ESG Comparative Guide

MAYER | BROWN

mondaq
Connecting knowledge & people

ESG Comparative Guide

Article Author(s)	Contributing Editor
MAYER BROWN	
Johannes Weichbrodt	**Radha Curpen**
Patrick Scholl	
Germany	Contributing Editor

1.Legal and enforcement framework

1. 1. What regulatory regimes and codes of practice primarily govern environmental, social and governance (ESG) regulation and implementation in your jurisdiction?

Germany
Mayer Brown

A large proportion of ESG regulation in Germany is based on EU law. In addition, there is a variety of national ESG regulation, in particular focusing on sustainability, climate change, renewable energy and gender equality. It is impossible to name all German regulations that have an ESG angle to them. Prominent recent examples include the following:

- the Supply Chain Due Diligence Act;
- the Climate Protection Act;
- the Pay Transparency Act; and
- the Second Act on Equal Participation of Women in Management Positions.

Further, a commission established by the Ministry of Justice publishes the German Corporate Governance Codex annually, containing principles, recommendations and suggestions for the management board and the supervisory board that are intended to ensure that the company is managed in its best interests. The current (2022) version includes several ESG-related recommendations, such as a requirement that the supervisory board consider and assess ESG-related risks and opportunities for the company and include these in the company's ESG strategy.

Regulatory authorities are another key driver in this area: for some time, they have been urging the companies they supervise to give appropriate consideration to sustainability risks in particular. In its supervisory priorities for 2021, the Federal Financial Supervisory Authority (BaFin) announced that insurance supervision would "implement the requirements of the BaFin leaflet on dealing with sustainability risks in supervisory practice in 2021". BaFin will also "promote greater consideration of sustainability risks – including in credit risk management".

1. 2. Is the ESG framework in your jurisdiction primarily based on hard (mandatory) law and regulation or soft (eg, 'comply or explain') codes of governance?

Germany
Mayer Brown

The ESG framework in Germany is based on a combination of hard law and regulation, as well as soft codes of governance. For example, the ESG laws listed in response to question 1.1 are hard law and will be enforced by the German authorities; while the Corporate Governance Codex consists of non-binding recommendations.

1. 3. Which bodies are responsible for implementing and enforcing the rules and codes that make up the ESG framework? What powers do they have?

Germany

Mayer Brown

The body which is responsible for implementing and enforcing the ESG rules in Germany depends on the individual act that is being enforced. For example:

- the Supply Chain Due Diligence Act is enforced by the Federal Office of Economics and Export Control (BAFA). BAFA has powers to oversee compliance with the obligations imposed by the act – for example, by entering business premises or requesting information. Where BAFA finds a violation, it has the power to issue specific injunctions intended to end the violation (including issuing periodic penalty payments where the company remains to fail to comply) or to issue fines for past violations, based on the gravity of the violation and the company's gross revenue. Companies may also be banned from participating in public procurement procedures for a period of three years where a fine exceeds €175,000;
- the Climate Protection Act provides climate goals and sets certain emission goals for specific industry sectors. The Federal Environment Agency oversees the emissions data for certain industry sectors and issues respective reports. The responsibility for achieving the goals for specific industry sectors is allocated to the relevant federal ministries (eg, the Federal Ministry of Economics and Climate Protection is responsible for reductions in the energy and industry sectors). Where emissions goals are not fulfilled, the competent ministries must develop plans in order to comply with the goals;
- the Pay Transparency Act primarily establishes the basis for claims based on unequal remuneration before the German courts; and
- the Second Act on Equal Participation of Women in Management Positions sets binding targets for more women in management positions and provides for several changes in existing German laws (eg, the Stock Corporation Act) in order to achieve these targets. Enforcement will be subject to the respective law that is affected by the changes. The act changes several different German laws with the goal of promoting more women in management positions by setting targets with respect to the proportion of women in such positions. In addition, this act establishes an obligation for companies to report on the proportion of women in management positions. The legislature has also introduced the possibility to sanction the breach of reporting obligations, which is considered an administrative offence.

1. 4. What is the regulators' general approach to ESG and the enforcement of the ESG framework in your jurisdiction?

Germany
Mayer Brown

In the last couple of years, the German government has had a clear focus on sustainability. In particular, the new German government (a mid-left coalition formed by the Social-Democratic Party, the Liberal Party and the Greens), in office since December 2021, has an even greater focus on ESG topics. The coalition agreement addresses a wide range of ESG topics, such as climate protection and renewable energy, as well as supply chain due diligence and equal pay.

1. 5. What private sector initiatives have been launched in your jurisdiction to complement the ESG framework?

Germany
Mayer Brown

In Germany, there are various private sector initiatives complementing the ESG framework. For example, in the retail sector, several companies and the *Deutsche Gesellschaft für Internationale Zusammenarbeit* have launched an initiative to introduce living wages in the banana sector. Another example is German Environment Help, a particularly active non-governmental organisation that has been engaged in numerous environmental-related court proceedings, from suing cities to ban diesel vehicles from their streets to suing automotive manufacturers to stop producing combustion engines.

2.Scope of application

2. 1. Which entities are captured by the rules and codes that make up the principal elements of the ESG framework in your jurisdiction?

Germany
Mayer Brown

This depends on the relevant act that includes ESG elements – for example, the Pay Transparency Act primarily grants rights to employees on which they can base remuneration claims; while the German Corporate Governance Codex is addressed to listed companies and companies with access to capital markets pursuant to Section 161, paragraph 1 sentence 1 of the Stock Corporation Act. However, companies which are not capital market oriented may nevertheless use the code's recommendations and suggestions as guidelines.

A recent and very far-reaching example is the Supply Chain Due Diligence Act, which as of 1 January 2023 will apply to all companies with a seat and more than 3,000 employees in Germany. As of 1 January 2024, the scope will be extended to companies with more than 1,000 employees in Germany.

2. 2. How are entities in your jurisdiction that are not subject to specific rules or codes implementing ESG?

Germany
Mayer Brown

Due to the growing importance of ESG in society, companies that are not subject to specific rules or codes are also more alert to ESG issues. Such companies may design their ESG strategy according to the examples provided by the regulation and soft law. This exercise may also be beneficial from the consumer's perspective, as companies that do not consider ESG as part of their strategy increasingly face reputational damage.

Companies should also keep an eye on the European Union's proposal for a directive on corporate sustainability due diligence (targeting the supply chain) which has a broad scope of application and is further reaching than the Supply Chain Due Diligence Act.

2. 3. What are the principal ESG issues in your jurisdiction that are either part of the ESG framework or part of the implementation of ESG?

Germany
Mayer Brown

The ESG issues most frequently addressed by German law relate to climate change or supply chain due diligence. In particular, the Supply Chain Due Diligence Act covers a vast number of companies in Germany, which are obliged to implement a risk management system to oversee their supply chains and address any human rights or environmental risks. This will be a challenge for German companies, especially in sectors such as retail, where companies can have tens of thousands of suppliers. The act even has an effect on companies that are not directly subject to it, because they may be suppliers of those which are.

Furthermore, companies will face other ESG-related issues, such as non-financial reporting obligations.

3.Disclosure and transparency

3. 1. What primary disclosure obligations relating to ESG apply in your jurisdiction?

Germany
Mayer Brown

In Germany, the most important sustainability disclosure requirements are regulated at the European level in the form of regulations or directives. It has become increasingly apparent in recent years that there is a great willingness for further harmonisation both in politics and in economic sectors.

Non-financial disclosure of companies and financial institutions: So far, the EU Non-Financial Reporting Directive (2014/95/EU) applies and lays down the rules on the disclosure of non-financial and diversity information by certain large companies. This directive amends the EU Accounting Directive (2013/34/EU). EU rules on non-financial reporting currently apply to large public interest companies with more than 500 employees. This covers approximately 11,700 large companies and groups across the European Union, including listed companies, banks, insurance companies and other companies designated by national authorities as public interest entities.

'Public interest entities' are undertakings within the scope of Article 1 and Annexes I and II of the NFRD. According to Articles 1(1) and 2(1) and Annexes I and II, the following types of undertakings are defined as public interest companies in Germany:

- stock corporations;
- partnerships limited by shares;
- limited liability companies;
- general partnerships; and
- limited partnerships.

Under the NFRD, large companies must publish information related to:

- environmental matters;
- social matters and treatment of employees;
- respect for human rights;
- anti-corruption and bribery; and
- diversity on company boards (in terms of age, gender, educational and professional background).

Germany had transposed the NFRD into national law through the Corporate Social Responsibility Directive Implementation Act.

In Germany, capital market-oriented corporations, insurance companies, credit institutions, limited partnerships and cooperatives must submit this report if they:

- have more than 500 employees; or
- meet two out of three size criteria:
  - €40 million in turnover;
  - €20 million in total assets; and/or
  - at least 250 employees.

The main provisions in this respect are Sections 289b to e of the Commercial Code.

In April 2021, it was decided to extend the scope of the NFRD to smaller companies and the proposal for the Corporate Sustainability Reporting Directive (CSRD) was issued, which:

- amends the existing reporting requirements of the NFRD, as the information companies report is insufficient;
- ensures that companies report the information that investors and other financial market participants need subject to the Sustainable Finance Disclosure Regulation (2019/2088) (SFDR) – see further below;
- extends the scope to all large companies and all companies listed on regulated markets without the previous 500-employee threshold (except listed micro-enterprises);
- requires the audit (assurance) of reported information;
- introduces more detailed reporting requirements and a requirement to report according to mandatory EU sustainability reporting standards;
- allows small and medium-sized enterprises to report according to standards that are simpler than the standards that will apply for large companies; and
- requires companies to digitally 'tag' the reported information so that it is machine readable and feeds into the European single access point envisaged in the capital markets union action plan.

In addition, the CSRD proposal amends the EU Transparency Directive (2004/109/EC) to:

- extend the scope of the sustainability reporting requirements to companies with securities listed on regulated markets; and
- clarify the supervisory regime for sustainability reporting by these companies.

The European Financial Reporting Advisory Group is responsible for developing draft reporting standards under the CSRD proposal. The standards will be tailored to EU policies, while building on and contributing to international standardisation initiatives. In addition, the International Sustainability Standards Board published proposals on 31 March 2022 that build upon the recommendations of the Task Force on Climate-Related Financial Disclosures and incorporate industry-based disclosure requirements derived from Sustainability Accounting Standards Board standards.

Financial products-related disclosure: The objective of the Sustainable Finance Disclosure Regulation (SFDR) is to channel private investment towards sustainable investing while preventing 'greenwashing'. The SFDR started to be phased in on 10 March 2021; regulatory reporting under Article 11 commenced on 1

January 2022. The European Commission adopted Regulatory Technical Standards (Delegated Regulation (EU) 2022/1288, SFDR RTS), which provide:

- details on the principal adverse impact statement on the financial market participants' or advisers' websites; and
- pre-contractual and periodic disclosure templates, including on:
  - sustainability indicators;
  - asset allocation; and
  - the extent of EU Taxonomy alignment by way of a key performance indicator.

The SFDR RTS will apply as of 1 January 2023.

They affect the following:

- financial market participants that are defined as investment firms, including asset managers which offer portfolio management services, pension providers and insurance-based investors, as well as qualifying venture capital and social entrepreneurship activities; and
- financial advisers.

Under the SFDR, these in-scope financial market participants and advisers must disclose sustainability-related information with respect to financial products (product-level and entity-level disclosure) on their websites as pre-contractual disclosures and reports. However, not all financial instruments are in scope. Certain financial instruments under the European Market in Financial Instruments Directive II (2014/65/EU), such as derivatives and securities with derivatives features, are still unregulated as such.

3. 2. What voluntary ESG disclosures are also commonly made in your jurisdiction?

Germany
Mayer Brown

German corporates and financial institutions started to integrate ESG policies and disclosures in their corporate policies and product developments. Often, such disclosures are driven from a marketing perspective to a large extent. These voluntary ESG disclosures are not yet regulated other than via general legal principles, such as competition laws or from a consumer-protection perspective.

German corporates and financial institutions base their ESG policies on a variety of global, voluntary standards to commit to sustainability objectives. These are often driven by initiatives of the financial sector, the UN and non-governmental organisations. Notable examples include:

- the UN Principles for Responsible Banking;
- the Principles for Responsible Investment (PRI);
- the UN Principles for Sustainable Insurance;
- the UN Global Compact;
- the Net-Zero Asset Owner Asset Owner Alliance;
- ClimateAction100+; and
- Finance for Biodiversity.

At the same time, financial market participants are participating in cross-sector initiatives such as the Diversity Charter and the Sustainable Finance Code of Conduct of the German Derivatives Association. In

addition, there are a number of national initiatives in the financial sector aimed at promoting sustainable finance, such as voluntary commitments by savings banks and voluntary agreements by the financial sector on climate protection.

Voluntary ESG disclosures will become less relevant once the CSRD is in full force and effect.

3. 3. What role is played in this regard by (a) the board and (b) other corporate bodies and/or officers?

Germany
Mayer Brown

Given the reputational aspects of such disclosures, the board is usually involved in decision-making processes.

3. 4. What best practices should be considered in relation to ESG reporting and disclosure?

Germany
Mayer Brown

ESG disclosures are subject to many risks – in particular, reputational risks based on greenwashing allegations or even litigation risks. Care should therefore be taken when preparing ESG disclosures; and all disclosures should be based on available data and measured against a conservative standard. It is always helpful if ESG disclosures are accompanied by third-party assessments or verifications, such as ESG ratings. However, in case of the use of ESG ratings, the basis of the ratings should be highlighted to make the public aware of the meaningfulness of the selected ratings. In addition, a strict monitoring of disclosures and their correctness should be implemented. Any kind of misinterpretations or omissions should be avoided.

4.Strategy and governance

4. 1. How is ESG strategy typically designed and implemented in companies in your jurisdiction?

Germany
Mayer Brown

Companies that take ESG seriously have typically made ESG a matter for decisions at the top level. This applies to companies either that are subject to non-financial reporting obligations or that have come to realise the value of ESG compliance for the success of their business. However, very few leave this responsibility at board level. For purposes of oversight, most companies in Germany have appointed either ESG officers or, even more frequently, ESG committees (and sometimes even special committees for different ESG areas) below board level.

Companies have increasingly been publishing their ESG commitments in recent years. The specific commitments vary and depend on the company that publishes them. The goals are wide ranging, from climate neutrality to diversity, human rights and anti-corruption. The most common goals seem to relate to

environment issues.

Specific ESG strategies must be designed for each company individually. Each company will define slightly different ESG strategies with a view to its own business. Still, large companies usually have expert teams which specialise in sustainability issues in different areas. In large companies, many activities are already taking place with regard to sustainability. In such cases, it is primarily a matter of coordinating these strategically. On the one hand, it should be ensured that the general strategic direction is adhered to in all departments. On the other hand, it must be ensured that any overlaps in the processing of the various ESG issues are avoided. To avoid redundancies and gaps, and to coordinate sustainability activities, some companies establish the role of a chief sustainability officer (CS) who – as mentioned – usually does not sit on the board. The implementation of ESG strategy can involve several tools, such as adjusting the variable compensation structure of a company to incentivise management to implement the ESG strategy effectively.

The 2022 version of the German Corporate Governance Codex includes several recommendations for companies on how to address sustainability matters. In particular:

- institutional investors are expected to use their shareholding rights in a transparent way while also taking sustainability matters into account;
- in addition to financial targets, a company's strategy should include sustainability-related targets;
- a company's internal controlling and risk management system should cover sustainability-related matters and be able to process sustainability-related data;
- the supervisory board should consider sustainability matters in its position overseeing and advising the management of a company;
- the supervisory board should consist of members who count sustainability matters as part of their skillset; and
- accounting and annual reporting should include reporting on sustainability matters.

4. 2. What role is played in this regard by (a) the board and (b) other corporate bodies and/or officers?

Germany
Mayer Brown

Establishing an ESG compliance function regularly follows from the directors' statutory duties of loyalty and care. The board's role is typically to select and appoint qualified and reliable individuals and assign to them the task of implementing a proper ESG compliance function. The selection of members is critical. The structure to be chosen should support an adequate decision-making process in light of the business judgement rule. Once the individuals are appointed, board members have an ongoing responsibility to ensure that they properly fulfil the duties assigned to them. The board must also ensure that appointees are adequately equipped with financial and other resources to fulfil their responsibilities.

The ESG officer or the committee is then tasked with developing an ESG compliance function. He or she will typically start by identifying and categorising ESG factors in order to allow the board to identify focus areas and weigh them in light of their relevance to the business and the various stakeholders. Once this process is completed, the board should take a decision on the approach to be taken. The entire process should be properly documented.

In addition, investors and stakeholders are increasingly attaching importance to sustainability issues in their operations and governance; and are exerting their influence on companies in part to ensure that they take these aspects into account. To meet these demands, companies must adapt their corporate governance and decision-making processes accordingly. For investors, corporate governance is increasingly a key factor and compliance issues are therefore frequently raised in investor discussions and shareholder meetings.

From the outset, the board must ensure that ESG officers and committees must not only develop ESG objectives, but also implement the right tools to monitor progress. Reports should be assessed and conclusions should be drawn from them to further develop the ESG goals and adjust them as necessary from time to time. ESG officers and committees must monitor the ongoing collection of ESG data and consider this in the reports. ESG officers and committees must also support the board in understanding the reporting and adjusting the ESG framework.

4. 3. What mechanisms are typically utilised to monitor the implementation of ESG strategy in your jurisdiction?

Germany
Mayer Brown

Different mechanisms are used to monitor the implementation of ESG strategy. A common starting point is the development of an ESG roadmap or framework that follows from a gap analysis. The ESG roadmap or framework delivers the necessary data points to define key performance indicators (KPIs) or the various internal and external functions that contribute to ESG compliance. Performance against such KPIs can then be assessed by asking the various stakeholders to complete questionnaires or to regularly submit reports on the progress that has been made. Other methods include peer analyses, scoring systems and analytic tools. Most companies use software solutions to track and assess their level of ESG compliance.

As an organisational measure, companies often appoint a CSO. Many companies also have a corporate sustainability board, which can be made up of members of the board of management and managers from various corporate units and functional areas, and which deals specifically with ESG. In addition, some companies take ESG objectives into account when determining the compensation of the management board members or other corporate bodies.

4. 4. What role is played in this regard by (a) the board and (b) other corporate bodies and/or officers?

Germany
Mayer Brown

See question 4.2.

4. 5. How is executive compensation typically aligned with ESG strategy in your jurisdiction?

Germany
Mayer Brown

Historically, executive compensation has been tied to financial metrics. More and more companies are changing their approach and now include ESG goals in their KPIs. The availability of ESG standards – such as the established GRI Standards or the standards of the European Financial Reporting Advisory Group that will be released shortly – makes it easier for companies to define adequate performance goals. Besides environmental objectives such as reducing a company's carbon footprint, other issues are now making their way into executive compensation schemes, such as:

- employee wellbeing;
- retention/attrition rates;
- payment of equity; and
- involvement of employee representatives.

Since 1 January 2020, companies whose shares are listed on a regulated stock exchange have been obliged to align their remuneration structures with 'sustainable and long-term' development. The legal basis for this is the restated Section 87(1), sentence 2 of the Stock Corporation Act, based on the Act Implementing the Second Shareholders' Rights Directive.

The German Corporate Governance Codex also requires listed companies whose shares are listed on a regulated stock exchange to align their remuneration structure with sustainable and long-term corporate development. Accordingly, listed companies must take appropriate account of the concept of sustainability by selecting certain financial and non-financial criteria against which to assess remuneration. Company-specific solutions should be developed for supervisory boards on the design of remuneration systems, including in particular on the implementation of the concept of sustainability.

Subject to the industry and the business model, it may make sense to focus on and incentivise a single target or alternatively to focus on many targets from different areas. To this end, performance criteria and measurement systems from sustainability reporting which has already taken place can be used as common and measurable targets for supervisory boards. The fulfilment of these customary and measurable targets will have a significant impact on the company's success and thus constitutes a meaningful incentive for the members of the management board.

4. 6. What best practices should be considered in relation to the design and implementation of ESG strategy?

Germany
Mayer Brown

The first step in designing and implementing an ESG strategy should always be a materiality (risk) assessment. Different companies have different ESG risks and priorities to focus on, depending on:

- the industry or region in which they operate;
- the products that they offer; and
- the workforce they employ.

This materiality assessment should deliver a clear list of ESG topics to prioritise. Once the priorities are defined, it is important to understand the current state of the business and run a gap analysis as a second step. The third step should be to develop objectives and goals based on gaps identified. Such objectives and

goals are generally summarised in an ESG roadmap or framework. Finally, actions should be defined and performance against pre-defined KPIs should be measured.

Best practices for designing and implementing ESG strategy could include:

- setting clear ESG targets for the business and segment (eg, as measurable ESG KPIs) as part of the company's strategy. Such KPIs can subsequently enable companies to implement effective actions and measures;
- having efficient and comprehensive data management to support the company in implementing its ESG strategy and complying with specific German regulations such as the Supply Chain Due Diligence Act. For example, having a data-based overview of the company's business and processes along the entire value chain will enable companies to adhere to their own ESG targets as well as targets required by ESG regulation;
- including training for management and employees on ESG-related matters and compliance with ESG regulations (eg, the German Supply Chain Due Diligence Act) as part of the company-wide compliance programme;
- clearly communicating the ESG strategy to employees and supporting the creation of valuable ESG know-how and best practices in all areas of the business; and
- maintaining a top-down ESG governance programme to oversee and coordinate the ESG strategy throughout the company, and promote responsibility and awareness among the management and the board.

5.Financing

5. 1. What is the general approach of lenders towards ESG in your jurisdiction? What internal and external information regarding a prospective borrower will they typically consider in this regard?

Germany
Mayer Brown

German lenders have significant interest in ESG financing – in particular, due to the focus of EU regulations on sustainable finance for the purposes of the transition towards a carbon-neutral economy.

This increasing motivation on the part of lenders relates in particular to the present mandate for the financial industry to become greener and more sustainable, and to promote sustainability in the form of ESG investments. In order to avoid potential reputational and litigation risks, lenders are placing greater emphasis on expanding their ESG research. In this context, reliable ESG ratings are of particular importance.

With increased interest from lenders comes increased demand from borrowers. In the absence of a specific financing purpose – except in the case of certain ESG projects such as wind farms – the main focus for borrowers is on demonstrating their commitment to sustainable aspects.

5. 2. Are bonds/loans that are marketed as green bonds/loans, social bonds/loans, sustainability bonds/loans or similar a feature of the markets in your jurisdiction?

Germany

Mayer Brown

The German green bond market has grown significantly in recent years, as investor interest has soared in a very short period of time; but this nothwithstanding, green bonds still account for a very small proportion of total bond issuance. The green bond market must grow more quickly to achieve the targets in the Paris Agreement (the first-ever universal, legally binding global climate change agreement, adopted at the Paris Climate Conference (COP21) in December 2015).

In this regard, the European Commission aims to adopt an EU-wide Green Bond Standard at the end of 2022 and has put a lot of effort into the drafting of the legislative act. Back in June 2019, the EU Technical Expert Group on Sustainable Finance published a proposal with initial recommendations; and two years later, on 6 July 2021, the European Commission proposed the Regulation on a Voluntary European Green Bond Standard (EU GBS) which is still under negotiations between the European Commission and the Council.

Under the current draft, any EU green bond would have to be aligned with the EU Taxonomy Regulation (2020/852). Adherence will remain voluntary; but where an issuer decides to issue a green bond under the EU GBS, it will have to provide the relevant documentation and reporting pursuant to the requirements set out in the EU GBS. Before the EU green bonds are issued, the issuer must have an EU green bond factsheet (similar to a framework) and a pre-issuance review of the factsheet by an external reviewer must take place. Additionally, issuers will have to publish annual allocation reports and will be responsible for any post-issuance review by an external reviewer. They will also need to draw up an impact report on the environmental impact of the use of proceeds.

In parallel with the green bond market, demand for loans or *Schuldschein* loan agreements with sustainability components has also increased steadily in Germany. Although sustainability-linked loans are still at a low level in terms of the number of transactions and the transaction volume, there is no mistaking their practical relevance, as evidenced by the growing interest of investors. Since the publication of the Sustainability-Linked Loan Principles (SLLP) in March 2019, demand has continuously developed worldwide. Likewise, in Germany, ongoing market development can be observed. The rapid development of sustainable loan financing is expected to continue in the coming years. Accordingly, it can also be assumed that documentation will undergo progressive standardisation.

5. 3. What key developments have taken place in the structuring of these instruments in your jurisdiction?

Germany
Mayer Brown

Within the ESG bond market segment, the International Capital Market Association is leading the development of voluntary market standards that show stable and continuous progress. The Green Bond Principles, the Social Bond Principles, the Sustainability Bond Guidelines and the Sustainability-Linked Bond Principles are a collection of voluntary frameworks with the stated mission and vision of promoting the role that global debt capital markets can play in financing progress towards environmental and social sustainability.

Comparable developments on the loan market are pushed forward by the Loan Market Association, which aims to create a high-level framework through the Green Loan Principles, the Social Loan Principles and the SLLP.

5. 4. What best practices should be considered in relation to ESG in the financing context?

Germany
Mayer Brown

One of the most important objectives is to avoid greenwashing in order to reduce reputational and litigation risks. Care should therefore be taken when structuring key performance indicators (KPIs) against which to measure the sustainability of a financing or borrower. It is best practice to base KPIs and all related disclosures to the extent possible on available data and ensure they are measured against a comparable standard. If estimates instead of data are used, it is sensible to provide sufficient details about the basis of the estimates.

Moreover, verification by a third party and the use of ESG ratings should always be taken into account. However, in case of the use of ESG ratings, the basis of the ESG ratings should be highlighted to make the public aware of the meaningfulness of the selected ratings. Needless to say, any kind of misleading information or omissions should be avoided.

6.ESG activism

6. 1. What role do institutional investors and other activist shareholders play in shaping ESG in your jurisdiction?

Germany
Mayer Brown

In Germany, there are various forms of shareholder activism – from issuing a letter of demands to the board or launching a media campaign to exercising rights as a shareholder of a listed company. This exerts pressure on companies and can influences their business decisions or strategies.

As shareholder activism is not a new concept and ESG is growing in importance for companies (not least due to far-reaching EU regulations), it is expected that shareholder activism will increasingly be used as a tool to influence a company's ESG strategy. Depending on the focus of an activist campaign, the targeted ESG issues can also vary. For example, one investor may be more focused on low-carbon emissions or climate-related targets, while others may be more focused on social aspects.

In general, companies are advised to assess their strategy and protect it against potential shareholder activism – for example, by designing an effective ESG strategy and adhering to existing ESG regulations.

6. 2. How do activist shareholders typically seek to exert influence on corporations in your jurisdiction in relation to ESG?

Germany
Mayer Brown

Typically, activist shareholders will initially send a letter to the management board or the supervisory board of the target, criticising current corporate strategy and governance. The letter will also include demands for

concrete remedial measures. In most cases, activist shareholders will also demand a meeting to discuss the issues raised in the letter.

If this initial step is unsuccessful, activist shareholders will initiate a further confrontational phase – for example, by involving the public or publishing the correspondence with the management or supervisory board to attract media attention. Subsequently, activist shareholders might also launch an entire media campaign (including press articles, dedicated websites and social media accounts). In addition, invested institutional investors and asset managers or voting advisers are being approached to seek a direct exchange with respect to the issues raised.

Blocking rights or other minority rights such as the filing of special audit motions or requests for additions to the agenda for shareholder meetings can also be used for activist purposes.

6. 3. Which areas of ESG are shareholders currently focused on?

Germany
Mayer Brown

Due to the social discourse on climate change and climate protection measures, as well as numerous legal regulations and regulatory projects with sustainability relevance, ESG shareholders are currently focusing in particular on sustainability issues.

The targets are primarily listed companies in emissions-intensive sectors that are particularly affected by sustainability-related transition and reputational risks, such as the chemicals and steel industries.

6. 4. Have there been any high-profile instances of ESG activism in recent years?

Germany
Mayer Brown

In 2021, two incidents of ESG activism attracted attention in Germany:

- German car manufacturer Volkswagen was targeted by an investor group led by the Church of England Pension Board. Its demands included expanding future reporting to include the group's climate-related political advocacy activities. After initial discussions with the management board were fruitless, the investors submitted a supplementary request in the run-up to the 2022 annual general meeting (under Section 122, para 2 sentence 1 of the Stock Corporation Act). However, they were unsuccessful in this case.
- A minority shareholder of German energy supplier RWE (holding a stake of only 0.03%) demanded that RWE spin off its lignite business and instead concentrate on renewable energy. Bilateral discussions with the management board remained unsuccessful. Subsequently, the minority shareholder submitted a supplementary proposal, pursuant to which the board should be instructed (in accordance with Section 83, para 1 sentence 1 of the Stock Corporation Act) to prepare a concrete plan for the spin-off and to present the proposed implementation measures at a general meeting. The motion was added to the agenda, but the proposal was rejected at the annual general meeting by a clear majority.

Although unsuccessful, these two examples confirm that shareholder activism is becoming a significant force in Germany when it comes to ESG interests. The practical significance of ESG activism is likely to extend

far beyond the two cases that have become public.

6. 5. Is ESG activism increasing or decreasing in your jurisdiction? How and why?

Germany
Mayer Brown

ESG shareholder activism is increasing in Germany due to the growing importance of sustainable corporate governance for capital market valuation. This trend is being further boosted and accompanied by numerous regulatory developments with a strong focus on ESG both in Germany and – more importantly – at the European level.

7.Other stakeholders and rights holders

7. 1. What role do stakeholders or rights holders (eg, employees, pensioners, creditors, customers, suppliers, and Indigenous communities) play in shaping ESG in your jurisdiction? What influence can they exert on a company?

Germany
Mayer Brown

There are various different ESG stakeholders that may approach management with ESG demands and expectations, including the following:

- Investors can influence and shape a company's strategy as shareholders. Increasingly, such influence may also be exercised by activist shareholders.
- Banks and insurers, as well as other lenders, are increasingly paying attention to sustainability issues.
- Direct and indirect suppliers along the supply chain are also important stakeholders when it comes to ESG issues. In particular, the Supply Chain Due Diligence Act will force businesses in Germany as well as their suppliers across the world to assess their human rights and environmental risks, and prevent or remedy any violations where necessary.
- End customers drive ESG as a topic in the public domain. The public is influencing the views of companies and other stakeholders on ESG. Non-ESG compliant behaviour increasingly threatens to cause reputational damage.
- Affected parties and non-governmental organisations are increasingly filing suit against human rights violations or environmental damages. In Germany, there have been a handful of high-profile cases of climate litigation.

8.Trends and predictions

8. 1. How would you describe the current ESG landscape and prevailing trends in your jurisdiction? Are any new developments anticipated in the next 12 months, including any proposed legislative reforms?

Germany
Mayer Brown

As ESG matters become more important, several trends are shaping the ESG landscape in Germany. The

Supply Chain Due Diligence Act enters into force as of 1 January 2023 and will force companies in Germany:

- to assess their risk of violating human rights and causing environmental damage; and
- where appropriate, to implement preventive or remedial measures.

Further, climate litigation is on the rise on Germany. For example:

- a German car manufacturer is facing claims aimed at eliminating polluting cars from the market; and
- a German energy company is facing claims for its alleged responsibility for climate change-induced damage in the Andes which has caused a risk of flooding.

This is complemented by shareholders taking a more activist stance and pressuring companies to implement ESG strategies and targets.

9.Tips and traps

9. 1. What are your top tips for effective ESG implementation in your jurisdiction and what potential sticking points would you highlight?

Germany
Mayer Brown

Effective ESG implementation should begin with a top-down approach in setting the ESG strategy and targets. It should also be clear who in the company's structure is responsible for overseeing the implementation of the ESG strategy – for example, by appointing:

- a human rights officer with responsibility for implementing the Supply Chain Due Diligence Act; and/or
- a corporate sustainability officer with responsibility for general oversight of ESG-related activities.

Companies are advised to start with a so-called 'gap analysis', which is primarily an exercise to compare the current ESG-related strategy with regulatory requirements (eg, supply chain due diligence or non-financial reporting). However, this exercise can be extended to cover non-regulatory risks, such as susceptibility to climate litigation or shareholder activism. Companies can then implement measures to address any detected issues and vet themselves for any non-regulatory threats, in order to be prepared for any issues that arise.

Co-Authored by Marcel Hörauf, Dr. Hagen Köckeritz, LLM, Dr. Marco Wilhelm, Luisa-Sophie Dany, LL.M., Inga Rupp, Wolfgang Löffler, LL.M., Maik Sebastian Lammers, LLM, Dr. Susanne Lenz, LLM, Dr. Ulrike Binder and Teresa Gerhold, LLM.

mondaq
Connecting knowledge & people

Bristol | Essex | New York | Sydney

t: +44 (0) 20 8544 8300
e: enquiries@mondaq.com