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Reformed corporate governance code submitted to the BMJV for re-examination

Good things come to those who wait? On January 23, 2020, the Government Commission on the German Corporate Governance Code submitted the new version of the Code adopted on December 16, 2019, to the Federal Ministry of Justice and Consumer Protection (BMJV) for review.



The new code – the most comprehensive reform in years – will enter into force with the subsequent publication by the Ministry in the electronic Federal Gazette. Until then, the version of the Code dated February 7, 2017 remains valid. The Government Commission had already presented the draft of the Code on May 22, 2019 following an extensive consultation process. In order to be able to understand any necessary adjustments to the final new version of the German Stock Corporation Act through the Second EU Shareholder Rights Directive (SRD II), the Government Commission had waited for the conclusion of the corresponding legislative procedure before finalising the new Code. In SRD II, which came into force on January 1, 2020, the legislator has still made changes to the provisions on Management Board compensation, which must be reflected in the Code. However, no material changes to the draft Code were necessary. It can be assumed that the revised German Corporate Governance Code will finally come into force shortly.

The named objectives of the Code reform were the improvement of transparency and the comprehensibility of the system of good corporate governance in Germany. The GCGC 2020 now distinguishes three categories, the first of which contains the basic principles and legal rules. The term “principles” is intended to commit companies to “apply or explain”. The second category remains the recommendations of the Codex Commission: here companies must explain or follow deviations (“comply or explain”). The third category consists of the non-binding “suggestions”.

In addition to the remuneration report, the remuneration system to be determined by the Supervisory Board and submitted to the Annual General Meeting for (advisory) voting is the core element – also its most controversial part – of the Codex reform. From now on, the German Stock Corporation Act will stipulate that in the future the Supervisory Board must establish the maximum remuneration for Management Board members (Section 87a(I) sentence 2 no. 1 Stock Corporation Act); the General Meeting may reduce this remuneration upon a resolution (Section 87a(IV) Stock Corporation Act). The new version of the Code also supplements the target remuneration with a maximum total remuneration (cap). This total – taking into account the remuneration of senior managers

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and the workforce as a whole – should also be communicable to the general public. The Code fails to stipulate what “communicable” is, however, so that the parties are faced with cold comfort for their negotiations.

Total remuneration consists of fixed remuneration on the one hand, and short-term variable and long-term variable remuneration components on the one hand. The short-term variable remuneration is linked to achieving operating targets and is to be paid out in cash. The long-term variable remuneration is geared solely to strategic corporate goals. The proposal to grant long-term variable remuneration exclusively in stock was dropped by the Commission after it faced massive criticism; this remuneration is now to be largely invested in company shares by the respective Management Board member. These requirements represent nevertheless massive interference in entrepreneurial freedom. The Supervisory Board will no longer be able to simply align the current, differently structured remuneration models – with all their advantages and disadvantages – to corporate requirements. It is not obvious why the vast majority of variable remuneration should not continue to be geared to financial ratios. And it is doubtful whether the new regulations will actually achieve added value compared to the previous system, which already knew extensive transparency and publicity of executive compensation. Additionally, different wording on remuneration in SRD II and the German Corporate Governance Code is opening up scope for interpretation.

To ensure an appropriate number of independent members from the group of shareholder representatives on the Supervisory Board, the Code for the first time stipulates a set of recommendations. According to these provisions, the following indicators do not indicate sufficient independence: that the Supervisory Board member was a member of the company’s Management Board in the two years prior to appointment, that he/she is maintaining or has maintained a material business relationship with the company or one of the entities dependent upon the company (e.g., as customer, supplier, lender or advisor) in the year up to his/her appointment, that he/she is a close family member of a Management Board member or has been a member of the Supervisory Board for more than twelve years. This assessment will be considerably more costly for companies in the future. If an indicator is met, not only appropriate disclosure, but also a change of the individual concerned will be necessary. Additionally, the set of indicators is not in compliance with the provisions of the Stock Corporation Act – after all, the legislator did not delete the criterion of independence from Section 100(5) Stock Corporation Act until 2016.

The GCGC 2020 addresses the problem of so-called overboarding by restricting the number of supervisory board mandates to five in non-group listed companies or comparable functions. The chairmanship counts twice (C.4 German Corporate Governance Code). If a Supervisory Board member is also a member of the Management Board of another company, a maximum of two external Supervisory Board mandates are to be permissible, with a chairmanship not to be accepted (C.5 German Corporate Governance Code).

The recommendation to limit the number of Supervisory Board mandates is highly welcome as it takes into account the increased scope of the Supervisory Board’s duties. In the new GCGC 2020 the initial appointment term of three years is no longer structured as a suggestion but as a recommendation. The term of shareholder representatives on the Supervisory Board is limited to three years, with reelection permitted. The shortening of terms, however, will not necessarily have a positive effect on the continuity of work in the Supervisory Board. Additionally, the influence of institutional investors and voting rights advisors will increase, while the willingness to make constructive and critical contributions to discussions in the Supervisory Board may decline.

After all, the Commission also aimed at reducing bureaucracy with the Code and resolved to simplify reporting on corporate governance. On the basis of its new code structure, however, it is forcing companies to rewrite their code statements entirely. One would hope that companies have already started to prepare accordingly.





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