

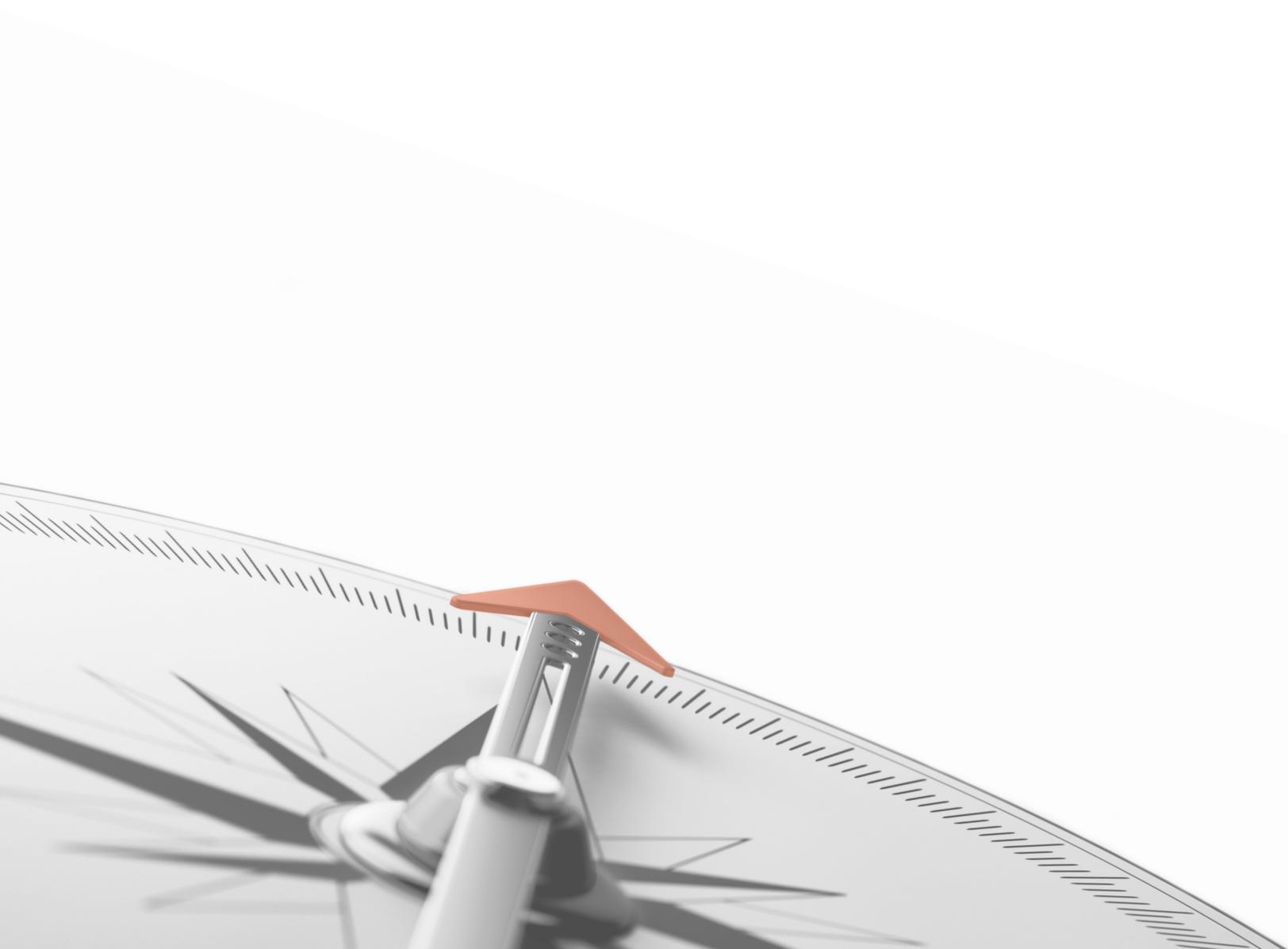
**2021**

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 updated in May 2019 and came into effect on March 20, 2020.

We have updated the guidelines to reflect the latest formulations of the Stock Corporations Act and Kodex.

## REGULATORY UPDATES

Following the transposition of SRD II into German law, the powers of the annual general meeting to approve director remuneration packages were increased as follows:

- Publicly-listed companies will be required to seek shareholder approval of the remuneration policy for management and supervisory board members on an advisory basis each time that a "material amendment" to the policy is made, but in any case at least once every four years. If the remuneration policy does not receive the support of a majority of votes cast, the policy must be reviewed and presented for another shareholder vote at the following annual meeting at the latest.
- The supervisory board will be required to set a maximum possible total remuneration level for the management board; the annual meeting may vote on a proposal to lower this maximum remuneration level.
- Publicly-listed companies will be required to seek shareholder approval of the remuneration report for the past fiscal year on an advisory basis at each annual meeting.
- Transitional provisions will apply to remuneration policy and report requirements. A vote on the remuneration policy is required for the first time at the first AGM following December 31, 2020. The

remuneration report must be prepared in the new format for the first time for the next fiscal year that commences following December 31, 2020, with a vote required for the first time at the AGM in the following fiscal year. This means that German companies will not be required to submit a remuneration policy vote until the 2021 AGM and there will not be a mandatory remuneration report vote until the 2022 AGM.

## **BEST PRACTICE RECOMMENDATIONS**

As discussed above, a new version of the Kodex entered into force in March 2020. The new Kodex represents the largest overhaul of the code in its history, and provides strengthened guidance to German issuers on supervisory board independence and management board remuneration.

## **SUMMARY OF CHANGES FOR THE 2021 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:

### **SUPERVISORY BOARD DIVERSITY**

We have updated these guidelines to clarify our general expectation that directors of both genders should comprise at least 30% of the supervisory boards of DAX and MDAX companies, and that all other CDAX company supervisory boards should not be composed solely of directors of the same gender. Where a proposed board election does not align with these targets, we will generally recommend that shareholders vote against the chair of the nominating committee (or equivalent) or a new nominee to the board, as appropriate.

We will generally provide exceptions to these policies to boards consisting of four or fewer members where a company provides compelling disclosure as to why it has failed to ensure gender balance on the board. Further, we will take into account recent progress made to improve board diversity while maintaining the required balance of board skills and refreshment, when accompanied by a commitment to address the gender gap in upcoming election cycles.

Please refer to the "Board Diversity" section of these guidelines for further information.

### **SUPERVISORY BOARD ELECTION TERMS**

We have updated these guidelines to clarify that while we believe that shorter board election terms would increase the accountability of supervisory board members to shareholders, we will not recommend that shareholders vote against directors that are nominated for the maximum term permissible under German law at this time. Nevertheless, we have clarified that where we have substantial concerns regarding the performance of the board or individual members who are not up for re-election, we may recommend that shareholders instead vote against the proposal to ratify the actions of the supervisory board.

Please refer to the "Classified Supervisory Boards and Term Lengths" section of these guidelines for further information.

### **MANAGEMENT BOARD REMUNERATION**

We have clarified our policies and processes for analysing mandatory remuneration policy and report proposals. While our approach in this regard does not materially differ from our Continental Europe Policy Guidelines, we have outlined our expectations in regard to prevailing market practice in Germany and the recommendations of the Kodex.

Please refer to the "The Link Between Pay and Performance" section of these guidelines and of our Continental Europe Policy Guidelines for further information.

# 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 that was first 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 Principle 1 of the German Corporate Governance Code (“Kodex”).

4 Article 111 of the German Stock Corporations Act (“AktG”) and Principle 6 of the Kodex.

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

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 12 years;<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 supervi-

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11 C.13 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 Recommendation C.7 of the Kodex. In certain cases, we will also consider supervisory board members to be affiliates when they have served fewer than 12 years 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 While Glass Lewis makes every effort to obtain relevant information regarding supervisory board members’ terms of office, this information is often not provided by microcap 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 and there is evidence of regular board refreshment.

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

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

16 Companies that regularly have between 500 and 1,999 employees are subject to the German Law on One-Third Participation (Drittelbeteiligungsgesetz, 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 while C.7 of the Kodex recommends that the majority of shareholder representatives shall be independent from the company and the management board, the Kodex provides no specific recommendations on independence from major shareholders for non-controlled companies. For companies with a controlling shareholder, C.9 of the Kodex recommends that at least two supervisory board members should be independent from this shareholder (or at least one where the supervisory board consists of six or fewer members).

sory board members are either affiliated or inside members, we typically<sup>18</sup> recommend voting against some of 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. 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>19</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>20</sup> (ii) is not independent of the company;<sup>21</sup> or (iii) is a recent former member of the company's management board.<sup>22</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>23</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 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.

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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.

19 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.

20 Recommendation D.4 of the Kodex.

21 Recommendation C.10 of the Kodex.

22 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.

23 Recommendation D.5 of the Kodex.

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>24</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>25</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>26</sup> except for a one-year transitional period under extraordinary circumstances.<sup>27</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>28</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>29</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 oversight of the management board,<sup>30</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>31</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.

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24 Recommendation C.5 of the Kodex.

25 Recommendation C.4 of the Kodex.

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

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

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

29 Recommendation C.11 of the Kodex.

30 Principle 6 of the Kodex. Pursuant to recommendation C.10 of the Kodex, the supervisory board chair should be independent from the company and its management board.

31 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>32</sup> which we believe to be reasonable.

## BOARD DIVERSITY

In line with our Continental Europe policy guidelines, we generally expect the supervisory boards of all main market, CDAX-listed German companies to not be solely composed of directors of the same gender. Further, we generally expect directors of each gender to comprise at least 30% of the supervisory boards of large and mid-cap companies. This policy will apply to DAX companies from 2021, and to MDAX companies from 2022. Where a proposed board election does not align with these targets, we will generally recommend that shareholders vote against the chair of the nominating committee (or equivalent) or a new nominee to the board, as appropriate.

We will generally provide exceptions to these policies to boards consisting of four or fewer members where a company provides compelling disclosure as to why it has failed to ensure gender balance on the board. Further, we will take into account recent progress made to improve board diversity while maintaining the required balance of board skills and refreshment, when accompanied by a commitment to address the gender gap in upcoming election cycles.

### 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>33</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>34</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>35</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>36</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.

<sup>32</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>33</sup> Article 96(2) of the German Stock Corporations Act (“AktG”).

<sup>34</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>35</sup> Article 96(2) of the German Stock Corporations Act (“AktG”).

<sup>36</sup> Article 124(2) of the German Stock Corporations Act (“AktG”).

## 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>37</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>38</sup> Companies will be required to 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>39</sup>

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 stakeholders 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.

## SUPERVISORY BOARD COMMITTEES

German public companies are recommended to have at least an audit committee and a nominating committee.<sup>40</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>41</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 be independent from the company, its management and, if applicable, the controlling shareholder. In addition, the audit committee chair should not also chair the supervisory board and should have "specific knowledge and experience" of accounting principles and the internal control process.<sup>42</sup> Further, we believe that at least one shareholder representative on the audit

<sup>37</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>38</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.

<sup>39</sup> "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.

<sup>40</sup> Recommendations D.3 and D.5 of the Kodex.

<sup>41</sup> 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 D.3 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.

<sup>42</sup> Recommendations C.10 and D.4 of the Kodex.

committee should possess sufficient knowledge of the sector in which the company operates.<sup>43</sup>

## REMUNERATION COMMITTEE

While the formation of a remuneration committee has become established market practice in Germany, we are mindful that the Kodex does not specifically recommend the formation of a remuneration committee and clarifies the responsibility of the supervisory board as a whole for a company's remuneration practices.<sup>44</sup> 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>45</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 cannot be elected for a term that exceeds five annual general meetings.<sup>46</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.

German companies have historically broadly proposed the election of supervisory board members for the maximum term permissible under German law, although market practice is slowly moving toward shorter terms.<sup>47</sup> While we believe shorter election terms would better align with international best practice, we do not generally recommend voting against candidates who are nominated for five-year terms at this time. We will continue to monitor developments in this space and may establish a policy in a future update to these guidelines should market practice improve.

However, in line with our Continental Europe policy guidelines, where we have serious concerns regarding the actions of the board and none of its members is up for election, we may recommend that shareholders hold the board accountable through a vote against the ratification of supervisory board acts.

### ELECTION OF SUPERVISORY BOARD MEMBERS AS A SLATE

German companies are recommended to elect supervisory board members individually.<sup>48</sup> Given that most companies comply with this best practice, we recommend voting against any election that is clearly proposed as a slate.

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<sup>43</sup> 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.

<sup>44</sup> Recommendation C.10 of the Kodex acknowledges the fact that a number of German supervisory boards have established committees that addresses management board remuneration, and calls for the chair of such committees to be independent of the company and management. However, Principle 23 of the Kodex and Article 87 of the German Stock Corporations Act ("AktG") clarify that the entire supervisory board is responsible for designing a clear and comprehensible management board remuneration system and determining the actual remuneration of each management board member.

<sup>45</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>46</sup> Article 102(1) of the German Stock Corporations Act ("AktG").

<sup>47</sup> The original draft for the 2019 Kodex contained a recommendation that supervisory board terms be limited to a maximum of three years. While this recommendation was removed following the stakeholder consultation process, there was an increase in companies proposing shorter board terms in 2020.

<sup>48</sup> Recommendation C.15 of the Kodex.

## ANNOUNCEMENT OF SUPERVISORY BOARD CHAIR CANDIDATE

In cases where the supervisory board chair is due to leave the board at an annual meeting, German companies will generally disclose which of the nominees or incumbent board members is to take over the supervisory board chair position.<sup>49</sup>

However, where a candidate to take over this position has not been disclosed, we will analyse supervisory board nominees under the assumption that each nominee is a potential candidate for the supervisory board chair position. This may, in particular, affect our analysis and recommendations of nominees that held a recent position on the Company's management board or who have a number of additional commitments at other publicly-listed companies. As such, in cases where a former executive of a company is being proposed for election to the supervisory board, we believe that shareholders can reasonably expect clear disclosure from the supervisory board regarding this individual's intended role on the board.

### **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.

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

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<sup>49</sup> Article 5.4.3 of the 2017 version of the Kodex recommended that "candidates for the Supervisory Board Chair shall be announced to shareholders". However, the 2019 version of the Kodex no longer contains a comparable recommendation.

<sup>50</sup> Article 286(1) of the German Stock Corporations Act ("AktG").

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, 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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51 Recommendation C.1 of the Kodex.

52 *Ibid.* The Kodex recommends that the implementation status of the profile of skills and expertise be published in the Corporate Governance Statement.

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 Recommendation C.13 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 of profits 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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Since July 31, 2009, the German Stock Corporations Act ("AktG") had allowed for the possibility of non-binding advisory votes on management board remuneration, although no mandatory requirement existed. Following the implementation of Shareholder Rights Directive II ("SRD II") into German law, finalised on December 12, 2019, and the entry into force of the revised Kodex, companies will be mandated to seek shareholder approval of the remuneration policy at least every four years (or upon implementation of material amendments) and of the remuneration report every year. Both votes will be advisory;<sup>63</sup> however, should the remuneration policy not receive the support of a majority of votes cast, companies are required to review the policy and present it for another shareholder vote at the following annual meeting at the latest.<sup>64</sup> The vote on the remuneration policy is mandatory from 2021, while the vote on the remuneration report will become mandatory from 2022.<sup>65</sup>

The remuneration policy and report must cover remuneration arrangements for both executive and non-executive directors. While companies may present a single remuneration policy vote to the general meeting, we generally believe that providing separate proposals for approval of the remuneration policy for the management board and for the supervisory board allows for a more meaningful vote. Where a company seeks approval of the policies in a single proposal and we have identified substantial concerns with the proposed remuneration policy for either the management board or the supervisory board, we will generally recommend that shareholders vote against the proposal.

Given the recent implementation of the revised Kodex, Glass Lewis does not expect companies to amend existing management board members' contracts to immediately implement the new recommendations. While a uniform implementation of such requirements into the contracts of all active management board members would improve transparency, we believe a gradual implementation upon renewal of each contract to be reasonable. In this case, however, we will expect companies to disclose: (i) which recommendations were implemented; (ii) which were not implemented and why; and (iii) any future commitments in this regard.

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.

Our policies regarding the terms of an executive pay system and report do not differ materially from our Continental Europe Policy Guidelines. However, we do account for a company's compliance with legal requirements and best practice in Germany, as described below, when evaluating these proposals.

## MANAGEMENT BOARD REMUNERATION POLICY

Glass Lewis's analysis and recommendation of a remuneration policy proposal are focused on the structure of the pay package, as detailed in our Continental Europe Policy Guidelines. Furthermore, 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" in the proposed policy.

<sup>63</sup> Art. 119(1)3 and 120a(1, 4) of the German Stock Corporations Act ("AktG"). Principle 23 of the Kodex. Pursuant to Art. 120a(5) of the AktG, small- and medium-size companies as defined by §267(1-2) of the German Commercial Code may opt to present the remuneration report to the general meeting as discussion item, rather than voting item.

<sup>64</sup> Art. 120a(3) of the German Stock Corporations Act ("AktG").

<sup>65</sup> Art. 2(1-2) of Gesetz zur Umsetzung der zweiten Aktionärsrechterichtlinie ("Act on the Implementation of SRD II").

Some of the issues we will consider when analysing remuneration policies that may contribute to a negative recommendation are as follows:

- Variable remuneration components are not based on the achievement of operating and strategic performance targets, which may be financial and non-financial in nature, as well as company-wide or individual, as defined by the supervisory board in the remuneration policy;<sup>66</sup>
- Financial and non-financial performance criteria, the selection process and vesting mechanisms thereof, are not sufficiently disclosed;<sup>67</sup>
- The remuneration policy is not suitably linked to the company's strategic priorities and oriented to long-term performance and sustainability;<sup>68</sup>
- The maximum payout opportunity for each management board member is not adequately disclosed;<sup>69</sup>
- The supervisory board does not retain discretion to reduce, withhold or reclaim management board members' remuneration to account for extraordinary developments;<sup>70</sup>
- The supervisory board retains discretion to allocate extraordinary awards outside the regular incentive plans and outside the deviations allowed by law to safeguard the long-term wellbeing of the company;<sup>71</sup>
- The terms of any deferral periods, recovery provisions and vesting restrictions on share-based awards are not disclosed, or any severance and pension provisions are not disclosed;<sup>72</sup>
- Substantial target and maximum remuneration increases are attributed solely to benchmarking exercises without further discussion or rationale;<sup>73</sup>
- The remuneration policy does not include disclosure detailing how the system was amended and how shareholder feedback on the system was taken into account;<sup>74</sup> and
- The remuneration policy does not include disclosure detailing how the remuneration of the company's wider workforce was taken into consideration when setting the levels of management board members' pay.<sup>75</sup>

## REMUNERATION REPORT

Glass Lewis's analysis and recommendation of a remuneration report proposal are focused on the implementation of the remuneration structure during the preceding fiscal year and on the disclosure thereof, as detailed in our Continental Europe Policy Guidelines. Additionally, according to German law, a remuneration report must be clear and understandable, and include the remuneration granted and paid during the past fiscal year to each current and former member of the supervisory board and management board of the company and its subsidiaries.<sup>76</sup>

Some of the issues we will consider when analysing remuneration reports that may contribute to a negative

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66 Recommendations G.1 and G.7 of the Kodex.

67 Art. 87a(4) AktG.

68 Art. 87a(1) AktG and Recommendation G.6 of the Kodex. Additionally, in July 2018 a group of German Corporate Governance experts published "Guidelines for Sustainable Management Board Remuneration Systems", highlighting the importance of linking executive pay to long-term sustainability.

69 Art. 87a(1) AktG and Recommendation G.1 of the Kodex.

70 Recommendation G.11 of the Kodex.

71 Art. 87a(2) AktG.

72 Art. 87a (5-8) AktG.

73 Recommendations G.2 and G.3 of the Kodex.

74 Art. 87a(11) AktG.

75 Art. 87a(9) AktG and Recommendation G.4 of the Kodex.

76 Art. 87a(1) and 162(1) AktG, Art. 285(9) HGB, and Principle 23 of the Kodex. Prior to the revision of the AktG, companies were permitted to seek shareholder approval to omit individual disclosure of management board members' remuneration; this is no longer permissible.

recommendation are as follows:

- The remuneration report does not contain clear disclosure detailing how target, maximum and actual remuneration amounts for each management board member were determined;<sup>77</sup>
- The remuneration report does not contain disclosure detailing the relative weight of each component of the pay package<sup>78</sup> and how each component supports the company's strategy and long-term development;<sup>79</sup>
- The relationship between granted and vested remuneration, the underlying levels of target performance achievement and the final size of vested awards are not comprehensible;<sup>80</sup>
- Performance goals were lowered during the performance period<sup>81</sup>
- The supervisory board approves severance pay for a member of the management board that is more than twice their total annual remuneration or the remaining term of their contract,<sup>82</sup> or stipulates special termination rights triggering severance payments exceeding the aforementioned cap in case of termination due to a change in control;<sup>83</sup>
- The remuneration report does not include a five-year comparison of annual remuneration, company performance and average full-time equivalent employee pay;<sup>84</sup>
- The remuneration report does not include disclosure detailing any deviations from the management board remuneration policy resolved on by the supervisory board during the preceding fiscal year, including an explanation of why said deviations were deemed necessary.<sup>85</sup>

The former version of the Kodex provided two templates for the disclosure of individual management board members' annual granted and allocated remuneration, broken down by element and minimum, target and maximum value of awards granted in the relevant fiscal year. This recommendation was removed from the new version of the Kodex; at the same time, the revised Stock Corporations Act does not include alternative disclosure requirements in this regard. Absent an alternative recommended method, we expect companies to continue to disclose management board remuneration using the Kodex model tables.

Further, in light of local and European best practice, we expect companies to explicitly address any feedback received from shareholders in their remuneration report should a say-on-pay proposal at the previous annual meeting receive significant opposition. 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.

## **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

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77 Art. 162(1) AktG and Recommendation G.1 of the Kodex.

78 Art. 87a(1) and 162(1) AktG and Recommendation G.1 of the Kodex.

79 Art. 162(1) AktG and Principle 23 of the Kodex.

80 Recommendations G.1 and G.9 of the Kodex.

81 Recommendation G.8 of the Kodex.

82 Recommendation G.13 of the Kodex.

83 Recommendation G.14 of the Kodex.

84 Art. 162(2) AktG.

85 Art. 162(1) AktG.

oriented toward a company's sustainable growth.<sup>86</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 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>87</sup>

## **SUPERVISORY BOARD REMUNERATION POLICY**

As with the management board remuneration policy, German companies are required to seek shareholder approval of the remuneration policy for the supervisory board at least every four years or whenever material amendments are made. Prior to the transposition of SRD II, German companies were required to either seek annual approval of the fees to be paid to supervisory board members, or to include the remuneration policy for supervisory board members in their articles of association and seek shareholder approval for any changes. Most German companies continue to include the remuneration policy for supervisory board members in their articles of association. Given the new legal requirement for shareholder approval of the supervisory board remuneration policy, Glass Lewis will generally recommend supporting proposals to remove the supervisory board remuneration policy from a company's articles of association.

Our policies regarding the terms of supervisory board remuneration proposals do not differ materially from our Continental Europe Policy Guidelines. While we generally believe that shareholders are best served when supervisory board members receive fixed remuneration only, in line with market practice in Germany and the recommendations of the Kodex,<sup>88</sup> we may accept limited performance-based awards, so long as such awards are based on clearly-defined, multi-year performance criteria and geared toward the long-term sustainable development of the company.

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<sup>86</sup> G.18 of the Kodex recommends that supervisory board members should receive fixed remuneration only, but that if performance-related remuneration is granted, it shall be geared to the long-term development 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.

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

<sup>88</sup> *Ibid.*

# 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>89</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; directors may 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>90</sup>

## 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% dis-

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<sup>89</sup> Article 120(1) of the German Stock Corporations Act ("AktG").

<sup>90</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.

close their shareholdings within four trading days of the acquisition or sale.<sup>91</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>92</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, financing 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>93</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>94</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 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.

<sup>91</sup> Article 33(1) of the German Securities Trading Act (Gesetz über den Wertpapierhandel or "WpHG").

<sup>92</sup> Article 43(1) of the German Securities Trading Act ("WpHG").

<sup>93</sup> Article 43(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>94</sup> Article 67 of the German Stock Corporations Act ("AktG").

# 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>95</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>96</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>97</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>98</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>99</sup> (ii) the company must not repurchase its shares for the purpose of trading,<sup>100</sup> and (iii) the authority to repurchase shares cannot be granted for a period of time exceeding five years.<sup>101</sup> In addition, banks and financial institutions may seek approval at a general meeting of shareholders to repurchase shares for the purpose of

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<sup>95</sup> Article 203(2) of the German Stock Corporations Act ("AktG").

<sup>96</sup> Article 202 of the German Stock Corporations Act ("AktG"). Article 186(3) of the German Stock Corporations Act (AktG) further limits issuances of shares for cash consideration without preemptive rights to 10% of a company's total share capital.

<sup>97</sup> Article 192(2) of the German Stock Corporations Act (AktG).

<sup>98</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>99</sup> Article 71(1.8) of the German Stock Corporations Act ("AktG").

<sup>100</sup> *Ibid.*

<sup>101</sup> *Ibid.*

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>102</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>102</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 countermotions and shareholder proposals. Shareholder countermotions 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>103</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>104</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>105</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.

Our policies regarding these matters do not differ materially from our Continental Europe Policy Guidelines.

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<sup>103</sup> Article 126 of the German Stock Corporations Act ("AktG").

<sup>104</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>105</sup> Article 122(2) of the German Stock Corporations Act ("AktG").

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