



# Largely Ineffective Demands: The Influence of Investors on German Management and Supervisory Board Diversity



# Overview of Study

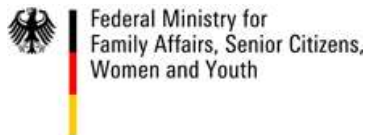
## Key question

Do large investors use their influence to push for more diversity in the supervisory boards and management boards of their German listed portfolio companies?

## Course of examination

1. Identified the 30 most influential institutional investors in the DAX<sup>®</sup> and MDAX<sup>®</sup>
2. Reviewed the top 30 investors' engagement and voting policies and their voting behavior under diversity aspects
3. Analyzed the applicable legal framework and resulting challenges for investors
4. Developed recommendations with concrete action items and practical tips

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# Methodology

1. Identification of the top 30 institutional investors based on EQS Group's ownership data base
  - Companies in scope: DAX<sup>®</sup> and MDAX<sup>®</sup> companies
  - Record date: 31 December 2020
2. Development of an evaluation matrix for an in-depth analysis of the engagement and voting policies of the top 30 institutional investors regarding their diversity expectations (source: Proxy Insight database)
3. Creation of a database for board members' biographical data based on information available from AllBright Foundation (composition of supervisory board/management board prior to agm 2020 and as of 31 December 2020)
4. Comparison of investors' engagement and voting policies with their actual voting behavior regarding the election of supervisory board members and the ratification of the acts of the members of the supervisory board and the management board (source: Proxy Insight database)

# The Impact of Investors on DAX<sup>®</sup> and MDAX<sup>®</sup> Companies

## Voting rights

	VOTING RIGHTS	MARKET CAP	
DAX <sup>®</sup>	24.57%	23.66%	€ 313.54 bn
MDAX <sup>®</sup>	22.10%	18.71%	€ 98.52 bn
DAX <sup>®</sup> & MDAX	22.93%	22.25%	€ 412.06 bn

- The top 30 investors accounted for appr. 23 % of the aggregate voting rights in all DAX<sup>®</sup> and MDAX<sup>®</sup> companies
- The remaining voting rights are to a large extent attributable to large anchor investors and other (partly non-identifiable) investors

## Major levers for more diversity

1. Making an impact at the time of the investment decision
2. Making an impact while being invested:
  - Election of supervisory board members
  - Vote on ratification of acts of members of the supervisory board and management board: voting against grant of discharge, e.g., in case of non-compliance with statutory diversity requirements, unambitious diversity targets, insufficient transparency regarding nomination processes

# Analysis of Engagement and Voting Policies of Top 30 Investors

1. Evaluation of each investor based on how each of the following diversity aspects are dealt with in the investor's engagement and voting policies
  - Diversity dimensions (understanding of „board diversity“)
  - Positioning (quantitative expectations, consequences of missing expectations)
  - Diversity strategy
  - Expectations regarding nomination processes
  - Comprehensive diversity approach beyond the top level
2. Evaluation of each diversity aspect individually and overall diversity evaluation on a scale from A (highest) to D (lowest)

INVESTOR	OVERALL EVALUATION	DIVERSITY DIMENSIONS	POSITIONING	DIVERSITY STRATEGY	NOMINATION PROCESS	COMPREHENSIVE APPROACH
	C	A	D	D	B	B

# Ranking of Investors based on their 2020 Engagement and Voting Policies (Sample)

INVESTOR	OVERALL EVALUATION	DIVERSITY DIMENSIONS	POSITIONING	DIVERSITY STRATEGY	NOMINATION PROCESS	COMPREHENSIVE APPROACH
JPMorgan	A	A	A	A	A	A
Schroders Investment	A	A	A	B	A	A
Allianz Global Investors (AGI)	A	A	A	A	B	B
State Street Global Advisors Europe	A	B	B	A	A	A
Fidelity International	B	A	B	A	D	A
Baillie Gifford Europe	B	A	D	B	B	A
DWS	B	A	B	B	C	B
Vanguard	B	A	D	B	B	B
BlackRock	B	A	B	D	A	D
DEKA	B	A	B	D	B	D
<b>AVERAGE</b>	<b>C (2.7)</b>	<b>B (2.1)</b>	<b>C (2.7)</b>	<b>C (3.2)</b>	<b>C (3.0)</b>	<b>C (2.9)</b>

- Half of the top 30 investors require a diverse composition of the boards of their portfolio companies
- Expectations for gender diversity on boards are relatively modest overall and not infrequently even fall behind statutory requirements

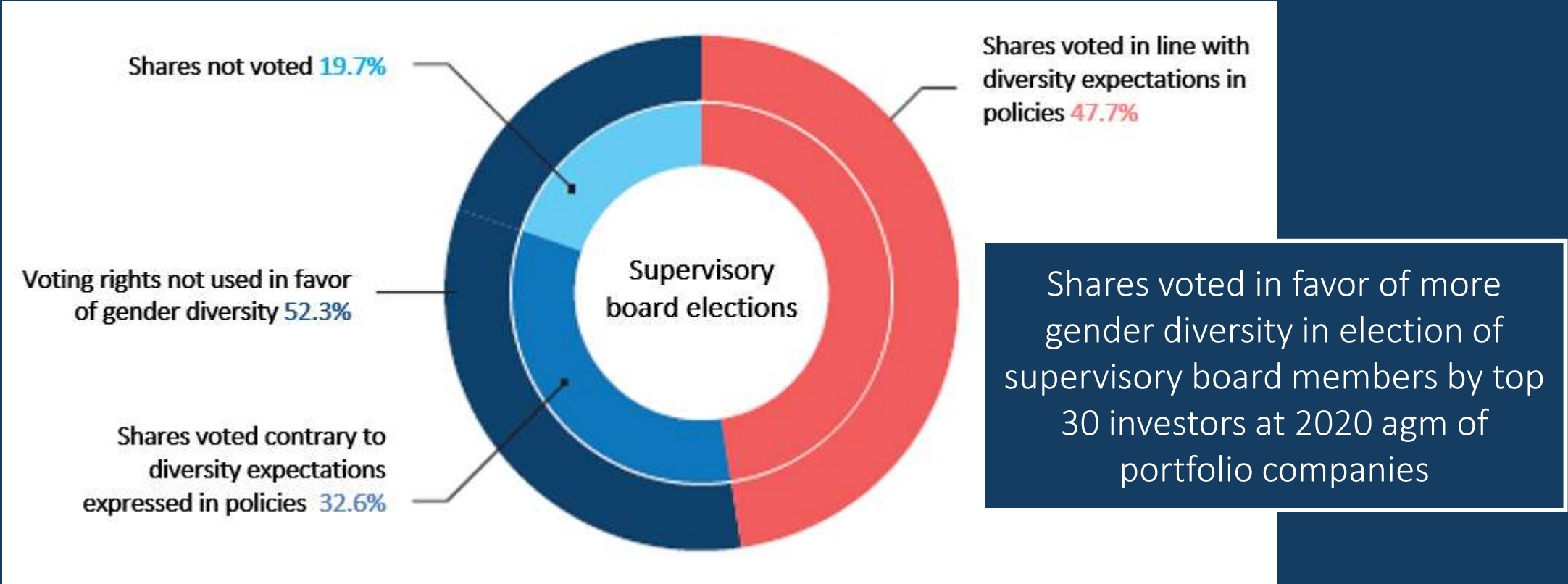
# Assessment of the Two Major Proxy Advisors (Proxy Voting Guidelines 2020)

PROXY ADVISOR	OVERALL EVALUATION	DIVERSITY DIMENSIONS	POSITIONING	DIVERSITY STRATEGY	NOMINATION PROCESS	COMPREHENSIVE APPROACH
Glass Lewis	<b>B</b>	<b>B</b>	<b>B</b>	<b>A</b>	<b>B</b>	<b>A</b>
ISS	<b>C</b>	<b>B</b>	<b>B</b>	<b>D</b>	<b>D</b>	<b>D</b>
AVERAGE	C (2.5)	B (2.0)	C (2.0)	C (2.5)	C (3.0)	C (2.5)

Proxy advisors could become important multipliers for more diversity in the supervisory board and management board of German listed companies.

- The impact of proxy advisors on diversity in DAX® and MDAX® companies should not be underestimated
- Glass Lewis is scoring well compared to the average of the top 30 investors, while diversity does not seem to have been a top priority for ISS in 2020

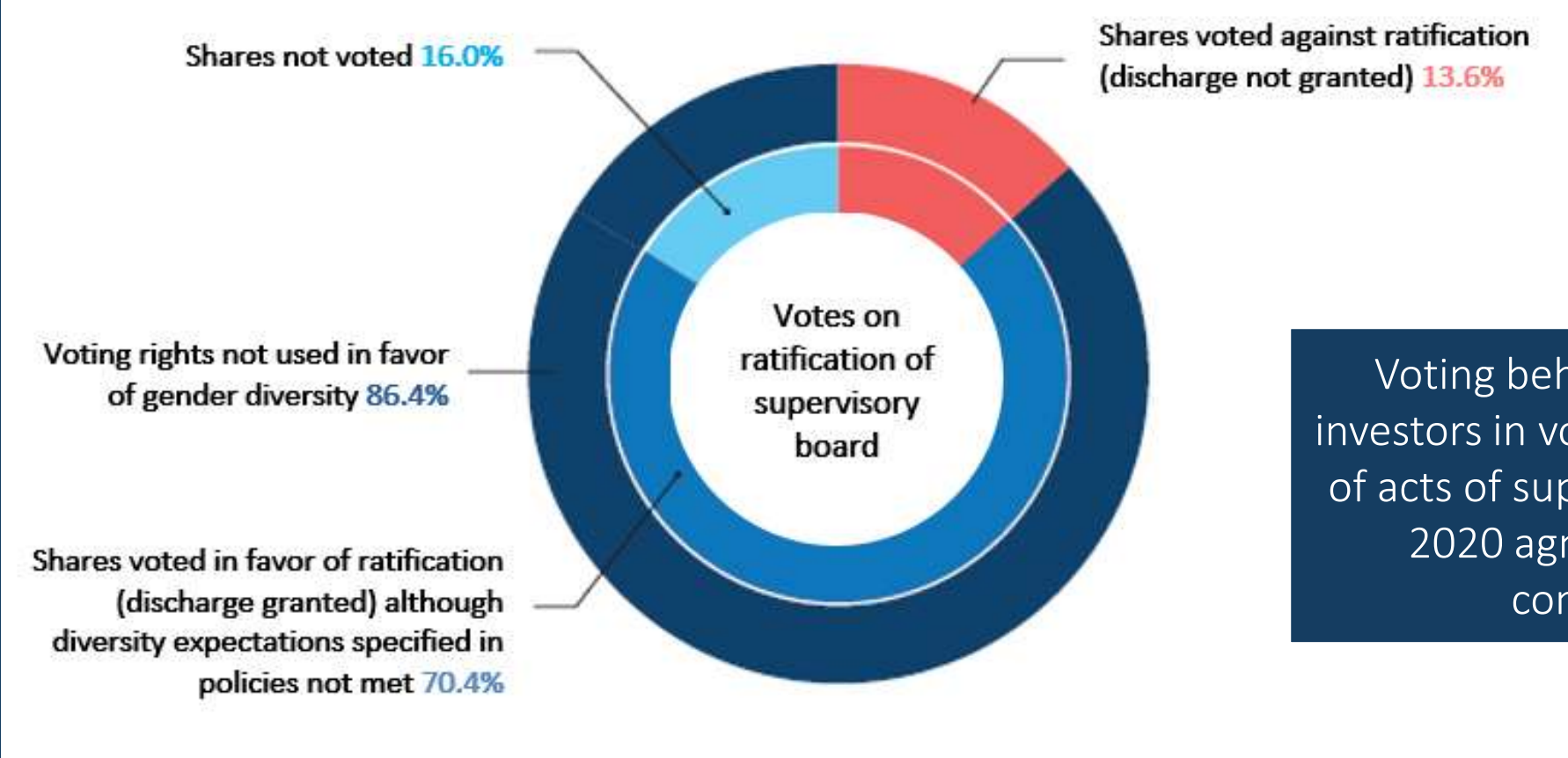
# Review of Voting Behavior – 2020 Supervisory Board Elections



NO intervention of investors in case of lack of diversity aspects other than gender, such as nationality or professional background



# Review of Supervisory Board Actions – 2020 Votes on Ratification of Acts of Supervisory Board



Voting behavior of top 30 investors in votes on ratification of acts of supervisory board at 2020 agm of portfolio companies

Lack of engagement for diversity was in no case mentioned as reason for not granting discharge → diversity did not play any role in 2020 agm resolutions on ratification of acts supervisory board

# Special Challenge: Corporate Governance Reporting

Investors can only make an impact on diversity if information and data relevant for their decisions are readily available:

1. To date, biographies of members of the management board and supervisory board are not always disclosed or at least not disclosed in a consistent format
2. Mandatory diversity-related disclosure does not follow consistent format → comparison between different companies hardly possible
  - a) Highly detailed and extensive diversity-related information can be found in various places of the annual corporate governance statement
  - b) In addition, diversity-related information on employees must be included in the annual non-financial statement, to the extent material to a company; application of available national or international disclosure standards, such as GRI, requiring more substantive information is not mandatory

# Challenges for International Investors: Particularities of the German Corporate Governance System

1. Engagement and voting policies of many international investors are not sufficiently tailored to the German „two tier“ corporate governance system (distinct responsibilities of supervisory board and management board)
  - Policies are often not suitable to steer the actions of supervisory boards and management boards towards more engagement for diversity in their companies
2. No clear understanding of the meaning and use of the vote on the ratification of the acts of the supervisory board
  - Certain slowness of the German corporate governance system
3. No clear understanding of the responsibilities of the supervisory board and its committees

# Recommendations

## For the Legislator

- Simplify diversity-related disclosure obligations of issuers
- Introduce standardized disclosure format
- Improve access to information

## For Investors

- Adopt clear engagement and voting policies with specific diversity expectations
- Take into account particularities of German two tier governance system
- Consider voting against ratification of supervisory/management board

## For Issuers

- Adapt to rising diversity expectations
- Develop diversity target models and concepts
- Chairperson of supervisory/management board to credibly stand behind diversity

# Add-on: The German Corporate Governance Code\* from a Diversity Perspective (1/4)

## General

1. In addition to a description of key legal provisions (contained in “principles”), the Code sets out “recommendations” and “suggestions” reflecting best practices for prudent and responsible management and oversight of listed German companies
2. The recommendations and suggestions of the Code are directed at supervisory boards and management boards, not at shareholders
3. The Preamble of the Code mentions the heightened responsibility of institutional investors:  
  
...Institutional investors are of particular importance to enterprises. They are expected to exercise their ownership rights actively and responsibly, in accordance with transparent principles that also respect the concept of sustainability...
4. Guidance on the Code’s understanding of diversity is provided in the explanatory notes:  
  
In line with ...the German Commercial Code, diversity is [,among other things,] defined through age, gender, the educational or professional background, as well as internationality

# Add-on: The German Corporate Governance Code from a Diversity Perspective (2/4)

## Diversity-related Code recommendations

- A1: When making appointments to executive positions, the Management Board shall consider diversity
- B1: When appointing Management Board members, the Supervisory Board shall take diversity into account
- C1: The Supervisory Board shall determine specific objectives regarding its composition, and shall prepare a profile of skills and expertise for the entire Board while taking the principle of diversity into account. Proposals by the Supervisory Board to the General Meeting shall take these objectives into account, ..... The implementation status shall be published in the Corporate Governance Statement .....

# Add-on: The German Corporate Governance Code from a Diversity Perspective (3/4)

## Assessment of the Code's approach on diversity

- The Code's broad understanding of diversity is generally positive
- Defining diversity by reference to a list of diversity criteria without providing any further context may have the unintended consequence of encouraging cherry picking of the diversity criteria that are easiest to meet
- Recommendations to “consider” or “take into account” diversity are fairly weak, since they are solely process-oriented rather than result-oriented
- The Code misses the general opportunity to enhance diversity as a driver of good governance
- The Code misses the specific opportunity to enhance gender diversity in supervisory boards and management boards of companies that are not subject to the statutory gender quota and minimum participation rules

# Add-on: The German Corporate Governance Code from a Diversity Perspective (4/4)

## Recommendations for the German Corporate Governance Commission

- Consider clarifying in the explanatory notes that the relevant diversity criteria shall be established on a company by company basis and that gender is generally relevant
- Consider making the diversity-related recommendations of the Code more forceful by converting them into result-oriented recommendations
- Consider introducing a gender minimum participation recommendation for supervisory boards and management boards of listed German companies not falling under the statutory quota and/or minimum participation rules
- Consider introducing a recommendation to adopt a diversity concept
- Consider clarifying in the Preamble that exercising shareholder ownership rights responsibly includes promoting diversity in their portfolio companies as one of the drivers of sustainability



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