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The Governance System of Germany: Background and Discussion of its Code

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ABSTRACT

This paper presents an overview of the German corporate governance system for listed companies and then delivers a more detailed analysis of its present state by reviewing the acceptance of the 2022 version of the German Corporate Governance Code (the "Code") based on the declarations of compliance disclosed by the large DAX companies represented in the DAX 40 index. It provides empirical evidence on the Code recommendations that companies readily adhere to, and the areas where they depart from or disagree with the Code. The analyses and discussions pursue two primary objectives: First, to offer investors and other stakeholders evidence on the extent to which leading companies listed in Germany comply with the country's recently updated code, giving some references to international practices, and second, to provide data-driven input for potential future revisions of the Code.

1 The German Corporate Governance System - Background

The corporate governance framework of a country typically consists of relevant legal and regulatory instruments, which form the "hard law" component of the framework, as well as a corporate governance code, complementing those instruments as "soft law". The German Corporate Governance Code (the "Code") forms the soft law component of the German corporate governance framework, complementing a number of statutory laws that address various aspects of corporate governance. The most relevant laws include the Stock Corporation Act, the Commercial Code, the Securities Trading Act, the Takeover Act, as well as the Co-Determination and the One-Third Participation Acts, which together set out the rules for employee representation on the supervisory board. These components form the backbone of corporate governance-related law, as illustrated by the various "Kommentare" that provide extensive comments on the law.[1]

In compliance with Article 20 (1) of the EU Accounting Directive, Section 161 of the German Stock Corporation Act (AktG), which entered into force in 2002, requires the management board and the supervisory board of a listed company to declare at least annually that the recommendations of the Code have been and are being complied with. If the Code's recommendations have not been applied or are not being applied, the reasons therefor have to be provided. The declarations of compliance are required to be made permanently accessible to the public on the companies' websites.

The Code consists of "principles", reflecting material legal prerequisites for responsible governance, and "recommendations" and "suggestions", which involve internationally and nationally acknowledged standards for good corporate governance. "Recommendations" of the Code are indicated in the text by using the word "shall", and companies are obliged by the Stock Corporation Act to disclose and explain any deviations from them. "Suggestions", on the other hand, are indicated by using the word "should" and do not require disclosure. The Regierungskommission Deutscher Corporate Governance Kodex ("the Commission") is responsible for formulating the Recommendations and Suggestions of the Code in dialogue with relevant stakeholders and for reviewing the Code regularly to determine any changes. The Commission consists of senior representatives of the management and supervisory boards of German listed companies and various stakeholders, including institutional and retail investors, academics, and auditors. Its members and the chairperson are appointed by the German Federal Minister of Justice and for Consumer Protection, but cannot be politically serving individuals.

Following its initial version in 2002, the Code was revised by the Commission a total of 14 times, including the most recent revision in 2022. The 2022 revision particularly aimed to ensure that environmental and social sustainability is taken into account in the management and supervision of listed companies and also involved amendments regarding audit committees, internal control systems, and risk management systems. The 2022 Code was published in the Federal Gazette on June 27, 2022, after which time its recommendations came into effect. The Code addresses governance-related issues in seven main parts: (A) Management and supervision, (B) appointments to the management board, (C) composition of the supervisory board, (D) supervisory board procedures, (E) conflicts of interest, (F) transparency and external reporting, and (G) remuneration of the management board and the supervisory board. Its 2022

[1] See, for instance, the commentaries on Section 161 of the Stock Corporation Act (MüKoAktG/W. Goette, 5. Aufl. 2022, AktG § 161; BeckOGK/Bayer/Scholz, 1.1.2023, AktG § 161) and on the German Corporate Governance Code (Kremer/Bachmann/Lutter/v. Werder, 9. Aufl. 2023, DCGK Kommentar).

revision resulted in 4 recommendations that were completely new (Recommendations A1, A3, A5, and D10) and 3 recommendations that were partly revised (Recommendations C1, D3, and D7).[2]

Before documenting the study's findings in Part 2, an overview of the distinctive features of Germany's corporate governance system is presented.

1.1 The Two-Tier Board Structure and Co-determination

The internationally two most distinctive features of the German corporate governance model are: (i) the mandatory two-tier board structure and (ii) the presence of employee representatives on the supervisory board. 26 (68%) of the 38 DAX companies examined in this study[3] have the legal form of an *Aktiengesellschaft* (AG), while 9 companies (24%) are incorporated as European stock corporations (*Societas Europaea,* SE), and only 3 companies (8%) are partnerships limited by shares (*Kommanditgesellschaft auf Aktien,* KGaA). Companies with a legal form of an AG or a KGaA are required in Germany to have a two-tier board structure consisting of a management board and a supervisory board. Although companies incorporated as an SE can choose between a one-tier or a two-tier board structure, the referred German SEs choose the two-tier option.[4] Generally described, the management board is responsible for the day-to-day management of the company, and the supervisory board supervises and advises the management board on strategic issues. Key roles of the supervisory board include appointing and, when needed, dismissing members of the management board as well as the approval of major company decisions. The supervisory board also determines the remuneration of management board members, and according to the Stock Corporation Act (Sections 87 and 116) its members can be held liable for establishing inappropriate executive remuneration. The remuneration structure is to be designed towards the promotion of the sustainable and long-term development of the company.

Importantly, the management board and the supervisory board should be strictly separate from each other, and they should not have any joint members. Germany's two-tier board structure contrasts with the system adopted in many other countries, such as Ireland, Spain, Sweden, the UK, and the US, which only allow a one-tier board. However, an increasing number of countries today offer the two-tier board structure as an option (OECD, 2021).

The supervisory board structure in Germany is complemented by inclusion of employee representatives. According to the Co-Determination Act, in companies with more than 2,000 employees, half of the supervisory board members represent the employees and the unions. For (practically rare) tied voting decisions, the chairperson that usually is a shareholder representative has the casting vote to ensure that a majority is obtained. In companies with 501 to 2,000 employees, one-third of the supervisory board members should be employee and union representatives, according to the One-Third Participation Act. The other half or two-thirds of the supervisory board consist of shareholder representatives elected by the shareholders in the shareholders' meeting. With respect to employee co-determination, companies with the legal form of SEs are subject to more flexible rules.[5]

[2] Please refer to the Code website (https://www.dcgk.de/en/code.html) for its official English translation.

[3] Airbus SE and Qiagen N.V. are not included in the study. Please see Part 2 for details.

[4] All of the 9 SEs whose declarations of compliance are reviewed in this study have chosen a two-tier board structure.

[5] For a more detailed discussion of the German corporate governance framework, please refer to Seibt and Kulenkamp (2022).

1.2 Size of the Supervisory Board

The co-determination rules contribute to the large size of boards in Germany. In companies subject to an equal representation of employees and shareholders in the supervisory boards, the board must have 12, 16, or 20 members, depending on the number of employees. The average supervisory board size in our sample of 38 DAX companies is 15.5. This contrasts sharply with the average board size in other countries, such as Italy (11), Netherlands (7), Spain (11), Sweden (11), Switzerland (11), the UK (10), and the US (11). Of the 19 countries surveyed by Spencer Stuart (2022), the country with the largest board size is France with 14 board members on average. The large supervisory board size of German companies should be reflected when considering corporate governance issues such as the functioning of the board, formation of board committees, overboarding, etc.

1.3 Supervisory Board Committees

To support the effectiveness of the board's work for larger companies, the Code recommends the formation of supervisory board committees. The obligation to establish an audit committee was included in German law relatively late. Only with the Act on the Strengthening of Financial Market Integrity (FISG) in 2021 following the Wirecard fraud scandal, audit committees became mandatory for listed companies. Furthermore, the FISG also required that at least one member of the Audit Committee has expertise in accounting and at least one other member has expertise in auditing.[6] In an international perspective, of the 50 jurisdictions reviewed by the OECD (2021) report, 90% require the establishment of an audit committee, while the remaining 10% recommend it. Regarding other board committees, 24% of the jurisdictions reviewed require the formation of a nomination committee, and 60%, including Germany, recommend it. Similarly, the formation of a remuneration committee is required by 32% of jurisdictions and recommended by 60%. Germany falls into the 8%, which do not require or recommend a remuneration committee.[7]

1.4 Ownership Structure

The level of ownership concentration in Germany is an important factor in German companies' corporate governance practices and designing corporate governance standards in comparison to other countries. In Germany, the percentage of companies where the 3 largest shareholders hold more than half of the company's equity capital is 59%. This sharply contrasts with the same percentage in the US (15%), the UK (19%), Sweden (22%), and the Netherlands (35%) (OECD, 2021). Therefore, some best practices of countries with a more dispersed ownership structure may not be directly relevant to the case of Germany.

The distribution of the company ownership across different investor categories also affects the country's corporate governance framework. At the global level, institutional investors hold 43% of the world market capitalisation, private corporations hold 11%, the public sector holds 10%, and strategic individuals hold 9% (Figure 1). With a lower ownership share of institutional investors and a corresponding higher share of private corporations and strategic individuals, Germany shows notable differences from the UK, the US, and the global aggregate figures.

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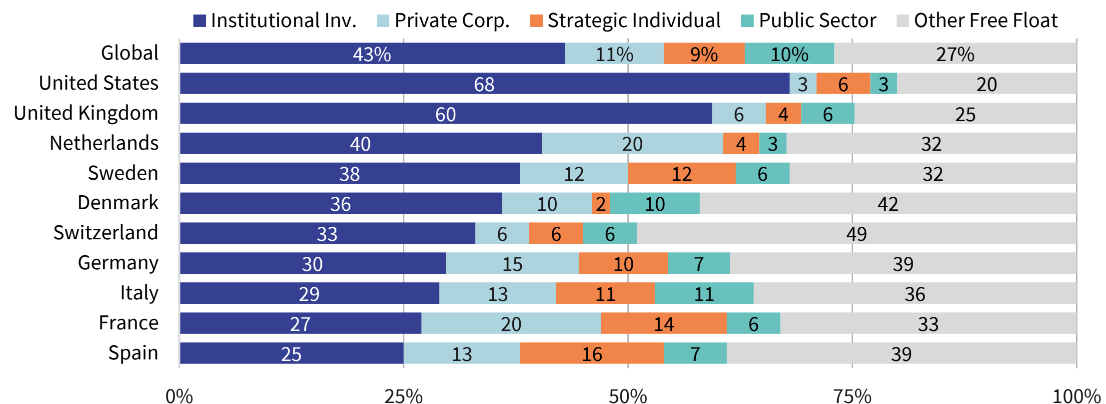
[6] See Sections 100(5) and 107(4) and of the Stock Corporation Act.

[7] The Code refers to a committee that addresses management board remuneration when recommending the independence of its chair, but the establishment of a remuneration committee is not explicitly recommended.

Figure 1
Ownership by investor category (%)



Source: Table 1.1 of OECD (2021)

2 Acceptance of the 2022 German Corporate Governance Code by the Large DAX Companies

The acceptance level of the 2022 Code is based on the declarations of compliance by the large companies in the DAX 40 index[8] representing around 80% of the market capitalisation of listed stock corporations in Germany (Deutsche Börse, 2023). The compliance data are collected from the companies' declarations of compliance with the Code for the year 2022. These declarations are strictly followed, and no judgments are made about their accuracy.[9] Since Airbus SE and Qiagen N.V. are not incorporated in Germany, they are exempt from disclosing this information; therefore, the sample consists of 38 companies.

The 2022 Code has a total of 62 recommendations over seven main parts. Each company has to report any deviations from these 62 recommendations and explain the reasons therefor. In this study, all recommendations with which a given company did not comply since its last declaration are recorded as cases of non-compliance. A temporary deviation from a recommendation is also recorded as a case of non-compliance, but if non-compliance has been cured it is separately noted.

[8] Our study is based on the DAX index members as of the time of its writing (July 2023), which include the following companies: adidas AG, Airbus SE, Allianz SE, BASF SE, Bayer AG, Beiersdorf AG, BMW AG, Brenntag SE, Commerzbank AG, Continental AG, Covestro AG, Daimler Truck Holding AG, Deutsche Bank AG, Deutsche Börse AG, Deutsche Post AG, Deutsche Telekom AG, E.ON SE, Fresenius SE & Co. KGaA, Hannover Rück SE, Heidelberg Materials AG, Henkel AG & Co. KGaA, Infineon Technologies AG, Mercedes-Benz Group AG, Merck KGaA, MTU Aero Engines AG, Münchener Rückversicherungs-Gesellschaft AG, Porsche AG, Porsche SE, Qiagen N.V., Rheinmetall AG, RWE AG, SAP SE, Sartorius AG, Siemens AG, Siemens Energy AG, Siemens Healthineers AG, Symrise AG, Volkswagen AG, Vonovia SE, and Zalando SE.

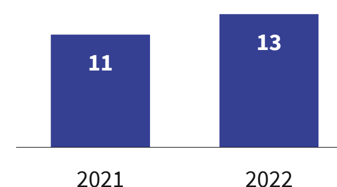
[9] A study that takes a different approach is the DVFA Scorecard for Corporate Governance, which evaluates and rates DAX, MDAX, and SDAX companies' corporate governance performance based on expert judgment and across numerous criteria with respect to legal requirements, Code recommendations as well as international standards. The DVFA Scorecard makes use of publicly available company information found in sources such as annual reports, sustainability reports, and company websites (DVFA, 2022). The new DVFA Scorecard based on 2022 disclosures is expected to be published in the last quarter of 2023.

2.1 Full Compliance with the Code

In 2022, 13 out of the 38 companies in the sample (34%) declared full compliance with all Code recommendations, an increase from 2021 when 11 out of 37 companies (30%) declared full compliance.[10]

This increase is noteworthy given that the Code has been materially revised in 2022, with 4 completely new and 3 partly revised recommendations.

Figure 2
Number of DAX 40 Companies



Note: Based on disclosures of 38 DAX companiesin 2022 and 37 companies in 2021. The company missing in 2021 was not fully-compliant in 2022.

2.2 Distribution of Deviations across the "Shall Recommendations"

The not fully compliant 25 DAX companies reported a total of 73 non-compliance cases in their declarations in 2022. Figure 3 provides the distribution of these deviations over the 62 recommendations. The deviations are highly concentrated in the sections "Composition of the Supervisory Board" and the "Remuneration of the Management Board". In each of these two sections, 30 non-compliance cases are reported, together accounting for 82% of deviations. The only other section with a significant number of non-compliance cases is "Appointments to the Management Board" with 9 cases reported. Overall, 23 out of the 73 deviations (31.5%) are reported as cured or planned to be cured within a reasonable time frame, typically within a year.

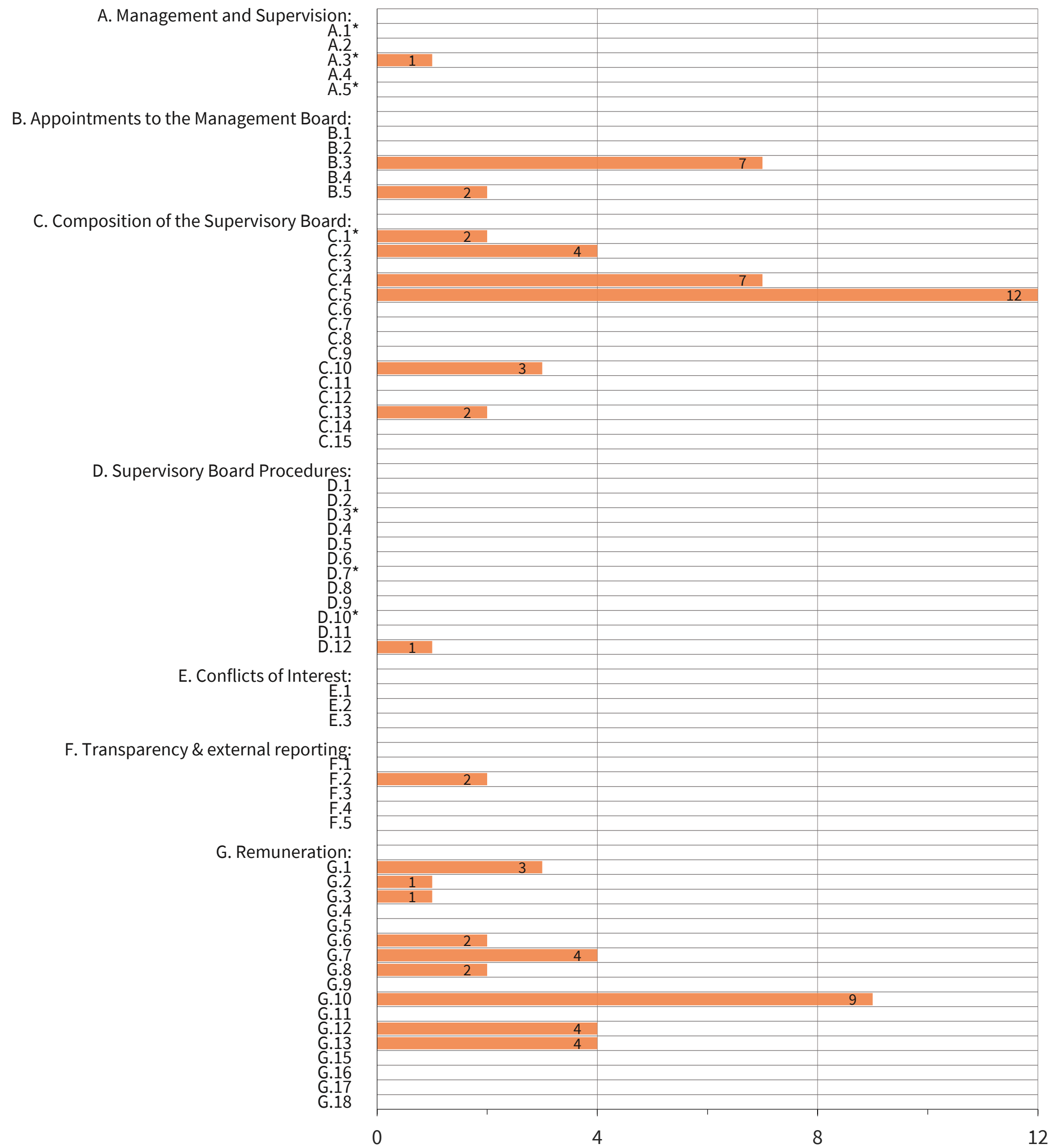
The 7 recommendations that were added or revised with the 2022 Code are marked in Figure 3 with an asterisk. Only 3 of the 73 deviations reported are related to these 7 recommendations: Two companies disclosed non-compliance with Recommendation C.1, which concerns the preparation of a profile of skills and expertise for the supervisory board. This was updated in 2022 to recommend that such profiles also comprise expertise regarding sustainability issues. Both companies stated that the reported deviation was temporary and had already been cured as of the reporting date. Another company reported non-compliance with Recommendation A.3, which is entirely new in the 2022 Code and recommends internal control and risk management systems to cover sustainability-related objectives. Processes and systems for collecting and processing sustainability-related data are also addressed in this recommendation. The non-compliant company reported that its management board and supervisory board intended to comply with this recommendation in the course of 2023.

That the number of fully-compliant companies increased from 2021 to 2022 and that only 3 out of the 73 deviations are related to the recommendations introduced by the 2022 Code could raise the question of whether these newly added recommendations were sufficiently ambitious or not fully grasped by the companies.

[10] Declarations of compliance for 2021 are available for all companies in the sample except for Porsche AG, which was not yet listed at the time. Porsche AG did not declare full compliance in 2022. Therefore its inclusion in the sample in 2022 does not contribute to the increase in the number of fully-compliant companies from 2021 to 2022.

Figure 3

Number of DAX Companies Declaring Non-Compliance with the Given "Shall Recommendation"

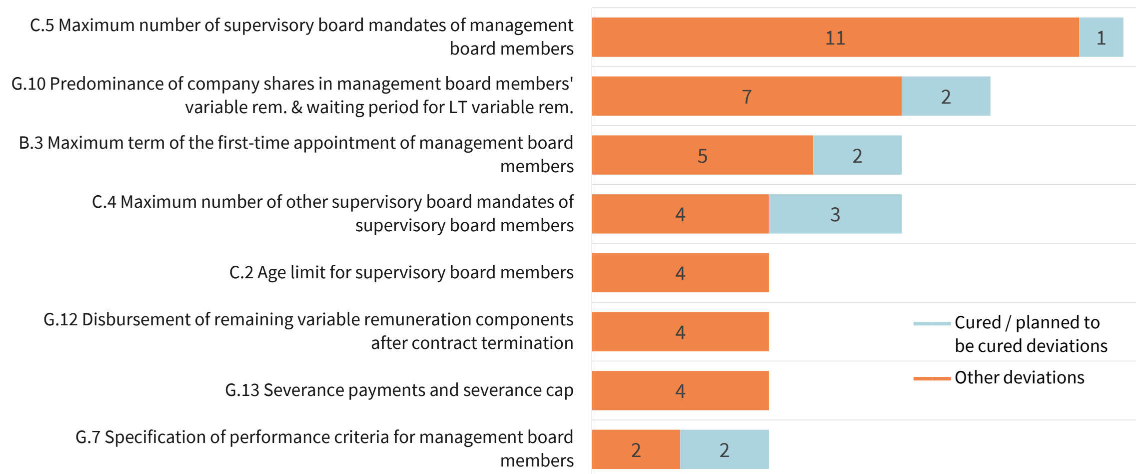


* Recommendations marked with an asterisk are those that were added or revised with the 2022 version of the code.

2.3 Recommendations with the Highest Rate of Non-compliance

Figure 4 reports the recommendations where more than 10% of companies (i.e., at least 4 companies) report non-compliance, with a brief description of the recommendation, the number of deviations reported, as well as the number of deviations that are declared as cured or planned to be cured within a reasonable time frame, typically within a year. The top 4 ranking does not change whether one considers the total number of deviations or the number of deviations that are neither cured nor planned to be cured. These 4 recommendations with the highest rate of non-compliance constitute 48% of the total number of deviations and are analysed in more detail in Sections 2.3.1 to 2.3.3.

Figure 4
Recommendations with the highest rate of non-compliance



2.3.1 Recommendations C.4 and C.5: Overboarding

As shown in Figure 4, the recommendation with the highest rate of non-compliance is C.5, which concerns the maximum number of supervisory board mandates of management board members. According to the recommendation, management board members shall not have, in total, more than two supervisory board mandates in non-group listed companies or comparable functions, and shall not accept a supervisory board chairmanship of a non-group listed company. 12 out of the 38 companies (32%) declare non-compliance and only 1 of the 12 discloses a planned cure within a few months.

Another recommendation with a high rate of non-compliance is C.4, which limits the number of other mandates that a supervisory board member who is not a management board member of a listed company can hold. Specifically, such a supervisory board member shall not accept more than 5 supervisory board mandates at non-group listed companies or comparable functions. An appointment as chair of the supervisory board is counted twice. The number of companies declaring non-compliance with this recommendation is 7 (18%), of which 3 report that the deviation has been cured.

Recommendations C.4 and C.5 both aim to ensure that board members have sufficient time to perform their responsibilities. A review of the reasons given for deviating from these recommendations shows that 10 of the 19 deviations reported can be categorised as non-compliance as a matter of principle. In other words, the deviating company does not name any specific board member who is not in compliance with the recommendation, but rather discloses that the company is not and will not be complying with the recommendation because setting an upper limit to outside mandates is not considered reasonable. For the remaining 9 deviations, a specific board member is named as non-compliant with either C.4 or C.5, and the typical explanation for non-compliance is to state that the management board and the supervisory board are convinced that the board member has sufficient time available to perform his/her duties.

Such an explanation may not always be sufficient to convince the shareholders. Principle V.E.3 of the G20/OECD Principles of Corporate Governance focuses on the issue of overboarding and states that specific limits on the number of board positions "may be less important than ensuring that members of the board enjoy legitimacy and confidence in the eyes of shareholders". Disclosures about other board and committee memberships, chair responsibilities, attendance records for individual board members, and any

other work undertaken on behalf of the board and the associated remuneration are recommended by the G20/OECD Principles to achieve legitimacy (OECD, 2023).

Similar limitations on overboarding exist in other countries. For example, France states in its corporate governance code that a non-executive director should not hold more than four other directorships in listed corporations, including foreign corporations, outside of the group. The same number for an executive officer is set to two.[11] In contrast, the UK follows a different approach. While the 2018 version of the UK Corporate Governance Code states that full-time executive directors should not take on more than one non-executive directorship in a FTSE 100 company or another significant appointment, it sets no limits on non-executive directors.[12] In its ongoing public consultation of the UK Code, the UK's Financial Reporting Council explains its continued preference not to set a limit for non-executive directors as follows: "[...] we do not believe it is helpful to specify in the Code (or in guidance) a maximum number of board appointments which can be held by a director, beyond the existing reference to full-time executive directors. This is because it is difficult to be precise about how much time each board position demands. For example, such a limit would not take into account varying committee membership requirements, the size and complexity of the organisations involved and other constraints on directors' time not related to board appointments." Nevertheless, the consultation document requests comments on the possibility to require additional disclosures similar to the OECD recommendations mentioned above (FRC, 2023).

It is also important to note here that although Recommendations C.4 and C.5 of the German Code put a limit on overboarding, the case of overboarding where the same person serves on the management boards of two companies is not addressed by these recommendations and hence does not need to be reported as a case of non-compliance. Although such a case is quite unusual and creates significant "conflicts of interest" issues, two DAX companies (Porsche AG and VW AG) have since September 2022 a joint CEO but do not report this in their respective declarations of compliance as this is not explicitly addressed in the Code. It is also noteworthy that these two companies have the highest number of non-compliance cases with the recommendations (See also Section 2.5).

2.3.2 Recommendation G.10: Design of variable remuneration of management board members

Recommendation G.10 has the second highest rate of non-compliance with 9 companies reporting deviations with 2 planning to cure the deviation in 2023. First, it recommends that variable remuneration amounts of management board members shall be invested predominantly in company shares by the respective board member, or are granted as share-based remuneration. Second, it recommends that long-term variable remuneration components are accessible to management board members only after four years. 4 of the 9 companies report non-compliance with only part of the recommendation: 2 companies with its first part and 2 countries with its second part.

The use of share-based remuneration and long-term incentive mechanisms are also commonly addressed in other countries' corporate governance frameworks. Long-term incentive mechanisms, such as equity incentives, stock options, etc., are required or recommended in 64% of 50 jurisdictions surveyed, and they typically set two-to-three-year time horizons (OECD, 2021).

A review of the explanations provided for the 7 deviations that are not planned to be cured shows that companies typically argue that their remuneration system, although not in conformity with G.10, nevertheless provides sufficient incentives for the sustainable development and long-term success of the

[11] See Section 20 of the 2022 Afep/Medef Corporate Governance Code of Listed Corporations.
[12] See Provision 15 of 2018 UK Corporate Governance Code.

company. In addition, one holding company argues that the price of the company's shares mainly depends on external factors beyond the management board's control, and therefore the share price cannot constitute a reasonable incentive.[13]

Since Section 120a of the German Stock Corporation Act requires companies to submit their remuneration systems to an advisory shareholder vote at every substantial change and, in any case, at least every four years, any unconvincing reasoning for deviating from the remuneration-related recommendations of the Code is likely to be subjected to additional discussion at upcoming general shareholder meetings.

2.3.3 Recommendation B.3: First-time appointment period of management board members

Another recommendation with a high rate of non-compliance is Recommendation B.3, stipulating that the first-time appointment of management board members shall not be for a period of more than three years. From an international viewpoint, this represents already a fairly lengthy appointment period but has a historic background of 5 years as normal appointment period.

7 out of 38 companies (18%) disclose non-compliance with this recommendation. Two of them explicitly state that the non-compliance was an exceptional case and that they will remain committed to the recommendation in future in accordance with the rules of procedure of their respective supervisory boards.

The companies typically provide fairly reasonable explanations for their non-compliance with this recommendation. The most common reason is to secure the expertise of the person appointed to the management board for the long term and/or to be able to win that person in the market for executive talent. A few other companies state that the person is appointed to the management board for longer than 3 years as s/he has already been employed by the company in the previous years and therefore has already established a convincing reputation within the company.

2.4 Precautionary Declarations

Given the weight of non-compliance declarations with investors in particular, some companies state in their declarations that non-compliance with a certain code recommendation is declared only for "precautionary purposes". Such a clause is typically added when the boards believe that the recommendation is likely not violated or will only be violated if certain conditions occur.

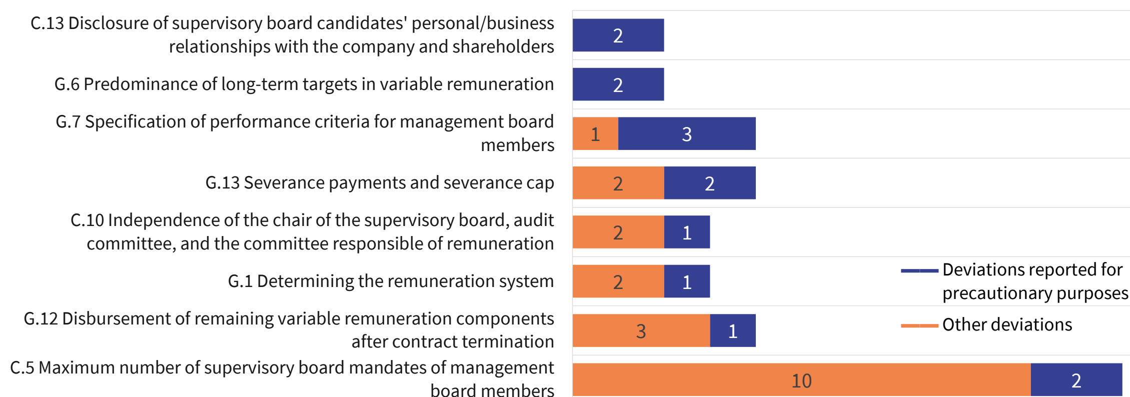
In 14 out of the 73 non-compliance cases (19%), companies emphasise that the disclosure is made for precautionary purposes. There are cases where the unspecificity of the Code is explicitly cited as a reason for making the precautionary disclosure. For instance, in relation to Recommendation C.13, which addresses the disclosure of supervisory board member candidates' personal and business relationships with the company, and any shareholders with a material interest in the company, one company states: "[...] in light of the lack of specificity as well as the unclear scope and limits of the recommendation, the supervisory board cannot rule out that the recommendation has not been or will not be fully complied with".[14]

Figure 5 shows the distribution of the 14 precautionary disclosures over Code recommendations, ranked based on the percentage of cases reported for precautionary purposes in the total number of deviations from the given recommendation. Recommendations C.13, G.6, G.7, and G.13 are those with at least half of the non-compliance cases disclosed for precautionary purposes. To ensure a common understanding

[13] See the declaration of compliance of Porsche Automobil Holding SE issued in December 2022.
[14] Ibid.

and consistency of disclosures across companies, a review of these recommendations by the Commission to provide clearer guidance may be helpful.

Figure 5
Non-compliance cases reported for precautionary purposes

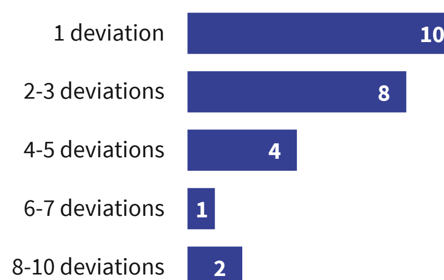


2.5 Companies with respect to the Number of Declared Non-compliance Cases

In 2022, 13 of the 38 DAX companies in the sample declared full compliance with the Code. Figure 6 reports the distribution of the remaining 25 companies with respect to the total number of deviations they report.

10 companies report non-compliance with only 1 recommendation, and 8 companies report non-compliance with 2 or 3 deviations. At the other end of the spectrum are 2 companies reporting 8 or more deviations. The 3 companies with the highest number of deviations are Porsche SE (7 deviations), Volkswagen AG (9 deviations), and Porsche AG (10 deviations). These three companies that are associated with each other account for 36% of the total number of deviations.

Figure 6
Number of companies by number of declared deviations



2.6 “Should-Suggestions” of the Code

In addition to its 62 recommendations, the German Corporate Governance Code contains six “Should-Suggestions” from which companies may depart without disclosure. The six suggestions are identified in the text with the use of the word “should” and are listed in Table 1. Suggestions may typically be viewed as candidate provisions that are on top of the list to become recommendations in future revisions of the Code.

As companies do not have to disclose their compliance status or reasons for non-compliance with the suggestions, it is not possible to assess their level of acceptance. The only five companies that made disclosures in 2022 about the suggestions were Allianz SE, BASF SE, Brenntag SE, Fresenius SE & Co. KGaA, and Henkel AG & Co. KgaA and they all declared full compliance with the Code’s suggestions. The Commission would perhaps want to consider a stronger language to encourage higher usage of this important tool for a fuller picture of the company’s governance situation.

Table 1
List of "Should-Suggestions"

A.4	Employees shall be given the opportunity to report, in a protected manner, suspected breaches of the law within the enterprise; third parties should also be given this opportunity.
A.6	The Supervisory Board Chair should be available – within reasonable limits – to discuss Supervisory Board-related issues with investors.
A.7	The Chair should take into account that the General Meeting be completed within four to six hours.
A.8	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 may decide on corporate actions.
G.14	Change of control clauses that commit to benefits in the case of early termination of a Management Board member's contract due to a change of control should not be agreed upon.
G.18	Supervisory Board remuneration should be fixed remuneration. If members of the Supervisory Board are granted performance-related remuneration, it shall be geared to the long-term development of the company.

Note: Only the sentences with a "should" clause are suggestions.

3 Material Governance Issues of the 2022 Code for Future Consideration

The above observations on the acceptance level of the 2022 Code by DAX companies can be a starting point for the next review of the German Corporate Governance Code. Further analysis of: (i) the almost instant compliance with the 2022 Code's new recommendations[15], (ii) the recommendations with the highest rate of non-compliance and the reasons for associated deviations[16], and (iii) the declarations that are mostly made for precautionary purposes[17], as well as (iv) the high concentration of deviations of a handful of companies[18] should be considered for the next update. The case of one person acting on two management boards (particularly as CEO) with different shareholders also warrants consideration.

In addition to the observations in Part 2 and relevance for the next Code review, three additional material governance issues in the 2022 Code could be addressed in the next review of the Commission:

3.1 Supervisory Board Chair's Engagement with Investors

Suggestion A.6 of the 2022 Code states: "The Supervisory Board Chair should be available – within reasonable limits – to discuss Supervisory Board-related issues with investors." This suggestion was included in the Code for the first time in its 2017 revision and has since remained a suggestion only, although a dialogue between supervisory board chairpersons and investors is today best practice for large companies in particular. This suggestion should therefore turn into a recommendation requiring companies to explain any deviation.

The UK Corporate Governance Code, for instance, provides in Provision 3 some international perspective on this issue. The provision states: "In addition to formal general meetings, the chair should seek regular engagement with major shareholders in order to understand their views on governance and performance against the strategy. [...] The chair should ensure that the board as a whole has a clear understanding of the views of shareholders" (FRC, 2018). The ongoing public consultation of the UK

[15] *See supra* Sections 2.1 and 2.2.
[16] *See supra* Section 2.3.
[17] *See supra* Section 2.4.
[18] *See supra* Section 2.5.

Corporate Governance Code considers a strengthening of Provision 3 with the addition of a new phrase requiring that the outcomes of the engagement which has taken place with shareholders during the reporting period be reported in the annual report (FRC, 2023).

3.2 Independence of Supervisory Board Members

The 2022 Code does not recommend a minimum number or percentage of directors who are independent from the company, the management board, as well as from the controlling shareholder(s). Although Recommendation C.6 uses this stricter definition of independence[19], it is not prescriptive about the number or percentage of independent directors, and remarkably leaves this classification (only) to the shareholder representatives of the supervisory board with the following statement: "The Supervisory Board shall include what it considers to be an appropriate number of independent members from the group of shareholder representatives, thereby taking into account the shareholder structure."

This approach gives substantial freedom of definition, particularly for companies with a high percentage of controlling shareholders and is not common in other countries. The OECD (2021) review of 50 jurisdictions finds that only four of the surveyed jurisdictions (Germany, the Czech Republic, Luxembourg, and the Slovak Republic) do not require or recommend a minimum number or ratio of independent directors. Some countries, including France, the Netherlands, Switzerland, and Sweden, recommend at least 50% of board members to be independent, while others set the limit even higher by recommending (Ireland and the UK) or requiring (the US) a majority of the board members to be independent.[20]

3.3 Cases Requiring Extraordinary General Meetings

Suggestion A.8 of the Code states: "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 may decide on corporate actions". It is suggested that this materially limited suggestion is changed to a recommendation and expanded so that also material, actively pursued takeovers or purchase as well as disposals of important activities (resulting in a substantial change to the company's existing profile) require extraordinary general meetings. In the acquisition of Monsanto by Bayer in 2018, for instance, shareholders had no vote on a radical shift of the company's focus from the pharmaceutical industry to activities in the agrochemical and agricultural biotechnology industry that resulted in substantial shareholder wealth declines.

In the UK, the Listing Rules require that a bidder with a premium listing obtain the prior approval of its shareholders in a general meeting to acquire shares for a consideration that is equal to or greater than 25% of its gross assets, profits, gross capital, or market capitalisation (Cheveley et al., 2022). The listing rules in the US, on the other hand, require shareholder approval only when a company intends to issue more than 20% of new shares to finance an acquisition. US executives who want to avoid a shareholder vote can easily structure the deal accordingly. A recent study by Becht et al. (2021) comparing the dollar value gains

[19] Recommendation C.6 defines an independent supervisory board member as follows: "Within the meaning of this recommendation, a Supervisory Board member is considered independent if he/she is independent from the company and its Management Board, and independent from any controlling shareholder."

[20] It should be noted that in France and the US, companies with higher ownership concentration are subject to less strict independence requirements than those stated here: Specifically, the corporate governance code in France states that in controlled companies, independent directors should account for at least a third of board members. In the US, companies of which more than half of the voting power (for the election of directors) is held by an individual, a group, or another company are exempt from the majority independent board requirement (OECD, 2021).

and losses between US and UK acquisitions has provided evidence that mandatory shareholder votes for acquisitions indeed discourage acquisitions that lead to losses to acquirer shareholders.

Concluding Comment: While the German corporate governance model is not always in line with other countries, a review of the Code's relevant provisions should consider the above issues, also to respect the expectations of international investors that now own a majority of the shares of the DAX 40 companies.[21]

[21] EY Analysis, July 2023, "Wem gehört der DAX?"

4 References

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