Deutsches Aktieninstitut

Some amendments requested

Position of Deutsches Aktieninstitut on the Draft Revisions to the G20/OECD Principles of Corporate Governance

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Introduction

Deutsches Aktieninstut appreciates the possibility to comment on the Draft Revisions to the G20/OECD Principles of Corporate Governance.

About us: Our members, around 200 in number, represent more than 85 percent of the stock market value of German companies. We bundle their interests and make their voices heard. In specialist exchange with policy-makers and supervisory authorities, we bring the perspectives of the real and financial economy into the political debate with measured regulation. Our approach is to identify solutions which pay appropriate attention to all interests.

Together with the Principles as stated on p. 12 we are of the opinion, that: “there is a risk that the variety of legal influences may cause unintentional overlaps and even conflicts, which may frustrate the ability to pursue key corporate governance objectives. It is important that policy makers are aware of this risk and take measures to ensure a coherent institutional and regulatory framework.”

Deutsches Aktieninstitut suggests:

1. The Sections on company groups should be redrafted. They do not reflect the sophisticated legislative status concerning groups in some jurisdictions and have a negative connotation.

2. In addition to what is said in the Principles, it is important to stress that in order to be able to make use of the possibility to hold general meetings in a virtual format, the law must be designed in a way that is practicable while safeguarding shareholders' rights. Companies also need safeguards from legislators in case digital tools fail, especially on the users’ side.

3. We disagree that Directors’ and officers’ liability insurance policies may change managerial incentives and thus warranting shareholder approval or disclosure.

4. We appreciate the thoughtful and balanced approach of the Principles in the chapter on sustainability. Especially, we welcome the call for high quality, understandable, enforceable and internationally accepted core standards as companies need a global baseline.

5. The Principle on conflicts of interests and transparency with regard to (ESG) rating agencies and proxy advisors should be more prescriptive rather than only descriptive, given the importance of agencies and proxy advisors for corporate governance.

6. The Principles imply that in case of an economic downturn corporate officers would immediately ask for an adjustment of the terms for their remuneration. We suggest to take into account in the text that strategies or parts thereof are not adjusted frequently, but rather in exceptional circumstances that may also justify an amendment in remuneration targets.

1 About the Principles

No. 1 reads "The Principles of Corporate Governance are intended to help policy makers evaluate and improve the legal, regulatory, and institutional framework for corporate governance, with a view to supporting economic efficiency, sustainable growth and financial stability. This is primarily achieved by providing shareholders, board members and executives, employees along with other stakeholders where a jurisdiction's legal and regulatory framework permit, as well as financial intermediaries and service providers with the right information and incentives to perform their monitoring roles and help to ensure accountability within a framework of checks and balances."

Deutsche Aktieninstitut wonders what the Guidelines intend when emphasizing the role of stakeholders referring to incentives and ensuring accountability. This is a very prominent place and especially with regard to incentives, and the intent of this placement is not clear from the rest of the Principles.

1 I., I.C and I.E: Authorities

It is welcomed that the Principles **stress independence of supervisory, regulatory and enforcement authorities** (I.E. p. 12): "To guard against conflicts of interest (including the potential for political or business interference in supervisory and enforcement processes), operational independence may be reinforced by autonomy over budgetary and human resource management decisions. Such autonomy should be coupled with high ethical standards and accountability mechanisms including timely, transparent and fully explained rulings that are open to public and governmental scrutiny."

As stated initially, we also welcome that the Principles **try to raise awareness for policymakers and regulators that have an array of legal domains**, such as company law, securities regulation, accounting and auditing standards, etc. As a result, policymakers and regulators **have an influence on corporate governance, which increases complexity for issuers**. A coherent institutional and regulatory framework is more important than ever. For example, the Green Deal in Europe and its corresponding initiatives contemporaneously nudging various addressees to strive for more sustainability using direct and indirect mechanisms to influence strategic decisions.

With the Principles, we see that under these circumstances, there is a risk that the variety of legal influences may cause unintentional overlaps and even conflicts.

We share the view that in order to guard **against conflicts of interest (including the potential for political or business interference in supervisory and enforcement processes**), operational independence should be reinforced.

Here, we would like to add that if, like in many jurisdictions, levies on supervised entities in combination with, or as an alternative to, government funding, are imposed, **there should be national principles of a structured and balanced approach in place when calculating the required contribution of (groups of) entities added**.

2 I.H., II.F.1, II.G. and IV.A.3. Company Groups

We have the impression that there is a general **negative connotation**, in the Principles concerning company groups. While generally highlighting the contribution of the Principles to innovation, productivity and entrepreneurship, and economic dynamism more broadly, the role of groups is not put in that context. The reference to risks like tax abuse stemming from company groups, the impression is created that there are no benefits from group building for the companies or the economy at large. **We think that such an approach is falling short when dealing with groups in the Principles**.

Here and in Principle II.F.1, **we miss a mention of jurisdictions with a specialized set of legal rules concerning de facto and contractual corporate groups and other procedures** (e.g. German "Konzernrecht") that prevent abusive related party transactions in group structures. The Principles state that a "key underlying principle for board members who are working within the structure of a group of companies is that even though a company might be controlled by another company, the duty of loyalty for a board member is related to the company and all of its shareholders and not to the controlling company of the group." With all that is stated before in II.G, it should be added that there are jurisdictions where powers of direction can be derived from a formal control agreement between parent and subsidiary with special safeguards in company law protecting minority shareholders. This is something else than the "parent" just being a de facto majority shareholder. So, the Principles do not present the whole picture with regard to possible structures in group law and the effects on directors' duties.

As the Principles are descriptive they should take into account various solutions jurisdiction have found in order to strike a balance in group law.

The Principles also call for an obligation to disclose group structures and their control arrangements as such schemes also allow shareholders, debtholders and potential investors to make better informed decisions, in IV.A.3. Group structures may change over a short time when acquisitions or establishment of smaller companies take place for certain regions, products or services. Therefore, such disclosure should be limited to the core group structure.

3 II.C.3. Virtual Shareholder Meetings

We welcome the Principle's progressive approach on general meetings in a virtual format. We believe that hybrid formats can have legitimacy for small and medium-sized companies, but to make efficient use of digitalisation, the fully virtual option should be enhanced. **In order to be able to make use of the instrument, the virtual shareholders' meeting must be designed in a way that is practicable while safeguarding shareholders' rights. However, for example, companies need safeguards from legislators in case digital tools fail, especially on the users' side (shareholders). The Principles should encourage that.**

4 II.C.5. Effective Shareholder Participation: D&O

The Principles state: "Directors' and officers' liability insurance policies may also change managerial incentives, thus warranting shareholder approval or disclosure." Does this really mean that the Principles assume that if there is a D&O insurance, managers will have an "incentive" to take more risk? We do not believe that an insurance that predominantly takes care of lawyer and legal costs can be regarded as an "incentive".

We do not quite understand the assumptions made by the Principles: should a new e.g. CEO accept the position not knowing if he or she will ultimately have a D&O insurance because the annual shareholder meeting may vote against providing one? We would like to point out that, e.g. in Germany, members of the supervisory or management boards are liable with their entire personal assets without limits for damages. At the same time, they face high risks of failing the business judgement rule in complex decision-making processes even if taken in good faith. Furthermore, we want to highlight that a D&O insurance serves also as a safeguard for a company and its shareholders. If a director is liable to pay substantial damages to a company he may not be able to cover this with his private assets.

We reject this requirement.

5 III.D. Conflicts of interest: Proxy Advisors, ESG and Credit Rating Agencies

We appreciate that the Principles state that "the methodologies used by service providers that produce ratings and indices should be transparent and publicly available to clients and market participants. This is particularly important when they are also referenced as metrics for regulatory purposes. Exclusive reliance on ratings in regulation may raise questions, while the process for deciding which ratings are eligible for use for regulatory purposes should be transparent and could be subject to evaluation at various levels of frequency." This is the same for the disclosure by proxy advisors as described in the Principles. **Here, the Principles should be more prescriptive rather than only descriptive, given the importance of agencies and proxy advisors for corporate governance.**

6 IV.D. Accountability of External Auditors to the Shareholders

The Principles state that "shareholders and external auditors should also have the possibility to communicate directly on the findings of the annual audit." A direct accountability and information duty of the external auditors to the shareholders deserves thorough deliberations. While on the one hand such a mechanism could be prone to and even pave the way towards misuses or even abuses, it might on the other hand also add another line of control to the system of auditors' supervision and enable the shareholders to hear another neutral and independent voice on the (financial and non-financial) performance of the company.

7 V.A. Board Members and Interests of Stakeholders

The Principles state: "Where consistent with jurisdictional requirements, boards may take into account the interests of stakeholders, notably when making business decisions in the interest of the company's long-term success and performance. This may help companies, for example, to attract productive employees, to be supported by the communities in which they operate, and to have more loyal customers, thus creating value for their shareholders." **We appreciate the balanced approach.**

8 V.A.1. Business Judgement Rule

We appreciate that the Principles point out the importance of protecting board members against litigation if a decision was made in good faith with due diligence as complexity increases also due to complex and conflicting legislation.

9 V.D.1. Reviewing and Guiding Corporate Strategy

In the chapter "About the Principles", in no. 10 it is stated that "board" as used in the Principles refers to the "supervisory board" while "key executives" refers to the "management board". If so, then the assumption here, that "The board is tasked with setting the overall strategy of the company; determining the company's policies; assessing and guiding performance; and overseeing the company's financial operations" is **wrong** because this is the description of the management board in our dualistic system. Although the next sentence refers to a possible different allocation of responsibilities between the supervisory and management boards in two-tier board systems, within the constant use of "board" in the Principles to follow the allocation to active responsibility and oversight becomes more and more opaque. Maybe the structure should be reconsidered.

10 V.D.5. Key Executive and Board Remuneration

The Principles state "The design of remuneration policies and contracts for board members and key executives is critical to set incentives that are aligned with a company's business strategy. These policies, however, may not fulfil their goal if they are frequently adjusted in the absence of a significant change in the business strategy or a structural transformation of the context in which the company operates. Specifically, the likelihood of an economic downturn is a factor that corporate officers reasonably can consider when accepting their remuneration package and may not immediately justify an adjustment of the terms for their remuneration." We believe that under normal circumstances strategies are not adjusted frequently, but under exceptional circumstances. **The Principles imply that corporate officers actively take the risk of an economic downturn when**

accepting that a part of their variable remuneration depends on strategic performance. In our opinion this is only true for normal economic cycles, where there is a chance to evaluate different possible scenarios, not exceptional events like the pandemic or a war in Europe and even the combination of both. Also, using the term "immediately" seems to have a rather negative connotation. Please also be aware, that the strategy itself may have to be adjusted in such cases, anyway. If a strategy is not followed anymore or has changed significantly, it would be strange to stick to it, e.g. in a multi-year performance assessment. **We suggest to take such considerations into account in this text.**

11 VI. Sustainability and Resilience

We appreciate the thoughtful and balanced approach of the Principles in this chapter. We especially welcome the call for high quality, understandable, enforceable and internationally accepted core standards (VI.A.2.) Most companies operate on an international level and therefore they need a global baseline. Also, standards have to be aligned with such baseline. Especially phasing in is important for smaller issuers (VI.A.5.), but not only with regard to assurance levels but also with regard to prioritising topics. So, climate change should be dealt with first, when establishing high quality standards.

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