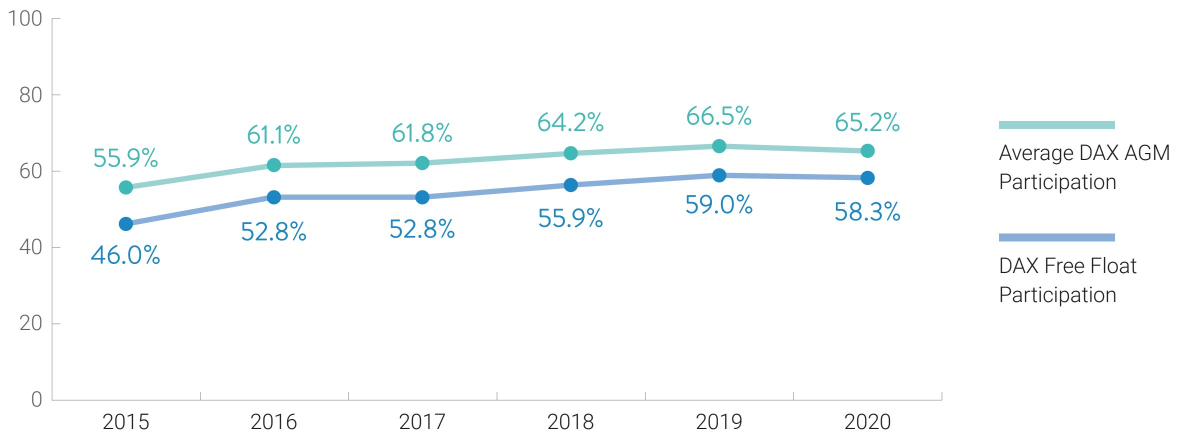
GERMANY

Looking at high level results of the 2020 AGM season, not much seems to have changed. In a year when hardly anything went as planned, it transpires that, in the end, DAX issuers did not have to fear their AGM results. Participation remained broadly in line with 2019 levels, average approval rates actually increased somewhat (even when discounting the vote impact of strategic investors), not a single management proposal failed, and only one would have if only free float investors had their say (compared to five in 2019) – all indicative of investor and proxy advisor leniency in a year of major shifts; from the (for some still surprising) arrival of SRDII and significant announcements on the workstreams of the EU Climate Action Plan, to Covid-19 and digital only AGMs. But where 2020 may have seemed calm, several 2021 topics already linger.

100%
of executive remuneration policies proposed in 2020 included ESG-related performance criteria

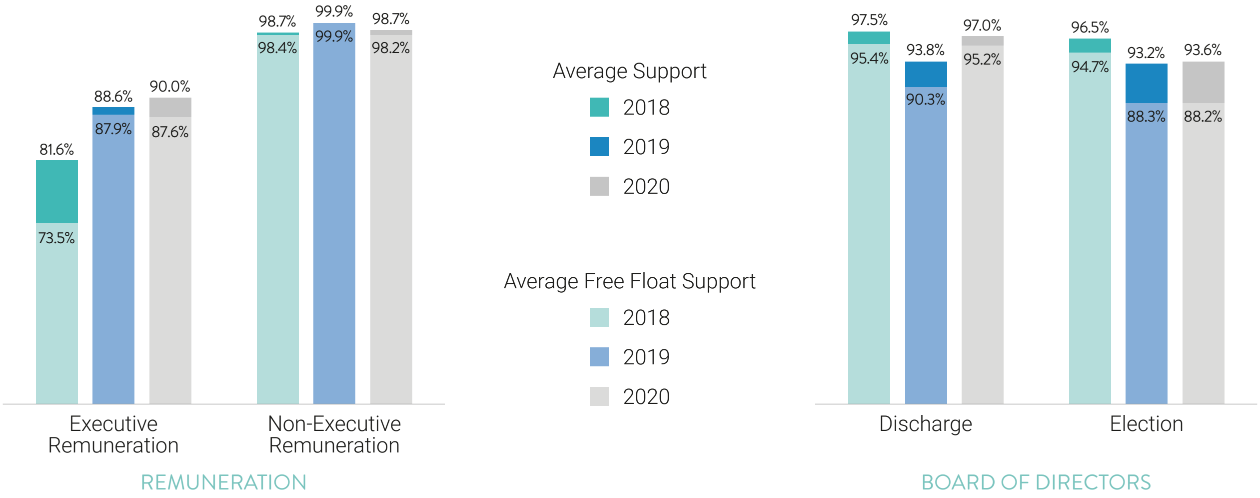
AVERAGE AGM PARTICIPATION, DAX 2015-2020



REMUNERATION

Average remuneration policy approval reached a record high in 2020, not just because of the higher number of typically less controversial non-executive pay policies. All executive remuneration policy proposals caught up with frequent structural investor requirements, such as clawbacks or ESG-related performance criteria. ISS, and with one exception GL as well, recommended in favour of all executive pay policies. Nevertheless, almost all proxy advisor analyses of DAX proposals referred to insufficient transparency on nature and stretch of performance criteria and targets, including their relevance for company strategy. Expectations on remuneration reports will increase significantly in 2021. Companies with upcoming elections of remuneration committee members may take this into consideration, even if they do not intend to propose a vote on an SRDII-aligned remuneration report.

AVERAGE AGM APPROVAL, DAX 2018-2020: REMUNERATION AND BOARD RELATED PROPOSALS



BOARD

In the public domain, Wirecard is mostly discussed in the realms of politics and regulatory oversight. However, issuers should be prepared that international institutional investors will expect reassurance regarding the effectiveness of the German two-tier Board structure in the context of management oversight and independent representation of minority shareholder interests. Companies planning their engagement for Q3/4 2020 should consider that only senior Supervisory Board members can credibly speak to that. If they don't, international investors may feel justified in increasing their pressure to reduce standard Board terms below the four years expected by ISS for 2021 or revise their overboarding limits further to allow Supervisory Board members additional capacity for engagement.

4 years

is the new upper limit for election terms of Supervisory Board members from 2021

OUTLOOK 2021

Initial Covid-19-related short-term measures were supported by investors as a management prerogative, even when stakeholder groups were greatly impacted. However, since then proxy advisors and investors have already lined up several expectations for the FY2020 reporting year that go beyond a cut in Management Board base salaries. Re-evaluations of issuers' materiality assessments, consideration of major stakeholders in executive pay decisions as well as the capacity to efficiently support supply chains and clients through the pandemic will be monitored more closely in 2021.

Article amendments to facilitate online AGM participation were comfortably approved. However, IVOX Glass Lewis, backed by major German institutional investors, regularly raised concerns over the possibility that issuers could extend the limitations on shareholder rights beyond the crisis.

Capital authorisations were treated with unusual flexibility, with even proxy advisors supporting well-justified increases above their standard authorisation limits. Going forward, capital authorisations will be assessed in the context of a company's crisis management. Paying a dividend now and asking for capital increases next year may be considered controversial. "Vorratsbeschlüsse" will require additional explanation among the international investor community.

AGMs 2020: INVESTOR INSIGHTS Q&A

Hendrik Schmidt, *Senior Corporate Governance Lead for Germany, Austria, Switzerland, UK and Ireland, Corporate Governance Center,* DWS

What were the key issues you observed from this year's AGM season in Germany?

In the uprunning of the SRDII implementation, remuneration was an issue, but more on the preparational side than in the AGM itself, as in Germany the systems will have to be put up for vote only in 2021. Besides that, director elections were the most important issues. Within here, accountability regarding sustainability and board composition itself were key topics. But we acknowledge and appreciate that there is increased transparency on nomination processes. For example, companies provide more often a competence matrix and relevant details about qualification. However, there are still quite some of proposed candidates which failed to fulfil our independence requirements or still carry too many mandates.

> "… we will consider how we can exercise better judgement of sustainability performance of companies and its directors."
> **Hendrik Schmidt**

According to our analysis, Board accountability is a major focus on many institutional investors. We see that in the effect of, for example, remuneration concerns directly affecting the elections of remuneration committee members, the demand for ESG responsibility being directly associated with individual Directors or a committee, or the increasing focus on the role and independence of the Board Chair.

What is your view on this development of increasing individual Director accountability?

We address accountability in an escalating way. First, we look at the discharge item and here we expect a trend towards individual discharge. Even though, en-block discharge is still legally allowed, providing an individual vote needs to be reconsidered as in the future, we will take the individual performance more into account. In cases where we observe failure of individual directors, this will also be reflected in elections.

Does it affect your perspective on the frequency of Director elections?

I do not think, we will see more frequent elections. We hear the demand by international investors as well as ISS, but we do not intend to implement shorter terms from our perspective – our views are aligned with legal framework, as the legal regime in Germany allows a maximum term of five years. In addition, it could contradict the long-term perspective of the board. Dual board structure is different, due to our clear separation of powers, where non-executive directors have more of a controlling function, which may be better exercised if we are not longing for annual re-election. In our view, companies can choose to elect their directors for three to five-year term.

What were the most significant changes in engagement priorities during the Covid-19 pandemic? What are your engagement priorities for next year?

We only just started the review process, and we will have a closer look into remuneration topics. We must review whether our expectations are clearly defined, precise, and sufficient. Going forward there will be a vote on the remuneration report and as far as I can see, we are likely to extend our views in this section.

Regarding directors and board composition, we will revisit our diversity policy and will have a look at our current guidelines with the aim to strengthen more diverse boards. Of course, the 2020 AGM season has shown that the treatment of shareholder rights will also affect the discharge in the future. Last but not least, we will consider how we can exercise better judgement of sustainability performance of companies and its directors.

When judging sustainability performance, what do you expect from companies?

For quite some time, we require Boards to have a director or committee dedicated to sustainability. Norm violations of companies as flagged in ratings may become a more severe issue in engaging with the directors and in director related agenda items. We will continue to critically evaluate agendas that propose equity issuance at the same time as share buy backs as they are intuitively opposing instruments of a company's finance strategy. Stronger alignment with strategy in all areas are important.

What is your view on what "good" non-financial performance criteria look like and how should they affect executive remuneration?

First, I prefer the term extra-financial compared to non-financial as it otherwise indicates that there is no economic impact – which is not the case in the long-term. We expect companies to align long-term incentives with relevant and material sustainability aspects of their corporate strategy. As there is no "one size fits all"-solution for the integration of extra-financial KPIs, there are e.g. sector-specific ESG-priorities or targets deriving from or associated with the Sustainable Development Goals (SDGs) by the United Nations. If companies commit to those initiatives, this commitment has to be reflected meaningfully and accordingly.

How should the role of board evolve to address the impact and consequences of the Covid-19 pandemic and social unrest (e.g the appropriateness of executive pay and the ratio of director to employee pay in relation to the overall economic and social situation as well as racial and ethnic diversity). If so, what are you looking for in particular?

We clearly expect Boards to assess also the consequences of the Covid-19-crisis on a more social level, i.e. the well-being of employees, supply-chain risks and appropriateness of rewards for executives vs. job cuts for the work-force. Diversity will gain even more traction and we expect Boards to be transparent about their activities, i.e. in nomination processes. We furthermore observe that excessive remuneration systems for executives bear room for discussions about social cohesion and that investors will have to act responsibly.

As a result of the Covid-19 pandemic, a number of AGMs were held as a hybrid meeting (physical and virtual component). What impact, if any, do you think this has on minority shareholder rights and what are your views on moving to a hybrid or fully virtual meeting going forward? (should a company's Articles of Association request to do so)?

Although we acknowledge the need for a rather short-term solution in the beginning for the crisis to provide a coherent legal framework that allows for AGMs without physical attendance, we criticize that shareholder rights were heavily impacted and diminished (i.e. right to ask questions or file shareholder resolutions). This was acceptable as an immediate response to the crisis but going forward, shareholder rights have to be fully reinstated in any future format of AGMs. This discussion needs to be conducted between companies and investors.

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> **Hendrik Schmidt**

AGMs 2020: INVESTOR INSIGHTS Q&A

Janne Werning,
Head of ESG Capital Markets and Stewardship,
Union Investment

What were the key issues you observed from this year's AGM season in Germany?

The Covid-19 pandemic did not spare the AGM season in Germany. In April, the Federal Government allowed companies to hold purely virtual shareholder meetings in order to protect the health of everybody involved. Instead of general debates and speeches, this year shareholders have to cope with simple video transmissions and live streams. These digital general meetings restricted the shareholders right to ask questions, speak and bring actions against the validity of the resolutions. The central role of the shareholders as a corrective for management board and supervisory board activities was in our view profoundly weakened. Virtual general meetings in this form are a blow to shareholder democracy. For Union Investment and many other shareholders, these digital formats can only be a supplement in the post-Corona world but will never be a full replacement.

What were the most significant changes in engagement priorities during the Covid-19 pandemic?

We saw that trends that have been there before Corona, intensified due to the pandemic. Of course, Corona raised questions regarding crisis management, stability of the business model, and the general strategy of the company. However, our engagement priorities continue to focus on the sustainability of the business model and the way in which the company copes with climate change, for example, rising CO2-prices. These issues were pressuring even before Corona, but are even stronger now.

As you rightly mentioned, all AGMs were held virtually. What impact do you think this has on minority shareholder rights and what are your views on moving to a hybrid or fully virtual meeting going forward?

We clearly oppose the fully virtual meeting idea going forward. Digital AGMs can only supplement the physical meeting. We are in the 21st century; AGMs must be supplemented by virtual transmissions. A company that has done a good job in the past does not have to fear the general debate and dodge the questions of its shareholders. Management and supervisory boards should be willing to face the owners of the company once a year. This holds true for minority shareholders just as well. In our view, shareholder democracy needs the process of opinion forming within the AGM. We consider it as vital for a healthy relationship between company and shareholders. Moreover, shareholders do not only cast their vote, but use the AGM framework to enter into a close engagement. These are crucial instruments of shareholder democracy and companies should not distance themselves from shareholders.

When judging sustainability performance, what do you expect from companies?

It is less about what we expect, but what the financial market expects from companies. We see a huge shift in investor attention and investments to a more disciplined and rigorous approach to evaluate ESG criteria. ESG performance plays a pivotal role in our investment decision-making. Companies failing to meet investor expectations on environmental, social and governance factors clearly risk losing access to capital markets.

What is your view on what "good" non-financial performance criteria look like and how should they affect executive remuneration?

To meet our expectations, companies should build a strong connection between financial and non-financial performance. Companies should pursue a robust approach to analyzing risks and opportunities from climate change and incorporate those into executive remuneration in order to build confidence and trust on investors' side. Ultimately, those criteria always depend on both the individual company and its sector. For example, within the energy sector of course CO2 emission reduction is a key issue, whereas in the IT sector social factors like data security are way more important. That being said, we see a growing demand for a sustainability accounting standard that also helps defining those KPIs that deliver consistent, comparable, reliable, and assurable information relevant to enterprise value creation and ultimately sustainable development. This demand comes from the investors' side, but also from policymakers and regulators. In this regard, well renowned bodies such as the International Integrated Reporting Council, the CDP, the Climate Disclosure Standards Board, the Global Reporting Initiative, and the Sustainability Accounting Standards Board announced an idea of what is needed to make progress toward comprehensive corporate reporting. We believe that this absolutely leads in the right direction.

According to our analysis, Board accountability is a major focus of many institutional investors. We see that in the effect of, for example, remuneration concerns directly affecting the elections of remuneration committee members, the demand for ESG responsibility being directly associated with individual Directors or a committee, or the increasing focus on the role and independence of the Board Chair. What is your view on this development of increasing individual Director accountability?

Most importantly, we believe that board accountability is fundamental to strong corporate governance. Increasing regulation, the perception of business in society, and of course the effects of climate change, have significant impact on companies' business models. Thus, as the financial market continues to organize around those questions, the board's accountability on these topics will increase. Individual directors will need to understand how the company's strategy is linked to sustainability. And let me be frank here, ESG issues that used to be of secondary importance to board members and were misunderstood as philanthropy are now key factors in the assessment. Those questions will affect the company's bottom line and present significant changes and risks to the business. Thus, every investor expects the board to understand, measure, and report it.

How do you reflect insufficient ESG targets in compensation policies in your AGM vote decision?

We are transparent and absolutely clear on that: Union Investment supports all actions that will sustainably increase the value of a company in the long term and votes against any actions that go against this objective. On ESG targets, we expect the incorporation of materially significant ESG performance indicators ('key sustainability indicators', e.g. environmental or social factors) into long-term remuneration. In case we find insufficient ESG targets in compensation polices it will lead to a vote against from our side.

What's your perspective on the frequency of Director elections?

The election process is fundamental for board accountability. As a responsible investor, it is important to us to critically and constructively accompany the companies we cover. To fulfill this responsibility, it is important to be able to exert influence. Therefore, a regular election of the board members and directors is important for us with regard to our ability to react to developments and to express our satisfaction or dissatisfaction with the work of the board members and directors. In Germany, a tenure of 5 years is still common. We consider this as being clearly too long and strongly demand shorter tenures.

What are your engagement priorities for next year?

One of our engagement priorities in the next year is to identify those companies that are in the process of sustainable change, that are ready for a transformation towards more sustainability, that want to change and are able to do so. As an active and sustainable investor, it is important to find and support these companies, and in the best case identify them before the market has discovered the potential in the transformation story. This requires on the one hand classic fundamental research skills, but on the other hand also intensive dialogue with companies. Furthermore, one of our core beliefs proved to be true during the Covid-19-pandemic: Companies that are characterized by good corporate governance and show a well-developed management of social and environmental issues prove to have a crisis-resistant business model. Having said that, corporate governance issues (such as board effectiveness, remuneration, diversity), human rights (e.g. in the supply chain) and environmental issues (climate change mitigation and adaptation) will remain high on our agenda.