder representatives and nominees to the supervisory board for DAX 30 companies with board elections. The purpose of this assessment is to provide further insight into the board refreshment process and allow for a more in-depth assessment of the composition of the supervisory board. While no specific voting recommendation policies are linked to the outcome of this assessment, we may utilise potential skills gaps to underline specific concerns with board or company performance and to assist case-by-case decisions when applying supervisory board election policies.

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50 Article 286(1) of the German Stock Corporations Act ("AktG").

51 Article 5.4.1 of the Kodex.

52 *Ibid.* The Kodex has neither provided companies with guidance on the format or content of the skills and expertise profile nor specifically recommended that companies disclose the profile in their public filings.

53 This policy will generally be applied to constituents of the DAX, MDAX, and SDAX indices only. For boards without a nominating committee, we will generally attribute accountability to the supervisory board chair or the chair of an additional board committee which appears to hold a substantial level of responsibility for the composition of the board.

54 Article 5.4.1 of the Kodex recommends the disclosure of personal and business relationships of every candidate with the company, the governing bodies of the corporation and any shareholders with a direct or indirect stake of more than 10% of a company's voting rights.

# Transparency and Integrity in Financial Reporting

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In Germany, shareholders are presented with the audited financial statements for the past fiscal year and are asked to vote on the appointment of the statutory auditor and the allocation and the allocation of profits or dividends on an annual basis.<sup>55</sup> While we have outlined the principle characteristics of these types of proposals that we encounter in Germany below, our policies regarding these issues are not materially different from our Continental Europe Policy Guidelines.

## ACCOUNTS AND REPORTS/CONSOLIDATED ACCOUNTS AND REPORTS

In Germany, a company's audited consolidated and non-consolidated financial statements must be approved by the supervisory board and subsequently presented to the management board within two months of the receipt of the independent auditor's report.<sup>56</sup> Following approval by the management and supervisory boards, the audited financial statements are presented to shareholders at the annual meeting, which must be held within eight months of the close of the fiscal year.<sup>57</sup> However, shareholders will be asked to approve the submitted financial statements under the following three circumstances: (i) when the management and supervisory boards cannot agree on the approval of the financial statements; (ii) when the management and supervisory boards decide, for any reason, that the annual meeting will have the final authority to approve the financial statements;<sup>58</sup> or (iii) if the company's legal form is a partnership limited by shares (KGaA).<sup>59</sup>

## ALLOCATION OF PROFITS/DIVIDENDS

In accordance with German law, companies may choose to allocate their profits to one or more of the following categories, subject to shareholder approval: (i) a dividend paid to shareholders; (ii) revenue reserves; (iii) retained earnings; or (iv) unappropriated net profits.<sup>60</sup> In any case, not more than half of a company's annual profits may be allocated to revenue reserves without explicit shareholder approval.<sup>61</sup> Additionally, a German company's articles may contain provisions that allow management to make an advance dividend payment based on annual financial statements, up to half of the Company's reported net profits, with the approval of the supervisory board.<sup>62</sup>

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55 Article 119 of the German Stock Corporations Act ("AktG").

56 Article 171 of the German Stock Corporations Act ("AktG").

57 Article 175(1) of the German Stock Corporations Act ("AktG").

58 Articles 172 and 173(1) of the German Stock Corporations Act ("AktG").

59 Article 286(1) of the German Stock Corporations Act ("AktG").

60 Article 170(2) of the German Stock Corporations Act ("AktG").

61 Article 58(2) of the German Stock Corporations Act ("AktG").

62 Article 59 of the German Stock Corporations Act ("AktG").

# The Link Between Pay and Performance

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German company law does not currently provide for a mandatory shareholder vote on management board remuneration. However, the German Stock Corporations Act (“AktG”) was amended on July 31, 2009, to allow for the possibility of non-binding advisory votes on management board remuneration policy.<sup>63</sup> These votes may either be proposed by the supervisory board or requested by shareholders in the form of a shareholder proposal or countermotion. The Kodex does not currently contain any recommendations regarding a shareholder vote on management board remuneration.

In addition, shareholders of German companies are regularly asked to approve changes to supervisory board fee policies and equity remuneration plans for employees. Our policies regarding these matters do not differ materially from our Continental Europe Policy Guidelines. However, we do account for a company’s compliance with best practice in Germany, as described below, when evaluating these proposals.

Moreover, we believe that the new Guidelines for Sustainable Management Board Remuneration Systems and upcoming changes to the regulatory environment in Germany will lead to a number of German companies reconsidering incentive plans for management board members. Without materially amending our guidelines at this time, Glass Lewis will continue to monitor evolving best practice and consider say-on-pay proposals in Germany in the context of new best practice recommendations.

## VOTE ON MANAGEMENT BOARD REMUNERATION (“SAY-ON-PAY”)

Most say-on-pay proposals in Germany seek shareholder approval of a company’s remuneration policy for the upcoming fiscal year, although some proposals may ask shareholders to approve the policy applied during the past fiscal year. The Kodex sets out general recommendations for best practices regarding management board remuneration. However, provisions relating to the disclosure of management board remuneration are considerably more definitive. The current version of the Kodex recommends that companies disclose the following payments made to each individual management board member:

- the benefits granted for the year under review, including the maximum and minimum potential remuneration for variable components;
- the allocation of fixed and variable remuneration (short and long-term) for the year under review, broken down into the relevant reference years; and
- the service cost for the year under review, including pension provisions and other benefits.<sup>64</sup>

Further, the Kodex specifies that this information should be displayed in line with the model tables provided within its annexes. Given that the Corporate Governance Commission has particularly focused on the drafting and clarification of these templates, Glass Lewis expects all German companies to comply with the standardised format unless a particularly cogent justification is provided.

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<sup>63</sup> Article 120(4) of the German Stock Corporations Act (“AktG”).

<sup>64</sup> Article 4.2.5 of the Kodex.

When evaluating a company's compliance with best practices in Germany, the following deficiencies may cause Glass Lewis to recommend a vote against a remuneration policy:

- Management board members do not receive performance-based variable cash or equity remuneration;<sup>65</sup>
- Management board remuneration is not linked to appropriate, forward-looking, multi-year individual and company performance targets;<sup>66</sup>
- Performance goals are not demanding or were lowered when management failed or was unlikely to meet original goals;<sup>67</sup>
- Overall and individual remuneration components are not subject to clearly disclosed caps;<sup>68</sup>
- The remuneration report does not contain clear disclosure detailing the component of each management board member's remuneration;<sup>69</sup> and/or
- The supervisory board approves severance pay for a member of the management board that is more than twice his or her total annual remuneration or three times his or her total annual remuneration, in the case of a change of control.<sup>70</sup>

When assessing a remuneration structure, its disclosure and any related amendments, we will focus our recommendation on the overall effect of structural changes, as well as on any improvement or deterioration in disclosure, taking into consideration the general "direction of travel" undertaken by a company.

Additionally, in light of the current European and German best practice, we expect companies to submit a say-on-pay proposal to shareholder approval where any significant amendments to management board remuneration were proposed or implemented during the year, or when a say-on-pay proposal was rejected or received significant<sup>71</sup> shareholder opposition at the last AGM. Should a company fail to facilitate such a vote, we will consider recommending against the ratification of the supervisory board.

## SUPERVISORY BOARD REMUNERATION PLANS

Under German law, supervisory board members' remuneration must either be approved by a general meeting of shareholders or specified in a company's articles of association. The Kodex specifies that if remuneration plans for supervisory board members includes a variable, performance-related component, it should be oriented toward a company's sustainable growth.<sup>72</sup> Glass Lewis does not believe that performance-based variable remuneration serves shareholders' interests, as non-executive directors who receive performance-based remuneration may be forced to weigh their own interests against the interests of shareholders and the company. Therefore, while we will support remuneration proposals that include limited variable remuneration for supervisory board members, we will recommend voting against any proposal that seeks to add or increase

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65 Article 4.2.3 of the Kodex.

66 Articles 4.2.2 and 4.2.3 of the Kodex.

67 Article 4.2.3 of the Kodex.

68 *Ibid.*

69 Articles 4.2.4 and 4.2.5 of the Kodex. We will make an exception when a three-quarters majority of shareholders has exempted the company from disclosing management remuneration on an individual basis. Articles 285 and 314 of the German Commercial Code (Handelsgesetzbuch or "HGB") require disclosure of each element of executive remuneration on an individual basis; however, Article 286 of the Commercial Code allows shareholders to approve, by a three-quarters majority, an amendment to the company's articles of association that exempts companies from the requirement that management board remuneration be disclosed on an individual basis for periods of up to five years, with the possibility of renewal.

70 Article 4.2.3 of the Kodex.

71 In line with our Continental Europe guidelines, we will generally consider an against vote greater than 20% of votes cast to be significant, while taking into account the ownership structure and any mitigating circumstances around the specific vote when making this determination.

72 Article 5.4.6 of the Kodex recommends that performance-related remuneration for supervisory board members should be based on the long-term performance of the company. We note, however, that according to the EU Recommendation on the role of non-executive directors, receiving or having received significant additional remuneration, particularly in the form of participation in a share option or any other performance-related pay scheme is seen as potentially capable of compromising the independence of non-executive directors.

performance-based fees to a supervisory board members' remuneration. Additionally, we may recommend that shareholders vote against any supervisory board fee policies that include variable fees based solely on short-term profit-based metrics.

Notably, each supervisory board member's remuneration should be disclosed individually, with fixed and variable components accounted for separately.<sup>73</sup>

## **EXEMPTION FROM MANAGEMENT BOARD REMUNERATION REPORTING REQUIREMENTS**

German companies are required to disclose each component of each member of the management board's remuneration separately, unless a company's articles of association specify that executive disclosure will be disclosed as one lump sum.<sup>74</sup> We recommend that shareholders vote against proposals to amend a company's articles of association in order to avoid individual management board remuneration disclosure.

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<sup>73</sup> *Ibid.*

<sup>74</sup> Articles 285 and 314 of the German Commercial Code (Handelsgesetzbuch or "HGB") require disclosure of each element of management board remuneration on an individual basis; however, Article 286 of the Commercial Code allows shareholders to approve, by a three-quarters majority, an amendment to the company's articles of association that exempts companies from the requirement that management board remuneration be disclosed on an individual basis for periods of up to five years, with the possibility of renewal.

# Governance Structure and the Shareholder Franchise

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In Germany, shareholders are asked to approve proposals regarding a company's governance structure, as well as the ratification of management and supervisory board acts and amendments to the articles of association. While we have outlined the principle characteristics of these types of proposals that we encounter in Germany below, our policies regarding these issues are not materially different from our Continental Europe Policy Guidelines.

## RATIFICATION OF SUPERVISORY AND MANAGEMENT BOARD ACTS

For up to eight months after the end of a fiscal year, German companies may request that shareholders discharge the members of the supervisory board and/or management board from any and all of their actions during the past fiscal year. Shareholders holding at least 10% of a company's share capital, or shares with an aggregate nominal value of at least €1 million, may request that individual members of the supervisory or management boards be discharged separately.<sup>75</sup>

In Germany, ratifying the acts of the management and supervisory boards is primarily a vote of confidence and does not release its members from liability for their actions. They will still be held liable for any tortious or negligent act committed in the performance of their duties. In accordance with best practice in Germany, we believe the ratification of management and supervisory board acts should be presented as a separate voting item for each individual board member in cases where there are known shareholder concerns regarding a board or individual's performance during the past fiscal year. In cases where we would have recommended that shareholders vote against the ratification of an individual board member, but shareholders are only provided with the opportunity to ratify the board as a whole, we will generally recommend that shareholders oppose ratification for the entire board.

In cases where we believe that ongoing investigations or proceedings may cast significant doubt on the performance of the management or supervisory board in the past fiscal year, but that the potential outcome of such investigations or proceedings is unclear at the time of convocation of the general meeting, we believe that companies should propose that a decision on ratification be postponed until a future general meeting. If shareholders are not provided with this opportunity, we will generally recommend that shareholders abstain from voting on such ratification proposals; in cases where abstain votes are neither counted as valid votes cast nor displayed in the minutes of general meetings, we will generally recommend that shareholders vote against ratification proposals under the aforementioned circumstances.

Absent compelling evidence that the management and supervisory board has failed to satisfactorily perform its duty to shareholders in the past fiscal year, we generally recommend that shareholders approve ratification proposals.<sup>76</sup>

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<sup>75</sup> Article 120(1) of the German Stock Corporations Act ("AktG").

<sup>76</sup> Recommendations on the ratification of management and supervisory board acts are taken on a case-by-case basis. The general conditions for recommendation against such proposals are detailed in our Continental Europe Guidelines.

## OWNERSHIP REPORTING REQUIREMENTS

German law requires that any shareholder whose percentage ownership of outstanding shares or voting rights in a company rises above or falls below the thresholds of 3%, 5%, 10%, 15%, 20%, 25%, 30%, 50%, or 75% disclose their shareholdings within four trading days of the acquisition or sale.<sup>77</sup> The management board is then required to disclose this information to shareholders.

In addition, shareholders who cross the 10% ownership threshold are required to disclose the following information within 20 trading days of the acquisition:<sup>78</sup> (i) whether the acquisition was motivated by a trading profit goal or a strategic investment decision; (ii) whether the shareholder intends to acquire further voting rights in the next 12 months; (iii) whether the shareholder intends to influence the composition of the company's board or management; and (iv) the shareholder's intentions with regard to the company's capital structure and dividend policy. In addition, the shareholder must reveal the source of his or her financing for the acquisition, especially whether the acquisition was financed through debt or equity. Lastly, the shareholder must update the company if any of the four aforementioned intentions change, for as long as the shareholder maintains ownership of at least 10% of the voting rights. The company, in turn, is required to make all of the aforementioned information public.

## EXEMPTIONS FROM OWNERSHIP REPORTING REQUIREMENTS

In accordance with German law, companies may request an exemption<sup>79</sup> from the increased reporting requirements mentioned above for shareholders who cross the 10% ownership threshold. In general, we believe that exempting certain companies from market-wide disclosure requirements may disadvantage shareholders of the companies that seek such exemptions. We are especially concerned that seeking an exemption from required reporting standards may create the opportunity for management and/or major shareholders to act in their own interests to the exclusion of the interests of minority shareholders. As such, we will generally not support proposals seeking an exemption from reporting requirements, unless management provides a specific and justifiable reason and the exemption will not harm minority shareholders' interests.

## RESTRICTIONS ON SHARE REGISTRATION

Under certain conditions, German companies may impose registration restrictions on shareholders who own shares through an intermediary. Companies may seek shareholder approval to amend the articles of association in order to implement one of the following restrictions:<sup>80</sup> (i) an absolute cap on the number of shares that may be entered into the share register under the name of a deposit institution that is not the direct beneficial owner of the shares; (ii) an absolute cap on voting rights assigned to shares registered in the name of a deposit institution; (iii) a duty to disclose specified identifying information for beneficial owners that exceed a certain threshold; or (iv) a suspension of voting rights for shareholders who do not comply with a company's disclosure requirements. In our view, shareholders should have the right to vote in direct proportion to their holdings. While we believe that shareholders should fully disclose their holdings in accordance with the law, we do not support restricting shareholders' voting rights beyond what is required by law. As such, we will not support proposals that seek to restrict shareholders' voting rights in any way.

## SUPERMAJORITY VOTE REQUIREMENTS

German law requires the support of a supermajority of votes cast on certain voting decisions at shareholder meetings in order for the motion to be passed; however, we will generally recommend voting against any proposal that extends this supermajority requirement to decisions not stipulated by law, except where the relevant provision is designed to protect minority shareholders. German companies can generally establish a lower threshold in their articles of association than is required by law to approve certain voting items. In cases

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<sup>77</sup> Article 21(1) of the German Securities Trading Act (Gesetz über den Wertpapierhandel or "WpHG").

<sup>78</sup> Article 27a(1) of the German Securities Trading Act ("WpHG").

<sup>79</sup> Article 27a(3) of the German Securities Trading Act ("WpHG") allows companies to seek an exemption through an amendment to the articles of association approved by shareholders.

<sup>80</sup> Article 67 of the German Stock Corporations Act ("AktG").

where a company seeks to abolish supermajority voting requirements we will evaluate such proposals on a case-by-case basis. In certain instances, amendments to voting requirements may have a deleterious effect on shareholders rights where a company has a large or controlling shareholder. We will consider a broad range of factors including the company's shareholder structure; quorum requirements; impending transactions — involving the company or a major shareholder — and any internal conflicts within the company.

# Capital Management

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In Germany, shareholders are regularly asked to approve capital proposals, namely increases in authorised and conditional capital, the issuance of convertible debt instruments and the authority to repurchase shares. Such authorities generally extend for five years. Our policies with regard to these matters do not differ materially from our Continental Europe Policy Guidelines.

## AUTHORISED CAPITAL

German companies generally ask shareholders to approve an unallocated pool of authorised but unissued shares, which may be issued with or without preemptive rights.<sup>81</sup> Shares issued pursuant to these authorities may be used for a broad range of corporate purposes, including raising funds for expansion plans, refinancing existing loans, or carrying out mergers and acquisitions. By law, a company's authorised capital may not exceed 50% of a company's issued share capital and is valid for a maximum period of five years.<sup>82</sup> Best practice in Germany, although not specifically stated in any codified recommendations, provides that preemptive rights should be preserved for share issues from authorised capital in excess of 20% of issued share capital at the date of approval. As such, and in line with our Continental Europe Policy Guidelines, we will generally recommend voting against any authorised capital proposal which does not preserve preemptive rights above 20% of current issued share capital; further, we believe all general authorities to issue shares should have a common cap. Glass Lewis will recommend voting against any proposal that does not explicitly extend a 20% cap on share issues without preemptive rights to authorised and conditional capital authorities previously existing and/or proposed at the meeting, other than those reserved for unique purposes such as equity incentive plans.

## CONDITIONAL CAPITAL

German companies may ask shareholders to approve "conditional" or "contingent" capital. These capital increases may only be used under certain specifications, such as the issuance of shares to fulfill a company's obligations to holders of convertible debt instruments or stock options.<sup>83</sup> By law, a company's conditional capital may not exceed 50% of a company's issued share capital and is valid for a maximum period of five years.<sup>84</sup> As such, we will evaluate these proposals in conjunction with the proposed authority that allows the company to utilise it. Furthermore, we will apply the same scrutiny to the preservation of preemptive rights as explained above under "Authorised Capital."

## AUTHORITY TO REPURCHASE SHARES

If German companies intend to buy back shares, they are subject to the following conditions: (i) the volume of shares to be repurchased must not exceed 10% of the nominal share capital and only funds that could have otherwise been paid out to shareholders in the form of dividends can be disbursed for repurchase transactions;<sup>85</sup> (ii) the company must not repurchase its shares for the purpose of trading,<sup>86</sup> and (iii) the authority to repurchase shares cannot be granted for a period of time exceeding five years.<sup>87</sup> In addition, banks and financial

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<sup>81</sup> Article 203(2) of the German Stock Corporations Act ("AktG").

<sup>82</sup> Article 202(2) and 202(3) of the German Stock Corporations Act ("AktG"). Article 186(3) of the German Stock Corporation Act (AktG) further limits issuances of shares for cash consideration without preemptive rights to 10% of a company's total share capital.

<sup>83</sup> Article 192(2) of the German Stock Corporations Act (AktG).

<sup>84</sup> Article 192(3) of the German Stock Corporations Act (AktG). The law further limits issuances of convertible debt instruments for cash consideration without preemptive rights to 10% of a company's total share capital.

<sup>85</sup> Article 71(1.8) of the German Stock Corporations Act ("AktG").

<sup>86</sup> *Ibid.*

<sup>87</sup> *Ibid.*

institutions may seek approval at a general meeting of shareholders to repurchase shares for the purpose of securities trading, within a limit of 5% of the company's share capital. When seeking such an approval, the highest and lowest price must be stated.<sup>88</sup>

Given these legal provisions, we will generally recommend supporting a proposed authority to repurchase and/or trade in shares in Germany.

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<sup>88</sup> Article 71(1.7) of the German Stock Corporations Act ("AktG").

# Shareholder Initiatives

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In Germany, there are two types of shareholder initiatives that may be included on the agenda of a general shareholders' meeting: shareholder counter motions and shareholder proposals. Shareholder counter motions are much more common than shareholder proposals, as they can be put forward by any shareholder who submits the motion in accordance with the applicable legal requirements.<sup>89</sup> Counter motions must correspond to a voting proposal on the agenda for the general meeting and generally urge shareholders to vote against the proposal put forth by management. However, counter motions may also propose separate voting decisions, including the amendment of a proposal put forth by management. These proposals generally request changes to a company's dividend policy, capital authorities, or supervisory board composition. They may also request that a special audit into management or supervisory board activities be carried out.

Shareholder counter motions may or may not be proposed as separate voting items at the general meeting. In general, Glass Lewis will provide voting recommendations for all shareholder counter motions that are clearly designated as separate voting items.<sup>90</sup> Given the broad range of topics that may be addressed by counter motions, we will analyse each counter motion on a case-by-case basis. In general, however, we will not support counter motions that seek to manage a company's day-to-day business, which we believe is better managed by the management and supervisory boards.

In Germany, shareholders owning at least 5% of a company's share capital, or a nominal value of €500,000 in a company's shares, may request that a separate proposal be included on the agenda of a general meeting of shareholders.<sup>91</sup> Such requests must be submitted at least 30 days prior to the meeting date. Though shareholder proposals are rare in Germany, when submitted, they generally propose the appointment of a special auditor to investigate management or supervisory board actions, the removal of supervisory board members or the election of dissident supervisory board members.

We evaluate shareholder proposals or counter motions at German companies on a case-by-case basis. We generally favour proposals that are likely to increase shareholder value and/or promote and protect shareholder rights. We typically prefer to leave decisions regarding day-to-day management of the business and policy decisions such as those related to political, social or environmental issues to management and the board except when there is a clear and direct link between the proposal and an economic or financial risk for the company. We feel strongly that shareholders should not attempt to micromanage the business or its executives through the initiative process. Rather, shareholders should use all available means to push for governance structures that protect shareholders, including through supervisory board elections to promote the composition of a board they can trust to make informed and prudent decisions that are in the best interests of the business and shareholders. We believe that shareholders should hold supervisory board members accountable for management and policy decisions through board election and ratification proposals.

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<sup>89</sup> Article 126 of the German Stock Corporations Act ("AktG").

<sup>90</sup> Counter motions that will be voted on separately at the meeting are generally designated by a letter on the proxy form. Where such a letter is assigned, we will provide voting recommendations. We note that the statutory filing deadline for shareholder counter motions is 14 days before the meeting. As such, we are not always able to provide voting recommendations for all shareholder counter motions in advance of the vote cutoff.

<sup>91</sup> Article 122(2) of the German Stock Corporations Act ("AktG").

## DISCLAIMER

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