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Green Paper The EU corporate governance framework

Statement by the Federal Republic of Germany

Introductory remark

The Federal Government welcomes the fact that the European Commission is giving considerable thought to the topic of corporate governance with its Green Paper entitled “The EU corporate governance framework”, which has now been presented, and that it is asking questions as to the long-term need for reform without there being any topical political pressure.

However, there are two things which should not be overlooked: Firstly, much has already been achieved in recent years in the field of corporate governance, both at European and at national level, and there have been considerable improvements. Many new regulations have been introduced in the financial sector in particular. However, there have also been a great deal of changes for industry in Germany in other respects, for instance through the transposition of the Directive on the rights of shareholders, through the Act on the Appropriateness of Directors’ Remuneration (*Gesetz zur Angemessenheit der Vorstandsvergütung*), through the tightening up of directors’ liability (extension of the statute of limitation for damage claims for breach of duty) and through several refinements of the German Corporate Governance Code (*DCGK*). Secondly, company law, the structure of industry and the culture of corporate management and shareholder participation differ considerably between the Member States of the European Union. It may therefore prove to be not only difficult in many cases, but indeed not necessarily expedient to bring about uniform regulations for the entire EU. When it comes to all the questions which are tackled in the present Green Paper, the Federal Government therefore considers it to be important to examine in detail whether the topics introduced have not already been suitably dealt with nationally, or whether no solution was regarded as being necessary, whether the questions arising and the conceivable solutions are comparable in all Member States, whether action on corporate governance is actually needed at EU level and – if it is – at what level and in how much detail the content of the regulations should be created.

By its nature, the Green Paper overlaps with special regulations for individual sectors. There are currently parallel discussions in the finance sector which have been reflected in the

Green Paper on corporate governance in financial institutions and which are also planned to be incorporated in legislative proposals (capital requirements – CRD IV). The clarity and coherence of both general and sector-specific regulations, as well as a coordinated procedure in legislation, should be ensured: This means that questions which do not have any sector-specific characteristics (e.g. diversity of directors, transparency of the shareholder structure, shareholders' participation rights), are to be regulated at general level and adjusted to the particularities of the sector in special regulations where this is necessary to apply exceptions and modifications. Where such particularities require a special regulation, it should be ensured that the general regulations do not contradict the sector-specific regulations and that competition between the regulatory levels is resolved in a manner that is unambiguous and transparent for legal practitioners. Special requirements which necessitate a separate regulation for financial enterprises lie in the areas of risk management, of remuneration (where its suitability is assessed from the point of view of risk), of the aptitude of directors for their specialist areas, as well as of dealing with conflicts of interest, and – possibly – also in further regulatory fields relating to the directors (such as accumulation of mandates, quantitative restriction of mandates, particular structural requirements).

General questions

(1) Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.

The question is definitely to be answered in the affirmative. Many of the corporate governance measures which have been the subject of public debate tackle only the major listed companies, these being for instance DAX30 in Germany. They have sufficient staff and resources to comply for instance with extensive obligations to report, with transparency measures, and with organisational involvement in the work of the directors. The bureaucracy costs imposed on them do hurt, but are still acceptable in relation to their turnover and profit. It is frequently the small listed companies which are completely overlooked and which are burdened with new strains every time a new regulatory measure is introduced.

The Federal Government is however against differentiating the corporate governance regulations at European level by drawing one or more dividing lines among listed companies. This would further complicate the European legal framework and its subsequent

transposition in the national legal systems. The Federal Government hence suggests wherever possible formulating any regulations so flexibly that they do not necessarily need to be implemented by all companies (but for instance only by large capital market-orientated companies). One example: Mandatory requirements for supervisory board committees are senseless with supervisory boards which have three members, and probably also with as many as six members. The European legal framework should hence be structured in an open manner, such as through recommendations or provisions contained in directives.

What is more, the Federal Government considers it to be necessary in the context of the assessment of the consequences of any measures taken at EU level which also affect small and medium-sized enterprises (SMEs) to pay particular attention to the burdens they might impose and to extensively carry out the SME test.

(2) Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?

The theoretical backdrop to the corporate governance discussion is provided by the principal-agent conflict. This naturally does not occur, or occurs hardly at all, with non-listed companies in which one or a small number of owners determine the fate of the company and exert a direct influence on the company management or indeed are the company's managers. This applies regardless of the size of the non-listed company. The corporate governance discussion hence always centres on companies with dispersed, absent owners. The Federal Government is hence strongly in favour of continuing to largely restrict any future corporate governance measures at EU level to listed companies.

Financial institutions constitute a special case, for which proposals are also being discussed at EU level, cf. the Green Paper on corporate governance in financial institutions and remuneration policy. As a matter of principle, however, business or management manuals for good corporate management are better suited to unlisted companies. This is not a matter for the legislature.

1. **Board of directors**

(3) *Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided?*

In the German system of a divided Board consisting of the supervisory board and the board of directors, the law rules out the CEO and the chair of the supervisory board being the same person. This separation has proven to be extremely worthwhile. Since the German system has always practiced such a separation, the Federal Government is reserved in terms of its vote as to what the EU should do in this area with validity for other Member States.

(4) *Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?*

It certainly makes sense for companies to have a profile of requirements for the composition of their board of directors. The prevailing opinion today is that not every member of the board of directors can meet all the requirements, but that there is a need for a skilled, deliberate mix of qualifications. What is more, in the view of the Federal Government there is a need for gender-specific diversity to open up the potential for highly-qualified women in the composition of the board of directors. Since the specific composition however will once again differ from one company to another, and moreover is also subject to a constant process of learning and adjustment in industry, this should not be subject to inflexible detailed regulations. Thus, as to the regulatory content, at most there can be a general appeal to set oneself such requirement profiles. In the view of the Federal Government there is a need for a statutory regulation neither at EU level, nor at national level. It is likely to be quite sufficient if such an approach is contained in the national corporate governance codes. Accordingly, there are no such statutory regulations in Germany, but only recommendations contained in the German Corporate Governance Code (exception: section 100 subs. 5 of the Companies Act [*Aktiengesetz*], which was created in the context of the transposition of the Directive on statutory audit [2006/43/EC of 17 May 2006], and which provides that with capital market-orientated companies at least one independent member of the supervisory board must have expertise in the fields of reporting or auditing). No. 5.4.1 of the German Corporate Governance Code reads as follows:

“The supervisory board shall be composed such that its members as a whole possess the knowledge, skills and specialist experience required to carry out the tasks properly.”

What is more, No. 5.3.2 of the Code for instance regulates as follows for the audit committee:

“The chairperson of the audit committee should have special knowledge and experience in the application of accounting principles and internal control procedures. He/she should be independent and should not be a former member of the board of directors of the company whose appointment ended less than two years previously.”

Also, the principles on this topic contained in the Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board of 15 February 2005 (2005/162/EC; hereinafter referred to as “2005 Recommendation”), in particular in No. 4 (Number of independent directors) and No. 11 (Qualifications) should be referred to. The principles contained here appear to be expedient and adequate.

It should be pointed out by way of a precaution that the right of co-determination must be taken into account in any discussion of the profile of supervisory board members.

(5) Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?

The diversity discussion should not be restricted to gender-specific diversity, that is in particular to whether the share of women in top positions in listed companies should be increased. This topic however has top priority and significance in Germany, and is taken very seriously by the Federal Government.

The parties of which the Federal Government is composed have agreed in the Coalition Agreement that the share of women in senior positions in industry should be considerably increased, and have drawn up a phased plan, in particular to increase the proportion of women on boards of directors and supervisory boards. The means by which this objective is to be achieved have not yet been conclusively clarified. The German Corporate Governance Code was already amended accordingly in 2010, and contains a good, promising approach for listed companies (cf. on this the response to Question 6). Whether and how the implementation of the recommendation takes place and whether it leads to the desired, anticipated increase of the share of women on boards of directors and supervisory boards will be attentively observed in policy terms and evaluated by the Federal Government.

The recommendations contained in the German Corporate Governance Code however relate not only to the participation of women, but rather to the entire spectrum of diversity, that is for instance to the internationality and plurality of experience and opinions. Also in this regard, the Code recommends the formulation of concrete objectives and the publication of reports on progress made towards meeting them. Against this background, the Federal Government does not consider any regulations at EU level to be necessary.

(6) *Should listed companies be required to ensure a better gender balance on boards? If so, how?*

The discussion of the most expedient measures to promote women to top positions in industry, in particular also as regards membership of supervisory boards, is advancing apace in many Member States. The Federal Government considers this topic to be extraordinarily important. It is also to be seen in connection with the increasing demand for specialist workers, the need for broad access to the potential offered by highly-skilled women, as well as in the context of the good performance of companies with female managers. There is however no consensus at present for a mandatory statutory setting of quotas at national or international level in the opinion of the Federal Government.

The following recommendations on gender diversity on supervisory boards were inserted in No. 5.4.1 subs. 2 and 3 the German Corporate Governance Code in 2010:

“The supervisory board is to designate concrete goals for its composition which, in compliance with the specific situation in which the company finds itself, take into consideration the international activity of the company, potential conflicts of interest, a set age limit for supervisory board members, and diversity. These concrete goals are in particular to provide for suitable participation of women.

Proposals on the part the supervisory board in the competent elected bodies are to take these goals into account. The objectives of the supervisory board and the state of implementation should be published in the corporate governance report.”

(7) *Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?*

This is a question which has been the subject of an engaged discussion in Germany for about 20 years and which has repeatedly given rise to new proposals for regulation and brought about legal amendments. In accordance with the Companies Act (section 100), the maximum number of mandates which may be held is restricted to ten, exceptions applying to mandates in groups of companies, and chairmanships of supervisory boards being counted as double. In the finance sector, there is a maximum of up to five mandates with companies

supervised by the Federal Financial Supervisory Authority (BaFin) (section 36 subs. 3 of the Banking Act [*Kreditwesengesetz – KWG*] and section 7a subs. 4 of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz – VAG*). The German Corporate Governance Code recommends in general terms that supervisory board members who belong to the board of directors of a listed company may not hold more than a total of three supervisory board mandates in listed companies outside the group or in supervisory bodies of companies with comparable requirements (No. 5.4.5 of the Code).

The fundamental problem is the justification of the argumentative approach on the one hand, and the major difficulty entailed by a general abstract regulation on the other. A mandatory general-abstract regulation would apply to members of boards of directors in large companies, board chairs, chairs of committees or normal members, as well as to members in medium-sized and small listed companies. It would also apply to professional supervisory board members and those who at the same time still engage in activities on a board of directors in another company or have other considerable tasks in their lives which cannot all be easily summed up in detailed statutory requirements. All relatively undemanding nominal regulations on restrictions of offices hence have the effect of a lawnmower, can only work in an extremely approximate manner, and disadvantages have to be accepted.

The Federal Government therefore does not consider it to be expedient to attempt to bring about a regulation at European level on restricting the number of offices held.

(8) Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?

It may be good board practice, depending on the sector and size of a company, to carry out an internal or external evaluation of the Board's performance. The Federal Government considers the recommendation to carry out an evaluation in national corporate governance codes to be correct and placed at a suitable level. Provisions at EU level are not considered to be necessary.

No. 5.6 of the German Corporate Governance Code contains such a recommendation:

“The supervisory board should regularly review the efficiency of its activities.”

Statements with regard to the nature, procedure and frequency of the evaluation are left to the respective supervisory board as an overall body. Making more detailed statutory requirements on this appears to be unnecessary overregulation. This also applies to the

proposals made in the Green Paper that the review should also cover the quality and timeliness of information received by the board, the management's response to requests for clarification and the role of the chairman. The Federal Government rejects this.

(9) *Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?*

Since the disclosure of the board of directors' remuneration, including individual remuneration with all perks, is already mandatory under German law, there is no need for the Federal Government to make any further statement on this.

With regard to the disclosure of remuneration policy and of the annual remuneration report, the Commission Recommendation of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies (2004/913/EC; hereinafter referred to as "2004 Recommendation"), which was supplemented by the Commission Recommendation of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies (2009/385/EC; hereinafter referred to as "2009 Recommendation") provided detailed, sensible principles. No further measures at European level are required in the opinion of the Federal Government.

(10) *Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?*

In German company law, by the Act on the Suitability of Board Remuneration (*Gesetz zur Angemessenheit der Vorstandsvergütung – VorstAG*), which came into force on 5 August 2009, an optional and merely advisory resolution of the General Meeting on remuneration policy was introduced in law. This regulation was received very well by companies. Almost all companies at least from the large DAX30 stock index held such "say on pay" ballots in 2010. The Federal Government feels that such resolutions make sense. The manner in which these questions were dealt with in the Commission's 2004 and 2009 recommendations appears to be adequate.

(11) Do you agree that the board should approve and take responsibility for the company's 'risk appetite' and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?

The Federal Government fundamentally agrees.

Risks and opportunities are inseparable components of entrepreneurialism in a market-based economy. Since it is the board of directors which is entitled and obliged to carry out company management on its own responsibility under German law, it is principally its task to identify the internal and external risks facing the company and to decide whether they are to be taken up and how they are to be dealt with (cf. also No. 4.1.4 of the Code: "The board of directors shall ensure suitable risk management and risk control within the company."). According to the German dual system, the supervisory board must supervise the management by the board of directors, section 111 subs. 1 of the Companies Act. This supervision may not be restricted to exclusively past-related control, but must also be preventively orientated. Thus, the supervisory board can and must deliberate with the board of directors in order to exert an influence on the company's future commercial policy, and in this sense is to take part in the managerial task of the board of directors. The German Corporate Governance Code expresses this in No. 5.1.1:

"It is the task of the supervisory board to advise regularly and to supervise the board of directors in managing the company. It shall be involved in decisions of fundamental significance for the company."

Understood in this sense, it is to be affirmed that the board of directors should approve and take responsibility for the company's 'risk appetite'. The Federal Government rejects the concept of a broader responsibility incumbent on the board of directors, namely that it should provide the board of directors with a general framework for accepting risks or should draft general guidelines. It is decisive that the highest company bodies are aware of and responsible for dealing with risks (risk analysis, evaluation and control) – the Green Paper correctly refers to this by defining risk policy "set from the top". However, the German understanding is that risk policy is not to be defined solely by the board of directors, but in line with the division of competences between the board of directors and the management board according to the respective national law.

The Federal Government has reservations about new disclosure obligations with regard to dealing with risks.

(12) *Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?*

As stated with regard to question (11), the board of directors is entitled and obliged under German law to take the actions required to manage the company and to guarantee their effectiveness. The management board must monitor whether the board of directors has complied with this obligation. If the board of directors culpably breaches its obligation to monitor, it is obliged to provide compensation. Therefore the German view is that both the board of directors and the supervisory board must ensure that effective precautions are taken with regard to risk management.

The Federal Government points out that the terms "risk management" and "risk management systems" have several meanings and that their use in German laws and legal acts of the EU has led to difficulties in interpretation. The use of the term "risk management system" in Article 46a § 1 (c) of Directive 78/660/EEC ("[...] a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process;", inserted by Article 1 Number 7 of Directive 2006/46/EC) and the German transposition of this directive in section 289 subs. 5 of the Commercial Code (*Handelsgesetzbuch*) ("[...] shall in the situation report describe the major characteristics of the internal control and risk management system with regard to the financial reporting process."), as well as its use in Article 41 § 2 (b) of Directive 2006/43/EC and the German transposition in section 107 subs. 3 sentence 2 of the Companies Act, have given rise to questions as to the interpretation of section 91 subs. 2 of the Companies Act ("The board of directors shall take suitable measures, in particular shall establish a monitoring system to identify developments early which place the continuation of the company at risk."). Risk management can on the one hand mean extensive risk management, taking commercial aspects into account, but on the other hand can only deal with developments which place survival at risk. In the view of the Federal Government, it hence appears to be necessary to ensure a precise definition wherever the terms "risk management" or "risk management systems" are used.

2. Shareholders

(13) Please point to any existing EU legal rules which, in your view, may contribute to inappropriate short-termism among investors and suggest how these rules could be changed to prevent such behaviour.

The Federal Government welcomes the effort not to contribute through statutory frameworks to an inappropriately short-term orientation on the part of investors. No EU legal rules are known, in particular from the fiscal domain, which lead to inappropriate short-termism among investors.

(14) Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?

It would be advisable here to think less about bureaucratic conditions for institutional investors than about economic incentive structures. It would be conceivable for instance to explicitly permit and hence encourage the payment of higher dividends to long-term investors. The recommendations contained in the report of the "Reflection Group On the Future of EU Company Law" presented in April 2011 point in the right direction in this regard.

Measures are already being taken in Directive 2009/65/EC (UCITS Directive) and in the Directive on Alternative Investment Fund Managers (AIFM Directive), as well as in their transposition in national law, with regard to the incentive structure and performance evaluation for the administrators of undertakings for collective investment in transferable securities (UCITS) and alternative investment fund managers. Special significance attaches to the disclosure of the incentive structure and the performance evaluation.

For instance, administrators of UCITS must state in contractual conditions according to which method, in what amount and on the basis of what calculation the fees and effort remuneration are to be made to them, to the deposit bank and to third parties. The investment goals are agreed between the administrator and the investors. This also includes whether short-term or long-term investment strategies are to be pursued. The administrators are obliged when carrying out their activity to act exclusively in the interest of investors and of the integrity of the market.

Equally, administrators of alternative investment funds in accordance with the AIFM Directive must act in the best interest of the funds which they administer or the investors of these funds and the integrity of the market. Requirements are also imposed on them relating to

remuneration policy. Furthermore, the totals of the paid remunerations must be disclosed in the annual report. Appropriate regulations of remuneration policy are already planned for the amendment to the UCITS Directive, which is envisioned to take place in autumn 2011. At present, the minimum requirements for investment companies (InvMaRisk) at national level provide that the design of the incentive systems, and of the remuneration systems in particular, must be aligned to the goals set out in the investment strategies.

(15) Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?

Transparency with regard to strategies, costs, trade and exercising voting rights contributes towards better investor control of asset managers. Directive 2009/65/EC (UCITS Directive) and the Directive on Alternative Investment Fund Managers (AIFM Directive), and their transposition in national law, already create transparency rules for administrators of undertakings for collective investment in transferable securities (UCITS), as well as for alternative investment fund managers.

The contractual conditions concluded between investors and administrators of UCITS must include amongst other things an agreement on investment strategy (e.g. which assets may be acquired to what degree) and remuneration. Moreover, the annual and bi-annual reports contain information on investment strategies and costs.

Rules on the exercise of voting rights exclusively in the interest of investors and of the integrity of the market can already be found in the sector's rules of conduct, as well as in the Investment Conduct and Organisation Ordinance (*Investment-Verhaltens- und Organisationsverordnung*), which came into force on 1 July 2011 and which transposes Commission Directive 2010/43/EU. Accordingly, the capital investment company must work out suitable, effective strategies as to when and how the voting rights which come along with the assets are to be exercised. These strategies must encompass measures and procedures making it possible to monitor the relevant events within society, to ensure that the exercise of voting rights concurs with the investment goals and the investment policy of the respective investment assets and to prevent or regulate conflicts of interest resulting from the exercise of voting rights.

In accordance with the AIFM Directive, alternative investment fund managers also have to inform investors inter alia about the investment strategy, the goals of the fund, the costs, the type of assets in which the fund may invest, the techniques which it may employ and all concomitant risks, as well as any investment restrictions.

Additionally, reference is made to the appropriate provisions contained in Directive 2004/39/EC on markets in financial instruments (MiFID) and Commission Directive 2006/73/EC implementing Directive 2004/39/EC (MiFID implementing Directive) (Article 19 § 8 of the MiFID, Articles 41 and 42 of the MiFID implementing Directive) as well as to the duties to provide information in accordance with Article 19 §§ 2 and 3 of the MiFID and Articles 27 to 34 of the MiFID implementing Directive. Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) also already contains relevant provisions (cf. in particular Article 44 (Risk management), Article 49 (Outsourcing), Article 132 (Investments), as does Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision (Pension Funds Directive - cf. in particular Articles 18 and 19). The Federal Government considers it imperative to avoid duplicate regulations.

(16) Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?

It does not appear to be necessary to impose any additional requirements on asset managers. Regulations to ensure transparency and avoid conflicts of interest are important. They are however already adequately regulated by national provisions and those contained in the MiFID (Art. 13, 18, 21 et seqq.) and in MiFID implementing Directive 2006/73/EC.

Rules have already been set in place in Directive 2009/65/EC (UCITS Directive), in the Directive on Alternative Investment Fund Managers (AIFM Directive), in the implementing measures which expand on these, in particular in Commission Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company (OJ L 176 of 10.7.2010, p. 42), as well as in the transposition of these Directives into national law, for the administrators of undertakings for collective investment in transferable securities (UCITS), as well as for alternative investment fund managers, to identify, prevent, regulate and disclose conflicts of interest.

(17) What would be the best way for the EU to facilitate shareholder cooperation?

An official Internet platform (shareholder forum, section 127a of the Companies Act) has been set up under German law in order to facilitate shareholder cooperation. This platform has unfortunately been virtually ignored by shareholders. That may however be due to the unfavourable, overly bureaucratic, costly execution, so that this should not necessarily stand in the way of such instruments in general.

Lending sharper contours to the existing EU provisions on “acting in concert” to facilitate cooperation between shareholders in suitable cases is likely to be the subject of careful scrutiny with regard to the concomitant implications of transparency with regard to participation.

(18) Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?

Transparency requirements for proxy advisors make sense. They could be achieved by providing for corresponding statutory disclosure obligations or through a sector-wide code of conduct. Topics in appropriate regulations should include both conflicts of interest and their resolution, as well as with general criteria for analysis methods, taking account of the regulations on commercial secrets.

(19) Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?

An obligatory separation of advising institutional investors in exercising proxies on the one hand and corporate governance advice for issuers on the other hand should only be considered if transparency obligations are unsuccessful. Any further measures should definitely be preceded by a comprehensive stocktake and analysis of the proxy advisor market.

(20) Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).

The German legislature has already taken national legislative measures in the shape of the Act on Registered Shares and to Facilitate the Exercise of Voting Rights (*Gesetz zur Namensaktie und zur Erleichterung der Stimmrechtsausübung – NaStraG*) of 18 January 2001 and the Risk Limitation Act (*Risikobegrenzungsgesetz*) of 12 August 2008 in order to make it easier for companies to identify their shareholders. The recommendations of the “Reflection Group On the Future of EU Company Law” point in the right direction in this regard.

(21) Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?

German company law already provides for very far-reaching minority rights. These relate in very general terms to the rights to attend the General Meeting, the right to speak and ask questions at the General Meeting, the right to make requests and counter requests, the right to lodge actions to rescind resolutions (which in Germany accrues as a matter of principle to owners of a single share), mechanisms making it easier to enforce an action based on liability, etc.

Under German law, the supervisory board members are elected in the General Meeting with a simple majority. Germany has no provision for special minority members of the supervisory board, and it would also not be possible to introduce these. Whoever has the majority of shares must be enabled to control the company and to carry out a change of strategy. Since however 50% of the posts on the supervisory board are already occupied by worker representatives, at least in those companies which have equal-share co-determination, it is not possible to carry out a further subdivision on the shareholder side. This would entail a change to the system.

German law has developed law concerning groups of companies specifically to govern the relationship between majority shareholders and large shareholders. It provides for protection of minority shareholders firstly through formalised rights to information. For instance, a controlling agreement or a profit transfer agreement concluded between two companies only

becomes effective when approved by the General Meeting (section 293 of the Companies Act). This requirement of approval is accompanied by the obligation incumbent on the board of directors to file a written report on the company-transfer agreement (section 293a of the Companies Act), which is to be interpreted in the context of the General Meeting, which decides on approval of the company-transfer agreement. Finally, the board of directors must discuss the agreement orally at the General Meeting. To safeguard the economic interest of the minority shareholders, German law concerning groups of companies furthermore provides that the controlling agreement or profit transfer agreement must contain provisions on an equalisation and a settlement for shareholders outside the agreement. The shareholder is hence entitled to remain within the controlled company and receive an annual equalisation or to leave the company with a settlement. The suitability of the equalisation and of the settlement are examined by an expert auditor and are amenable to judicial review. Additionally, if there is no controlling agreement, German law concerning groups of companies also provides for special protection mechanisms favouring the creditors and minority shareholders of a dependent company (cf. information re Question 22).

In view of the existence of a large number of cross-border groups of companies, a recommendation to recognise a group interest, as recently proposed by the "Reflection Group On the Future of EU Company Law", could certainly be helpful. In other respects, the Federal Government currently does not consider there to be any need for mandatory EU legal provisions in this area.

(22) Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

Related party transactions may clash with capital maintenance principles under the law on corporations. The law as it stands provides requirements under European law on this through Art. 15 § 1 of the Second Council Directive on coordination of safeguards. In accordance with the provision contained in the German Companies Act, distributions to shareholders may as a matter of principle only be effected from the existing balance sheet profit. Exceptions are only permissible if the payments are made on the basis of an existing controlling agreement or a profit transfer agreement or are covered by a fully-fledged right to counter performance or repayment (section 57 subs. 1 of the Companies Act). Additionally, German law concerning groups of companies provides protective precautions in the event of transactions between related companies which favour creditors and minority shareholders. These protective mechanisms are based on the principle that disadvantages shouldered by an independent company in the interest of the group must be balanced out. The shareholders

can also apply for a special review of the connections when there is a good reason, and hence help disclose liability arrangements (section 315 of the Companies Act).

(23) Are there measures to be taken, and if so, which ones, to promote at EU level employee share ownership?

Employee share ownership is promoted by two routes in Germany which can also be claimed in combination and which were most recently expanded in 2009. The principles of voluntariness and equal treatment apply equally to both types of promotion:

1. exemption from tax and social charges when the employer assigns non-wage compensations or tax exemption where workers engage in salary exchange.
2. reimbursement of employer's savings allowance for capital accumulation benefits paid by employers.

The investor's risk of employee share ownership for employees can be securitised. Participants may regulate the nature of insolvency protection on their own responsibility. With worker loans and registered bonds, insolvency security must be taken up through a bank guarantee or an insurance company in order to be able to claim the state benefit. Such security against insolvency is not necessary if the employer is a domestic financial institution.

More and more companies in Germany have introduced forms of employee share ownership in recent years. The Federal Government is interested in as many companies as possible availing themselves of employee share ownership so that its positive impact on major entrepreneurial success factors can have a broader spread. This applies in particular to the segment of small and medium-sized enterprises. The Federal Government is hence supporting initiatives which attract greater public attention to the topic and encourage all those concerned (companies, trade unions, workers) to tackle employee share ownership and its advantages and to put corresponding models into practice.

Against this background, the Federal Government also welcomes measures at European level which bring the topic of employee share ownership into the public eye and encourage all those involved to deal with employee share ownership and its advantages in greater detail. There is however no need for a uniform EU-wide arrangement. That would not do justice to the diversity of companies and the legal and social frameworks in the Member States.

3. The 'Comply or Explain' Framework – Monitoring and Implementing Corporate Governance Codes

(24) Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

Preliminary remark: Germany has a code which is relevant for all listed companies and which was formulated by the Government Commission on Corporate Governance. To comply with this one code, all open corporations must make a statement. The Federal Government holds the view that the “comply or explain” mechanism has proven its value in Germany (very instructive first report from the Corporate Governance Commission of November 2010). It explicitly points out that it would be highly detrimental to this successful model if the content of the regulations ensuing from the codes were to be formulated in directives at the level of EU legislation. Directives cannot be transposed by a code, but only through national law.

As far as the specific question is concerned: The Federal Government is highly sceptical with regard to this point. The comply or explain arrangement in Germany contained in section 161 of the Companies Act had in fact initially only demanded a “comply declaration” from companies. A statement of non-compliance with individual recommendations of our corporate governance code was not at first demanded. The background for this was that the legislature presumed that it will in any case be in the interest of companies which depend on the capital market to provide an explanation as to why they deviate from recommendations contained in the Corporate Governance Code. This has also turned out to be true. There is hence actually no need for any mandatory statutory arrangement obliging them to do so.

On the other hand, companies which are listed, but are less dependent on the capital market, for instance because of having a major shareholder, may do less to explain deviating from the Code. In such cases, however, the influence exerted by the capital market and the interest of the capital market in the instrument as a whole will also be scant, which is why a more detailed statement in response to supervisory pressure would also not be particularly well observed. As a result of the requirement under EU law to have a comply or explain arrangement (Article 46a § 1 (b) of Directive 78/660/EEC, inserted by Article 1 Number 7 of Directive 2006/46/EC), section 161 subs. 1 of the Companies Act now includes the following provision:

“The boards of directors and supervisory boards of listed companies shall declare annually that the recommendations of the governmental German “Corporate Governance Code” Commission was and will be complied with or what recommendations were not or are not being applied, and why not.”

This arrangement now also forces the company to submit an explanation of why they did not comply with a recommendation or will not comply with one in future. It is not recognisable in Germany that there are major problems when it comes to compliance with this obligation to explain. Also, no public criticism has been voiced that the statements are not sufficient, incomplete or not authoritative. The low return rate of responses from the institutional investors in the study mentioned in the Green Paper however does not provide an adequate empirical basis for this presumption. A mandatory arrangement under EU legislation to provide more detailed statements, or indeed to describe the alternative solution selected in place of the Code’s recommendation, is not considered to be necessary. The mandatory statement of an alternative solution already appears to be problematic because it is also possible not to choose any alternative at all, and that this should indeed be so.

(25) Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?

The idea of a corporate governance code with a “comply or explain” arrangement is based on the concept that non-mandatory statutory arrangements are developed by industry itself and compliance or non-compliance with them is subject to the criticism of the capital market. The Federal Government has always considered that companies which deviate from the recommendations of the code and give plausible reasons for this are by no means to be criticised. Rather, it is those companies which deserve criticism that act counter to the interest of the company and against their better judgment, only complying with a code in order to save stating or disclosing to shareholders. If, therefore, the comply or explain mechanism and the entire code concept works, this is because the capital market takes up and evaluates the statements, and where appropriate draws its conclusions from them. If the statements are not convincing or are incomplete or are not authoritative, the capital market should also draw its conclusions from this. If a company is not subject to capital market control, for instance because it has only few shares in dispersed ownership, the statements

will in any case be hardly noticed. There is then no additional gain in having them improved through bureaucratic supervisory measures.

The Federal Government very much doubts whether well-meaning supervisory monitoring and a subsequent solution for improvement really does justice to the economic and procedural sense of the corporate governance code with its “comply or explain” arrangement.

What is more, such a state supervisory power or whatever kind of monitoring (by the Code Commission, by auditors etc.) would entail a major organisational effort. Monitoring would have to be very careful and be carried out with a uniform standard since one may presume that any complaints would have a negative impact on the capital market. Against this background, liability risks on the part of the state agencies would also be considered. In the final analysis, an undesirable standardisation of the statements would also come about. The monitoring agency would make it known what responses were acceptable in what form, and the companies would then employ these in a formulaic manner in order to avoid further annoyance.

The Federal Government hence rejects a power on the part of state agencies or private monitoring facilities, which would have to be established, to examine the corporate governance statements of listed public limited companies.