

Articles

German Socially Responsible Investment: Barriers and Opportunities

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Abstract

In socially responsible investment terms, Germany is a contradiction. The country is considered by many as one of the pioneers of post-war environmentalism and social reform. Yet, German financial institutions are amongst the European laggards in adopting environmentally and socially informed approaches to investment. This article identifies a variety of legal, institutional and attitudinal factors which hinder the growth of the German SRI market. Its paltry size does not reflect evidence of any specific disinterest among German investors in social and environmental issues. Rather, it arises from a combination of structural impediments, particularly the institutional arrangements for German pension schemes that hinder their participation in financial markets, regulations which encourage conservative investments, and investors' preference for low-risk assets and avoidance of shareholder activism. Legal and institutional reforms over the past decade have in theory created better opportunities for SRI in Germany, although they have yet to engender significant changes in the market.

A. The Problem

Why does Germany have a relatively small market for socially responsible investment (SRI), and have recent reforms created opportunities to increase its extent? In addressing these questions, we aim to fill a gap in the literature about SRI, which has focused on its place in the Anglo-American markets.¹ We identify and analyze the legal, institutional and other factors that influence and hinder the German SRI market. Our focus is on the *extent* of SRI in Germany, rather than the quality of its implementation or influence (although anecdotal

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¹ See, e.g., M. O'Brien Hylton, 'Socially Responsible' Investing: Doing Good Versus Doing Well in an Inefficient Market, 42 AM. U. L. REV. 1 (1992) 1; Rosy Thornton, *Ethical Investments: A Case of Disjointed Thinking*, 67 CAMBRIDGE L. J. 396, 419 (2008). Also, scholarship on German or European SRI is sometimes not available in English: see, e.g., Jan Scharlau, *SOCIALLY RESPONSIBLE INVESTMENT: DIE DEUTSCHEN UND EUROPARECHTLICHEN RAHMENBEDINGUNGEN* (2009).

evidence about such factors is noted). Rather than examining global-wide impediments to SRI, as already widely researched,² such as market and legal pressures to invest myopically and speculatively,³ we focus on issues that are particularly relevant to Germany. We argue that the lack of SRI in Germany does not reflect evidence of any specific disinterest among German investors in the social and environmental sequelae of their financial decisions. Rather, it reflects a combination of structural impediments to the market. They include the state provision of pensions, which limits savings that can be invested in the market, the modest role of equities markets in German's finance which remains dominated by bank lending, investment law controls, and household savers' preference for low-risk investments. Recent legislative reforms to company, pension and financial governance have somewhat, but not entirely, removed these impediments.

It is important to recognize that an improved climate for SRI in Germany will not necessarily allow SRI to become a mainstream approach in German financial markets, given that SRI functions in Germany, as elsewhere, within a wider capitalist system that structurally limits the scope for a truly green economy that respects biosphere limits. The purpose of this article is not to examine the deeper reforms necessary to put capitalism on an ecologically sustainable footing,⁴ but rather to consider why SRI is not as extensive in Germany as in the leading SRI markets of other countries.

The paucity of SRI in Germany should be of concern for several reasons. Socially responsible investment, which can be defined in various ways but generally seeks to integrate environmental and social concerns into investment decision-making,⁵ has become more urgent worldwide in the context of both the emerging global environmental crisis and the growing crisis of finance capitalism. Ecological problems such as climate change and loss of biodiversity threaten humankind's long-term prosperity.⁶ Much of the

² E.g., Carmen Juravle & Alan Lewis, *Identifying Impediments to SRI in Europe: A Review of the Practitioner and Academic Literature*, 17 *BUS. ETHICS* 285 (2008); BENJAMIN J. RICHARDSON, *SOCIALLY RESPONSIBLE INVESTMENT LAW: REGULATING THE UNSEEN POLLUTERS* (2008).

³ William Lazonick & Mary O'Sullivan, *Maximising Shareholder Value: A New Ideology for Corporate Governance*, 29 *ECON & SOC.* 13 (2000).

⁴ For insights into this more radical, comprehensive agenda of reform, see, e.g., LESTER R. BROWN, *ECO-ECONOMY: BUILDING AN ECONOMY FOR THE EARTH* (2001); HERMAN E. DALY & JOHN COBB, *FOR THE COMMON GOOD: REDIRECTING THE ECONOMY TOWARDS COMMUNITY, THE ENVIRONMENT AND A SUSTAINABLE FUTURE* (1990); MICHAEL JACOBS, *GREEN ECONOMY: ENVIRONMENT, SUSTAINABLE DEVELOPMENT AND THE POLITICS OF THE FUTURE* (1993).

⁵ For an introduction to the goals and means of SRI, see FUNG HUNG-GAY, SHERYL LAW & JOF YAU, *SOCIALLY RESPONSIBLE INVESTMENT IN A GLOBAL ENVIRONMENT* (2010); *SUSTAINABLE INVESTING: THE ART OF LONG TERM PERFORMANCE* (CARY KROSINSKY & NICK ROBINS eds., 2008); *RESPONSIBLE INVESTING IN TIMES OF TURMOIL: THE FUTURE OF SRI* (W. Vandekerckhove, et. al., eds., 2011).

⁶ See *News Release: Why is Biodiversity in Crisis?*, *IUCN Red List of Threatened Species*, (3 September 2010), <http://www.iucnredlist.org/news/biodiversity-crisis> (last accessed 1 January 2011) (reporting that "the escalating

intensification of environmental pressure is attributable to deregulated financial markets, which have stimulated economic growth and corporate expansion.⁷ While finance capitalism has been soundly critiqued for being a vector of economic crisis and irrational exuberance,⁸ its contribution to environmentally unsustainable practices is less well acknowledged.

The movement for SRI is attempting to address these problems. It provides a means by which ethical investors may challenge corporate irresponsibility when states fail to act. Since most companies rely on debt or equity funding to sustain their activities, in theory investors can influence corporate behavior by making finance subject to environmental and social considerations.⁹ In a sense, therefore, SRI may be construed as a form of market governance, supplementing official law. But SRI is broad label for diverse investment practices, many of which do not have such aspirations. Some financiers practice SRI not to influence corporate behavior but rather simply to avoid being *complicit* in activities they deem morally objectionable. Faith-based investors tend to take this approach.¹⁰ By contrast, mainstream institutional investors such as pension funds tend to have an interest in SRI only if they perceive it as a way to gain financial advantage, given evidence of the potential financial materiality of some aspects of corporate social and environmental performance.¹¹

So far, no form of SRI has become particularly extensive or influential. Ostensibly, it has acquired some respectability in parts of Europe and North America, as some studies estimate that about 10 percent of all investment portfolios are now managed for SRI

extinction crisis shows that the diversity of nature cannot support the current pressure that humanity is placing on the planet"); U.N. ENV'T PROGRAMME, GLOBAL ENVIRONMENT OUTLOOK GEO-4: ENVIRONMENT FOR DEVELOPMENT 6 (2007); *Global Environment Outlook*, U.N. ENV'T PROGRAMME, <http://www.unep.org/geo> (last accessed 1 January 2011).

⁷ GORDON CLARK & DARIUS WÓJCIK, *THE GEOGRAPHY OF FINANCE: CORPORATE GOVERNANCE IN THE GLOBAL MARKETPLACE* (2007).

⁸ See ROBERT J. SHILLER, *IRRATIONAL EXUBERANCE* (2000); JOHN BROGLE, *THE BATTLE FOR THE SOUL OF CAPITALISM* (2005); Frederic Jameson, *Culture and Finance Capitalism*, 24 *CRIT. INQ.* 246 (1997).

⁹ Pietra Rivoli, *Making a Difference or Making a Statement? Finance Research and Socially Responsible Investment*, 13 *BUS. ETHICS Q.* 271 (2003).

¹⁰ PAOLA TRIOLO, MARTIN PALMER & STEVE WAYGOOD, *A CAPITAL SOLUTION: FAITH, FINANCE AND CONCERN FOR A LIVING PLANET* (2000).

¹¹ UNITED NATIONS ENVIRONMENT PROGRAMME-FINANCE INITIATIVE (UNEFPFI), *THE MATERIALITY OF SOCIAL, ENVIRONMENTAL AND CORPORATE GOVERNANCE ISSUES IN EQUITY PRICING* (2004).

purposes.¹² But much investment masquerading as SRI perhaps differs little from conventional finance; for instance, the major surveys of SRI in the United States (US) include a fund that ethically screens merely against *one* activity, such as tobacco stocks, yet counts their *entire* standard investment portfolio.¹³ As a voluntary movement, operating in a market with strong countervailing pressures to act only for private self-interest, SRI suffers from fungible standards, salesmanship and cheap rhetoric.¹⁴ Paradoxically, therefore, whereas SRI once stood for change when governments had failed to act, if it is to be force again for social justice and environmental sustainability, SRI requires a helping hand from the state itself through a more enabling policy framework to encourage social investing.

If an investment is to qualify as SRI, at a minimum, decisions regarding the selection, retention or disposal of such an asset should incorporate social and environmental considerations, ranging from labor standards, human rights, climate change, nature conservation and many other similar factors that are commonly the subject of ethical concern and public policy. In other words, an investment institution should not only have regard to traditional financial risk and return criteria, but also consider their social and environmental impacts. Where such impacts are material, it may be appropriate to avoid such an investment altogether, or to engage with corporate management to seek a change in corporate policy or practice. Social and environmental issues should not only be considered by investors when they might have financial repercussions, but should be treated as valuable concerns in their own right. Whether such concerns should always trump countervailing financial considerations is a complex question, to which social investors will respond differently.¹⁵ However, if we take a long-term perspective, it should be recognized that economic prosperity cannot continue indefinitely without maintaining a healthy environment. Ignoring climate change, for example, will likely have profoundly adverse economic consequences for humankind and the planet alike. Therefore, taking a long-term approach to investment can reduce the seeming competition between “rival” economic and environmental goals.

¹² *E.g.*, US Social Investment Forum, Socially Responsible Investing Assets in US Top \$3 Trillion; Nearly 1 Out of Every 8 Dollars under Professional Management, Press release (9 November 2010), <http://www.socialinvest.org/news/releases/pressrelease.cfm?id=168>.

¹³ US SOCIAL INVESTMENT FORUM, 2005 REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES: A 10-YEAR REVIEW 9 (2006). A survey of more than 600 SRI funds, by the Natural Capital Institute, found that over 90 percent of Fortune 500 index companies are included in at least one SRI portfolio: PAUL HAWKEN, SOCIALLY RESPONSIBLE INVESTING (2004).

¹⁴ Donald Schepers & S. Prakash Sethi, *Do Socially Responsible Funds Actually Deliver What they Promise? Bridging the Gap Between the Promise and Performance of Socially Responsible Funds*, 108 BUS. & SOC. REV. 11 (2003).

¹⁵ HUNG-GAY FUNG, SHERYL A. LAW & JOT LAU, SOCIALLY RESPONSIBLE INVESTMENT IN A GLOBAL ENVIRONMENT 46 (2010).

The purpose of this article is not to delve deeply into the debates about what SRI is or should be, but it is important to keep in perspective that there is an evolving understanding about the characteristics and purpose of SRI, and that ultimately any discussion about how to regulate and promote SRI in Germany (or elsewhere) must not ignore this debate. Recent initiatives, such as the proposed German Sustainability Code, developed by the German Council for Sustainable Development, could provide the necessary substantive criteria to inform the SRI market.¹⁶ The goals of the draft Code, which builds on evolving international standards for corporate social responsibility, include “to provide the financial market with reliable information as a means of converting the concept of sustainability into effective, comprehensible and credible action.”¹⁷

To evaluate Germany’s SRI market in its wider context, part B of this article surveys how other states have sought to govern SRI. Empirical data about the state of the SRI market in Germany, in comparison to other jurisdictions, is analyzed in part C. This data is used in part D to attempt to identify those legal, institutional and cultural characteristics which are particular to Germany, and assesses how they may impede or drive SRI. These identified features include the German pension system and the reluctance of German investors to invest in shares. Parts E and F examine opportunities to improve SRI in Germany. Part E looks at recent reforms which might overcome the traditional lack of investor-related activism. Part F examines German banks as potential promoters of SRI, as banks have traditionally played a dominant role in corporate finance. The conclusions of this article and some areas for future research are noted in part G.

B. SRI and Its Governance

SRI is conducted through a range of techniques. They principally include negative screens (excluding finance to firms engaged in offensive activities), *best-in-class* screens (selecting the most socially responsible firms relative to their peers), shareholder advocacy (promoting change within companies through shareholder rights) and, in the banking sector, financing on preferential terms for socially or environmentally beneficial projects.¹⁸ The SRI community has also sought to exert influence through codes of conduct to which financial institutions may voluntarily accept commitments; they include the United Nations

¹⁶ GERMAN COUNCIL FOR SUSTAINABLE DEVELOPMENT, TOWARDS A GERMAN SUSTAINABILITY CODE (December 2010), http://www.nachhaltigkeitsrat.de/uploads/media/RNE_Nov_2010_-_German_Sustainability_Code_Dialogue_phase_en_01.pdf.

¹⁷ *Id.*, 1.

¹⁸ RICHARDSON, *supra* note 2, at 89-101.

Principles for Responsible Investment (UNPRI),¹⁹ designed for institutional investors, and the Equator Principles, intended for banks financing projects.²⁰

While much SRI aspires to be a form of market governance, attempting without official imprimatur to promote corporate social responsibility, paradoxically SRI is unlikely to become more prevalent and influential without a more enabling policy and regulatory framework provided by states. Corporate finance theory implies that SRI cannot generally influence the cost of capital of firms, and thereby give a market advantage to conscientious companies over their polluting rivals.²¹ Unless SRI is based on a business case, such as the measurable financial effect of a company's environmental behavior, the decisions of social investors who are a minority in the market probably will not affect a firm's cash flow and business prospects. Thus, social investors can hardly affect targeted firms' stock price.²² Social investors, in other words, tend to be price takers, not price makers. In regard to debt finance, socially-conscious banks can be relatively better placed to influence borrowers, especially small enterprises that have few financing options, as well as any firms seeking particularly large project financing.²³ Yet in a competitive credit market, lenders also have incentives not to raise the bar too high for risk of losing clients to less scrupulous financiers. The SRI movement's own codes of conduct, which attempt to promote more systematic change across the market rather than targeting individual firms, are also unlikely to make a major difference because they tend to suffer from relatively facile standards and lax monitoring.²⁴

While some national-level legal reforms to promote SRI have emerged in various countries recently, they are not very ambitious and are too ad hoc to change financiers' behavior significantly.²⁵ Under the sway of neo-liberal thinking, lightly regulated financial markets are still viewed by most policy-makers as most efficient and conducive to economic

¹⁹ See <http://www.unpri.org> (last accessed 1 January 2011).

²⁰ See <http://www.equator-principles.com> (last accessed 1 January 2011).

²¹ Rivoli, *supra* note 9.

²² Wallace Davidson, Dan Worell & Abuzar El-Jelly, *Influencing Managers to Change Unpopular Corporate Behavior through Boycotts and Divestitures*, 34 BUS. & SOC. 171 (1995).

²³ MARCEL JEUCKEN, *SUSTAINABLE FINANCE AND BANKING: THE FINANCIAL SECTOR AND THE FUTURE OF THE PLANET* (2001); Paul Thompson, *Bank Lending and the Environment: Policies and Opportunities*, 16 INT'L J. BANK MARK. 243 (1998).

²⁴ Benjamin J. Richardson, *Financing Sustainability: The New Transnational Governance of Socially Responsible Investment*, 17 YBK INT'L ENV'TL L. 73 (2007).

²⁵ *Id.*, 73.

growth.²⁶ The SRI reforms have thus tended to emphasize economic and informational policy instruments that leave investors the discretion to make the ultimate decisions. For example, the United Kingdom (UK) and several other European states, and Australia, oblige occupational pension funds to *disclose* their SRI policies (but do not oblige having such an investment policy).²⁷ Another requirement, adopted in Canada and the US, requires mutual funds to disclose their shareholding proxy voting policies and voting records.²⁸ Other measures include economic incentives (e.g., green investment tax concessions, offered in the Netherlands),²⁹ and making lenders potentially liable for pollution problems connected to their borrowers (in the US).³⁰ By modifying financiers' incentives and knowledge, reflexive law theory implies that such process-based standards may stimulate changes in social values that contribute to sustainability.³¹ Several governments have gone further to ban specific undesirable investments, as an adjunct to primary controls; for example, Belgium prohibits investments in companies that produce or distribute cluster bombs.³² Legal obligations to actively promote SRI are confined to public pension funds, with such reforms adopted in New Zealand, Norway and Sweden.³³

²⁶ EDWARD SHAW, *FINANCIAL DEEPENING IN ECONOMIC DEVELOPMENT* (1975); Ajit Singh, *Financial Liberalisation, Stockmarkets and Economic Development*, 107 *ECON. J.* 771 (1997).

²⁷ *E.g.*, UK's Occupational Pension Schemes (Investment) Regulations, 2005: cl. 2(3)(b)(vi)-(3)(c); Australia's *Corporations Act*, 2001 (Cth), para. 1013D(1)(l); France's *Projet de loi sur l'épargne salariale* (7 February 2001). No. 2001-152, Arts. 21, 23.

²⁸ SECURITIES EXCHANGE COMMISSION, *DISCLOSURE OF PROXY VOTING POLICIES AND PROXY VOTING RECORDS BY REGISTERED MANAGEMENT INVESTMENT COMPANIES* (31 January 2003), 17 CFR Parts 239, 249, 270, & 274; CANADIAN SECURITIES ADMINISTRATORS, *NATIONAL INSTRUMENT 81-106 INVESTMENT FUND CONTINUOUS DISCLOSURE AND COMPANION POLICY 81-106CP* (2005).

²⁹ Known as the *Green Project Directive*, introduced in 1995: the scheme was amended in 2002 and 2005: *Regeling groenprojecten buitenland*, *Staatscourant* 1 (2 January 2002 31; *Regeling groenprojecten*, *Staatscourant* 131 (11 July 2005): 13; *see further* MARCEL JEUCKEN, *SUSTAINABLE FINANCE AND BANKING: THE FINANCIAL SECTOR AND THE FUTURE OF THE PLANET* 92-94 (2001).

³⁰ *Comprehensive Environmental Response, Compensation and Liability Act*, 1980, Pub. L. No. 96-510; but the legislation was amended in 1996 to limit lenders' potential liability: Olaf de S. Domis, *New Law Finally Limits Environmental Liability*, 161 *AM. BANKER* 3 (1996).

³¹ David Case, *Changing Corporate Behavior through Environmental Management Systems*, 31 *WILLIAM & MARY ENV'TL L. & POL. REV.* 7 (2006); Eric W. Orts, *Reflexive Environmental Law*, 89 *NW. U.L. REV.* 1127 (1995).

³² Netwerk Vlaanderen, *Belgium Bans Investments in Cluster Munitions*, Press release (2 March 2007), <http://www.netwerkvlaanderen.be> (last accessed 1 January 2011).

³³ UNEPFI ASSET MANAGEMENT WORKING GROUP AND UK SOCIAL INVESTMENT FORUM, *RESPONSIBLE INVESTMENT IN FOCUS: HOW LEADING PUBLIC PENSION FUNDS ARE MEETING THE CHALLENGE* (2007),

At an international level, an even larger regulatory lacuna concerning SRI exists. Market liberalization and technological advances have greatly accelerated the mobility and liquidity of financial capital across borders.³⁴ Largely missing from these policy prescriptions are mechanisms to ensure that transnational firms and their investors who benefit from the liberal economic framework adhere to high standards of corporate governance and social responsibility. While globalization has helped disseminate and universalize standards for SRI and corporate social responsibility,³⁵ governmental regulation of financial markets at an international level remains sparse and deeply fragmented. An assortment of institutions, such as the Bank for International Settlements and the International Organization of Securities Commissions, provide a very loose regulatory framework at a global level.³⁶ They serve primarily to facilitate cooperation among national regulators and to promote cross-border movement of capital.³⁷ The 1997 General Agreement on Trade in Services (GATS) subsidiary Agreement on Financial Services³⁸ aims to eliminate discriminatory and market access-impairing measures so that insurers, banks, and other institutions have access to the financial service markets of all member states.³⁹ Yet, GATS does not provide any organizational machinery to supervise financial markets and lacks any SRI-related standards.

The most advanced supra-national regulatory framework for financial markets is in the European Union (EU),⁴⁰ where a single market for financial services, originally based on the

³⁴ Cynthia Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U. CAL. DAVIS L. REV. 705, 731 (2002).

³⁵ See Geoffrey Leonard & Christopher Duerksen, *Environmental Regulation and the Location of Industry: An International Perspective*, 15 COLUM. J. WORLD BUS. 52 (1980); John Wilson, *Capital Mobility and Environmental Standards: Is there a Theoretical Basis for a Race to the Bottom?* in FAIR TRADE AND HARMONIZATION: ECONOMIC ANALYSIS, vol. 1, 393 (Jagdish Bhagwati & Robert E. Hudec eds., 1996).

³⁶ See Mario Giovanoli, *A New Architecture for the Global Financial Market: An Outline of Legal Issues*, in INTERNATIONAL MONETARY LAW: ISSUES FOR THE NEW MILLENNIUM 3 (Mario Giovanoli ed., 2000).

³⁷ See generally MICHAEL CARLBERG, INTERNATIONAL ECONOMIC POLICY COORDINATION (2005); Kern Alexander, Rahul Dhumale & John Eatwell, GLOBAL GOVERNANCE OF FINANCIAL SYSTEMS (2006).

³⁸ Vincent Presti, *Barings Bar None: The Financial Service Agreement of the GATS and its Potential Impact on Derivatives Trading*, 21 MARYLAND J. INT'L L. & TRADE 145 (1997). The legal text of the GATS, including the Annex on Financial Services and the Understanding on Commitments in Financial Services, are part of the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations: see http://www.wto.org/english/docs_e/legal_e/final_e.htm (last accessed 1 January 2011).

³⁹ The Agreement entered into force on 1 March 1999. See further AADITYA MATTOO, FINANCIAL SERVICES AND THE WTO: LIBERALIZATION IN THE DEVELOPING AND TRANSITION ECONOMIES (1998).

⁴⁰ By way of introduction, see EUROPEAN COMMISSION, INSTITUTIONAL ARRANGEMENTS FOR THE REGULATION AND SUPERVISION OF THE FINANCIAL SECTOR (2000).

principle of mutual recognition rather than harmonization of regulatory standards, has evolved over several decades. In the wake of the Lisbon Strategy of 2000, the EU embarked on more calculated reform to further integrate and improve the efficiency of European capital markets.⁴¹ While it should facilitate a pan-European market for SRI funds in the retail sector by removing market barriers, the reforms do not promote SRI *per se*. This lacuna stands at odds with the Amsterdam amendments of 1997 to the EU Treaty, which sought to enshrine the principle of *integration* of environmental standards across all EU policy sectors.⁴²

Thus, there is little or no regulatory pressure from the EU or at the international level for SRI-related legal reform in Germany. The result is that the state of the German SRI market can be explained largely in terms of domestic factors within Germany, as the following sections detail.

C. The SRI Market in Germany

Many environmentalists might assume that Germany is a world leader for SRI. The country is renowned for its high public awareness, advocacy and reform on the environment.⁴³ Surveys show that Germans consistently express heightened environmental concern.⁴⁴ Much of this concern has translated into the political arena, where the German Green Party has enjoyed considerable electoral success.⁴⁵ It is thus no coincidence that Germany is the cradle for many of the world's most progressive environmental laws.⁴⁶ Yet, little of

⁴¹ *Presidency Conclusions, Lisbon European Council, March 23-24, 2000*, 3 EUR. U. BULL. 7 (2000).

⁴² The current version is Art. 11, Treaty of the Functioning of the European Union, (2008) O.J. C 115/47, which states: "Environmental protection requirements must be integrated into the definition and implementation of the Union policies and activities, in particular with a view to promoting sustainable development." The principle of integration also appears in a weaker form in the Single European Act, in Art.130R(2) EC: "Environmental protection requirements shall be a component of the Community's other policies." On the lack of consistency between the European Treaty level and the level of secondary law in the company and business law area, see BEATE SJAFELL, *TOWARDS A SUSTAINABLE EUROPEAN COMPANY LAW* (2009).

⁴³ Heinrich Pehle, *Germany: Domestic Obstacles to an International Forerunner*, in *EUROPEAN ENVIRONMENTAL POLICY: THE PIONEERS* 161 (Michael S. Andersen & Duncan Liefferink eds., 1997).

⁴⁴ Anja Baukloh & Jochen Roose, *The Environmental Movement and Environmental Concern in Contemporary Germany*, in *THE CULTURE OF GERMAN ENVIRONMENTALISM: ANXIETIES, VISIONS AND REALITIES* 81 (Axel Goodbody ed., 2002).

⁴⁵ See Federal Returning Officer, *Final Result of the Election to the German Bundestag 2009*, http://www.bundeswahlleiter.de/en/bundestagswahlen/BTW_BUND_09/ergebnisse/bundesergebnisse/index.html (last accessed 1 January 2011).

⁴⁶ These laws include Germany's Renewable Energy Sources Act, 2004 (Erneuerbare-Energien-Gesetz EEG) and Environmental Damage Act, 2007 (UShadG).

this impetus has translated into a strong German movement for environmentally responsible finance.

A niche SRI sector has nonetheless emerged in Germany. That the first SRI vehicle in Germany, launched in 1974, involved an investment bank — the GLS-Gemeinschaftsbank,⁴⁷ signifies the historic importance of Germany's banking sector rather than its stock markets for socially-conscious investors. Its first SRI retail fund, BfG ökoRent, was not launched until 1989,⁴⁸ nearly 20 years after the first such funds were launched in the US.⁴⁹ The Sustainable Investment Forum (*Forum Nachhaltige Geldanlagen*) is today the main collective voice for SRI in German-speaking countries, with 120 member financial institutions from Germany, Austria and Switzerland.⁵⁰ Established in 2001, the Forum promotes dialogue and information exchange, and is an advocate for an improved legal and policy framework for SRI, which it sees as primarily designed to foster environmentally sustainable development.⁵¹ Another relevant group is the Association of Critical Shareholders (*Kritische Aktionäre*), a network of ethical shareholders who campaign for improvements in corporate social and environmental behavior.⁵²

Although Germany has Europe's largest economy, its SRI market is tiny compared to SRI in Europe overall, and SRI in many other individual EU states. It is also miniscule compared to the US market, even allowing for likely exaggeration in the estimated size of US social investments. According to the Sustainable Investment Forum's most recent research, the SRI market in Germany was worth nearly €13 billion in August 2010;⁵³ compared to the total volume of investment assets in Germany of €1706.1 billion, the share of SRI was thus only about 0.8 percent.⁵⁴ Another indicator of Germany's modest SRI sector is that as of January 2011 the country has only 12 financial institutions among the UNPRI's list of 861

⁴⁷ See <http://www.gls.de/die-gls-bank/ueber-uns/gls-bank/english-portrait.html> (last accessed 1 January 2011).

⁴⁸ JOANNA RACHOCKA, *SOCIALLY RESPONSIBLE INVESTMENT IN EUROPE* 16 (2007).

⁴⁹ The first SRI retail fund in the US was probably the Pax World Fund, established in 1971.

⁵⁰ See <http://www.forum-ng.org> (last accessed 1 January 2011).

⁵¹ Henry Schaefer, *Ethical Investment of German Non-profit Organizations – Conceptual Outline and Empirical Results*, 13 *BUS. ETHICS: EURO. REV.* 269, 270 (2004).

⁵² See <http://www.kritischeaktionäre.de> (last accessed 1 January 2011).

⁵³ FORUM NACHHALTIGE GELDANLAGEN, *MARKTBERICHT NACHHALTIGE GELDANLAGEN 2010: DEUTSCHLAND, ÖSTERREICH UND DIE SCHWEIZ* 19 (2010).

⁵⁴ *Id.*

signatories; this number compares to 112 signatories from the UK and 118 from Australia —countries with smaller economies than Germany.⁵⁵

While international comparisons of SRI might be suspect in the absence of a common, authoritative methodology, most surveys conducted by European SRI associations rely on comparable criteria. The most recent comparative data comes from the European SRI Study 2010, conducted by the European Social Investment Organisation (Eurosif),⁵⁶ an organization that regularly conducts such surveys in the region. This part of the article summarizes elements of the German SRI market, which seem to differ substantially from the European SRI market. Since the UK is the leading market for SRI in Europe, it will be highlighted to demonstrate those differences. Eurosif defines SRI generically as “any type of investment process that combines investors’ financial objectives with their concerns about Environmental, Social and Governance (ESG) issues”⁵⁷ and differentiates between *core* SRI, involving ESG screens, and *broad* SRI (incorporating shareholder activism and corporate engagement on ESG issues). For the purpose of its survey, Eurosif defined national markets by the country where the SRI assets are managed, rather than the original source of the capital.⁵⁸

Firstly, in absolute terms, the German SRI market is small. According to the 2010 Eurosif survey, it amounted to only €13 billion. By contrast, the UK had €1043 billion, and Europe as a whole had approximately €5000 billion. The discrepancy between Germany and the rest of Europe is even starker when comparing the total financial assets under management to SRI assets: Germany’s SRI market share was only 0.8 percent, compared to 27.6 percent in the UK and 10 percent in Europe generally.⁵⁹ Another noteworthy fact is that relatively few institutional investors (e.g., occupational pension funds) in Germany practice SRI: in 2010, 55 percent of SRI assets were held by the institutional sector. This picture is very different from that of many European countries, such as the UK, Norway and the Netherlands, where such institutional investors are sometimes a major driver of SRI; in 2010, UK institutional investors held 96 percent of the country’s SRI assets, while across Europe on average institutional investors held 66 percent of the SRI market.⁶⁰

⁵⁵ Signatories to the Principles for Responsible Investment, <http://www.unpri.org/signatories/> (last accessed 1 January 2011).

⁵⁶ EUROSIF, EUROPEAN SRI STUDY 201 (2010).

⁵⁷ *Id.*, 8.

⁵⁸ *Id.*, 9.

⁵⁹ The SRI market share in the UK is surprisingly large. However, the EUROSIF study notes that of the total £938.9 billion SRI assets, compared to the total managed investment assets in the UK worth £3.4 trillion, most comprised “broad” SRI (worth £884.2 billion): *id.*, 53.

⁶⁰ *Id.*, 16, 42, 43, 54.

Concomitantly, therefore, the number of private *retail* investors (e.g., mutual funds selling directly to individuals) involved in SRI is relatively larger in Germany.⁶¹ Moreover, the most important institutional investors in Germany are ecumenical organizations and charitable foundations, although the vast majority of them expects an investment return comparable to the market average.⁶²

Another discrepancy is that while German investors, as with many of their continental European, peers tend to prefer corporate bonds rather than the stock market, equity investment is much higher in the UK, which also has the largest SRI market in Europe.⁶³ In Germany, stock equity comprised 38 percent of the SRI asset allocation, while bonds comprised 58 percent and other assets made up the remaining 8 percent. In the UK, the equivalent numbers in 2010 were 74 percent (stock equity), 10 percent (bonds) and 16 percent (other). The difference between bonds and equity investment is crucial, because bond-holders lack the rights that shareholders typically enjoy to influence corporate policy. Investor-related activism on corporate social and environmental behavior is thus not as common in Germany as in other countries in Europe, and even less common compared to North America.⁶⁴ Eurosif singled out the lack of such activism among German investors.⁶⁵ The German Sustainable Investment Forum also found in its national SRI study that 75 percent of all surveyed organizations do not engage in any shareholder activism.⁶⁶

Having thus established the principal characteristics of the SRI market in Germany with regard to its relative extent, actors, and methods, we can now analyze the determinative factors. What we do not know however, owing to a lack of empirical data, is the substantive social and environmental issues favored by German social investors, and their relative influence in shaping corporate behavior. This is a deficiency of much of the SRI literature about other markets.

⁶¹ *Id.*, 36.

⁶² Schaefer, *supra* note 51, 283.

⁶³ EUROSIF, *supra* note 56, at 17, 51. Interestingly, though, investment in equities has dropped from 50 percent in 2008 to 33 percent in 2010 on the European level, making bonds the favored asset (from 39 percent in 2008 to 53 percent in 2010); *id.*, 7.

⁶⁴ US SOCIAL INVESTMENT FORUM, 2010 REPORT SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES 40-56 (2010).

⁶⁵ *Id.*, 35.

⁶⁶ FORUM NACHHALTIGE GELDANLAGEN, MARKTBERICHT NACHHALTIGE GELDANLAGEN 2010 – DEUTSCHLAND, OESTERREICH UND DIE SCHWEIZ 21 (2010).

D. Obstacles to SRI in Germany

I. The Lack of Institutional Investors - the German Pension System

Institutional investors, particularly occupational and state pension funds, are presently the main driver of SRI, holding 66 percent of the total SRI assets under management in Europe.⁶⁷ As noted in the previous section, their presence in the German SRI market is relatively small, and mainly comprises religious and philanthropic institutions. The limited involvement of pension funds is particularly striking, which may be explained by the institutional structure of Germany's pension system.⁶⁸ While extensive legal reforms to its pension system occurred in the previous decade, they have yet to lead to significantly more SRI. A recent report co-authored by the German Federal Environmental Ministry noted that, "Although the Germans are seen internationally to be leaders in the area of environmental protection and 86 percent of occupational pension clients request that their pension schemes not invest in companies making environmentally damaging products, German occupational pension schemes are deemed unprogressive when it comes to comprehensive integration of sustainability aspects."⁶⁹

There are three pillars to the German pension system: the public pay-as-you-go (PAYG) pensions, occupational pensions, and private pensions. The first pillar is a mandatory public system — the largest of the three — which funds the current pensions of the retired from the premiums paid by the working population.⁷⁰ Because premiums are therefore spent immediately rather than saved, negligible capital stock may be amassed that could then be deployed for SRI, as is the case in other countries whose pension systems are fully funded.⁷¹ The second and third pillars, comprising voluntary company-based pension schemes, which take various institutional forms, were designed to supplement the PAYG system. Their overall financial assets are much smaller than the first pillar, but they are

⁶⁷ EUROSIF, *supra* note 56, 7.

⁶⁸ HENRY SCHAEFER, WIE NACHHALTIG IST DIE KREDITANLAGE IN DEUTSCHLAND? 6 (2005), http://www.uni-stuttgart.de/argus-responsibility/fileadmin/downloads/Wie_nachh_Geldanlage.pdf (last accessed 1 January 2011).

⁶⁹ FORTIS INVESTMENTS & FEDERAL ENVIRONMENTAL MINISTRY OF GERMANY, OCCUPATIONAL PENSIONS AND SUSTAINABLE INVESTMENTS IN GERMANY 5 (2008).

⁷⁰ AXEL H. BOERSCH-SUPAN & CHRISTINA B. WILKE, REFORMING THE GERMAN PUBLIC PENSION SYSTEM 3 (2005). http://www.rand.org/labor/aging/rsi/rsi_papers/2006_axel1.pdf (last accessed 1 January 2011).

⁷¹ SILKE RIEDEL & ANTJE SCHNEEWEISS, CHANCEN UND ENTWICKLUNGSMOEGELICHKEITEN FUER EIN AKTIVES AKTIONAERSTUM IN DEUTSCHLAND — EINE MACHBARKEITSSSTUDIE 12 (2008).

fully funded.⁷² The second pillar, occupational pensions, is organized into different investment vehicles: direct pension promises (*Direktzusage*), benefit funds (*Unterstuetzungskasse*), direct insurances (*Direktversicherung*), staff pension funds (*Pensionskasse*) and pension funds (*Pensionsfond*).⁷³ The third pillar is non-occupational pensions, which are funded by individuals privately, and are commonly invested in a variety of financial services offered by insurance companies, banks or investment companies.⁷⁴ Since the second and third pillars are fully funded, financial institutions offering services relating to these pensions could pursue SRI. Yet in practice this occurs rarely.

The mere fact that occupational and private pensions are not mandatory, but rather viewed as supplements to the PAYG-pensions, might suggest that they simply lack the size to contribute substantially to SRI, especially when compared to the massive pension funds in some other European countries. However, occupational and private pensions have grown steadily in recent years, largely due to German legislation⁷⁵ providing incentives for workers to take up such pensions in order to compensate for the shrinking PAYG-system.⁷⁶ Since 2001, the number of subsidized private pension agreements of the most popular type, *Riester-Rente*, have soared from 1.4 million in 2001 to 13.8 million in 2010.⁷⁷ One might assume, therefore, that the potential pool of investors for SRI would increase to levels comparable in other jurisdictions.

Yet, pension sector investors have had a subdued presence in the SRI market because of the structure of certain investment vehicles for occupational pensions, and because of investment principles imposed by German legislation. While the latter factor is also an issue in many other jurisdictions, the structure of Germany's pension sector is a more unique feature, that explains the country's stunted SRI market. Important opportunities for SRI arise where corporations can be influenced directly, such as by investors using

⁷² Boersch-Supan & Wilke, *supra* note 70, 8.

⁷³ *Id.*, 16.

⁷⁴ SCHARLAU, *supra* note 1, 112.

⁷⁵ Law on the Reform of the pay-as-you-go-Pension System (Gesetz zur Reform der gesetzlichen Rentenversicherung und zur Foerderung eines kapitalgedeckten Altersvorsorgevermoegens (AVmG)), June 29 2001, (2001) BGBl. I 1310.

⁷⁶ The PAYG system has been shrinking, caused by the demographic shift of an ageing population with fewer workers to finance the pensions of a growing number of recipients: Boersch-Supan & Wilke, *supra* note 70, 4.

⁷⁷ Bundesministerium fuer Arbeit und Soziales, *Entwicklung der Riester-Rente* (2010), http://www.bmas.de/portal/47362/property=pdf/2010_08_11_entwicklung_private_vorsorge_2_Quarta_l_2010_schaubild.pdf.

shareholder rights to advocate social and environmental issues,⁷⁸ and where corporations can make direct use of the capital invested, such as by investors purchasing shares at initial public offerings.⁷⁹ Conversely, SRI is less effective where investments are made indirectly, for instance by purchasing financial products from banks or insurance companies, whose fund managers are on short-term performance contracts which discourage attention to non-financial factors. Hypothetically, SRI can be promoted through any of the investment vehicles for occupational pensions. However, direct pension promises and benefit funds are least likely to do so.

Direct pensions are popular with companies because the employer can potentially use its employees' contributions prior to workers' retirement to fund the operational needs of the business.⁸⁰ Since there is little external investment, direct pension promises are unlikely to provide capital for SRI. By contrast, benefit funds, which are legally autonomous from the employer company,⁸¹ may be managed by one or more separate investment enterprises. Employees have no legal entitlement to benefits from such funds, which enjoy virtually no restrictions on how the capital may be invested.⁸² Frequently the capital raised is loaned back to the employer companies, and is thus not invested in the market.⁸³ Therefore, both direct pension promises and benefit funds, which comprise slightly over 60 percent of occupational pension fund assets in Germany, are not likely to be a significant means of SRI. The other occupational pension schemes (direct insurances, pension funds and staff pension funds), which benefit from government subsidies,⁸⁴ are becoming more widespread. Since their investments are made externally through investment companies,⁸⁵ these schemes are in a better position to participate in the market and practice SRI.

⁷⁸ Schaefer, *supra* note 68, 2.

⁷⁹ STEPHAN ROTTMANN, *ERFOLGREICH INVESTIEREN IN GRUENE GELDANLAGEN* 46-47 (2009).

⁸⁰ TIMO SCHWIETERING, *TREUHAENDISCHE VERANTWORTUNG UND ETHISCHES INVESTMENT – CHANCEN UND ZWAENGE AM DEUTSCHEN PENSIONS-KASSENMARKT* 21 (LLB dissertation, Universitaet Bayreuth, 2007).

⁸¹ *Id.*, 22.

⁸² *Id.*

⁸³ Verbraucherzentrale Bundesverband, *Unterstützungskasse: Frei in der Vermögensanlage* (2008), <http://www.vorsorgedurchblick.de/projekt01/side182.html> (last accessed 1 January 2011).

⁸⁴ To be eligible for government subsidies, investment vehicles have to guarantee payment of a life annuity payable from the date of retirement; they must not provide for lump-sum disbursements: Boersch-Supan & Wilke, *supra* note 70, 11.

⁸⁵ SCHARLAU, *supra* note 1, 113.

II. Investment Restrictions

The previous remarks, should not imply that pension funds are without legal restrictions on their chosen investments. All pension schemes in Germany are closely regulated in a manner that can impede SRI, with parallels to the Anglo-American jurisdictions where there is a long-standing debate on the extent to which the fiduciary duties of institutional investors constrain their ability to practice SRI in the absence of financial benefits to beneficiaries.⁸⁶ Fiduciary standards require financial intermediaries to invest prudently in the exclusive interests of their beneficiaries, and in accordance with the purpose of the particular fund.⁸⁷ Some British court rulings⁸⁸ suggest investment fiduciaries would be liable to their beneficiaries if they knowingly or negligently sacrifice financial returns for ethical causes.⁸⁹

German pension fund law, as in other EU states, functions in the shadow of the EU's Occupational Pensions Directive.⁹⁰ It requires Member States to ensure that pension plans formulate and review, at least every three years, a statement of investment policy principles.⁹¹ The Directive posits several investment rules that dovetail with the common law fiduciary standards, including obligations to act in the "best interests" of beneficiaries and to ensure the security, diversification, liquidity, and profitability of the investment portfolio. None of these rules, however, mention environmental or social considerations. During negotiation of the Directive, the EU Parliamentary Committee on Economic and Monetary Affairs proposed an amendment to require each fund to include a statement of its "ethical and socially responsible investment principles."⁹² The European Parliament did not support the amendment.

⁸⁶ FRESHFIELDS BRUCKHAUS DERINGER, A LEGAL FRAMEWORK FOR THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES INTO INSTITUTIONAL INVESTMENT (2005).

⁸⁷ John Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?* 114 YALE L. J. 929 (2005).

⁸⁸ *Cowan v Scargill* [1985] 1 Ch. 270; *Martin v. City of Edinburgh District Council* [1988] SLT 329; *Bishop of Oxford v. Church Commissioners for England* [1992] 1 WLR 1241.

⁸⁹ Discussed further in Benjamin J. Richardson, *Do the Fiduciary Duties of Pension Funds Hinder Socially Responsible Investment?* 22(2) BANK. & FIN. L. REV. 145 (2007).

⁹⁰ Directive 2003/41/EC of June 3, 2003, O.J. L. 235/10.

⁹¹ *Id.*, Art. 12.

⁹² European Parliament, Committee on Economic and Monetary Affairs, *Draft Report on the Proposal for a European Parliament and Council Directive on the Activities of Institutions for Occupational Retirement Provision*, PE 295.986/AM/48-134 (8 May 2001), 52.

In German domestic law, where SRI is neither explicitly prohibited nor mandated, standards in various financial regulations resemble common law fiduciary rules. But one departure from the exclusive focus on beneficiaries found in common law fiduciary duties is the stipulation in the German Investment Modernization Act of 2003 that managers of investment funds must act not only “in the sole interest of its investors” but also for “the integrity of the market.”⁹³ While the latter goal is designed to address traditional forms of market abuse, in theory it might be interpreted more ambitiously to include goals of sustainable, long-term investment, consistent with the objectives of SRI. Regarding obligations of specific funds, insurance companies (including staff pension funds) and pension funds are subject to the Law on the Supervision of Insurance Companies (*Versicherungsaufsichtsgesetz*, VAG), which obliges them to seek the highest possible profitability and security for the fund, ensure diversification and liquidity of the portfolio, and manage investments professionally.⁹⁴ For insurance companies (including staff pension funds), this duty is supplemented by the portfolio asset restrictions imposed by the *Anlageverordnung* (AnIV); it limits investment in shares to 35 percent of a fund’s overall investment portfolio.⁹⁵ While other German pension funds are not subject to such investment asset restrictions, in practice only between 16 to 22 percent of their capital is invested in shares; the majority of assets are held in low-risk assets.⁹⁶ This bias suggests that despite the absence of express asset restrictions, the general duty of section 115 I 3 of the VAG impedes investment in company shares. While the VAG does not expressly prohibit SRI, it is permissible only to the extent that it would not have an adverse financial effect, lessen security or reduce the spread of risks.⁹⁷ Such considerations in common law jurisdictions have similarly colored the interpretation of institutional investors’ fiduciary duties.

Despite these potential legal obstacles, German regulations require disclosure of certain information to pension scheme beneficiaries, thus implying that SRI per se is not unlawful.⁹⁸ For state-supported personal pension plans and company pension schemes,

⁹³ Investment Modernization Act (*Investmentmodernisierungsgesetz*), 2003, para. 9(2).

⁹⁴ Law on the Supervision of Insurance Companies (*Versicherungsaufsichtsgesetz* (VAG)), 17 December 1992, (1993) BGBl. I 2, para. 54 I, 115 I 3, II; and Pension Fund Investment decree-law (*Pensionsfond-Kapitalanlageverordnung* (PFKapAV)), 21 December 2001, (2001) BGBl. I 4185.

⁹⁵ Para. 2, 3, 6, Regulation on the Investment of Assets of Insurance Companies (*Verordnung ueber die Anlage des gebundenen Vermoegens von Versicherungsunternehmen* (AnIV)), 20 December 2001, (2001) BGBl. I 3913.

⁹⁶ Deutsches Institut fuer Altersvorsorge, *Wie Pensionsfonds das Geld der Versicherten anlagen* (2010), http://diavorsorge.de/files/pensionsfonds_anlagestruktur.pdf (last accessed 1 January 2011); BUNDESANSTALT FUER FINANZDIENSTLEISTUNGSAUFSICHT, *JAHRESBERICHT 2009 114* (2010).

⁹⁷ SCHARLAU, *supra* note 1, 120-21.

⁹⁸ Para. 115 Part 4, VAG,

there is a mandatory reporting duty under the Certification of Retirement Pension Contracts Act (AltZertG). Section 7(4) stipulates: "Within the framework of its annual reporting the provider of the pension plan shall also report in writing whether and how ethical, social and environmental issues are considered in the employment of the pension contributions paid."⁹⁹ In the case of direct insurance policies and pension funds for company pension schemes, section 115(4) of the VAG provides: "The pension fund shall always inform the beneficiaries in writing when the policy or plan is closed and in writing annually whether and how ethical, social and environmental issues are considered in the employment of the pension contributions paid."¹⁰⁰ The German legislation in this regard goes beyond the precedent set in UK pension law, which required British pension funds only to disclose whether they have an SRI policy, but not *how* any such a policy is implemented.¹⁰¹ The public disclosure duties were not only designed to protect beneficiaries by providing them with information about the investments chosen by their fund managers, but also to raise awareness about ethical, social and environmental issues in order to increase the demand for SRI.

German legislation also requires groups of corporations¹⁰² and large corporations¹⁰³ to integrate non-financial performance indicators such as environmental issues and employees' concerns into management reports.¹⁰⁴ These changes in legislation were triggered partly by EU directives.¹⁰⁵ These measures may also encourage SRI by facilitating pension funds' evaluation of corporate environmental performance.¹⁰⁶ In theory, mandating disclosure of environmental liabilities and activities can facilitate financial institutions' scrutiny of the environmental behavior of businesses, and market forces can respond by factoring environmental costs and performance into company valuations.

⁹⁹ Translation by DEUTSCHE BANK RESEARCH, RESPONSIBLE INVESTMENTS 5 (24 June 2010), https://www.dwsinvestments.com/EN/docs/research/responsible_investments.pdf.

¹⁰⁰ *Id.*

¹⁰¹ Pensions Act, 1995; Occupational Pension Schemes (Investment) Regulations, 2005, cl. 2(3)(b)(vi)-(3)(c). The regulations were originally introduced in 1999.

¹⁰² Commercial Code (Handelsgesetzbuch (HGB)) as altered by the Law on Reasonable Wages of the Management Board (Vorstandsverguetungsgesetz (VorstAG) of 31 July 2009, (2009) BGBl. I 2509..

¹⁰³ *Id.*, para. 289 III.

¹⁰⁴ See Accounting Law Reform Act, 2004 (Bilanzrechtsreformgesetz).

¹⁰⁵ Directive 2003/51/EC of June 18, 2003, O.J. L 178, 2003; and Directive 78/660/EEC of 25 July 1978.

¹⁰⁶ BUNDESMINISTERIUM FUER UMWELT, NATURSCHUTZ UND REAKTORSICHERHEIT, WAS INVESTOREN WOLLEN – NACHHALTIGKEIT IN DER LAGEBERICHTERSTATTUNG 4 (2009).

Whether such goals will be achieved, however, remains unclear. There has been some research on the implementation of the German disclosure rules by occupational pension providers completed by Fortis Investments and the Federal Environmental Ministry of Germany. They found that approximately half the respondents in their 2008 study were “taking into account” sustainability issues in their investment decisions and activities.¹⁰⁷ The most significant usage of sustainability criteria was for investment in equity funds, involving, for instance, excluding or including a certain company’s shares based on negative and/or positive SRI criteria.¹⁰⁸ But the study also found that “some occupational pension providers still are not reporting on the (non-) use of ethical, social and ecological criteria. There are providers who were unaware of their reporting obligation until contacted to take part in this study.”¹⁰⁹ Other surveys of the German market conducted by Sustainable Development Management, in conjunction with Swisscanto, in 2005 and 2007 reported that Germany remained a European laggard on SRI, with only 5 percent German pension funds reporting that they had a “very good” understanding of sustainable investments.¹¹⁰ Similarly, the scope and quality of corporate environmental disclosure in Germany has been uneven and sometimes unreliable.¹¹¹ Research on comparable provisions in UK pensions law also suggest that the disclosure provisions have had limited effect, with mandated disclosures tending to offer only vague, boilerplate statements.¹¹² Disclosure regulation gives financiers the option of choosing *not* to take social and environmental matters into account, provided they disclose that choice.

The laws that are most relevant to SRI are perhaps those that ostensibly do not directly concern financial markets. Environmental legislation can stimulate SRI, for instance by making companies that engage in environmentally harmful developments less profitable for their investors. Conversely, environmental law can financially reward green firms.

¹⁰⁷ FORTIS INVESTMENTS & FEDERAL ENVIRONMENTAL MINISTRY OF GERMANY, *supra* note 69, 9.

¹⁰⁸ *Id.*, 10.

¹⁰⁹ *Id.*, 12.

¹¹⁰ Discussed in Hugh Wheelan, *Germany in Global SRI Adoption Comparison*, RESPONSIBLE-INVESTOR.COM (23 November 2007), http://www.responsible-investor.com/home/article/germany_lags_in_global_sri_adoption_comparison (last accessed on 1 January 2011).

¹¹¹ See Denis Cormier, Michel Magnan, & Barbara Van Velthoven, *Environmental Disclosure Quality in Large German Companies: Economic Incentives, Public Pressures or Institutional Conditions?* 14 EUR. ACCOUNT. REV. 3 (2005); James Guthrie & Lee Parker, *Corporate Social Disclosure Practice: A Comparative International Analysis*, 3 ADVANCES IN PUBLIC INTEREST ACCOUNTING 159 (1990).

¹¹² CHRIS GRIBBEN & ADAM FARUK, WILL UK PENSION FUNDS BECOME MORE RESPONSIBLE? A SURVEY OF TRUSTEES - 2004 (2004); FAIR PENSIONS, UK PENSION SCHEME TRANSPARENCY ON SOCIAL, ENVIRONMENTAL AND ETHICAL ISSUES (2006).

Germany's renewable energy legislation¹¹³ guarantees high fixed prices to suppliers of electricity from clean, renewable sources; thereby, the legislation has made investments in wind energy so attractive that they have reputedly become one of the largest beneficiaries of the German SRI market.¹¹⁴

In conclusion, at this stage we can say that institutional investors providing pension services have not been particularly active in the German SRI market. This is largely due to the structure of the German pension system: the PAYG-system is still dominant, and though other types of pension vehicles have grown steadily since the reformation of the pension system in 2001, their asset portfolios remain much lower than those of comparable pension plans in other European countries.¹¹⁵ Furthermore, German legislation relating to investment principles hinders SRI if it may compromise financial returns. On the other hand, legislation relating to the disclosure of investment strategies and the disclosure of non-financial information may encourage SRI, but these effects are not yet evident.

III. Asset Allocation: German Reluctance to Invest in Shares

As explained earlier, investors in Germany tend to favor bonds rather than stocks. This preference is particularly striking when compared to the allocation of assets in the UK, with the leading SRI market in Europe, where stocks constitute nearly three-quarters of all SRI assets.¹¹⁶ While the German reluctance to invest in shares is due partly to legislative investment restrictions, it is also likely due to the attitudes of German investors.

They appear to be more conservative and risk-averse than their Anglo-American counterparts. Rather than investing in assets that are perceived to be risky, such as shares, German investors prefer to invest in interest-bearing, low-risk assets such as government bonds.¹¹⁷ Yet the few investment funds that cater specifically to the German SRI retail market have tended to follow the investment practices found in Anglo-American countries, such as favoring corporate stocks; interest-bearing assets linked to SRI are very uncommon

¹¹³ Wolfram Krewitt & Joachim Nitsch, *The German Renewable Energy Sources Act—An Investment into the Future Pays Off, Already Today*, 28 RENEWABLE ENERGY 533 (2003).

¹¹⁴ KLAUS JACOB, ET AL., LEAD MARKETS FOR ENVIRONMENTAL INNOVATIONS 220 (2005).

¹¹⁵ Bundesanstalt fuer Finanzdienstleistungsaufsicht, *supra* note 96, 114.

¹¹⁶ EUROSIF, *supra* note 56.

¹¹⁷ Schaefer, *supra* note 51, 270

in Germany.¹¹⁸ Surprisingly, therefore, providers of SRI in the German market have therefore largely failed to create investment vehicles that are tailored to local investors' preferences.¹¹⁹ Institutional investors in Germany are also more reluctant to invest in shares than Anglo-American or Scandinavian investors.¹²⁰ Even institutional investors that fall outside of the restrictions of the pension fund legislation, such as faith-based and charitable investors, prefer to invest in low-risk assets.¹²¹

German investors' reluctance to invest in shares is related to the fact that local companies prefer to raise capital by debt rather than equity financing. The number of companies listed on the stock exchange or engaged in private equity is still few compared to other countries.¹²² As few German companies are publicly traded, purchasing shares might therefore not be perceived by the public as an ideal way to invest capital. Bank loans are the principal source of corporate finance in Germany, as in other countries such as Japan with the so-called *bank-based* corporate governance systems.¹²³ In recent years, because of the increasing global integration of financial markets, German companies have turned to capital markets to raise finance.¹²⁴ This trend may open new means of SRI.

Another explanation for the asset allocation in the German SRI market is the phenomenon of the *Deutschland AG* ("German Public Limited Company"), which was dominant until the last decade. Most German companies listed on the stock exchange were mutually owned by a relatively small network of companies' executives, state governments, banks and insurance companies, in order to control each other and to ensure that outsiders could not gain excessive influence by purchasing shares.¹²⁵ Buying shares in companies was thus

¹¹⁸ Henry Schaefer, *Nachhaltiges Bankgeschaefit als Heilsbringer in der Bankenkrise? Neue Missverstaendnisse und alte Selbstverstaendnisse*, FORUM WIRTSCHAFTSETHIK 28, 33 (2009).

¹¹⁹ Schaefer, *supra* note 68, 8-9.

¹²⁰ Riedel & Schneeweiss, *supra* note 71, 13-14.

¹²¹ *Id.*

¹²² Schaefer, *supra* note 51, 270-71.

¹²³ See ANDREAS HACKETHAL & REINHARD H. SCHMIDT, FINANCING PATTERNS: MEASUREMENT CONCEPTS AND EMPIRICAL RESULTS (2003); Jenny Corbett & Tim Jenkinson, *The Financing of Industry, 1970-1989: An International Comparison*, 10 J. JAPANESE & INT'L ECONOMIES 71 (1996).

¹²⁴ Libby Assassi, Anastasia Nesvetailova & Duncan Wigan, *Global Finance in the New Century: Deregulation and Beyond*, in GLOBAL FINANCE IN THE NEW CENTURY: BEYOND DEREGULATION 1, 7 (Libby Assassi, Anastasia Nesvetailova & Duncan Wigan eds., 2007).

¹²⁵ John W. Cioffi, *Corporate Governance Reform, Regulatory Politics, and the Foundations of Finance Capitalism in the United States and Germany*, 7 GERMAN L.J. 533, 540 (2006).

made unattractive to other investors.¹²⁶ These insular, cross-shareholding structures have been breaking down in recent years for several reasons. Firstly, as noted above, German companies listed on the stock exchange rely less exclusively on debt-financing.¹²⁷ Secondly, companies have been selling shares held in other companies that proved to be uneconomical, in order to focus on their core business.¹²⁸ Thirdly, changes in German legislation regarding corporate and taxation law,¹²⁹ which were introduced in the 1990s and 2000s to attract global investors, have helped dilute concentrated ownership of firms.¹³⁰

The changes to the *Deutschland AG* should also appeal to social investors, especially those who wish to buy shares in innovative environmentally-focused businesses pioneering new green technologies, as well as to influence firms' social or environmental behavior through shareholder activism and engagement with management. But while shareholder structures have thus been drifting towards those found in Anglo-American countries,¹³¹ research suggests German investors still remain somewhat taciturn to buy shares.¹³² Until such attitudes change, in order to make SRI more attractive to German investors fund providers likely must make a greater effort to tailor their services to suit the apparent German risk-averse psyche. This requires offering a wider range of investment vehicles such as interest-bearing assets or life insurances.¹³³

¹²⁶ Riedel & Schneeweiss, *supra* note 71, 15.

¹²⁷ Jens Kengelbach & Alexander Roos, *Entflechtung der Deutschland AG – Empirische Untersuchung der Reduktion von Kapital- und Personalverflechtungen zwischen deutschen boersennotierten Gesellschaften*, M. & A. REV. 11, 11 (2006).

¹²⁸ Riedel & Schneeweiss, *supra* note 71, 15.

¹²⁹ See Second Financial Market Promotion Act (Gesetz ueber den Wertpapierhandel und zur Aenderung boersenrechtlicher und wertpapierrechtlicher Vorschriften (2. FFG)), 26 July 1994, (1994) BGBl. I 1749; Law on Control and Transparency in the Commercial Sector (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG)), 30 April 1998, (1998) BGBl. I 768; Law to facilitate the Raising of Capital (Kapitalaufnahmeerleichterungsgesetz (KapAEG)), April 20, 1998, (1998) BGBl. I 707; Law on the further Reform of Corporation Law and Accounting Law (Gesetz zur weiteren Reform des Aktien- und Bilanzrechts, zu Transparenz und Publizitaet (TransPuG)), 26 July 2002, (2002) BGBl. I 2681; Law on the Improvement of Investor Protection (Anlageschutzverbesserungsgesetz (AnSVG)), 29 October 2004, (2004) BGBl. I 2630.

¹³⁰ Kengelbach & Roos, *supra* note 127, 16.

¹³¹ CLARK & WÓJCIK, *supra* note 8, 128-29.

¹³² Riedel & Schneeweiss, *supra* note 71, 15.

¹³³ Schaefer, *supra* note 68, 9.

E. SRI Strategies: Overcoming the Lack of Investor-Related Activism

I. Traditional Legal and Institutional Barriers in Corporate Governance

Investor-related activism, suggests Schaefer, “neither has tradition nor meaning in the system of German corporate governance.”¹³⁴ The measures social investors may take to influence the behavior of companies range from dialogue and negotiations with management to use of their rights as shareholders such as filing resolutions and voting at meetings. The traditional lack of investor-related activism in Germany was caused by institutional and legal barriers, which have now largely been removed and replaced by legislation that provide some useful tools for social investors.

One explanation for the customary lack of investor activism is that various social issues, which might be subject to such activism by socially conscious shareholders in other countries, are closely regulated under German social legislation. The most prominent examples are *Mitbestimmungsgesetz* (Law on Codetermination) and *Betriebsverfassungsgesetz* (Law on Work Councils). The former provides for the supervisory board of the two-tier management system of large corporations¹³⁵ to comprise equally employee and shareholder representatives.¹³⁶ The latter statute grants worker councils¹³⁷ substantial rights within the company by requiring their involvement in a large number of managerial decisions about employee-related issues. In this way, potential conflicts arising between employees and the corporation, which might be addressed by investor-related activism, are institutionalized using alternate governance frameworks.¹³⁸ These worker representatives would appear to be natural allies for SRI funds that include the treatment of labor in their ethical criteria. The system of labor “co-determination” and worker councils has in theory led companies to be mindful of interests beyond shareholders,¹³⁹ and thus investor-related activism might not be viewed by German

¹³⁴ Schaefer, *supra* note 51, 271.

¹³⁵ Such corporations usually have to employ more than 2000 employees, para. 1, Law on Codetermination (*Mitbestimmungsgesetz* (*MitbestG*)) of 4 May 1976, (1976) BGBl. I 1153,

¹³⁶ *Id.*, para. 7.

¹³⁷ Work councils can be elected by employees in companies which employ at least five employees, para. 1, Law on Work Councils (*Betriebsverfassungsgesetz* (*BetrVG*)), 25 September 2001, (2001) BGBl. I 2518; *see further* John Addison, Claus Schnabel & Joachim Wagner, *Works Councils in Germany: Their Effects on Establishment Performance*, 53 OX. ECON. PAPERS 659 (2001).

¹³⁸ Schaefer, *supra* note 51, 271.

¹³⁹ KLAUS J. HOPT & PATRICK C. LEYENS, BOARD MODELS IN EUROPE. RECENT DEVELOPMENTS OF INTERNAL CORPORATE GOVERNANCE STRUCTURES IN GERMANY, THE UNITED KINGDOM, FRANCE, AND ITALY 7 (2004).

investors as such a crucial tool to voice criticism as it has been by investors in Anglo-American corporate governance systems. Waring and Edwards suggest “in the countries without a strong tradition of social regulation, such as the US, SRI is becoming the functional equivalent of such regulation in that it imposes constraints on the employment practices implemented by management.”¹⁴⁰

Another plausible reason for the lack of investor-related activism is that, until the 1990s, a large segment of the German economy was not open to equity investors. The *Mittelstand* (small and medium sized, often family-run companies), often considered a backbone of German economy,¹⁴¹ were not always incorporated; and if they were, they would be largely run as *GmbHs* (limited liability companies), which are not publicly traded and would rely on debt-financing if they needed to raise capital.¹⁴² The number of public stock corporations in Germany remains fairly small,¹⁴³ with only approximately 1100 traded on the German stock exchange in October 2010,¹⁴⁴ but up from 802 in 1995.¹⁴⁵ Hence, private, unlisted companies have constituted the vast bulk of German firms.¹⁴⁶

A further consideration is that Germany did not have sufficient institutional mechanisms to facilitate capital markets growth until the 1990s.¹⁴⁷ Since these market forces were weak, incentives for investment in German corporations — investment being an indispensable condition for investor-related activism — were low. Until the mid-1990s, Germany had eight local self-regulating stock exchanges and fragmented state rather than federal securities’ regulation.¹⁴⁸ Further, disclosure and accounting rules did not comply with

¹⁴⁰ Peter Waring & Tony Edwards, *Socially Responsible Investment: Explaining its Uneven Development and Human Resource Management Consequences*, 16(3) CORP. GOV. 135, 137 (2008).

¹⁴¹ Cioffi, *supra* note 125, 551.

¹⁴² Schaefer, *supra* note 51, 270-71.

¹⁴³ There were approximately 15,000 stock corporations in 2005: Ulrich Noack & Dirk Zetzsche, *Corporate Governance Reform in Germany: The Second Decade*, EURO BUS. L. REV. 1033, 1034 (2005).

¹⁴⁴ BOERSE FRANKFURT, AKTIENSUCHE (2010), <http://www.boerse-frankfurt.de/DE/index.aspx?pagelD=30>.

¹⁴⁵ William Emmons & Frank Schmid, *Universal Banking Rights, Control Rights and Corporate Finance in Germany*, FRBSL 19, 29 (1998).

¹⁴⁶ Noack & Zetzsche, *supra* note 143, 1034.

¹⁴⁷ Benjamin J. Richardson, *Greening the Financial Sector: Legal Reforms in the European Union*, 7 YBK INT’L ENV’T L. 159, 168 (2007).

¹⁴⁸ Cioffi, *supra* note 125, 540.

international standards, thus discouraging foreign investment in particular.¹⁴⁹ Even though German corporate law traditionally provided shareholders with strong rights,¹⁵⁰ investment was somewhat unattractive due to the network of crossholding shares and the influence of banks, under the *Deutschland AG*.¹⁵¹ The voting power of banks was reinforced through the use of proxy voting regulations.¹⁵² Furthermore, large blockholders often held shares with multiple voting rights to retain control over the company without increasing their investment.¹⁵³ This system continued to work for many years as German banks acted simultaneously as creditors and shareholders for domestic companies.¹⁵⁴

II. Restructuring Germany's Financial and Corporate Law Systems

Since the late 1990s, reforms to Germany's financial and corporate law systems have begun to create a more conducive institutional environment for investor activism on SRI. In the 1990s the German economy was stagnating as exports declined, international competition stiffened, and German reunification proved to be very expensive.¹⁵⁵ In their quest to attract large investors, German governments legislated to remove some barriers to investment. By 2002, all financial market and services regulation was integrated into a uniform federal regulatory regime, governed by one centralized authority (*Bundesanstalt fuer Finanzdienstleistungsaufsicht* (BaFin) – the German Financial Supervisory Authority).¹⁵⁶ Moreover, measures were taken to improve securities law by enhancing transparency, and imposing civil and criminal liability for misconduct in markets.¹⁵⁷ In 2005, legislation strengthening auditor independence and introducing international accounting standards

¹⁴⁹ *Id.*

¹⁵⁰ Noack & Zetsche, *supra* note 143, 1036.

¹⁵¹ Riedel & Schneeweiss, *supra* note 71, 15.

¹⁵² Cioffi, *supra* note 125, 540-41.

¹⁵³ Emmons & Schmid, *supra* note 145, 28.

¹⁵⁴ Cioffi, *supra* note 125, 540.

¹⁵⁵ See Hans-Werner Sinn, *Germany's Economic Unification: An Assessment after Ten Years*, 10 REV IN'T ECON. 113 (2002).

¹⁵⁶ Among the most important laws were the Second Financial Market Promotion Act (Gesetz ueber den Wertpapierhandel und zur Aenderung boersenrechtlicher und wertpapierrechtlicher Vorschriften (2 FFG)), 26 July 1994, (1994) BGBl. I 1749.

¹⁵⁷ Law on the Improvement of Investor Protection (Anlageschutzverbesserungsgesetz (AnSVG)), Oct. 29, 2004, (2004) BGBl. I 2630.

for publicly traded corporations was also passed.¹⁵⁸ These reforms strengthened the impact of market forces and made Germany more attractive to investment.¹⁵⁹ In addition, as discussed below, several laws were passed to amend corporate law that enhanced shareholder rights. But these reforms, which have incorporated elements of the Anglo-American system, have made the German system of labor co-determination, which some commentators believe was never a serious threat to the power of shareholders and managers,¹⁶⁰ even more precarious. Therefore, while the reforms have improved the means to promote corporate social responsibility through shareholder-driven SRI, they have perhaps correspondingly weakened the means for such change through trade union pressure.

Multiple voting shares and voting restrictions proved to be a major obstacle to investor-related activism, as they impeded investors from gaining influence in a company. For that reason, they were prohibited by the Law on Control and Transparency (KonTraG) of 1998.¹⁶¹ At present, according to the general rule in section 12(1)-(2) of the Law on Stock Corporations (AktG),¹⁶² each share equals one vote. Only preferred stocks may carry no voting rights.¹⁶³ These new rules significantly weakened the defensive ownership structures in German corporations¹⁶⁴ and thereby bolstered the incentives to purchase shares.

Another major incentive to invest in German corporations was created by the introduction of section 161 AktG, which requires publicly traded stock corporations to declare annually whether or not they comply with the German Corporate Governance Code (GCGC); if the management and the supervisory board choose to deviate from the GCGC, they must disclose their reasons. The Code thus exerts “some indirect pressure on public corporations to adopt generally accepted corporate governance practices” commonly

¹⁵⁸ Law on the Introduction of International Accounting Standards and on the Enhancement of the Quality of Annual Audits (Gesetz zur Einfuehrung internationaler Rechnungslegungsstandards und zur Sicherung der Qualitaet der Abschlusspruefung; Bilanzrechtsreformgesetz (BilReG)), 4 December 2004, (2004) BGBl. I 3166.

¹⁵⁹ Richardson, *supra* note 147, 168.

¹⁶⁰ Wolfgang Streeck, *German Capitalism: Does It Exist? Can It Survive?* 2 NEW POLIT. ECON. 23 (1997).

¹⁶¹ Law on Control and Transparency (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG)), 30 April 1998, (1998) BGBl. I 786.

¹⁶² Law on Stock Corporations (Aktengesetz (AktG)), 6 September 1965, (1965) BGBl. I 1089.

¹⁶³ Para. 139, AktG.

¹⁶⁴ Cioffi, *supra* note 125, 554.

found in Anglo-American legislation.¹⁶⁵ As the governing framework for German corporations is contained in many different laws and regulations, and almost all German stock corporations comply with the Code,¹⁶⁶ it plays a crucial role in educating investors about the appropriate governance of German corporations.¹⁶⁷

The 2005 Law on Corporate Integrity and Modernization of the Right of Resolution-Annulment (UMAG)¹⁶⁸ has further encouraged exercising shareholder rights. It replaced the system of *Hinterlegung*, which prevented shareholders, particularly foreign shareholders, from attending shareholder meetings.¹⁶⁹ The UMAG established the shareholder forum, a special section of the electronic Federal Gazette, which enables communication among shareholders.¹⁷⁰ Such coordination can be vital if shareholders wish to exercise minority rights that require a special quorum.¹⁷¹ The shareholder forum thus significantly strengthened the prospects for collective shareholder activism, which is of particular benefit to social investors.

The latest changes to German corporate law were introduced in 2009 by the Law on the Implementation of the Directive of Shareholder Rights (ARUG),¹⁷² which facilitates shareholder rights in several ways. Firstly, it enables shareholders to be informed about shareholders' meeting more efficiently by means of electronic communication including the Internet.¹⁷³ Secondly, it allows shareholders' meetings to be broadcast online, if this is

¹⁶⁵ Noack & Zetsche, *supra* note 143, 1039.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*, 1038.

¹⁶⁸ Law on Corporate Integrity and Modernisation of the Right of Resolution-Annulment (Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG)), 22 September 2005, (2005) BGBl. I 2802.

¹⁶⁹ Hans Schaefer, *Shareholder Activism und Corporate Governance*, NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT 900, 900 (2007).

¹⁷⁰ Enshrined in para. 127a, AktG.

¹⁷¹ Till Naruisch & Fabian Liepe, *Latest Developments in the German Law on Public Companies by the Act on Corporate Integrity and Modernisation of the Right of Resolution-Annulment (UMAG) – Shareholder Activism and Directors' Liability Reloaded*, J. Bus. L. 225, 236 (2007).

¹⁷² Law on the Implementation of the Directive of Shareholder Rights (Gesetz zur Umsetzung der Aktionärsrichtlinie (ARUG)), 30 July 2009, (2009) BGBl. I 2479; and *see* Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies.

¹⁷³ Florian Drinhausen & Astrid Keinath, *Auswirkungen des ARUG auf die künftige Hauptversammlungspraxis*, BETRIEBS BERATER 2322, 2322 (2009); *see* para.124a 1 Nr. 1, 3, AktG.

set out in the articles of incorporation, thus enabling participating shareholders to exercise all of their rights electronically.¹⁷⁴ This provision is particularly useful for foreign investors.¹⁷⁵ Thirdly, the filing of proxies has been made easier. Custodian banks cast votes for their depositors, namely investment funds, whose assets have to be administered by a custodian bank by law.¹⁷⁶ While shareholders can instruct custodian banks on how to cast their votes, these banks can deviate from instructions or not cast votes at all.¹⁷⁷ Because this left shareholders with negligible influence on the voting behavior of custodian banks, it decreased the likelihood of any shareholder activism.¹⁷⁸ However, such behavior of custodian banks is now less likely, as the law requires banks to report the reasons for any deviation from their depositors' instructions,¹⁷⁹ and obliges custodian banks to offer to transfer the voting power to a third person appointed by the depositor.¹⁸⁰ These mechanisms provide strong incentives not to deviate from instructions. Social investors who rely on the services of custodian banks are therefore unlikely to face legal obstacles if they wish to be active shareholders.

The current legal framework for investor-related activism under the Public Companies Act (*Aktiengesetz*) also provides social investors with some measures to influence corporations' behavior. The matters that the shareholders' meeting may consider are set out in section 119 I of the AktG. Any matter relating to the management of the corporation belongs to the sole responsibility of the management board (*Vorstand*),¹⁸¹ which is supervised by the supervisory board (*Aufsichtsrat*).¹⁸² Section 23(5) of the AktG restricts amendments to a company's articles of incorporation. Since many SRI issues relate to the management of the corporation and the overall purpose of the company, the powers of the shareholders' meeting are limited.¹⁸³ However, social investors can address such

¹⁷⁴ Para. 118 I 2, AktG.

¹⁷⁵ Dirk Zetzsche, *Die neue Aktionärsrechte-Richtlinie: Auf dem Weg zur Virtuellen Hauptversammlung*, NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT 686, 692 (2007).

¹⁷⁶ See para. 20-29 Investment Code (Investmentgesetz (InvG)), 15 December 2003, (2003) BGBl. I 2676.

¹⁷⁷ See para. 135 I 4, III 3, AktG.

¹⁷⁸ Riedel & Schneeweiss, *supra* note 71, at 20.

¹⁷⁹ Para. 135 III 3, AktG.

¹⁸⁰ *Id.*, para. 135 I 5.

¹⁸¹ *Id.*, para. 76 I.

¹⁸² *Id.*, para. 111 I.

¹⁸³ SCHARLAU, *supra* note 1, at 147.

matters by making use of their shareholder rights, namely the rights to demand information, submit matters for shareholder vote, and to vote. Shareholders can ask management to disclose information about topics raised at the shareholders' meeting agenda, regardless of the number of shares they hold.¹⁸⁴ This right is of particular use to social investors because of the duty imposed on large corporations to integrate non-financial performance indicators in management reports.¹⁸⁵ The management board must elaborate on the management report at the shareholders' meeting,¹⁸⁶ giving investors an opportunity to demand further information on social or environmental issues.¹⁸⁷

Among other useful rights, shareholders in German companies may submit proposals for shareholder vote.¹⁸⁸ Moreover, a group of shareholders representing at least 5 percent of a company's capital may call a shareholders' meeting,¹⁸⁹ and a similar percentage of shareholders or a group of shareholders holding €500,000 worth of shares may add an entirely new matter to a meeting agenda.¹⁹⁰ Although such proposals cannot *per se* dictate how management runs the corporation,¹⁹¹ advocating improvements to a company's social and environmental behavior through shareholder proposals may raise awareness of such issues and stimulate reconsideration of corporate policies and practices.¹⁹² Shareholders also enjoy the power to appoint members of the supervisory board, which could be an influential means of promoting SRI.¹⁹³

Social investors often prefer to engage with corporate management informally to raise their concerns rather than confront them at the shareholders' meeting. Such communication is not regulated under German law, although some legal boundaries are set. The *Aktiengesetz* states that shareholders, given the same circumstances, are to be

¹⁸⁴ Para. 131 I 1, Aktiengesetz.

¹⁸⁵ *Id.*, para. 289 III, 315 I 4, HGB.

¹⁸⁶ *Id.*, para. 176 I 2, 175 II.

¹⁸⁷ *Id.*, para. 131 III.

¹⁸⁸ *Id.*, para. 124 IV 2, 126.

¹⁸⁹ *Id.*, para. 122 I. This section also provides that a company's articles of incorporation may deviate from this standard to set a lower percentage of shareholder votes necessary to call a meeting.

¹⁹⁰ *Id.*, para. 122 II.

¹⁹¹ *Id.*, para. 76 I.

¹⁹² *Id.*

¹⁹³ *Id.*, para. 119 I Nr. 1.

treated equally, especially in regard to the disclosure of information.¹⁹⁴ Informal talks may constitute insider information under the Securities Trading Act (*Wertpapierhandelsgesetz: WpHG*),¹⁹⁵ which could arise if the investor tried to pressure management to act in a certain manner by threatening to sell shares held.¹⁹⁶

Finally, among recent corporate reforms in Germany potentially relevant to SRI, the implied references to sustainable development in section 87 I of the *AktG*, and reflected in section 4.1.1 *CGC*,¹⁹⁷ may facilitate SRI in Germany by making the companies subject to these provisions more mindful of their social and environmental performance. The *AktG* section, which has greater legal weight than the *CGC*, is commonly interpreted as only linking the remuneration of the management board to the long-term financial performance of their company. However, some commentators argue that the provision could imply more, specifically the goals of socially and environmentally sustainable development.¹⁹⁸ While these reforms were adopted in light of the impacts of the financial crisis of 2008 and the need to curb speculative and myopic economic activity, courts and regulators may eventually interpret them more broadly to include consideration of social and environmental factors that affect the long-term financial success of a business.

F. German Banks as Promoters of SRI

One peculiarity of the German economy is the preeminent role of the German banking system as a creditor of many firms. An important question is whether it can provide an alternate vehicle for SRI in Germany. Although the foregoing discussion may lead one to believe so, there is no legal obligation on banks to promote SRI apart from certain types of banks being mandated to foster the economic development of the regions they are based in. The majority of German banks appear to engage in SRI only if there is a clear business rationale.

¹⁹⁴ *Id.*, para. 53a.

¹⁹⁵ Para. 13 I, Securities Trading Act (*Wertpapierhandelsgesetz (WpHG)*), 9 September 1998, (1998) BGBl. I 2708.

¹⁹⁶ See para. 13 I 3 Nr. 1, *WpHG*; Schaefer, *supra* note 169, 901.

¹⁹⁷ The relevant part of the Code provides “The Management Board is responsible for independently managing the enterprise with the objective of *sustainable creation of value* and in the interest of the enterprise, thus taking into account the interests of the shareholders, its employees and other stakeholders” (emphasis added).

¹⁹⁸ Gudula Deipenbrock, *Sustainable Development, the Interest(s) of the Company and the Role of the Board from the Perspective of a German Aktiengesellschaft*, University of Oslo Faculty of Law Legal Studies Research Paper Series No. 2010-02, 22-23 (2010).

The banking system has traditionally been very influential in German corporate affairs because many companies rely on debt-funding,¹⁹⁹ as well as a wide range of financial services provided by banks.²⁰⁰ The result can be an intimate relationship between banks and companies (known as the *Hausbank* principle), involving loans to corporate clients being secured by the bank holding shares in the firm.²⁰¹ In the US and UK, by contrast, such relationships are more at arm's length, with banks generally distancing themselves from corporate governance and operational affairs. Although recently there has been some loosening of the important functions German banks play in corporate governance, owing to legal changes and increased global competition in the financial markets,²⁰² banks remain the key source of external funding to German companies, especially for small and medium-sized firms.²⁰³ Since such firms are hardly ever publicly traded, banks are in the best position to promote SRI among these *Mittelstand* businesses that comprise a large part of the German economy.²⁰⁴ The relationships between banks and companies often endure for decades, ameliorating pressures for short-term financial return and encouraging long-term growth strategies; thus, the German model ostensibly should foster sustainable development.²⁰⁵

The role of banks as creditors of German companies is closely connected to the structure of the banking system. Germany's banks are structured along three pillars: commercial banks, cooperatives and public sector banks, with the first two sharing approximately equally about 85 percent of the lending market.²⁰⁶ The primary focus of the public sector banks, by law, is not profit maximization but rather to foster the economic development of

¹⁹⁹ Schaefer, *supra* note 118, 271.

²⁰⁰ Richardson, *supra* note 147, 167-68.

²⁰¹ Andreas Hackethal, *German Banks and Banking Structure*, in *THE GERMAN FINANCIAL SYSTEM* 71, 71 (Jan P. Krahen & Reinhard H Schmidt eds., 2004); JEREMY EDWARDS & KLAUS FISCHER, *BANKS, FINANCE AND INVESTMENT IN GERMANY* (1994).

²⁰² Alberto Onetti & Alessia Pisoni, *Ownership and Control in Germany: Do Cross-Shareholdings Reflect Bank Control on Large Companies?* 6 *CORP. OWNERSHIP & CONTROL* 54, 73 (2009).

²⁰³ STEPHAN GOETZL & JUERGEN GROS, *REGIONALBANKEN SEIT 160 JAHREN: DIE VOLKSBANKEN UND RAIFFEISENBANKEN – MERKMALE, STRUKTUREN, LEISTUNGEN* 12 (2009).

²⁰⁴ Cioffi, *supra* note 125, 551.

²⁰⁵ See Richardson, *supra* note 147, 168.

²⁰⁶ ALLAN BRUNNER, ET AL., *GERMANY'S THREE-PILLAR BANKING SYSTEM: CROSS COUNTRY PERSPECTIVES IN EUROPE* 2 (2004); Deutsche Bundesbank, *Die Ertragslage der deutschen Kreditinstitute, September 2010* 12 (2010), http://www.bundesbank.de/download/statistik/bankenstatistik/guv_tab1.pdf (last accessed 1 January 2011).

their local regions²⁰⁷ (which is often implemented by funding small and medium-sized companies).²⁰⁸ By contrast, cooperative banks are owned by their members and have a statutory obligation to support their financing needs rather than to maximize profits.²⁰⁹ While commercial banks lack this social mandate, a few such as UmweltBank²¹⁰ have targeted the SRI sector as a business niche. Some cooperative banks, such as EthikBank²¹¹ and GLS-Gemeinschaftsbank,²¹² have also embraced the SRI sector. Common characteristics of these green and ethical lenders include: regular and independently verified sustainability reporting; screening borrower operations for sound environmental management; financing local community development; and improving access to banking services through social inclusion policies.²¹³

A 2003 study by the Wuppertal Institute on measures taken by banks and insurance companies in regard to sustainability found that only a few offered *green* funds, and the volume of investment was miniscule.²¹⁴ It also found that while lenders commonly considered environmental issues in property financing, such as potential environmental liability on *brownfield* sites,²¹⁵ corporate environmental performance was rarely considered a major criterion in project financing or other forms of corporate lending.²¹⁶ Only the dedicated environmental banks (which themselves have sought a business advantage by filling a market niche in this area) comprehensively took account of sustainability concerns and promoted good environmental practices.²¹⁷ Other research on

²⁰⁷ See para. 2 I-III, Law on Savings Banks of the State of North Rhine-Westphalia (Sparkassengesetz (SpkG)), 18 November 2008, (2008) GV NRW 696/SGV NRW 764.

²⁰⁸ Hackethal, *supra* note 201, 79.

²⁰⁹ See para. 1 I, Law on Cooperatives (Genossenschaftsgesetz (GenG)), Oct. 16, 2006, (2006) BGBl. I 2230.

²¹⁰ See <http://www.umweltbank.de> (last accessed 1 January 2011).

²¹¹ See <http://www.ethikbank.de> (last accessed 1 January 2011).

²¹² See <http://www.gls.de/die-gls-bank/ueber-uns/gls-bank/english-portrait.html> (last accessed 1 January 2011).

²¹³ Marcel Jeucken & Jan Bouma, *The Changing Environment of Banks*, 27 GREENER MAN. INT'L 21 (1999); EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS, CORPORATE SOCIAL RESPONSIBILITY: THE PERFORMANCE OF COOPERATIVE BANKS (2005).

²¹⁴ TIMO BUSCH & THOMAS ORBACH, ZUKUNFTSFAEHIGER FINANZSEKTOR: DIE NACHHALTIGKEITSLISTUNG VON BANKEN UND VERSICHERUNGEN 35-36 (2003), http://www.wupperinst.org/uploads/tx_wibeitrag/WP129.pdf (last accessed 1 January 2011).

²¹⁵ *Id.*

²¹⁶ *Id.*, 40.

²¹⁷ *Id.*, 41-42.

the relationship between banks and household customers has found that financial advisers employed by banks and other financiers have generally failed “to inform customers proactively about ethical funds and some bank employees even falsely denied their existence.”²¹⁸

Any misrepresentation by a bank (or indeed any institution selling investment services) regarding the characteristics of so-called ethical or green funds, risks legal liability. In recent years controversy has arisen about several German churches operating banks that invested in unethical companies. Examples include Pax Bank and Liga Bank, both Catholic banks, which had bought shares in tobacco businesses, weapon industries, and nuclear power utilities.²¹⁹ Ironically, they had also invested in a US pharmaceutical company (Wyeth) that produces birth control pills. After the public outcry, the banks divested most of their problematic assets. While there are no known examples in Germany relating specifically to SRI funds,²²⁰ there have been several *misselling* claims made against German financial institutions that have been litigated.²²¹ Primarily on the basis of financial regulation and contract law, financial advisers have a duty to inform clients about the main characteristics of funds they sell including financial risks.²²² EU legislation in the banking and finance area also creates duties on persons providing investment advice to ensure that the financial product meets the investment objectives of their clients.²²³ While most

²¹⁸ Ulf Schrader, *Ignorant Advice - Customer Advisory Service for Ethical Investment Funds*, 15 BUS. STRAT. ENV'T 200, 200 (2006).

²¹⁹ Von Marvin Oppong und Peter Wensierski, *Banken: Sündige Rendite*, SPIEGEL (Sept. 12, 2010); <http://www.spiegel.de/spiegel/0,1518,717173-2,00.html> (last accessed 12 February 2011).

²²⁰ There are a few examples in other jurisdictions, which illustrate the legal risks. For example, in 2008 the US Securities Exchange Commission reached a US\$500,000 civil settlement with Pax World Management for its negligent failure to comply with its self-imposed SRI restrictions, in violation of securities regulations: US Securities Exchange Commission, *In the Matter of Pax World Management Corp.*, Administrative Proceeding File No. 3-13107 (July, 2008).

²²¹ Perhaps the most famous judgment regarding the liability of financial advisers for misinforming clients about investments is the “Bond” case, decided by the German Supreme Court: BGH 6 July 1993, *BGHZ* 123, 126. According to the Court, the recommended investment advice should be geared towards the personal circumstances of the client and thus be suitable for that client. If the bank lacks information concerning these facts about the client, it is obliged to obtain such information, ruled the Court. There has been considerable recent case law relating to clients suing their banks for failure to advise about the risks associated with Lehman Brothers investments: e.g., LG Potsdam of 24 June 2009 (8 O. 61/09); LG Hamburg of 10 July 2009 (329 O. 44/09). See further about the Lehman litigation, Klaus Maerker, *Fehlerhafte Anlageberatung beim Verkauf von Lehman-Zertifikaten - eine Zwischenbilanz*, 10 Neue Juristische Online-Zeitschrift 524 (2010).

²²² See Michael Coester & Basil Markesimis, *Liability of Financial Experts in German and American Law: An Exercise in Comparative Methodology*, 51 AM. J. COMP. L. 275 (2003).

²²³ Notably, Directive 2004/39/EC of the European Parliament and of the Council of 21 Apr. 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, OJEC 2004 L 145/1. See

German banks only seem to promote sustainability if there is a demonstrable financial rationale, the legal structures governing public sector banks and cooperative banks are most likely to promote sustainability: both have a mandate to serve local communities and businesses within their region. But there are no laws explicitly requiring such banks to conduct their affairs in an *environmentally* sustainable way. Indeed, state laws on public sector savings banks²²⁴ indicate that, as a general rule, they may engage in all forms of business that (commercial) banks undertake under the federal Law on Banks and other Providers of Financial Services.²²⁵ Consequently, the business practices of many of the larger, public sector banks do not appear to differ greatly from those of commercial banks. The same is true for many cooperative banks.²²⁶ The financial crisis of 2008–09 forced many savings banks to turn to the German government for aid,²²⁷ suggesting that public sector banks are prone to the same short-termism, profit-maximizing business strategies of their commercial peers.²²⁸ While one might suppose that the shortcomings of the financial crisis might encourage public sector and cooperative banks to refocus their business towards sustainability, recent public declarations of the German association of savings banks fail to consider seriously social or environmental criteria.²²⁹

G. Conclusions

Although the German SRI market has grown steadily during very recent years, SRI is not as widespread as in other European countries.²³⁰ This article has identified explanations that appear to be particular to Germany, assessed how they may impede the growth of SRI, and considered reforms that might overcome them.

further, Olha O. Cherednychenko, *European Securities Regulation, Private Law and the Investment Firm-Client Relationship*, 5 EURO REV. PRIVATE L. 925 (2009).

²²⁴ See para. 1, SpkVO.

²²⁵ Law on Banks and other Providers of Financial Services (Gesetz ueber das Kreditwesen (KWG)), Sept 9, 1998, (1998) BGBl. I 2776.

²²⁶ Goetzl & Gros, *supra* note 203, 100.

²²⁷ *BayernLB und WestLB beraten ueber Fusion*, DER TAGESSPIEGEL (Sept. 20, 2010), <http://www.tagesspiegel.de/wirtschaft/kreise-bayernlb-und-westlb-beraten-ueber-fusion/1937970.html> (last accessed 1 January 2011).

²²⁸ Schaefer, *supra* note 123, 36.

²²⁹ DEUTSCHER SPARKASSEN- UND GIROVERBAND, ZUFRIEDENE KUNDEN DURCH HOCHWERTIGE BERATUNG – DAS SELBSTVERSTÄNDNIS DER SPARKASSEN IN DER ANLAGEBERATUNG (2010); DEUTSCHER SPARKASSEN- UND GIROVERBAND, VERTRAUEN GEWINNT – LEHREN AUS DER FINANZKRISE (2010).

²³⁰ EUROSIF, *supra* note 56, 35.

One element of the German SRI market that differs substantially from its neighbors is the lack of involvement of institutional investors. It owes to the German pension system. While the pension reform of 2001, by introducing subsidies to fully-funded occupational and private pensions, has increased the likelihood that investors providing pension services may engage in SRI, the majority of pensions remain administered under the PAYG-system. Hence, providers of pension services in Germany are unlikely for the foreseeable future to match the volumes of pension finance in other European countries whose pension systems are entirely fully funded. Since churches and charities lack the potential to raise as much capital as pension funds, they are unlikely to fuel the German SRI market as much as other institutional investors have in other European countries.

Another feature of the German SRI market is the relative paucity of investment in shares. This anomaly is caused partly by investment restrictions imposed on institutional investors by legislation, but owes also to a considerable extent to the less verifiable assumption that German investors prefer low-risk assets. They have not been exposed to the concept of equity investment as much as investors have in other countries. Since the financial crisis of 2008-09 severely impacted Germany, and seems to have further fortified German investors' preference to invest in low-risk assets,²³¹ it is unlikely that the level of investment in shares will rise significantly in the near future. To make SRI more attractive to German investors, SRI retail funds should therefore offer a wider range of low-risk SRI vehicles such as interest-bearing assets or life insurances.²³²

Those investors who buy shares rarely engage in shareholder activism; in fact, research by Eurosif indicates that the level of engagement in any type of investor-related activism is relatively low on the German SRI market. However, the reformed framework of German company law provides social investors with a number of powerful measures to engage in investor-related activism. Although Germany has no tradition of investor-related activism, such activism should soon increase. The changes introduced by the ARUG facilitate the exercise of shareholder rights for foreign investors in particular who at this stage are more likely than local investors to have an interest in SRI..²³³

A German peculiarity that was not reflected by the Eurosif study is the potential of the German banking system to contribute to the SRI market. While a few lenders specialize as

²³¹Barbara Gillmann, *Aktien sind genauso out wie Drogen*, HANDELSBLATT (2010), <http://www.handelsblatt.com/finanzen/anlagestrategie/shell-studie-aktien-sind-genauso-out-wie-drogen;2655342> (last visited Jan. 1, 2011); *Konservative Geldanlagen im Aufwaertstrend*, GELD-MAGAZIN (2009), <http://www.geld-magazin.de/finanzen/sparen-anlegen/sparen-anlegen-einzelansicht/article/konservative-geldanlagen-im-aufwaertstrend.html> (last accessed 1 January 2011).

²³²Schaefer, *supra* note 68, 8-9.

²³³Waring & Edwards, *supra* note 140, 141.

green and ethical banks, and savings and cooperative banks are legally mandated to foster the economic development of their regions, the majority of German banks have so far not demonstrated any particular interest in SRI. Unless a wider range of SRI issues can be reflected in conventional market prices, such as the cost of greenhouse gas emissions, or unless banks are legally required to include such issues in their decision-making, the potential of German banks to promote sustainability is rather limited.

While this article has illuminated the obstacles to and opportunities for SRI in Germany, it leaves some important questions for future investigation. Most importantly, we must be careful to assume that comparisons of the *extent* of SRI between Germany and other countries equate by the same magnitude to the relative *quality* of their SRI. While SRI in Germany might be relatively small, its implementation and influence might be much more effective than what has been achieved by social investors in other markets. Empirical research is needed before definitive explanations can be reached about the apparently uneven development of SRI in Germany compared to its peers. A second area for future research is to assess whether the recent financial and corporate law reforms in Germany will eventually lead to more SRI; it is somewhat premature to judge the reforms' long-term effects, but allowing for another five to ten years of implementation should help determine the answer to this question. In particular, it would be useful to examine whether the implied references to sustainable development in section 87 I of the *AktG* and section 4.1.1 *CGC* will facilitate SRI in Germany by making subject companies more attentive to their social and environmental performance.