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Prof. Dr Rolf Nonnenmacher
Vorsitzender, Regierungskommission
Deutscher Corporate Governance Kodex
c/o Deutsches Aktieninstitut e.V.
Senckenberganlage 28
60325 Frankfurt am Main
Germany

Via email: regierungskommission@dcgk.de

31 January 2019

Dear Prof Dr Rolf Nonnenmacher,
Dear Members of the Commission on the German Corporate Governance Code,

BMO Global Asset Management's comments on the proposed amendments to the German Corporate Governance Code

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 €220 billion of assets. In addition, BMO GAM has been mandated to vote and/or engage in dialogue on behalf of a further 36 investment institutions (including a number of German pension funds) with assets totalling over €138 billion (as at 30 September 2018).

We are committed to good stewardship of our portfolio companies and have been engaging with German issuers on corporate governance and broader ESG matters for many years. We also make our views known through our votes which we disclose publicly and also proactively share with companies to encourage further dialogue. We have also shared our views on best practice governance standards in discussions with the Commission on the German Corporate Governance Code over a number of years and through prior Code consultation responses.

Thank you for the opportunity to comment on the amendments to the Code. Over a number of years, we have been concerned that corporate governance standards in Germany have diverged in certain areas from accepted best practice in many other developed markets.

We therefore welcome the overall objective of the Commission for enhanced relevance of the Code and particularly welcome and wholly support:

- A channel for **investors to meet with a designated member such as the Chair of the Supervisory Board;**
- Recommendation B.1 of the new Code for **Supervisory Board members to only be appointed for a period not exceeding three years**;
- The inclusion under recommendation B.8 **of tenure length (at 12 years) as a factor impacting director independence**;
- Recommendation B.5 on **overboarding**;
- Principle 23, which implies **annual non-binding vote on executive pay**.

If fully utilised by companies and investors, these provisions can contribute to higher corporate governance standards in the German market, improved corporate culture and investor confidence.

We would like to provide additional comments to some of the proposed amendments and highlight further areas we would like the Code to address.

Dialogue between the Supervisory Board Chair and Institutional Investors
As investors in German companies, we welcome regular and structured opportunities to meet with Board members we elect, or a designated member such as the Chair of the Supervisory Board or other designated members of the Supervisory or Management Board, to discuss our views and raise any governance-related concerns. We welcome the Code's reference to the Supervisory Board Chair being available to investors to discuss Supervisory Board-related issues but would urge the Commission to make the following changes:

- Change Principle 3, A.2 to a "shall" recommendation, whereby companies would be obliged to consider their preparedness and disclose and explain any departures from the recommendation each year.
- Make explicit that, in discussions with investors, the Chair/designated Board member should also be able to cover topics including, but not limited to, strategy, ESG, management succession planning, Management Board compensation, auditor independence.
- Include a recommendation for the Chairman of the Supervisory Board to report the content of meetings with investors to the entire Board to avoid information asymmetries.
- Include a best practice recommendation for the Chairs of the key committees to be available for meetings with investors. We also highly value such opportunities in markets where they are available and believe that they yielded important insights about the effectiveness of the board and can help bolster investor trust in a business.

Supervisory Board Independence
As mentioned above, we welcome the recognition in the new Code that members who have served on the Supervisory Board for over 12 years are no longer to be considered independent. We also welcome the articulation of other relationships that may render a member not independent. However, to ensure that all relevant relationships that may impact independence are taken in to account, we urge the Commission to include in recommendation B.8 the scenario where a Supervisory Board member is a representative of a significant shareholder (for example, above 5%). We do not consider that members who represent the interests of significant holders on the Board can be truly impartial and independent from the perspective of minority investors.

It is our position that, for public companies, independent non-executive directors should:

- Not be former executives of the company. We do not support the idea of a "cooling off" period for former executives, although in the case of individuals who have served in a junior capacity, a hiatus may be appropriate;
- Not have close family ties with the company's advisers, directors or senior employees;
- Not have served on the Board for more than 12 years, as they may lose their independent perspective;
- Not hold cross-directorships or have significant links with other directors;

- Not be major shareholders or representatives of any special interest group, including government representatives in cases of state ownership or representatives of affiliated companies;
- Have no significant commercial involvement with the company as professional advisers, major suppliers or customers;
- As a rule, not be entitled to performance-related pay, stock options, pensions, or benefit from large donations to charitable causes of their choice;
- Not normally hold other directorships in companies in a closely-related industry.

In voting on Supervisory Board elections, we would generally not support the (re-)election of directors who do not meet the above independence criteria and where Boards are also not sufficiently independent. For controlled companies, we accept that at least one third of the entire Supervisory Board is comprised of independent members but would expect that half of the Board be independent in the case of non-controlled entities.

We strongly urge the Commission to articulate what it regards as an appropriate proportion of independent Supervisory Board members representing shareholders, taking into account company ownership. A recommendation for a desirable level of independence would send a strong signal to companies that appropriate Board independence is an important part of good governance practice.

Supervisory Board Overboarding
We believe that there is value in members of Management Boards taking up to one Supervisory Board position. The demands on the time of a full-time executive director are substantial. At the same time demands on the time of Supervisory Board members have never been greater, particularly at larger complex entities, and during exceptional circumstances. In this context, we would consider that the currently proposed limit of two additional Supervisory mandates for executives should be reduced to **one additional mandate** in the new Code.

Supervisory Board Tenure
We welcome the introduction of three-year Board terms which will help promote a pro-active approach by Boards to non-executive succession planning and Board refreshment.

As an institution, we prefer to have all directors standing for annual election to strengthen the accountability of the Board to shareholders and would encourage the Commission to consider a recommendation to this end as an aspirational for those companies seeking to meet international best practice standards. We believe that annual elections are of particular relevance in the German market where shareholders are not able to hold management to account though a direct vote but are reliant on the robust and effective oversight of the Supervisor Board members, whose decision-making investors should be able to review each year.

As an interim step, we would encourage a provision for the Chair of the Board, as well as the Chairs 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.

In the absence of annual elections, one route investors currently have to express discontent with Board composition or decision making on a specific topic is to vote against the discharge of the Supervisory Board; this is a blunt tool and not our preferred choice for raising concerns about independence, over-Boarding, etc.

Audit Committee Matters
We would prefer that all shareholder representatives in the Audit Committee 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.

We are supportive of the Code recommendation that the Chairman of the Audit Committee shall be independent and not a former member of the Management Board. However, we urge the Commission to strengthen its best practice recommendation for the composition of the Audit Committee as a whole and also stipulate that at least one committee member shall have recent and relevant financial, accounting or audit experience, and all Audit Committee members should be financially literate.

Management Board Remuneration

The Code proposes that the General Meeting adopt advisory resolutions on the approval of the remuneration system for the Management Board members suggested by the Supervisory Board, as well as on the remuneration report for the preceding financial year. **We urge the Commission to explicitly state the frequency of the shareholder votes:**

- In our view a non-binding vote on the remuneration system should take place at least every three years. We would also encourage the Commission consider making this vote binding in future.
- We would expect **an annual shareholder vote on the remuneration report.**

The Commission foresees that a significant portion of variable pay should be made through annual long-term equity-linked grants. Given the stated purpose of these grants to deliver on strategic objectives, we strongly believe that they should **only pay out after pre-defined (and disclosed) performance targets are met at the end of the performance period of at least four years.** We urge the Commission to stipulate that performance will be measured at the end of the performance period. We believe that this approach fundamentally differs from the proposed and better aligns management and investor interests.

We welcome the provision for clawbacks but believe that the Commission should include a “shall” recommendation for Boards to publish clawback policy. Clawback policies may also be supplemented with extended deferral periods for bonus as well as share plans.

We also expect a careful use and robust justification of benchmarks and comprehensive disclosure of performance targets as well as actual performance against pre-set targets for both short- and longer-term incentive awards.

Given the strong upward trend in total executive compensation globally which has led to broad societal discontent, we expect companies to fully justify pay levels awarded including in the context of pay levels across the workforce.

We would encourage the Commission to encourage mitigation of termination payments to the extent permissible under German law, in case a director has taken up employment elsewhere and to adjust the length and size of any payments accordingly. We regard one year’s base pay and pension entitlements (in addition to pro-rated incentive awards) as sufficient severance, including on change in control. An interim step could be one where larger severance packages are subject to a separate shareholder vote.

In all cases we look to Supervisory Board members, not their consultants, to be fully in charge and accountable for Management Board remuneration decisions. We encourage a reference in the new Code to this end.

Shareholder Approval for Substantial Transactions

We believe that it is a fundamental right of shareholders to have the opportunity to approve material transactions outside the ordinary course of business. This is afforded to shareholders in other developed markets. We do not consider a regime which allows significant deals (for example, of the calibre of Bayer/Monsanto, Praxair/Linde or Siemens/Alstom) to take effect without prior approval of the shareholder base to be in the interest of investors in the German entity.

We strongly urge the Regierungskommission to stipulate that companies "shall" put substantial transactions to the shareholder vote.

Shareholder Approval for and Related Party Transactions
Minority shareholders' interests are most likely at risk in companies with large or controlling shareholders, who can exert significant influence over their Supervisory and administrative bodies, and/or where members of the Supervisory and administrative bodies are conflicted due to direct or indirect interest in such related-party transactions (RPTs). **For this reason, we believe that only independent shareholder approval of material RPTs can offer sufficient protection to minority investors**. Therefore, where the RPT involves a director or shareholder, this director or shareholder should be excluded from the vote and from having a determining role in the approval process.
We strongly urge the Regierungskommission to stipulate that companies "shall" put relevant and material RPTs to the shareholder vote and amend proposed Principle 11 to this end. 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[1].

Principle of "One Share - One Vote"
We urge the re-inclusion in the Code of the principle that each share carries one vote which we see as a key shareholder right. We **support the existing wording that there be "no shares with multiple voting rights, preferential voting rights ("golden" shares) or maximum voting rights".**

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

Yours sincerely,

Kalina Lazarova
Director, Analyst, Responsible Investment

[1] 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.