S&P Global
Ratings

Environmental, Social, And Governance Evaluation

Koninklijke (Royal) Philips N.V.

Primary contacts
Marketa Horkova
+44-207-176-3743
marketa.horkova@spglobal.com

Noemie de la Gorce
+ 44-207-176-9836
Noemie.delagorce@spglobal.com

Secondary contact
Anna Overton
+ 44-207-176-3642
anna.overton@spglobal.com

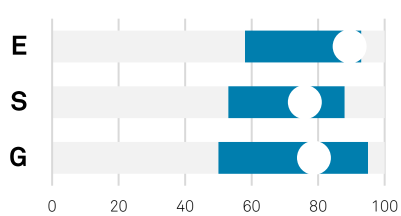
Summary

Founded in 1891 and headquartered in the Netherlands, Koninklijke (Royal) Philips N.V. (Philips) is a diversified health technology and consumer products group. In 2020, Philips generated revenue of €19.5 billion and S&P Global Ratings-adjusted EBITDA of €2.9 billion. The group consists of three major segments: Diagnosis and Treatment (42% of 2020 revenue); Personal Health (28%); and Connected Care and Informatics (28%). Diagnosis and Treatment includes diagnostic imaging, ultrasound scanners, and image-guided therapy. Personal Health includes oral care, mother and child care products, male grooming and skin care, and small home appliances. The Connected Care and Informatics segment includes respiratory drug delivery products, patient monitoring, health care informatics, home ventilators, and respiratory masks. The group is present in over 100 countries, and its largest markets are the U.S. (34% of 2020 revenue), Western Europe (24%), and China (12%). Philips operates 32 production sites in 22 countries and employs over 81,000 staff.

Our ESG Evaluation of 90 reflects our view that sustainability is at the core of Philips' corporate strategy. The company built a digital, integrated, and solution-based business model before most of its global peers, which it leverages to respond to key challenges in the health care industry, such as inequality in the access and affordability of care, and the shortage of medical professionals. We believe its business model will benefit from secular trends in the industry, including the unprecedented acceleration in connected care as a result of the COVID-19 pandemic. Philips also distinguishes itself by its robust governance, advanced supply chain management, and leading environmental practices, although it operates in an industry with relatively low environmental impact. We anticipate the company will manage its increasing exposure to risks related to data governance and cybersecurity well, but do not believe these can be fully mitigated.

ESG Profile Score

81 /100



Company-specific attainable and actual scores

Preparedness Opinion (Scoring Impact)

Best in class (+9)

ESG Evaluation

90/100

A higher score indicates better sustainability

Component Scores

Environmental Profile		Social Profile		Governance Profile	
Sector/Region Score	**43/50**	**Sector/Region Score**	**38/50**	**Sector/Region Score**	**30/35**
Greenhouse gas emissions	**Leading**	Workforce and diversity	**Good**	Structure and oversight	**Strong**
Waste and pollution	**Leading**	Safety management	**Strong**	Code and values	**Good**
Water use	**Strong**	Customer engagement	**Strong**	Transparency and reporting	**Strong**
Land use and biodiversity	**Strong**	Communities	**Strong**	Financial and operational risks	**None**
General factors (optional)	**None**	General factors (optional)	**None**	General factors (optional)	**None**
Entity-Specific Score	**47/50**	**Entity-Specific Score**	**39/50**	**Entity-Specific Score**	**49/65**
E-Profile (30%)	**90/100**	**S-Profile (30%)**	**77/100**	**G-Profile (40%)**	**79/100**

ESG Profile (including any adjustments) **81/100**

This figure is subject to rounding

Preparedness Summary

Philips' best-in-class preparedness reflects its successful transformation from an industrial holding to a highly innovative and uniquely positioned company in the health care industry. Its senior leadership has anticipated secular trends in the industry ahead of most of its global peers, including the shift to digital, integrated, and solution-based care. As a result, the group will more likely benefit from the unprecedented acceleration in digital care caused by the pandemic. We believe Philips continues to demonstrate excellent awareness and assessment of potential future disruptions, including those associated with its digital care strategy. However, its ability to navigate challenges with respect to data governance and cybersecurity will require ongoing investments and leadership attention given the rapidly evolving environment.

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

Preparedness Opinion (Scoring Impact) **Best in class (+9)**

ESG Evaluation **90/100**

Environmental Profile

90/100

Sector/Region Score (43/50)

Health care equipment providers have low exposure to environmental risks relative to other sectors. They are not heavy users of land, water, or fossil fuels, and greenhouse gas (GHG) emissions are relatively low. Their main direct environmental risks relate to the energy use, water use, and the handling and disposal of toxic materials used in the manufacturing of medical devices. The industry also has indirect environmental impact, including energy used to power health care equipment by customers (downstream), as well as potential water, pollution, and biodiversity impacts associated with the sourcing of precious minerals and metals (upstream).

Entity-Specific Score (47/50)

Greenhouse gas emissions	Waste and pollution	Water use	Land use and biodiversity	General factors
Leading	**Leading**	**Strong**	**Strong**	**None**

Philips applies leading environmental standards across its value chain. The company distinguishes itself in the management of its indirect environmental impact, which we view as more material. While many industry peers have general commitments to improve the environmental footprint of their products, Philips has the infrastructure to track, report, and set quantitative targets to increase the proportion of sales coming from eco-designed products, which it says have lower environmental impact on a life cycle basis than conventional products. Philips labels those products according to its own method due to the lack of external standards. This method is audited by an external auditor and publicly disclosed, which we view as best practice. The company has committed to achieve 100% of eco-designed products by 2025, and stood at 71% in 2020. It has also set an aspirational target of collecting all medical equipment reaching its end of life as part of its circular economy policy, which we view as a unique initiative in the industry, although its feasibility remains to be seen. Philips has a higher waste recycling rate than many peers and achieved its commitment to increase its recycling rate to 90% by 2020.

Philips has the infrastructure and practices to maintain high environmental standards in its supply chain as it expands to regions with lower environmental regulations such as China. The company collects GHG and water data on its direct suppliers and engages with them to improve their environmental impact. In 2019, 37% of its suppliers had GHG reduction targets validated by the independent third-party Sciences Based Target Initiatives (SBTi), which we view as best practice.

Philips has a track record of setting and achieving more ambitious targets in its direct operations than many of its industry peers. We expect the company will maintain below-average GHG intensity (estimated as scope 1 and 2 intensity per million of revenue). It already reduced its GHG intensity by 66% since 2015, and committed to achieve a 90% reduction by 2040. This target is validated by SBTi. Philips' water intensity has consistently declined and remained lower than many industry peers' over the past five years, at about 46 cubic meters per euro of revenue. It has not faced any significant land and water pollution incidents in the recent past. Its proportion of hazardous waste has slightly decreased over the past five years, and remained in line with the sector average.

Social Profile

77/100

Sector/Region Score (38/50)

Philips operates in the health care equipment and supplies sector, which has moderate exposure to social risks relative to other sectors. Social risks include access to affordable and quality medical care, protection of customer data, and product safety. Philips also benefits from the relatively high social standards in its main markets.

Entity-Specific Score (39/50)

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

Philips is better positioned than many industry peers to provide access to medical care to customers and communities because of its diversified regional footprint and portfolio of products and services. Its business model based on providing integrated and customized solutions to hospitals--from manufacturing equipment to providing softwares and services such as data analytics--will continue to support customer retention and satisfaction, in our view. The connected nature of Philips' products and services has also supported its penetration in markets with limited health care infrastructure and a growing middle class, such as India and Indonesia. It partners with multiple stakeholders--including startups, local governments, and development banks--to improve access to care in underserved markets through apps and other digital forms. Its network of local research centers across four continents may also help the company to identify and target local needs. Philips has committed to improve health care access for 2.5 billion customers and patients by 2030. Its approach to measuring progress against this goal is audited by an external auditor and well recognized by external stakeholders.

We believe Philips is also well positioned to manage cyberrisks. Cybersecurity is increasingly important, given the company's reliance on sophisticated information technology (IT), sensitive data on patients' health, and connection to the IT infrastructure of customers such as hospitals. In 2020, Philips was the first medical device manufacturer to receive a new Underwriters Laboratories cybersecurity testing certification, which we view positively relative to peers.

Philips has a strong safety track record, and lower exposure to product safety than industry peers manufacturing devices implanted in human bodies. While the company has faced recalls over the past 10 years, none had significant reputational or financial impact. In addition, most of its recalls are software-related, which are more easily fixed than product recalls. Unlike some of its peers, Philips is not facing any significant ongoing product litigations. It also has a better performance on employee safety metrics, including a lower illness frequency rate (0.24 in 2020).

Philips' commitment to pay a living wage to all its staff, and its management of human rights risk in its supply chain sets the company apart from peers. An independent third-party audit conducted across its operations shows that the group achieved its living wage target in 2020. The company has stable employee engagement and turnover, and it has a relatively low gender pay gap, which may support talent development and retention, in our view. However, Philips' proportion of female employees remains below the industry average. Its human rights policy is based on continuous stakeholder engagement, including with suppliers and industry peers, above standard industry practices.

Governance Profile

79/100

Sector/Region Score (30/35)

Philips is headquartered in the Netherlands, where governance standards are high. In our view, the country has strong institutional effectiveness, rule of law, and an advanced ecosystem for sustainable finance, which supports high levels of disclosure and awareness on sustainability topics. In addition, the company derives 65% of its revenue from countries with strong governance standards, including the U.S., Japan, and Germany, which further supports our assessment. That said, we also factor in Philips' increasing exposure to countries such as China, where we see higher exposure to governance risks.

Entity-Specific Score (49/65)

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

Philips' governance structure follows the Dutch Corporate Governance Code, which we view as aligned with international best practices. Philips' supervisory board (referred to as the board thereafter) is fully independent, with a tenure of five years on average. While two of the current members have been on the board for more than 10 years, which could somewhat affect their independence, their term is expected to end in May 2021 pending shareholder approval. The board is diverse in terms of gender and nationality, with four women and a majority of non-Dutch nationals, which we see as aligned with the company's international footprint. We also believe that directors have relevant previous experience to support Philips' strategy, including in health care, finance, consumer goods, and electronic equipment. Some members also have experience in the technology and software sectors, which we see as increasingly important in the industry.

Philips' remuneration policy also follows recommendations from the Dutch Corporate Governance Code. These include requiring a binding vote from shareholders on executive remuneration, tracking pay ratios, and providing fixed remuneration to its directors. The company links three-quarters of the total remuneration of its CEO and other executives to financial objectives. Half of this variable pay is share-based and linked to earnings per share and total shareholder return targets, with a standard vesting period of three years. The other half is cash-based and delivered annually. We believe these practices are aligned with international standards. The average ratio between the CEO and employee pay has increased over the past five years to 60:1 in 2019 from 40:1 in 2015, but remains well below that of many of its sector peers.

Philips has well-established governance policies, including on anti-corruption, whistleblowing, and antitrust, but faces investigation for antitrust allegations and tender irregularities in Italy, Brazil, and China. It also continues to face civil litigations following its condemnation by the European Commission in 2012 over alleged anti-competitive activities. We will monitor the outcomes of those litigations, which we do not expect to have material financial or reputational impact.

Philips has comprehensive financial and sustainability disclosures audited by an external auditor. These include its policies on most material environmental and social risks, and approaches used to calculate key performance indicators, including green revenue and millions of lives improved. Philips reported its tax contributions by countries of operation in 2020.

Preparedness Opinion

Best in class
(+9)

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

Philips' best-in-class preparedness reflects its successful transformation from an industrial holding to a highly innovative and uniquely positioned company in the health care industry. Its senior leadership has anticipated secular trends in the industry ahead of most of its global peers, including the shift to digital, integrated, and solution-based care. As a result, it will more likely benefit from the unprecedented acceleration in digital care caused by the pandemic. We believe Philips continues to demonstrate excellent awareness and assessment of potential future disruptions, including those associated with its digital care strategy. However, its ability to navigate challenges with respect to data governance and cybersecurity will require ongoing investments and leadership attention given the rapidly evolving environment.

Philips has four strategic objectives: enhancing the patient experience, improving health outcomes, lowering the cost of care, and improving the work life of care providers. These objectives align with Philips' purpose of improving the continuum of care globally. They could also contribute to respond to key challenges in the health care industry, including persisting inequalities in access to care and the increasing shortage of medical professionals. In our view, the company's progress against its strategic objectives will be supported by its active stakeholder engagement and strong sustainability practices. It will also benefit from its hybrid innovation strategy, focused on responding to global challenges in the health care industry while adapting to local needs.

Awareness	Developing	Good	**Excellent**

Philips' senior leadership has demonstrated excellent awareness of potential disruptions and long-term growth opportunities. It has led Philips' transformation from an industrial holding manufacturing lighting, electronics, and medical equipment, to a highly innovative health technology company. This transition toward health care has enabled Philips to capitalize on growth opportunities in the industry, including from changing demographics and the increasing prevalence of chronic diseases. Within the health care market, the company has embraced the shift to connected, integrated, and service-based care ahead of its global peers.

We believe Philips' track record of anticipating emerging trends reflects the deep awareness and long-term thinking of its board and senior management. The leadership explores emerging trends over a 10-year horizon, including in geopolitics, technology, demographics, and care. It also monitors potential disruptions from its supply chain, talent shortages, and the competitive landscape. The composition and skillset of the board has evolved to reflect future strategic trends. Directors also bolster their awareness by conducting operational onsite visits twice a year and inviting industry experts quarterly. Philips has conducted an annual survey of health professionals since 2016, which provide further insights on global and local trends in health care.

Assessment	Developing	Good	**Excellent**

Philips' senior leadership leverages a comprehensive set of tools to assess the impact of potential disruptions on its strategy, in line with best practices. It conducts scenario analysis to assess how trends such as population growth, aging population, and countries' health care budget, will shape the future of health care. Scenarios are also used to explore emerging trends in technology and data governance. Philips recognizes that those risks are typically more volatile than in the health care industry, and may require more immediate and frequent monitoring. Scenario analysis also informs the company's assessment of the geopolitical landscape and its potential impact on its complex supply chain.

In addition to explore emerging risks and potential disruptions, Philips' board and senior management also review on a regular basis its strategic, operational, financial, and compliance risks. Strategic risks include merger and acquisitions, intellectual property, and risks in emerging markets, among others. The company has defined a risk tolerance for each risk category, which is typically low for strategic risks.

Action Plan	Developing	**Good**	Excellent

We assess Philips' action plan as good because we believe the company has anticipated secular trends in the health care industry ahead of many industry peers. However, we anticipate rising challenges associated with its increasingly digital business model, including on data governance and cybersecurity.

Philips has achieved a unique position in the health technology industry. It has moved away from a pure seller of medical equipment to a provider of solutions, combining equipment and services. These services range from the installation and maintenance of equipment; to data collection, storage and analysis; customer training; and recycling equipment that reaches its end of life. It is also more integrated across the care spectrum than many global peers, offering solutions from prevention to diagnosis, treatment, and recovery. We expect Philips to benefit from the unprecedented acceleration in connected care following the pandemic, including among senior populations. As health care providers seek to sustain and scale virtual care services beyond the pandemic, we anticipate they will increasingly rely on solution-based offerings to improve the efficiency of clinical workflows and provide frictionless consumer and patient experiences. Unlike many peers, Philips has already built the infrastructure to respond to this demand.

Philips' digital care strategy relies on smooth information flows between its own systems and the IT infrastructure of its customers, primarily hospitals. The success of its strategy will therefore depend on the ability and willingness of its customers and the broader public to embrace new technologies. It will also depend on Philips' ability to prevent potential data mishandling. The company has robust cybersecurity protocols and data governance on its own systems. However, it has less control over the quality of the cybersystems of its customers.

Culture	Developing	Good	**Excellent**

We expect Philips' culture to remain highly innovative and conducive to sustainability and stakeholder engagement. The company's innovation strategy serves its objective of improving health care access for 2.5 billion customers and patients by 2030, and incorporates both global and local needs. Global needs are reflected into the strategy's objectives: new products or services should primarily help to save time of health care professionals and respond to shortages of medical staff globally. Those social benefits need to be demonstrated through clinical evidence. Local needs, on the other hand, are identified through Philips' network of research and development centers spread across Europe, North America, Asia, and Africa. We see this network as more geographically diverse than many global peers'. In regions with less developed infrastructure, the company develops partnerships with governments, development banks, or industry peers to customize solutions to local needs. For example, Philips partnered with a Dutch development bank to finance the first cardiology center in Addis Ababa, Ethiopia.

To boost its innovation capabilities in the digital space, Philips has hired software engineers, who now represent half of its researchers globally. To mitigate risks of talent shortage, especially data science specialists, the company has partnered with universities, as well as startups through its Philips Ventures program. It also has well-established programs to reward innovation among employees, for example by awarding the title of research fellow to researchers who have demonstrated excellent performance.

We believe Philips' focus on sustainability and stakeholder engagement is deeply rooted into its culture. The company has often demonstrated leading sustainability practices, for example by publishing an annual environmental profit and loss report since 2017 and contributing to develop a social impact assessment. Its supply chain management is also at par with global best practices, combining engagement, capacity building, and monitoring. We will continue to monitor Philips' ability to maintain this sustainability and stakeholder-focused culture as it expands to growth markets with less stringent environmental and social regulation, including China.

Decision-Making	Developing	Good	**Excellent**

Philips' senior management has demonstrated deep involvement and commitment to the company's purpose of improving the continuum of care. It has direct oversight on the company's goal of improving health care access for 2.5 billion customers and patients by 2030 and championed many sustainability-related initiatives, including the company's living wage policy. It has also set a target to increase sales from solutions to above 45% from 37% between 2020 and 2025, and consistently allocated a high proportion of its revenue (about 10%) to research and development. The company has prioritized innovation leveraging of data science, artificial intelligence, software development and enhancement, in line with its digital care strategy. Philips' senior management also has a track record of smoothly executing targeted acquisitions. The acquisition of Capsule Technologies--a provider of medical device integration and data technologies for hospitals and health care organizations--in January 2021 will further expand its control over data processes and strengthen its capabilities in data analytics.

In parallel, Philips' senior management has proactively engaged with its shareholders to ensure support for its long-term vision and avoid short-term activism. It has a track record of issuing sustainability financing to finance its environmental, innovation, and sustainability objectives. We understand that the board has included nonfinancial objectives in the long-term incentive plan of its executive remuneration (10% in 2020), and that those objectives are cascaded across the organization. Annual variable pay of executives, however, is only linked to financial objectives.

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 Philips has partially adopted the TCFD recommended disclosures. Our opinion is solely based on information accessible on Philips' website, including the company's TCFD and annual report, and does not include the company's answers to the Climate Disclosure Project (CDP) questionnaire.

Philips describes its main climate-related risks and opportunities. However, it does not classify the risks by time horizon, and does not describe their potential impacts. While Philips indicates that it has conducted a range of climate scenarios and that none of them resulted in material risks for its strategy, it does not describe which climate scenarios were used and how it assessed the materiality of climate-related risks.

Philips discloses that climate-related risks are integrated to its overall risk management system. These risks are categorized between operational and strategic risks, and the management of those risk categories are described in the annual report. However, the company does not specify how climate risks are identified, assessed, and managed. It also does not describe how the board and executive committee oversee its exposure to climate-related risks. Philips discloses the metrics used to measure and manage climate-related risks including scope 1, 2 and 3, energy consumed, and operational energy efficiency metrics. The company publishes climate-related targets, and reports its progress annually. While Philips indicates that it uses an internal carbon price, it does not disclose the exact amount. It also does not specify what climate-related objectives are included in its remuneration policy.

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.
Not adopted	**Partially adopted**	**Not adopted**	**Partially 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.
Not adopted	**Not adopted**	**Not 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.
	Not adopted	**Adopted**	**Adopted**

Sector And Region Risk

Primary sector(s)	Health Care Equipment and Supplies
Primary operating region(s)	The Netherlands, U.S., China, Japan, Germany

Sector Risk Summary

Our E and S Sector Scores reflect the exposure to environmental of social risks of the health care equipment and supplies sector, where Philips derives a majority of its revenue (80% in 2020).

Environmental exposure

Suppliers of health care equipment and devices have exposure to environmental risks related to energy use, water use, and waste discharge. However, compared with other industries, this sector is not a heavy user of land or fossil fuels, and GHG emissions are relatively low. The main environmental risks associated with direct operations--including the manufacturing of medical devices and logistics operations--mostly include energy use, water use, and the handling and disposal of toxic materials. We believe the indirect environmental impact is more material for this industry. This includes energy used to power health care equipment by customers, and the management of the end of life of equipment and devices (downstream); as well as potential water, pollution and biodiversity impacts associated with the sourcing of precious minerals and metals and packaging (upstream). Climate events can represent risks but are mainly opportunities. For medical equipment companies, opportunities exist in the development of equipment to support the cure of new climate-related diseases.

Social exposure

Social risk is the most important component of the ESG framework for suppliers of health care equipment and devices given its supportive function to the health care industry. Pressure is mounting on issues such as the widening gap in health care 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. 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. 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 the reliance of suppliers of health care equipment on highly qualified engineers and digital systems, human capital management (such as promoting good working conditions, protecting employee health and safety and retaining talents) is an important consideration.

Regional Risk Summary

The Netherlands

The Netherlands has strong institutional effectiveness and rule of law. It has a very active pension fund industry that has been a leader in sustainable investing and stewardship, creating an advanced ecosystem for sustainable finance. In terms of reporting, companies with more than 500 employees are implementing the EU Non-Financial Reporting Directive, which mandates disclosing ESG (including diversity) risk. Compared to other European countries, the Netherlands has more dispersed ownership structures with few controlled listed companies. The Frijns Committee (Corporate Governance Code Monitoring Committee) publishes the Dutch Corporate Governance Code, last edited in 2017. The code follows the stakeholder model and focuses on long-term sustainability. There is high compliance with the code's recommendations. Equally, the new Dutch Stewardship Code, which became effective January 2019, considers all stakeholders' interests, not just shareholders'. In February 2019, the government completed a consultation period on a bill proposal to implement a 250-day thinking period for boards. The proposal, which could be an anti-takeover mechanism, raised concerns about shareholder rights because it would give the supervisory board 250 days if shareholders submit a proposal to appoint or remove a director, or if there's a take overbid. Shareholder rights provisions are otherwise strong, including a binding vote on executive remuneration.

U.S.

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 Organization for Economic Cooperation and Development (OECD) countries and has been so for over century. Social services are similarly less generous than in most wealthy countries. Governance mischaracterized 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 that of Delaware where over half over all U.S. listed companies and close to 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 an increasing 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.

China

Social standards are in line with most other major developing economies. The government recently strengthened legal protection for workers and consumers. Chinese corporate governance standards are also on par with other economies at this stage of development. The central government's recent push to reform state-owned enterprise structures in line with good governance practices is a major development. In 2018, China revised its code of corporate governance for listed companies, accounting for OECD requirements and particularly focusing on

ESG disclosure and board diversity. Official corruption has become less of a problem over the past few years due to the central government's anti-corruption drive. This effort has also been extended to government-related companies and financial institutions. Still, corruption among private enterprises remains an issue. Although judicial reforms are ongoing, the private sector has yet to trust that the rule of law is significantly improving.

Japan

Corporate governance practices and policies are good but somewhat below the standards of other major advanced economies. Board diversity and transparency are areas where businesses lag their counterparts in other advanced markets. Improving Japanese corporate governance, backed by the recent government's strong initiative, has been a key aspect of the current government's economic revival strategy. The Japanese regulator's revision of the stewardship code in 2020 and the corporate governance code in 2018 were important advances but implementation has been somewhat slow. Despite improvements some traditional habits are proving quite entrenched. These include cross-shareholdings among companies, limited outside director oversight, and limited diversification in management. Gender diversity in senior positions remains low--under 4% of executives in listed companies are women--although the government aims to reach 10% female executives and 30% female senior managers by 2020. Japanese boards are typically male-dominated and often by former executives with long tenures. Although it has been improving, the lack of diversity on boards in terms of age, background, gender, and experience might impede progress to transparent governance and decision-making that is nimble enough to adapt to a rapidly changing business environment.

Germany

Germany has strong institutional and governance effectiveness, with solid 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 of 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: management board of executives, which is overseen by a supervisory board comprising nonexecutives including shareholder and employee or labor union representatives. While 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.

This report does not constitute a rating action.