

22 December 2016

Herr Dr Gentz  
Vorsitzender, Regierungskommission  
Deutscher Corporate Governance Kodex  
c/o Deutsches Aktieninstitut e.V.  
Niederneu 13-19  
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Germany

Via email: [regierungskommission@dcgk.de](mailto:regierungskommission@dcgk.de)

Dear Herr Dr Gentz,

### **BMO Global Asset Management's comments on the proposed amendment to the German Corporate Governance Kodex 2017**

I am writing to you on behalf of BMO Global Asset Management (BMO GAM). BMO GAM is an investment management firm whose institutional and retail clients collectively represent over \$238 billion of assets. In addition, BMO GAM EMEA has been mandated to vote and/or engage in dialogue on behalf of a further 26 investment institutions with assets, including equities and corporate bonds, totalling over £77 billion/€89 billion/\$100 billion (as at 30 September 2016).

Thank you for the opportunity to comment on the amendments to the Kodex. We very much welcome the Commission's push for greater transparency aimed at facilitating governance assessment by stakeholders, specifically around Compliance Management Systems, whistleblowing arrangements, Supervisory Board member independence and biographies. We particularly welcome the focus on reasoned explanations by companies in cases of non-compliance with recommendations of the Kodex and the clear recommendation for the Chairman of the Supervisory Board to be prepared to enter in dialogue with investors. These elements, if fully utilised by companies and investors, can contribute to higher corporate governance standards in the German market, improved corporate culture and investor confidence. Finally, we view as a positive step the decision to make public institutions' responses to the Kodex's amendments.

We would like to provide specific feedback to some of the proposed amendments and make further comments on issues that the Kodex may address. Some of these submissions can be incorporated in the Kodex as "suggestions" in order to reduce the compliance burden while setting best practice expectations.

#### **Amendments to Section 5.2**

As investors in German companies, we welcome regular and structured opportunities to meet with board members we elect, including the Chairman of the Supervisory Board and other designated members of the Supervisory or Management Board, to discuss our views and raise any governance-related concerns<sup>1</sup>.

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<sup>1</sup> We are supportive of the Guiding Principles for the Dialogue between Investors and German Supervisory Boards, July 2016.

Supervisory Boards should be proactive in making sure important news is imparted, subject to appropriate inside information procedures, and should react helpfully to investor questions. In investment meetings with shareholders, companies should be prepared to address relevant corporate governance, as well as environmental and social issues. We would, therefore, welcome a further recommendation in the Kodex explicitly encouraging dialogue between Supervisory Boards and investors on specific matters, including:

- The role of the Supervisory Board in the setting of company strategy;
- The role of the Audit Committee and the interaction between the Chairman of the Audit Committee and the external auditor and CFO;
- Nomination process and succession planning for both Management and Supervisory Board members, including desired profiles (*see further detail in Transparency of the Nomination Process below*);
- Evaluation of Supervisory Board members including skills gap analysis/matrices; Supervisory Board fees;
- Management Board compensation and in the context of strategic goals and company performance.

Furthermore, we would encourage the Kodex to suggest that the Chairman of the Supervisory Board and other relevant members, proactively make themselves available for consultation with shareholders on these substantive matters.

Given that expectations of the Chairman exceed those of other Supervisory Board members, we would welcome additional guidance in the Kodex around the clearer identification of the Chairman. The Kodex may suggest that companies clearly state if a Supervisory Board member standing for (re-) election fulfils the role of Chairman or has been designated by the Board to take the Chairmanship, for example in the cases where the serving Chairman is due to retire.

Finally, we encourage the Commission to include a recommendation setting out the obligation of the Chairman of the Supervisory Board to report the content of meetings with investors to the entire Board to avoid information asymmetries.

### **Amendments to Section 5.3.2**

#### ***Audit Committees***

We are supportive of the Kodex recommendation that the Chairman of the Audit Committee shall be independent and not a former member of the Management Board. We furthermore expect all Audit Committee members to be independent. We believe that this is a fundamental provision given that the Audit Committee provides an important safeguard for shareholders and for other stakeholders that rely upon the integrity of the report and accounts as a basis for their dealings with the company. We would encourage the Commission to strengthen its best practice recommendation for the composition of the Audit Committee.

### **Amendments to Section 5.4.1**

#### ***Transparency of the Nomination Process***

We welcome the proposed changes recommending that companies set up a profile of competencies for all of the Supervisory Board and the clarification regarding the availability of curriculum vitae and abstracts about candidate essential activities. We are also supportive of the new provisions on investor dialogue and the Kodex existing recommendations for nomination committees to be composed exclusively of shareholder representatives. We would welcome further guidance by the Kodex on the level reporting expected from companies around board candidate nominations:

We believe that reporting on the following main elements would preserve necessary confidentiality and flexibility for boards while providing investors with better insight into the nomination process:

- Full relevant biographical details of both new nominees and all incumbent board members. In particular, investors are interested in the background, experience and skills of the nominee/director that are of particular value to the board.
- A desired skills matrix for the board, any identified gaps in competence, skills, experience on the board and steps taken to address these needs;
- A description of the board appointment process, which in our view should be led by a majority independent Nomination Committee. The description should set out whether the Committee involved an external executive search firm or handled the process internally.
- A regular board evaluation report, utilising external facilitations, describing the effectiveness of the entire board, the contributions made by each member, its systems for interaction between the board and company management and any areas for improvement.

#### **Further suggestions under Section 5.4.1**

##### ***Board Independence and Refreshment***

It is our view that prolonged board membership can jeopardise a director's independence and, most importantly, impede board refreshment, thus creating a possibility that over time the board may not be equipped with the experience and skills necessary for effective oversight. Regular board refreshment helps bring in the necessary skills and experience and ensure diversity; it also helps address concerns over independence and allows for effective succession planning while maintaining continuity on the board. We would therefore welcome more specific suggestions in the Kodex for a best practice limit to directors' tenure for all German companies.

We also urge the Commission to consider, as part of the Kodex review, the merits of a recommendation on shorter director terms and the implementation of either staggered election cycles or, ideally, annual re-elections, in order to facilitate a more dynamic board refreshment process. We view board tenures in Germany, which are some of the longest in Europe, as an area which would merit particular attention by the Commission.

We generally prefer to have all directors standing for election annually to strengthen the accountability of the board to shareholders. Failing that, we encourage the Chairman of the board, as well as the Chairmen of the Audit, Remuneration and Nomination Committees to stand for annual re-election to strengthen accountability on the core functions of the board. We also believe that a minimum of one-third of board members should stand for election annually.

##### ***Time Commitments and Meeting Attendance***

We generally expect Supervisory Board members to ensure they have sufficient time and energy to discharge their roles and attend all necessary meetings. We expect members to attend at least 75% of meetings, either in person or, occasionally, by phone and would therefore welcome Kodex suggestions for simple tabular disclosure of the number of board and committee meetings each board member has attended from a total possible number and brief explanations where meetings were missed.

#### **Amendments to Sections 4.2.3**

##### ***Management Compensation***

We support the amendments to the Kodex around transparent compensation disclosure and have been encouraging company Remuneration Committees to follow them while also proactively seeking investor views. We would welcome further guidance from the Kodex on the disclosure of "demanding, relevant comparison parameters" for variable compensation components, which includes:

- Specific prospective performance targets (in addition to general criteria) and meaningful analysis of the extent to which the targets are actually met;
- Where performance targets are commercially sensitive, disclosure of the targets and the level to which they were met can be provided retrospectively to justify corresponding payouts.

We would also encourage the Commission to consider in future revisions of the Kodex a recommendation that severance/change-in-control payments do not exceed two year's fixed pay, bringing arrangement closer into line with international good practice, with our own view of best practice being one year's fixed pay.

To facilitate regular and robust dialogue between investors and boards on management compensation and to ensure continued improvement in pay transparency, we strongly encourage the Commission to recommend that companies put compensation to a shareholder vote on an annual basis.

### **Amendments to Sections 2.1.3**

#### ***Exercise of ownership rights***

As an active investor for many years, we believe that robust engagement and voting by institutional investors is critical to the health of financial markets and long-term value creation. We are a signatory and to the UK Stewardship Code, first published in 2010, and apply principles of the Code to our equity holdings in the UK and overseas. We have been supporting the development of Stewardship Codes in multiple other jurisdictions and therefore wholly welcome the inclusion in the Kodex of a provision for institutional investors requiring them to exercise their ownership-rights actively and responsibly.

### **Further suggestions on issues that the Kodex may address**

#### ***Related Party Transactions***

Section 4.3.3 recommends that legal transactions outside the ordinary course of business with persons or companies a management board member is close to require the approval of the Supervisory Board. We further believe that shareholders should also have the opportunity to approve material Related Party Transactions (RPTs) outside the ordinary course of business. We would urge the Regierungskommission to consider the merits of recommending that companies put relevant and material RPTs to the shareholder vote. To ensure that the RPT approval regime is both workable in practice and does not impose an unnecessary burden on companies, it should provide for certain reasonable exemptions<sup>2</sup>.

We would welcome further discussion with you on both the specific and general issues raised in this letter and look forward to hearing from you. Our contact details are below.

Yours sincerely,



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<sup>2</sup>In this context, ordinary course of business should be clearly defined, such that the size and incidence of the transaction and whether its terms are unusual in the circumstances are considered. Furthermore, any statement that RPTs were made on terms equivalent to those that prevail in arm's length transactions should be made only if such terms can be substantiated.