

GERMAN CORPORATE GOVERNANCE CODE

INTRODUCTION TO THE PRI

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. PRI has 1600 signatories globally with USD\$62 trillion in assets under management. In Germany there are 60 signatories, 17 of which are asset owners. The PRI's 2017 annual conference, *PRI In Person*, will be hosted in Berlin¹.

Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and corporate governance factors, and the long-term health and stability of the market as a whole. It is driven by a growing recognition in the financial community that evaluation of ESG issues is a fundamental part of assessing portfolio value and investment performance.

ABOUT THE CODE

Since its introduction in 2002, the Code has provided a common framework for German companies to advance their governance practices. Good governance can lower the cost of capital and attract investment. Corporate governance is the most common reason given by PRI signatories in their company engagement.

The Commission's annual revision ensures the Code reflects market practice. The consultation was cross-posted on the PRI's collaboration platform².

¹ Details here: <https://www.unpri.org/events/pri-in-person-2017-2017-09-25-2017-09-27-43/register>

² <https://www.unpri.org/collaborate>, <https://www.unpri.org/group/policy-consultation-german-corporate-governance-code-2533> (PRI log in required)

SUMMARY

The PRI welcomes the opportunity to comment on the revisions to the German Corporate Governance Code (the “Code”), published on the Regierungskommission website (www.dcgk.de) (the “Commission”).

The PRI makes the following recommendations to the Commission:

- 1. Adopt consistent terminology for ESG factors.**
- 2. Assist companies in coordinating their corporate governance disclosures around common performance metrics.**
- 3. Clarify that risk management and risk controlling includes consideration of ESG factors.**
- 4. Introduce recommended practice relating to the sustainability skills required by the supervisory board.**
- 5. Establish greater transparency on the components of Director remuneration**
- 6. Review and consider implementing the recommendations of PRI’s recent paper, [Integrating ESG issues into executive pay: a review of global utility and extractive companies](#).**

In Q1 2017, the PRI, UNEP FI and The Generation Foundation will publish a *German Roadmap*, which makes recommendations to support national stakeholders in implementing clear and accountable policy and practice that clarify investors’ duties with regards to ESG factors. The roadmap will also consider the likely implications forthcoming EU policy including the revised Institutions for Occupational Retirement Provision (IORP) Directive and the revised Shareholder Rights Directive to Germany’s capital market. More details are available at www.fiduciaryduty21.org.

CONTACT DETAILS

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CONSULTATION RESPONSE

The PRI is providing a response to revisions which directly relate to our programme of work.

Amendment to article 2.1.3: Especially institutional investors are required to exercise their ownership-rights actively and responsibly in accordance with a consistent and transparent framework of rules respecting also the concept of sustainability/Corporate Social Responsibility.

The PRI supports this amendment, consistent with the PRI's mission³ and Principles. Principle 2 of the PRI's Six Principles states: *We will be active owners and incorporate ESG issues into our ownership policies and practices.* Stewardship activity is a long-term instrument; its benefits accrue over several years.

In addition, we recommend that the Commission:

1. Adopt consistent terminology for ESG factors.

The terms "non-financial", "ESG", "corporate social responsibility (CSR)" and "sustainability" reporting are often used interchangeably by stakeholders. Although CSR information is in part due to increase in investor interest, it is often written for a broader stakeholder audience, not presented in the necessary context and reported with information unconnected with the core operations of the business. In relation to stewardship and active-ownership, we recommend that the Commission adopt the terminology "ESG factors" to avoid confusion between these forms of reporting.

2. Assist companies in coordinating their corporate governance disclosures around common performance metrics.

Given the demand for company reporting on ESG factors from the investor community and the costs that issuers and investors are willing to incur in both, producing and analysing it, the Commission should assist companies in coordinating their corporate governance disclosures around common performance metrics.

In addition, we recommend that the following principles shape the Code's requirements for corporate disclosures (sections 6 and 7 of the Code: Transparency and Reporting):

- ESG factors should be disclosed in the same wrapper as the annual report and the other outputs of conventional accounting practice, with clear links between ESG factors and the company's business model and risk factors.

³ The PRI's mission states: "We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole. The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation."

- Companies should report using common performance metrics to allow for comparability, in particular, comparability by industry, portfolio and across time-series; codifying industry and sector-specific key performance indicators for ESG factors.
- ESG data should be assured, consistent with material financial data. We suggest a phased introduction.
- Companies should disclose additional company-specific ESG risks and opportunities.

Amendment to article 4.1.4: The Management Board ensures appropriate risk management and risk controlling in the enterprise.

Risk management and risk controls are important to a corporation's financial prospects. Investors should have an understanding of a company's risk management strategy to enable an investor to assess the sustainability, in financial terms (including ESG factors), of the company's business model⁴.

We recommend that the Commission:

3. **Clarify that risk management and risk controlling includes consideration of ESG factors.**
4. **Introduce recommended practice relating to the sustainability skills required by the supervisory board.** This should include the identification of training needs. Proactive training may also be supported by reactive training triggered by events such as new products, new markets or changes in strategy.

Amendment to article 4.2.3: Multi-annual, variable compensation components that are partially respected in the calculation shall not be paid out ahead of schedule.

The PRI agrees with the alignment of variable remuneration with a company's long-term value-creation prospects. Linking ESG performance to pay can help hold executive management to account for the delivery of sustainable business goals. Executive pay should be aligned with performance and long-term strategy in order to protect and create value, but existing remuneration plans often do not promote sustainable value creation, which is in the interest of both companies and their investors. This lack of alignment is of concern for long-term investors, and presents opportunities for engagement to promote the consideration of ESG factors when setting pay.

We recommend that the Commission:

5. **Establish greater transparency on the components of Director remuneration.** This should include:
 - Disclosure of how the remuneration of directors was established.

⁴ See https://www.db.com/newsroom_news/2016/ghp/esg-and-financial-performance-aggregated-evidence-from-more-than-200-empirical-studies-en-11363.htm.

- Transparency around the role of the committee and/or other independent expertise engaged to determine pay.
- Disclosure of the split between fixed and variable pay as a minimum. In addition, the PRI would encourage clear, intelligible disclosure of the elements of variable pay (shares, options, pensions and other benefits) and how these elements are linked to the long term performance of the company, including the sustainability of the company.
- Disclosure on relative change in remuneration. We encourage companies to provide a supporting statement which justifies the decisions made.

6. Review and consider implementing the recommendations of PRI's recent paper, [Integrating ESG issues into executive pay: a review of global utility and extractive companies](#).