31 January 2019

Aviva Investors' Response to Proposed revisions to the German Corporate Governance Code

General comments

Aviva Investors is the global asset management business of Aviva, managing assets in excess of £345 billion[1] across a range of real estate, equity, fixed income, money market and alternative funds. We operate in Europe, the United Kingdom, North America, and select Asian markets. Aviva Investors is a major long-term institutional investor with a wealth of experience in corporate governance and investor stewardship. By serving our customers well, we are building a business which is strong and sustainable, which our people are proud to work for and which makes a positive contribution to society. This response represents the view of Aviva Investors.

Summary

Aviva Investors is pleased to respond to the Regierungskommission's (Commission's) consultation on proposed changes to the Deutscher Corporate Governance Kodex (Code). We believe that the Code has contributed to making Germany an attractive place to invest and do business. This review presents an opportunity to ensure that the Code plays an even greater role in fostering long-term, sustainable business behaviour — something which is central to Aviva's own strategy and values. Whilst we appreciate Germany's unique governance system, notably the prominent role of employees on German supervisory boards, we welcome this revision as it is better aligned with international corporate governance standards. We support the new Code structure's reliance on principles, and the underpinning recommendations and suggestions. We also welcome the more concise nature of the Code. While we appreciate its closer alignment with international standards, we believe there is scope for the revisions to go further in a number of areas as outlined below. In addition, as some recommendations depart significantly from current market practice, companies would benefit from more detailed guidance on the recommendations' implementation. Aviva Investors is a member of the International Corporate Governance Network (ICGN) and we are supportive of their consultation response. We would however like to emphasise the points below.

[1] As at 30 September 2018

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Sustainable value creation and stakeholders

We support the Code's added reference to the need for executive management and board of directors to "be aware" of the company's "responsibility vis-à-vis society, noting that social and environmental factors can influence corporate success." We welcome this addition as this is in line with our conviction that companies that adopt a holistic approach to managing their social and environmental impacts will be better placed to deliver long-term sustainable value.

However, we consider that simply being "aware" of social and environmental factors is not sufficient to drive cultural and behavioural change within the boardroom. We would encourage the Commission to consider mandating a specific board responsibility and commitment recommendation within the Code's principles and not only in its foreword. We supported similar recommendations put forward in the 2018 revisions to both the UK Corporate Governance Code and the French Afep-Medef Corporate Governance Code which both placed greater emphasis on the board's role with regards to stakeholder relations and companies' role within society (or corporate purpose).

Further, we expect material environmental, social and governance (ESG) performance measures to be included in executive directors' variable incentive arrangements. As with all performance measures, these should be clear and transparent with specified measurable metrics and targets. ESG considerations may be introduced for example via malus and clawback mechanisms or as a form of underpin.

Shareholder engagement

Principle 3 states that a company is required ("shall") to publish its own rules of procedures on its websites. We believe that good governance is based on transparent communication between a company and its shareholders and therefore support this recommendation. We would, however, have expected the revised Code to formally recommend the Chairman's responsibilities to be expanded to include dialogue with investors. This would be in line with the European Shareholder Rights Directive. We would strongly encourage the Commission to amend A2 to a shall-recommendation instead of a should-suggestion. In addition, in our opinion, shareholders should be able to engage with the entire supervisory board, as some directors may be better placed to engage on particular subjects (audit chair or remuneration chairs will be able to comment on key governance issues for example). In our experience a number of companies have been reluctant to facilitate shareholder access to their supervisory board members. All directors directly appointed by shareholders should be willing and able to communicate directly with investors and explain the position and actions of the board. We think the Code has an opportunity to take a stronger stance on this matter.

Board composition

<u>Director terms</u>

The introduction of the three-year term (Principle 19) for both supervisory board members and management board members shows greater alignment with international practice and will enhance the accountability of board members. However, we would strongly encourage the Commission to consider recommending for directors of large companies to come up for re-election on an annual basis. This will ensure individuals are properly accountable to shareholders. Furthermore, we have not observed any impairment to board continuity and long-term planning in markets where there is annual director elections.

<u>Over-boarding</u>

We also welcome the refining of over-boarding definitions (Principle 21). However, we would encourage the Commission to take a more conservative approach on this issue, as we consider that directors must have the necessary capacity to devote additional time to their companies in the event any of these may experience significant challenges or M&A activity, without neglecting his/her other directorships. As a result, we consider that executive officers should not hold more than one other directorship in listed corporations; whilst supervisory board directors should not hold more than four directorships in listed corporations in aggregate. This reduces according to the significance of the posts,. i.e. a Chair role often requires at least double the time than a non-executive role.

<u>Supervisory board independence</u>

Whilst we welcome the additional criteria within the independence definition (Principle 21 B8) we believe that the language around “close family relationship” with a controlling shareholder would fail to capture some cases of non-independence. We would encourage the Commission to consider the following term instead: “related or associated relationship.” We also believe the Code should have a stronger guideline around the recommended independence level on the supervisory board. B7 states that “the Board should include what it considers to be an appropriate number of independent members.” We note that in your rationale you mention that “more than half of the shareholder representatives shall be independent from the company and the management board, and at least two shareholder representatives shall be independent from a controlling shareholder.” In addition, the revised Code suggests that the Chair of the Supervisory board and the nomination committee could be associated with the controlling shareholders. These criteria raise concerns for minority shareholders. In our view the majority of shareholder elected directors should be independent from the company, the management board and the controlling shareholder, particularly when there is a non-independent Chairperson. Such a recommendation in certain Asian countries such as India (clause 49 of the Listing Agreement), raise their recommended independence level in the case of a non-independent chairperson. Lastly, we support the audit committee Chair being independent from the company, management board as well as from the controlling shareholder.

Diversity

In addition, we welcome Principle 22 both on succession planning (C1) and diversity. The addition of a diversity criteria within the management board members' nomination process is key. However, we would encourage the Commission to clarify and include in specific recommendation factors such as diversity of experience, gender, skills, etc. We also welcome the Code's provision with regards to increasing female representation in management (Principle 8).

Audit

We also note that the Code proposes (Principle 9) allowing audit committee matters to be dealt with by the full board rather than the audit committee. This raises concerns relating to a potentially weakened audit committee accountability on audit quality oversight.

Finally, whilst we support better conflicts of interests management (Principles 10 and 11) we believe the Code should include greater transparency around managing conflicts of interests and related-party transactions. Related-party transactions should not only be disclosed to the supervisory board, whose role is to approve them, but also disclosed to shareholders in the annual report. We also believe that such transactions should be approved by a fully independent committee.

Remuneration

We support the opportunity for shareholders to vote annually on the remuneration report (Principle 23). In order to align with the European Shareholders Rights Directive, the Commission could also put in place a binding (instead of advisory) vote on the remuneration policy. We support the aim of these revisions (Principles 24-29) and their focus on the long-term with long-term variable remuneration exceeding the short-term variable

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remuneration, as well as the four years holding period for LTIP awards. However, we find the nature of the Code's requirements to be too prescriptive and believe companies need some level of flexibility in assessing the appropriate remuneration package structure for their individual circumstances. We are also conscious that the variable compensation structure designed to incentivise the achievement of annual strategic goals in the long-term incentive awards may result in an excessive focus of management attention on short-term rather than long-term. We would encourage the Commission to consider recommending the introduction of share ownership requirements for management board members, in order to better align their interests with shareholders'. This could for example be set as a proportion of fixed pay. Otherwise, management board members are likely, after the extended holding period, to sell all or most of their shares.

We would like to reiterate our support for the positive direction of travel of this review, trust that our comments are helpful. We would hope that all, if not some, of our suggestions are reflected in the final proposals, which we will review with interest.

Yours sincerely,

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