S&P Global
Ratings

**Environmental, Social, And Governance Evaluation**

# Grifols S.A.

**Analytical contacts**
Manuel Vela Monserrate
+34-914-233-194
manuel.vela@spglobal.com

Luisina Berberian
+34-91-788-7200
luisina.berberian@spglobal.com

**Research contributor**
Monal Jain
CRISIL Global Analytical Center, an S&P affiliate, Mumbai

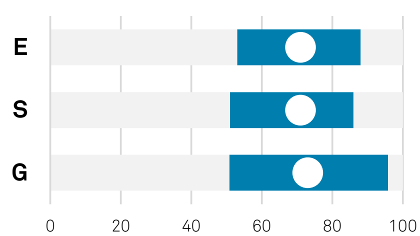
## Summary

Grifols is a Spain-based multinational pharmaceutical company that specializes in developing, manufacturing, and marketing blood plasma-derived products and therapeutic medicines, from which it generates around 80% of its revenue. The company is the European leader and the third largest worldwide in the plasma derivative market. Grifols also supplies devices, instruments, and reagents for clinical testing laboratories. Grifols operates through four segments: bioscience (80% of 2019 revenue), diagnostic (14%), hospital (3%) and bio supplies (5%).

Our ESG Evaluation of 73 reflects primarily Grifols' highly traceable value chain, which allows for safety risks to be identified from donor to patient. Grifols is much less exposed to scrutiny over the affordability of its products and the access to medicines than other pharmaceutical peers, because its products are not priced at the higher end of the range. These qualities are balanced by Grifols' operation in the niche and capital-intensive plasma industry that has a larger environmental footprint than the rest of the pharmaceutical industry. Grifols has been investing to reduce its environmental footprint, which has borne fruit in certain areas, such as its applied circular economy principles and leading pilot program of waste management, which we view as stronger than peers. But the company has higher greenhouse gas (GHG) emissions than pharmaceutical peers, because its operations--including collection and fractionation of blood plasma--are more energy intensive. Its higher water risk exposure relative to the sector is well managed with water saving measures in place. In addition, its history as a family-owned business could help support a focus on long-term sustainability. The level of board independence (46%), is in line with Spanish companies and above the 33% threshold recommended for listed companies in Spain with a single shareholder holding more than 30% of the company. Finally, we believe Grifols is adequately prepared to face future disruption, primarily reflecting its awareness and focus on affordability and accessibility, where we believe most emerging risks and opportunities will come from for Grifols in the future.

### ESG Profile Score

**73/100**




Company-specific attainable and actual scores

### Preparedness Opinion (Scoring Impact)

**Adequate (No Impact)**

## ESG Evaluation

**73/100**

A higher score indicates better sustainability

# Component Scores

## Environmental Profile

| Sector/Region Score | | 41/50 |
|---|---|---|
| | Greenhouse gas emissions | Lagging |
| | Waste and pollution | Strong |
| | Water use | Good |
| | Land use and biodiversity | Strong |
| | General factors (optional) | +2 |
| **Entity-Specific Score** | | 33/50 |
| **E-Profile (30%)** | | **74/100** |

## Social Profile

| Sector/Region Score | | 36/50 |
|---|---|---|
| | Workforce and diversity | Good |
| | Safety management | Strong |
| | Customer engagement | Strong |
| | Communities | Good |
| | General factors (optional) | None |
| **Entity-Specific Score** | | 35/50 |
| **S-Profile (30%)** | | **71/100** |

## Governance Profile

| Sector/Region Score | | 31/35 |
|---|---|---|
| | Structure and oversight | Good |
| | Code and values | Good |
| | Transparency and reporting | Strong |
| | Financial and operational risks | Neutral |
| | General factors (optional) | None |
| **Entity-Specific Score** | | 42/65 |
| **G-Profile (40%)** | | **73/100** |

**ESG Profile** (including any adjustments) **73/100**

This figure is subject to rounding

## Preparedness Summary

Grifols is adequately prepared to face future disruption and to take advantage of growing demand in the plasma derivatives industry. In addition, we view favorably Grifols' focus on expanding affordable access to its plasma-based treatments.

The board has shown appropriate engagement with long-term strategy development and execution. We view positively the strategic alliances that the company forms, and its ability to adapt quickly to new opportunities, such as the development of treatments for COVID-19. We believe this demonstrates excellent action-planning and decision-making.

| Capabilities | |
|---|---|
| Awareness | Good |
| Assessment | Good |
| Action plan | Excellent |
| **Embeddedness** | |
| Culture | Good |
| Decision-making | Excellent |

**Preparedness Opinion (Scoring Impact)** **Adequate (No Impact)**

**ESG Evaluation** **73/100**

# Environmental Profile

**74/100**

### Sector/Region Score (41/50)

Grifols operates in the pharmaceutical sector, manufacturing blood plasma-derived products (80% of revenue) and medical equipment and supplies (20%). The pharmaceutical industry has relatively low exposure to environmental risks compared with sectors. The main risks come from GHG emissions from energy use and refrigerants, plastic packaging waste and pharmaceutical pollutants leaching into water ways, and water used directly in production and for cleaning.

### Entity-Specific Score (33/50)

| Greenhouse gas emissions | Waste and pollution | Water use | Land use and biodiversity | General factors |
|---|---|---|---|---|
| **Lagging** | **Strong** | **Good** | **Strong** | **None** |

**Grifols' GHG intensity is higher than plasma peers and the broader pharma sector, despite its continuous investments in renewable energy, cogeneration, and resource efficiency.** The company targets consuming 70% of electricity from renewable sources by 2030; however, its progress is limited to date. Grifols also targets reducing its GHG emissions by 40% per production unit by 2030 from 2018 levels (10.6% achieved since 2016). Nevertheless, we view positively Grifols' strong initiatives to manage its emissions, including installing photovoltaic plants, replacing refrigerant gases with natural substitutes like ammonia, and purchasing renewable electricity through purchase power agreements. We also view positively the variable remuneration of the energy management team linked to energy efficiency improvement targets. We believe these investments and initiatives could eventually help Grifols bring its GHG emissions down to a level more in line with the industry median.

**Grifols' strong performance on waste and pollution reflects smaller hazardous waste generation compared with plasma peers, strong circular economy initiatives for waste management, and reduced exposure to sensitive pollutants compared with the broader pharmaceutical sector.** Plasma is a less harmful pollutant than other pharmaceuticals, being bio-based and less costly to remove in water treatment, and the company treats the water it uses for high organic content prior to discharging it back to the mains. We view positively the company's waste management practices that include anaerobic digestion, energy recovery, material recovery, modifying packaging, and being a part of various programs on raising awareness on disposal methods for hospitals and households. Grifols has a successful pilot of near 100% waste diversion from landfill in one of its facilities in the U.S., which we view as moving the industry forward. Grifols also focused on reducing wasted plasma, which is a concern in lower income countries.

**Grifols' proactive water management balances elevated water use and exposure to water stress regions compared with other pharmaceutical companies.** The group has been more active than most at implementing water-saving measures (at 75% of its manufacturing facilities; equivalent to 95% of its production), resulting in lower water intensity than peers and the industry average. This translated into a reduction in water use in 2019 (6.4% reduction in 2019, versus 2018, despite a 9.8% increase in production) and in wastewater discharge (17.4% reduction in 2019, versus 2018). We view these measures as commensurate with Grifols' exposure to water stress (20% of water consumption sourced from water-stressed regions like Murcia, California, and North Carolina). In addition, Grifols has had initiatives in place for several years to protect the natural areas and wildlife habitat on its properties, a practice we see as more advanced than peers.

# Social Profile

**71/100**

### Sector/Region Score (36/50)

We believe the pharmaceutical sector will experience increasing pressure from the growing gap in products accessibility, pricing transparency, cost control, and the focus on increasing safety and quality of care. Safety is also a major risk given that medical errors--including product recalls, misuse, and failure--could lead to public health issues, erosion of public trust, and litigation.

### Entity-Specific Score (35/50)

| Workforce and diversity | Safety management | Customer engagement | Communities | General factors |
|---|---|---|---|---|
| **Good** | **Strong** | **Strong** | **Good** | **None** |

**Grifols' unique and strong approach to product safety includes a plasma tracing program and moving regulatory safety requirements forward.** The group's safety track record has remained stronger than peers over the years, with zero product recalls or major incidents, despite the complexities involved in sourcing, processing, and delivering plasma-based therapies. Notably, Grifols has been the only plasma company to consistently publish the source and traceability of its plasma, and relevant information in case of product malformation or contamination. Grifols is considered an industry leader in terms of safety and quality standards by regulatory bodies such as the U.S. Food and Drug Administration. The traceability program also ensures the health of donors is closely monitored. We believe this level of monitoring is uncommon in the industry.

**Grifols' employee policies and workforce diversity are in line with those of industry peers.** Grifols' workforce has technical experts and clinic-based staff who require specific training, which the company manages using standard recruitment and employee engagement programs. Although turnover rates have shown an increasing trend in the last few years, we do not believe this is a concern, due to high employee satisfaction rates and the group's robust skills development program. Turnover rates are relatively high for Grifols (32% in 2019), due to the high proportion of entry level positions filled in the donor centers that tend to rotate frequently.

**Grifols has strong engagement with patients, public authorities, and private organizations to ensure the accessibility and affordability of its products.** The price of plasma has remained stable and does not have the same level of public scrutiny over the affordability of its products and the access to medicines, compared with other pharmaceuticals. Plasma is increasingly becoming a matter of national interest for many countries, given constrained supply. We view positively Grifols' active engagement with new customers to ensure the accessibility of plasma across different regions, as evidenced by its recent agreements with public health authorities in Egypt and Chinese plasma-based group Shanghai RAAS.

**We believe Grifols utilizes a transparent, fair, and stakeholder-centric approach to the sourcing of plasma.** Grifols compensates donors with a flat fee regardless of the plasma extracted, which removes any pervasive incentive to donate higher quantities. These practices, among others, support our view that Grifols is managing the public scrutiny of the industry's impact on community stakeholders well.

# Governance Profile

**73/100**

### Sector/Region Score (31/35)

Grifols is headquartered in Spain, a country that has strong rule of law and institutions and relatively robust governance standards. This is also the case for most of the countries in which Grifols operates (67% of revenue in 2019 originated from the U.S. and 15% from Europe).

### Entity-Specific Score (42/65)

| Structure and oversight | Code and values | Transparency and reporting | Financial and operational risks | General factors |
|---|---|---|---|---|
| **Good** | **Good** | **Strong** | **Neutral** | **None** |

**We view Grifols' board as adequately diversified in terms of gender, skillset, and experience, in line with the regional governance standards.** The board has a broad spectrum of experience in varied areas of finance, health care, science, legal, corporate management, and medicine and has 31% female directors, slightly lower than Spanish standards (which targets 40% female representation for publicly listed companies). The concentration of power posed by the proprietary chairman and co-CEOs representing the family stake is offset to some extent by the presence of an independent lead director. This is also supported by the independent chairs of the audit and the appointments and remuneration committees. Average tenure of board members is 10 years, with board members that represent the family having tenures extending 20 to 30 years. The level of board independence (46%), is in line with Spanish companies and above the 33% threshold recommended for listed companies in Spain with a single shareholder holding more than 30% of the company.

**Grifols has the relevant codes of conduct and aligns its mission with the sustainable development goals.** The board has an external evaluator for employee remuneration and gender pay-gap and the company reports metrics related to pay gaps at all levels, which we view as above industry standards. However, the company does not disclose its CEO-to-employee pay ratio and we view the executive remuneration to be entirely short-term focused. It receives a high proportion of negative votes from shareholders (39% in 2019). Still, the family-related legacy seems to be creating a natural long-term incentive for Grifols' co-CEOs. We note that the group has performed related-party transactions in the past and we will monitor the transparency of such transactions in line with global standards. Grifols has a global compliance program and a transparency-training program for its U.S. employees, in line with industry standards.

**We view Grifols' public disclosures as comprehensive, covering varied financial and nonfinancial metrics, targets, policies, and procedures to achieve set targets.** The company reports its sustainability metrics in line with various frameworks and international standards. The group has a transparent policy on disclosing donor compensation publicly and reports tax contribution by geography. We view the level of disclosure in line with global standard practices.

# Preparedness Opinion

**Adequate**
**(No Impact)**

| | | | | | |
|---|---|---|---|---|---|
| **Preparedness** | Low | Emerging | **Adequate** | Strong | Best in class |

| | | | |
|---|---|---|---|
| Awareness | Developing | **Good** | Excellent |
| Assessment | Developing | **Good** | Excellent |
| Action | Developing | Good | **Excellent** |
| Culture | Developing | **Good** | Excellent |
| Decision-making | Developing | Good | **Excellent** |

## Summary

Grifols' board has clear plans to maintain its position as one of the largest providers of plasma treatments and an organization that executes on the strategy. We believe the board leverages well its internal risk management to reveal risks and opportunities, and the company assesses risks and opportunities using traditional techniques such as internal audits. We believe Grifols' board has put in place robust action plans to secure collection and supply deals with countries throughout the world and the excellent strategic decision-making that leverages bottom-up innovation and savvy partnerships of companies developing new treatments. In our view, the company retains its position as a leading plasma company offering safe and affordably priced treatments to governments and doctors around the world.

Grifols' strategy is to continue to address the shortfall in plasma supply by working with key stakeholders to implement donor programs that suit different regulatory approaches to donations and shifts in plasma demand. The company's strategy remains resilient to uncertainty, thanks to a focus on innovative acquisitions in emerging markets and in treatment technologies. The company's focus on long-term social and environmental trends is well embedded within decision-making and tiers of management. The family ownership history creates a naturally long-term culture within the board and senior management that we view positively. Our view is that the company takes enough steps to ensure its culture is percolated throughout the organization and is mindful of this during acquisitions.

| | | | |
|---|---|---|---|
| **Awareness** | Developing | **Good** | Excellent |

Grifols has a strong standing in the plasma industry, backed by its long history and resilience through past crises. In our view, the company's strengths align with its strategy to expand into new emerging markets where plasma treatments are increasingly seen as an issue of national security. Risks and opportunities are brought to the board from several committees' in-depth discussions with management and internal audits, as well as from external expertise where necessary. The board has a clear view of which risks are operational and which are strategic in nature, demonstrating an advanced articulation of the nuances, and how these might play out. For example, recombinants are an emerging therapeutic trend, although it is currently uncertain to what extent these will form part of pharmaceutical treatments in the long term. The COVID-19 pandemic has shed further light on the importance of plasma and governments' need for a resilient supply. Given the opportunities in the plasma sector, we understand that Grifols has chosen to remain focused on plasma-based treatments. However, we believe this somewhat limits its awareness of possible disruptive nonplasma treatments, such as gene-based therapies or plasma recombinants.

| **Assessment** | Developing | **Good** | Excellent |
|---|---|---|---|

We understand Grifols' board assesses risks and opportunities using traditional enterprise risk management techniques, such as internal audits and materiality matrices, combined with the deep experience of board members. The head of internal audit reports at least three times a year to the risk committee on the results of the assessment, which we view as standard practice within large multinationals like Grifols. We note that the materiality of the risks and the dynamics are factored into their assessment processes, which we view as demonstrating a well-managed assessment framework. The board does not participate in scenario planning, which we see in more advanced companies. The company brings in external consultants every two years to improve these processes, and therefore stays up to date.

| **Action Plan** | Developing | Good | **Excellent** |
|---|---|---|---|

The board develops action plans for all levels of risks from immediate and impactful ones, to those with low certainty, which we view as advanced practice. We view positively that the board specifically includes relevant external stakeholders (namely, doctors and governments) in its plans, empowers its executive team to lead on execution, and remains engaged for updates. The rapid response of developing a treatment for COVID-19 is evidence, in our view, of a responsive board with the expertise to adapt the business to emerging opportunities. Research to address unmet medical needs and the use of plasma in a vast array of therapeutical indications, such as Grifols' AMBAR project to treat Alzheimer's, are also a testament of how the board supports innovation and drives new initiatives. For the more uncertain long-term risks, such as shifting geopolitics and national security, the board has a robust strategy that we believe will keep the company resilient. The board actively engages with public authorities and governmental institutions to address the global shortage of plasma and drives initiatives to ensure the accessibility and affordability of the group's treatments. For example, the announced strategic alliance between Grifols and the Egyptian government, which aims at addressing plasma shortages in the country, has been many years in the making.

| **Culture** | Developing | **Good** | Excellent |
|---|---|---|---|

Grifols' culture reflects its origins as a family business, which the board and senior management describe as an intrinsic motive to focus on the company's long-term sustainability. The CFO has the responsibility for integrating new acquisitions into Grifols and disseminating its culture. For example, when acquiring new facilities, Grifols may temporary shut production in one or several manufacturing plants to bring the safety standards up to the group level, which evidences Grifols' commitment to ensuring the group's culture is aligned across all of its facilities. Finally, we note that Grifols trains new employees on the Grifols' culture and how it applies to their new roles, which further supports our assessment.

# Preparedness

| Decision-Making | Developing | Good | **Excellent** |
|---|---|---|---|

The action plans set out by the board are clearly executed by executive management. We view positively the successful joint ventures and other strategic partnerships, combined with a strong series of announced new deals that often are negotiated over many years. For instance, we view positively Grifols' successful entry into the fast growing and unserved Chinese market, through the 26% stake acquisition of Shanghai RAAS. In China, plasma-based treatments are the only viable option, as there isn't much availability of other more expensive products, such as plasma recombinants. Grifols also benefits from an active innovation arm, GIANTS, that actively scans for new treatments that complement Grifols' product offering. For example, we view positively the recent Alkahest acquisition, which is a move into recombinant treatments that address age-related diseases. This demonstrates that long-term and social factors are well embedded within the company's strategic decision-making. Finally, environmental factors are embedded within the incentives of managers that have energy management responsibilities.

# Climate-Related Financial Disclosure

| TCFD Recommendations Alignment Assessment: | Not adopted | **Partially adopted** | Adopted |
|---|---|---|---|

We assessed to what extent the entity has adopted the Financial Stability Board's Taskforce on Climate-related Financial Disclosures' (TCFD) recommendations. We do not opine on the quality of the entity's disclosure or the climate change scenario assumptions, if any; but rather comment on the number of disclosures made, based on the TCFD's suggested disclosure list. Based on the entity's publicly available information, in our opinion Grifols S.A. has partially adopted the TCFD's recommended disclosures.

Grifols describes its main climate-related risks and opportunities. It also classifies the risks by time horizon and describes their potential financial impacts. Grifols considers the risks assessed for its business might not have any material impact on its operations and hence it does not conduct any scenario analysis. However, the company's climate strategy includes qualitative analysis of future physical scenarios. Grifols discloses that climate-related risks are integrated to its overall risk control and management system. These risks are categorized among regulatory, market, credit, business, operational, reputational, and ESG risks. The management of those risk categories is described in the integrated annual report and the CDP (formerly the Carbon Disclosure Project) report. It describes how climate risks are identified and assessed. It also published an environmental plan for 2020-2022 for managing climate-related risks and explained in detail the steps it has taken to mitigate those risks. Grifols' board of directors is responsible for approving the environmental policy that specifies its commitments to mitigate climate-related risks. There is limited disclosure on the board's oversight on climate-related risks via the audit and sustainability committees. Grifols discloses the metrics it uses to measure and manage climate-related risks including scope 1, 2, and 3, energy consumed, and water, waste, and carbon intensity metrics. The company publishes climate-related targets and reports its progress annually. It specifies the tie between energy-efficiency improvements for the company and its remuneration policy. Grifols does not use any internal carbon price because it considers such information irrelevant for its operations.

| Governance | Strategy | Risk management | Metrics and targets |
|---|---|---|---|
| Description of the board's oversight of climate-related risks and opportunities. | Description of the climate-related risks and opportunities identified over the short, medium, and long term. | Description of the organization's processes for identifying and assessing climate-related risks. | Disclosure of the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process. |
| **Partially adopted** | **Adopted** | **Adopted** | **Adopted** |
| Description of management's role in assessing and managing climate-related risks and opportunities. | Description of the impact of climate-related risks and opportunities on the organization's businesses, strategy and financial planning. | Description of the organization's processes for managing climate-related risks. | Disclosure of scope 1, 2 and, if appropriate, 3 GHG emissions, and the related risks. |
| **Adopted** | **Adopted** | **Adopted** | **Adopted** |
| | Description of the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario. | Description of how processes for identifying, assessing and managing climate-related risks are integrated into the organization's overall risk management. | Description the targets used by the organization to manage climate-related risks and opportunities and performance against targets. |
| | **Partially adopted** | **Adopted** | **Adopted** |

# Sector And Region Risk

| | |
|---|---|
| **Primary sector** | Health care |
| **Primary operating regions** | Spain, United States, Germany |

## Sector Risk Summary

Grifols operates exclusively in the health care sector.

### Environmental exposure

The health care sector includes health care providers (for profit and not-for-profit), pharmaceuticals, biotech, and suppliers of health care equipment and devices. Although generally well managed, health care companies have exposure to environmental risks related to energy use, water use, and waste discharge. The industry uses a lot of water and energy, particularly in pharmaceuticals and health care providers. However, compared with other industries, health care companies are not heavy users of land or fossil fuels, and GHG emissions are relatively low. Proper handling and disposal of toxic materials, whether bio-hazardous materials generated at hospitals and health care centers or toxic materials used in the manufacture of pharmaceuticals, life science products, and medical devices, is key. Climate events can represent risks but are mainly opportunities. For pharmaceutical and medical equipment companies, opportunities exist in the development of medicines and treatments to cure new climate-related diseases. However, for providers, there could be some risks from climate and environment-related diseases should the costs and demands of treating those illnesses exceed operational and financial capacity.

### Social exposure

Social risk is the most important component of the ESG framework for the health care industry, given its critical role in society. Pressure is mounting on issues, such as the growing gap in access, pricing transparency, cost control, and the focus on increasing safety and quality of care. Longer term, demographic changes, such as aging populations in developed countries, will further increase the societal need for health care. Access to affordable medical care and medications are major themes, including companies' pricing and claims payment policies. In many geographies and segments of the population, access to affordable, quality care is difficult to obtain. In countries where the health system has diverse payors and organizational structures, some organizations provide health care and related services without compensation or for very low, often unprofitable rates. An organization's commitment to continue providing these services, for the good of the local community, will increasingly come under pressure given expected rising demand and costs. Safety is also a major risk, given that medical errors--including product recalls, misuse, and failure--could lead to public health issues, an erosion of public trust, and litigation. This could weaken a company's reputation and financial position, as highlighted by the recent opioid crisis in the U.S. Pandemics pose another social risk in terms of the ability of health care systems to manage and treat large volumes of patients while assuring the health and safety of workers and patients. Given health care's reliance on highly qualified personnel and shortages of physicians, leading to competition for physicians between subsectors, human capital management (such as promoting good working conditions, protecting employee health and safety, and retaining talent) is an important consideration.

# Regional Risk Summary

## Spain

Spain has a strong rule of law and institutions despite, important internal political challenges including from regional independence movements. Spain's corporate governance framework for listed companies has two components: binding provisions from the company law and voluntary recommendations of the Spanish Corporate Governance Code published in 2015 by the Comisión Nacional del Mercado de Valores (CNMV), Spain's national securities commission. In January 2020 the CNMV started to review the code, proposing amendments to executive pay, voting rights, and increasing quotas for the percent of women on boards to 40% from 30%--all on a comply-or-explain basis only. The code followed significant legal reforms such as the Law 31/2014, which included binding votes on remuneration policy, stricter regulations on directors' classifications, and new ownership thresholds for shareholders' rights. By law, Spanish boards must establish committees for audits, remuneration, and nominations. Companies must disclose an annual corporate governance report. While the stock exchange does not have specific ESG requirements in its listing rules, companies of over 500 employees are implementing the EU Non-Financial Reporting Directive's recommendations, which mandate disclosing ESG (including diversity) risk.

## United States

With robust institutions and rule-of-law standards, the U.S. demonstrates many strong characteristics but lags several other countries with respect to ESG regulations and social indicators. Income inequality is higher than in other OECD countries and has been so for over a century. Social services are similarly less generous than in most wealthy countries. Governance is characterized by a very stable political system, strong rule of law, a powerful judiciary, and effective checks and balances. Conditions of doing business are generally high. The U.S. follows a rules-based approach to corporate governance focused on mandatory compliance with requirements from the major exchanges (NYSE and NASDAQ), as well as legislation. State corporate law is also a key source of corporate governance, particularly in Delaware where over half over all U.S. listed companies and nearly 70% of Fortune 500 companies are incorporated. Exchanges mandate high standards of corporate governance. The NYSE requires companies listing on its exchange to have boards made up of a majority of independent directors and have separate remuneration and nomination committees. However, formal requirements on ESG reporting are not as established as they are in European countries. While a growing number of companies have an independent chair, the combination of CEO and chair roles is still popular. This can undermine management oversight. Remuneration continues to be a contentious point, because U.S. executive pay dwarves global pay levels. The CEO-to-worker pay ratio is ever-increasing, leading to social tensions and shareholder criticism.

## Germany

Germany has strong institutional and governance effectiveness, with great transparency and accountability. Rule of law is strong, the judiciary is independent, and corruption is viewed as a minor issue. Germany has a moderate amount of ESG regulation. While Deutsche Börse AG does not require ESG reporting as a listing rule, companies with over 500 employees are implementing the EU Non-Financial Reporting Directive's recommendations, which mandate the disclosure of ESG data like diversity and pay ratios. The German Corporate Governance Code (Kodex) is the reference document for Germany's best practices and works on a comply-or-explain basis. A new version of the Kodex came into effect on Jan. 1, 2020, when the EU Shareholder Rights Directive II was transposed into German law. Notable improvements include recommendations on board independence, as well as board oversight of related-party transactions and executive pay. While the recommendations are less specific than most European codes, companies exhibit strong governance practices. Companies are typically governed by a two-tier board system: a management board of executives that is overseen by a supervisory board comprising nonexecutives including shareholder and employee or labor union representatives. Although not world-leading, there are corporate disclosure requirements for selected ESG aspects and both occupational pension funds and insurers must state whether and how they account for ESG considerations when managing pension fund assets under their control.

# Related Research

- "The ESG Risk Atlas: Sector And Regional Rationales And Scores," published July 22, 2020
- "Our Updated ESG Risk Atlas And Key Sustainability Factors: A Companion Guide," published July 22, 2020
- "Environmental, Social, And Governance Evaluation: Analytical Approach," published June 17, 2020
- "How We Apply Our ESG Evaluation Analytical Approach: Part 2," published June 17, 2020

*This report does not constitute a rating action.*