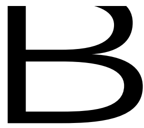

Baillie Gifford & Co
Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Tel. +44 (0)131 275 2000 Fax +44 (0)131 275 3999

www.bailliegifford.com

Regierungskommission Deutscher Corporate Governance Kodex
c/o Deutsches Aktieninstitut e.V.
Senckenberganlage 28
60325 Frankfurt am Main

31 January 2019

Dear Dr Rolf Nonnenmacher,

Public Consultation on the Proposed Amendments to the German Corporate Governance Code
Response by Baillie Gifford & Co

Baillie Gifford welcomes the opportunity to respond to the public consultation to the German Corporate Governance Code (GCGC).

Baillie Gifford is an investment manager with a long-only, active approach to investment which is based on identifying and holding high quality growth businesses that enjoy sustainable competitive advantages in their marketplace. The governance and management quality of our holdings are highly material considerations within our investment analysis. We conduct regular engagements with our holdings on governance with the aim of being constructive shareholders and good stewards of our clients' capital.

A. Management and Supervision

We welcome:

- The enhancement of recommendation **A.13** that the Supervisory Board shall meet *regularly* without management, to encourage independent thought and challenge.
- Strengthening recommendation **A.15** to introduce a time limit on the requirement for a Board self-assessment to be completed with external resource, to ensure this reflection on board strengths and gaps is completed regularly.

Recommendations/Comments:

- Whilst we recognise recommendation **A2** requires the Chair to be available to discuss Board-related issued with investors, the revisions could have gone further on the potential appointment of a Lead Independent Director and their availability to shareholders. This is an increasingly common Board position across a range of markets. During our engagements we have found it helpful to speak to another director on the Board, other than the Chair, on matters such as Chair succession when we have not seen sufficient progress. Alternatively, if the Chair is non-independent, having an alternative independent point of contact on the Board can be extremely helpful to raise points of concern as minority shareholders.

A list of the partners' names is available at the above address.

Authorised and regulated by the Financial Conduct Authority.

B. Composition of the Supervisory Board

We welcome:

- Recommendation **B.1** which reduces Supervisory Board member elections to three years. We have seen an increasing number of German companies opt for three-year election terms rather than the five years currently allowed. We see this as a very positive step in the right direction on director elections.
- The reduction of the number of outside mandates a member of the Board can take on **(B.5 & B.6)**
- The expansion of criteria for defining independence under recommendation **B.8**, captures key connections and/or relationships that should be considered when assessing independence. Requiring an explanation (**B.9**) if conditions are met but the director is still considered independent will be important for shareholders.
- Recommendation **B.10** requiring more than half of the shareholder representatives to be independent is a welcome addition to encourage outside experience, thoughts and challenge on the Board.

Recommendations/Comments:

- It may be helpful to clarify within the Code that the independence criteria outlined in recommendation **B.8** is not an exhaustive list, given varying governance structures and practices adopted by companies.
- Generally, we do not view a member of the Board that has previously worked for the company and/or been on the executive team an independent member of the board regardless of the cooling-off period. Whilst we welcome their appointment and think they can, within a balanced board, bring helpful insights – we believe they should be considered non-independent.
- We view quantitative guidelines regarding tenure of directors as a useful prompt for engagement with companies, e.g on succession plan for directors, rather than a hard rule. The Commission will be aware there are more stringent guidelines in other markets which investors may continue to guide German companies towards.
- We welcome attempts to set standards that prevent directors becoming overcommitted and/or time constrained which could impact on the quality of their oversight role as a director **(B.5 & B.6)**. However, these limits should be seen as guidance and a common-sense approach applied by both directors and the Nomination Committee Chair of the time required for directorships. Variables such as sector, size of business, growth stage and wider business/market challenges will mean that a limit on directorships with vary from business to business. If we are concerned about the level of directorships we will engage with the Nomination Committee Chair. Demonstration of thought given to the number and complexity of directorships is key and greater qualitative disclosure in this area would be helpful for investors. The limits proposed in the guidance, whilst lower, could potentially have been reduced further but key in practice is the justification for the number of boards a director decides to sit on.
- Regarding recommendation **B.10** the Commission could go further and we generally encourage over half of the whole Board, including directors that represent controlling shareholders, to be independent.

C. Appointments to the Management Board

No comments.

D. Remuneration of Management Board and Supervisory Board Members

We welcome:

- An annual vote on the remuneration system for management and the remuneration report as described in **Principle 23**. Some German companies do put forward remuneration for approval each year but in our experience, remuneration tends to be put forward to shareholder vote when there is a change to the policy, which is out of step with wider market practice in other regions.
- The guidance on remuneration in **Principle 24.** Particularly that "the variable remuneration components create an incentive to support sustainable growth of the enterprise".
- The definition of the remuneration system within **Principle 25**.

Recommendations/Comments:

- We agree that "variable remuneration is the key material incentive for pursuing the objective of business policy. It acts as the decisive motivation and reward for specific actions, for operational performance, for a strategic orientation that promotes the long-term sustainability of the company, and for responsible behaviour" as outlined by the Commission in the draft code **(B.II (3))**.
- The guidance encourages the short-term incentive plan to focus on operational metrics. We agree and believe the short-term incentive should be tied to operational performance of the business, particularly against financial metrics. Recommendation **D.7** states short-term remuneration "shall be disbursed in cash". We believe businesses should retain the flexibility to decide the method that is right for them and shares should remain open as an option.
- With reference to recommendation **D.9**, we agree that "long-term variable remuneration shall primarily act as an incentive for implementing strategic measures". When analysing long-term incentive plans we look for alignment between the metrics and targets within the long term strategy of the business and the metrics and targets within the long-term incentive plan of management. We believe there should be strong correlation between the two as remuneration should incentive management to achieve the long term goals of the company.
- From section **B.II (3)** within the Rationale, our understanding is the Commission recommends that the long-term strategic plan should be broken down into milestones for each reporting year. "Performance pertaining to the strategic initiatives and measures is rendered in the year under review, and also remunerated for this year". Whilst we understand that achievement of each is part of a long-term plan, there is a potential risk here that management become focused on annual short-term goals – particularly if the granting of pay is tied to the annual milestones. We encourage performance to be assessed after at least 3 years but preferably longer. We believe this provides management with breathing space to think and focus on long term achievement of the corporate strategy and promotes agility to react to changing external conditions if need be. We do not always support long-term incentive plans that are based on annual targets because of these concerns.
- We prefer long-term incentive plans to be tied to long-term operational aims of the business. Common amongst German companies we hold is for long-term remuneration to be tied to

share price with operational targets being set at or below consensus as an underpin. There are inherent risks of basing a long-term incentive plan solely on share price as this is an externality influenced by factors largely outside the control of management. Our concern is if operational performance of the business performs strongly over the long term, but this is not reflected in the share price, resulting in management not receiving any awards – which we would not want. To guard against this, some companies build in a buffer meaning remuneration is paid even if the company underperforms peers – something we routinely oppose due to a lack of alignment with shareholders. Alternatively, we would be concerned if management received awards because of strong share price but in practice operational performance had been poor. Long-term remuneration plans consisting of a balance of operational metrics tied to long term corporate strategy with stringent targets is a composition we generally encourage. We also encourage disclosure of forward looking targets attached to both the short and long-term incentive plan which the Code could be more explicit on.

- We would have liked to see the Commission stipulate Supervisory Board fees should be settled in cash. Under recommendation **D.20** the Supervisory Board can be granted performance linked remuneration. Generally, we have concerns regarding the impact performance-based shares can have on the independent judgement of Board members. We believe these types of awards should be granted to independent members of the Board by exception.

B. IV – Rationale for deleted recommendations and suggestions

Recommendations/Comments:

- It is proposed to remove the following from the current Code: "in the event of a takeover offer, the Management Board should convene an Extraordinary General Meeting at which shareholders will discuss the takeover offer and, if appropriate, decide on corporate actions". However, we strongly believe shareholders should be given the ability to exercise their vote on these matters. Please would the Commission be able to provide greater rationale on the removal of this provision and how it is in the long term interests of shareholders and wider stakeholders.

Thank you for providing the opportunity to feed into the revisions of the GCGC. We are supportive of the Commissions efforts to enhance the governance principles within the Code and hope our feedback on further steps that could be taken, and/or potential revisions, will be helpful when discussing further potential amendments. Please do not hesitate to contact us should you have any questions or wish to discuss any points further.