

REGIERUNGSKOMMISSION

Deutscher Corporate Governance Kodex

Rationale of the amendments to the German Corporate Governance Code adopted on 28 April 2022

Part 1: General explanatory notes

The amendments mainly concern:

1. Principles and recommendations for the consideration of environmental and social sustainability in the management and supervision of listed companies.
2. Principles and recommendations to be adapted to recent amendments to the Stock Corporation Act by the Act on Strengthening Financial Market Integrity (Gesetz zur Stärkung der Finanzmarktintegrität, FISG) and the Second Leadership Position Act (FüPoG II).

On sustainability in corporate practice:

In the versions of the preamble that have been in force since 2009, the Code considers corporate management to be committed to the interests of the company. "The Code highlights the obligation of Management Boards and Supervisory Boards – in line with the principles of the social market economy – to take into account the interests of the shareholders, the enterprise's workforce and the other groups related to the enterprise (stakeholders) to ensure the continued existence of the enterprise and its sustainable value creation (the enterprise's best interests)". (Preamble, para. 1, Sentence 3). According to Principle 1, the Management Board is responsible for managing the enterprise in its own best interests.

The Code Reform 2020 made the social responsibility of companies a special topic in paragraph 2 of the preamble. This statement in the preamble on social responsibility needs to be readjusted because the expectations regarding the consideration of sustainability factors in corporate governance have become much more specific in the meantime.

Corporate governance cannot be developed from the principal-agent model alone. The pluralistic goal concept of the Stock Corporation Act requires corporate management to understand the interests and expectations of shareholders and other stakeholders, including society, to take them into account within the concept of the company's interests and, building on this, to anchor sustainability in the business strategy. This is expressed in recommendations A.1 and A.3.

The term "sustainability" used in the revised version of the Code refers to environmental (ecology) and social goals. The UN Sustainable Development Goals can be used for orientation. Sustainability goals can represent opportunities and risks for companies. In this sense, we speak

of environmental and social factors. Sustainability goals can also relate to the impact of corporate activities on people and the environment and thus be an expression of corporate social responsibility.

On the adjustments to the FISG:

The new obligations to establish an internal control system and risk management system, to set up and appoint Audit Committees, and to monitor the quality of the audit of financial statements introduced by the Act on Strengthening Financial Market Integrity (Gesetz zur Stärkung der Finanzmarktintegrität, FISG), which came into force on July 1, 2021, require adjustments to the relevant principles and recommendations of the Code. This applies, for example, to the requirements regarding the expertise of members and the chairman of the Audit Committee.

Part 2: Individual rationales

Foreword

On paragraph 2 The European Commission's proposal for a Directive of the European Parliament and of the Council amending Directives 2013/34/EU, 2004/109/EC and 2006/43/EC and Regulation (EU) No. 537/2014 as regards corporate sustainability reporting, of April 21, 2021 (CSRD) contains a clear requirement for companies to consider not only the outside-in perspective but also the inside-out perspective (so-called double materiality). This concern, which is important for companies in their social responsibility, was previously only hinted at in sentence 1 and is now expressly supplemented in sentence 2.

The importance of sustainability aspects for corporate strategy is now addressed in a new recommendation A.1.

A. Management and supervision

I. Governance tasks of the Management Board

On A.1 Corporate management that is committed to the interests of the company consists of ensuring the continued existence of the company and its sustainable value creation, while taking into account the interests of shareholders and other stakeholders, including the environmental and social goals of society. This is reflected in the corporate strategy and, according to the sustainability reporting of many companies, corresponds to best practice.

Recommendation A.1 puts the stakeholder approach into concrete terms, in that both the effects of the sustainability factors on the company and the environmental and social effects of the company's activities are to be identified and measured using risk management methods. This is an important prerequisite for the development of corporate strategy.

In the long term, economic, environmental and social objectives are often mutually dependent. Ecological and social sustainability are just as much a prerequisite for long-term increase in value as economic strength and stability are a prerequisite for investments and other measures that serve ecological and social objectives.

On principle 4 In the first sentence of Principle 4, the word "geeigenten" is replaced by the word "angemessenen" in line with Section 91 (3) of the German

Stock Corporation Act (AktG).¹ In the new second sentence of principle 4, it is clarified that an effective internal control system and risk management system presuppose their internal monitoring (see the rationale on recommendation A.5).

The internal control system and the risk management system are interdependent parts of a comprehensive system. Internal controls serve to mitigate risks. For example, any effective compliance management system addresses carefully identified compliance risks and contains controls related to these risks.

- On A.3** Effective implementation of the corporate strategy requires comprehensive corporate controlling and performance monitoring. Legal obligations in the area of sustainability already result from the Supply Chain Due Diligence Act (Lieferkettensorgfaltspflichtengesetz). The reporting requirements of the Act implementing the Non-financial Reporting Directive today and the Corporate Sustainability Reporting Directive (CSRD) in the future cannot be met without such system-related prerequisites.
- On principle 5** Management boards of listed companies are now explicitly required to establish an appropriate and effective internal control system and risk management system (Section 91 para. 3 Stock Corporation Act, furthermore AktG). Since, according to the government's rationale, the internal control system also includes the principles, procedures and measures required to ensure compliance with the relevant legal provisions, there is also an obligation to establish a compliance management system geared to the company's risk situation.
- On A.4** The recommendation to establish a compliance management system in sentence 1 of A.2 (old version) had to be deleted because there is now a corresponding obligation (cf. principle 5 sentence 2). The remaining recommendation and suggestion A.4 (previously A.2) only has practical significance until the EU Whistleblower Directive (Directive (EU) 2019/1937 of the European Parliament and of the Council of October 23, 2019 on the protection of persons who report breaches of Union law) is implemented by a Whistleblower Protection Act.
- On A.5** Section 289 para. 4 of the German Commercial Code (HGB) requires capital market-oriented companies to describe the main features of the internal control and risk management system with regard to the financial reporting process. A more extensive disclosure corresponds to the explicit obligation to establish a comprehensive internal control system and risk management. The statement on the appropriateness and effectiveness of these systems will regularly refer to what the

¹ Please note that in the English version the term "appropriate" remains unchanged.

internal monitoring and, if applicable, external audit of the systems consisted of.

The disclosure of the main features of the compliance management system recommended in A.2 sentence 2 GCGC 2020 now results from recommendation A.5 in conjunction with principle 5.

An appropriate and effective internal control system and risk management system includes their internal monitoring by the Management Board. This monitoring lays the foundation for being able to provide comment within the meaning of Recommendation A.5. Monitoring the internal control system and the risk management system is one of the core tasks of Internal Audit.

Voluntary external audits carried out from time to time in accordance with the standards IDW PS 980, 981 and 982 are suitable for providing additional support for the above-mentioned comment. They are not a prerequisite for the opinion, neither is an audit of the internal control system and the risk management system by the auditor.

The description of the main features of the internal control system and the risk management system, insofar as it goes beyond the description of the main features of the accounting-related internal control system and risk management system pursuant to Section 289 para. 4 HGB, is neither prescribed by law nor required by GAS 20. In this respect, it constitutes so-called management report atypical disclosures, which are exempt from the audit requirement applicable to the management report provided they are clearly distinguished from the management report disclosures subject to audit and are marked as unaudited. The same applies to the comment on the appropriateness and effectiveness of the overall internal control system and risk management system

Pursuant to Section 107 (3) Sentence 2 of the Stock Corporation Act (AktG), which was inserted by the Audit Reform Act (Abschlussprüfungsreformgesetz) in 2016, the Audit Committee must also address the effectiveness of the internal control system, the risk management system and the internal audit system. With regard to the internal control system and the risk management system, the aforementioned monitoring by the Management Board is required. By laying the foundations for the comment, the Board of Management at the same time enables the Audit Committee to make the required assessment. In addition to self-assessments, external audits will be required from time to time to assess the effectiveness of the internal audit system.

II. Supervision tasks of the Supervisory Board

On principle 6 For the monitoring tasks of the Supervisory Board in Principle 6, it is clarified that these also include sustainability issues.

B. Appointments to the Management Board

On principle 9 Principle 9 is adapted to the legal situation created by the Second Second Leadership Position Act (FüPoG II).

C. Composition of the Supervisory Board

I. General requirements

On C.1 sentence 2 Supervisory boards require expertise commensurate with the importance of sustainability issues for the company concerned. This expertise need not be concentrated in one person. Relevant sub-aspects can also be contributed by different supervisory board members. The decisive factor is that supervisory board members are also in a position to monitor how environmental and social sustainability is taken into account in strategic direction and corporate planning.

On C.1 sentence 4 Disclosure of the status of implementation of the competence profile in the form of a qualification matrix allows shareholders and other stakeholders to assess the professional competence of the supervisory board..

D. Supervisory Board procedures

II. Cooperation within the Supervisory Board and with the Management Board

2. Supervisory Board committees

On principle 14 Sentence 2 refers to the mandatory establishment of an Audit Committee for public interest entities (Section 107 para. 4 sentence 1 AktG). If the Supervisory Board consists of only three members, this shall also be the Audit Committee.

On D.3 (old version) The mandatory establishment of an Audit Committee makes Recommendation D.3 GCGC 2020 redundant.

On principle 15 The principle reflects the legal requirements from Section 100 para 5 AktG regarding the expertise on the Audit Committee.

On D.3 (new version) The new statutory requirements for the composition of the Audit Committee deviate from the GCGC 2020 as follows:

- Section 107 para. 4 sentence 3 in conjunction with Section 100 para. 5 AktG do not require expertise in the areas of accounting

and auditing in the person of the chairman of the Audit Committee. According to the law, it is sufficient if at least two ordinary committee members embody the expertise in the two areas.

- The law makes no distinction in the level of expertise in the areas of accounting and auditing. The GCGC 2020, on the other hand, requires (of the chairman) "special knowledge and experience" in the application of accounting principles and internal control procedures, but allows to be "familiar" with the latter.
- The legislator maintains the deletion of the independence requirement for the financial expert by the Audit Reform Act (Abschlussprüfungsreformgesetz) 2016, while according to recommendation C.10 GCGC 2020 the chairman of the Audit Committee shall be independent of the company, the management board and a controlling shareholder.

The Chairman of the Audit Committee has primary responsibility for defining the committee's work program. He must communicate regularly with the Chief Financial Officer outside committee meetings and has the lead in working with the auditor. He must ensure the effectiveness of the committee's work, manage the process of inviting tenders for the audit of the financial statements, control the monitoring of the quality of the audit of the financial statements and, more recently, is also responsible for exercising the right of the members of the Audit Committee to obtain information from the heads of corporate departments in accordance with Section 107 para. 4 sentence 4 AktG. For this reason, one of the two experts is to chair the committee, while the second expert need not be independent.

The competence level of "specific knowledge and experience" defined in the GCGC 2020 is now to apply not only to accounting and internal control procedures, but also to the audit of financial statements. Experience in the fields of accounting and auditing presupposes that the person has worked in these fields. Formal qualifications and execution as a certified auditor are not required for this.

The accounting principles and the internal control and risk management systems also affect sustainability reporting, currently in accordance with Sections 289c and 315c of the Commercial Code (HGB) and in future in accordance with the CSRD, when implemented into national law. Expertise concerning sustainability reporting will have to be built up on a widespread basis.

The spectrum of possible relevant professional experience suggests that information on this should be included in the corporate governance statement.

The independence requirement for the chairperson of the Audit Committee already results from recommendation C.10 and does not need to be repeated in recommendation D.3.

4. Meetings and adoption of resolutions

On D.7 Instead of the suggestion that virtual attendance at meetings of the Supervisory Board that are held in person should not be the rule, the report of the Supervisory Board shall now specify the meeting modalities. This takes account of the changed technical requirements for meetings.

III. Cooperation with the external auditors

On D.10 Monitoring the audit quality of the audit is now an explicit duty of the Audit Committee (Section 107 para. (3) sentence 2 AktG). Recommendation D.11 GCGC 2020, which is identical in content, can therefore be omitted. The bullet point thus freed up is used for a description of best practice in the cooperation between the Audit Committee and the auditor.

Pursuant to Section 109 para. 1 sentence 3 AktG, the Management Board does not participate in meetings of the Supervisory Board and its committees if the auditor is called in as an expert, unless the Supervisory Board or the committee deems the participation of the Management Board to be necessary. Recommendation D.10 sentence 3 follows the idea that regular consultations at least of the Audit Committee with the auditor without the management board are necessary.