Sustainability: The German Experience

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Sustainability: what is the focus in Germany?

- Increasing awareness of population also due to Green Party impact since the 80ies (but the issues are now mostly common ground for all parties), The German Government has intensified its actions (including insistence on the 2016 UN Paris Agreement on max. 2°C limitation).
- Increasing activities of NGO’s (like CDP) have also produced higher public awareness.
- 70% of institutional investors today manage portfolios with regard to ESG standards.

Reporting matters:

- Large companies have been obliged since 2005 to produce relevant non-financial (CSR) reporting. Quality of such reporting is today quite good by the very big (DAX30) companies, but declines size related and by non-listed companies. Main problems: too many companies still produce separate financial and sustainability reports; also some reports are too glossy and self-serving.
- From FY2017 on, the implementation of the EU CSR Directive into German law obliges only large listed companies (< 600 in Germany) to prepare a ‘non-financial’ statement that includes relevant information on: environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.
- The new law allows different ways of reporting (integrated, combined or separated). It is hoped that ‘integrated reporting’ will come out as best practice. There is also a diversity of opinion what should be reported.
- Any reporting must meet the industry specific criteria. The KPI’s should reflect this.
Regulatory Environment:

- German regulation is so far focussed on power generation (including hasty nuclear energy exit after Fukushima and fostering wind and solar renewables through big tax and other subsidies). Also, as a result of the VW ‘Dieselgate’ affair, diesel cars might be banned from city centres due to health-damaging NOx emissions.
- The new reporting obligation on sustainability topics is not yet part of the statutory audit and financial reporting enforcement. This might lead to lesser quality compared to the financial report content.
- Regulation is likely to increase, e.g. with regards to green house gas emissions and non-financial reporting obligations. Stricter approaches are: direct regulation (like CFC prohibition); trading schemes (e.g. for emission rights) or green taxes (e.g. on fuel).

Impact on emerging markets:

- German companies’ awareness for supply chain matters will further increase, esp. as the law now obliges them to report on supply chain risks and the ESG-impact within the supply chain.
- Codes of conduct might be revised: for example mandatory site visits / audits could be increased.
- Good ESG performance should develop as a competitive advantage for suppliers in emerging markets.

General remarks for the roles and responsibilities of management and control bodies:

- Sustainability concerns companies’ future and concerns compliance, risk and opportunity management.
- Top management buy-in and tone from the top is key. Management is responsible for identifying most relevant value drivers, establishing policies and reporting methodology (KPIs), setting goals and implementing reporting systems and internal controls.
- Control bodies must assess how sustainability impacts a company’s strategy, compliance obligations and how management responds to this.
- Investment professionals should assess the quality and timeliness of non-financial reporting: if the non-financial statement undergoes less intensive assurance than other (financial) information, trustworthiness (especially of the underlying reporting systems and internal controls) is in question. Publication of the non-financial statement later than the financial statements indicates that this information most probably is not used to steer the company, though companies often claim so.