Investment Stewardship Group

Voting Bulletin: Volkswagen AG

As part of our fiduciary duty, BlackRock's Investment Stewardship team (BIS) advocates for sound corporate governance and business practices that are aligned with long-term sustainable financial performance. This objective underpins all our engagements and votes at company meetings.

We engage company leadership on key topics emphasizing governance practices including management of environmental and social factors that potentially have material economic, operational or reputational ramifications for the company.

We determine our engagement priorities based on our observation of market developments and emerging governance themes and evolve them year over year as necessary. The BIS team's key engagement priorities include:

1. Board quality
2. Environmental risks and opportunities
3. Corporate strategy and capital allocation
4. Compensation that promotes long-termism
5. Human capital management

Our approach to investment stewardship is grounded in an expectation that the board will oversee and advise management, influencing management's approach to key business issues. When effective corporate governance is lacking, we believe that voting against the responsible director(s) is often the most impactful action a shareholder can take.

We are committed to enhancing the transparency of our stewardship practices. Where we believe it will help to understand our voting decisions at shareholder meetings, we will publish a Voting Bulletin explaining the rationale for how we have voted, and (where relevant) provide information around our engagement with the issuer

Company	**Volkswagen AG**
Market	Germany
Meeting Date	30th September 2020
Key Resolutions[1]	Multiple
Board Recommendation	FOR all management items presented
BlackRock Vote	BlackRock voted AGAINST the discharge of a number of Management Board and Supervisory Board members (items 3.1, 3.3, 3.5 and items 4.1, 4.3, 4.6, 4.7, 4.8, 4.12,

[1] Meeting information can be accessed at: https://www.volkswagenag.com/en/InvestorRelations/shareholder-meetings/2020.html

	4.13, 4.15, 4.16, 4.17, 4.18, 4.19, 4.21) due to ongoing concerns with (i) oversight in relation to the emissions scandal, (ii) the insufficient level of independence on the Supervisory Board and its sub-committees, and (iii) the independence of the external auditor. We voted AGAINST item 5 to re-elect Dr. Hussain Ali Al Abdulla as Supervisory Board member due to the insufficient level of independence on the Supervisory Board.

Overview

Volkswagen Aktiengesellschaft (VW) is an automobile manufacturer based in Germany. Brands include Volkswagen Passenger Cars, Audi, SEAT, ŠKODA, Bentley, Bugatti, Lamborghini, Porsche, Ducati, Volkswagen Commercial Vehicles, Scania and MAN. In addition, the Volkswagen Group offers a wide range of financial services, including dealer and customer financing, leasing, banking and insurance activities, and fleet management.

BIS regularly reviews VW's governance structure and risk profile. BIS has engaged regularly with VW's Supervisory Board chair since 2016 on a range of environmental, social and governance topics, and has frequent dialogue with VW's Investor Relations and Sustainability teams. We have on numerous occasions encouraged the company to improve the number of independent directors on the Supervisory Board to enhance the level of independent oversight of management. We have regularly discussed board composition, minority shareholder interests and Supervisory Board transparency.

VW's Supervisory Board is subject to the *Mitbestimmung* (co-determination) model within the German corporate governance framework, which requires an equal number of Supervisory Board members representing the workers' unions and shareholders respectively. Separately, VW is a controlled company. Due to the company's share class structure and the distribution of voting rights, 90.1% of voting rights are controlled by three shareholders: Porsche Automobil Holding SE representing the Porsche-Piëch family, the State of Lower Saxony and Qatar Holding.[2] In addition to their control over voting rights, these shareholders are represented on the Supervisory Board. As part of its continued shareholding, the State of Lower Saxony can appoint two representatives to the Supervisory Board. The representatives of the other shareholders are elected by the shareholder meeting. When analyzing the independence level of the Supervisory Board, BIS only considers members who are elected by shareholders, and excludes government or employee representatives whose presence might be legally required.[3] With two independent members (at the time of the AGM), **the current level of independence on VW's Supervisory Board does not meet BIS' expectations for controlled companies.** In controlled companies, BlackRock expects the number of independent Supervisory Board members to be no less than one-third of the shareholder representatives.

Additionally, VW Supervisory Board members are appointed for five-year terms. BIS' concern with multiyear terms is that the opportunity to progressively improve the level of independence on the Supervisory Board becomes limited to the years where a member's term is expiring, assuming all Supervisory Board members serve their entire terms. Based on the expected timeline for the expiration of existing Supervisory Board terms, coupled with the company's lack of response to date to our concerns, we expect the level of independence to further decline within the next five years. One incumbent Supervisory Board member who is proposed for re-election at the AGM will reach a tenure of 12 years during his new mandate, if approved. In most EU markets, including Germany, BIS considers tenure beyond 12 years to be an impediment to independence.

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[2] As of 31st December 2019, for more information see: https://www.volkswagenag.com/en/InvestorRelations/shares/shareholder-structure.html

[3] See https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-emea.pdf

The insufficient level of independence on VW's Supervisory Board impedes its ability to form sub-committees that meet BIS' expectations of majority independence with an independent chair.

In our assessment, the insufficient independent oversight provided by VW's Supervisory Board played a major role in the events which led to the company employing what has become known as a 'defeat device' in some of its diesel engine cars, as uncovered in 2015. This was software which could detect when the engine's CO2 emissions were being tested and adjust performance in order to improve results. VW faces ongoing investigations and legal proceedings in relation to the 2015 incident, which continues to impact shareholder value.

BIS remains concerned with the level of fees paid to the company's independent external auditor. For the last two fiscal years, the level of fees paid for audit-related services was surpassed by those paid for services related to other matters, thus raising concerns with the independence of the auditor. No disclosure was provided in VW's annual report to explain and justify this practice. BIS notes that a new external auditor will be appointed this year.

Rationale for BlackRock's Vote

Based on our analysis and multi-year engagements with the company, BlackRock voted against the following agenda items:

Items 3.1, 3.3, 3.5: Resolution on the formal approval for fiscal year 2019 of the actions of the members of the Board of Management H. Diess, J. Heizmann and A. Renschler who held office in fiscal year 2019 (AGAINST)

We voted against the discharge of members of the Board of Management who were already serving at the time of the emissions incident. In doing so, we are holding those individuals accountable for the deficiencies in VW's governance practices and management of its material risks. This is consistent with our approach since VW's 2016 AGM.

Items 4.1, 4.3, 4.6, 4.7, 4.8, 4.12, 4.13, 4.15, 4.16, 4.17, 4.18, 4.19, 4.21: Resolution on the formal approval for fiscal year 2019 of the actions of the members of the Supervisory Board H.D. Pötsch, H.A. Al Abdulla, B. Dietze, H.P. Fischer, M. Heiß, L. Kiesling, P. Mosch, B. Osterloh, H.M. Piëch, F.O. Porsche, W. Porsche, C. Schönhardt and S. Weil who held office in fiscal year 2019 (AGAINST)

BIS has ongoing concerns with the insufficient level of independence on the Supervisory Board and its sub-committees. BIS' policy is to withhold support from the re-election or discharge of those members who are most accountable for Supervisory Board composition through their role on the Supervisory Board or membership of relevant board sub-committees. We voted against the discharge of nomination committee members H.D. Pötsch, W. Porsche and S. Weil for the insufficient level of independence on the Supervisory Board, and of Supervisory Board chair H.D. Pötsch for the insufficient level of independence on the sub-committees.

In light of BIS' concern regarding the independence of the external auditor, we voted against the discharge of Supervisory Board members B. Dietze, M. Heiß, B. Osterloh, F.O. Porsche and C. Schönhardt, all of whom served on the audit committee during fiscal year 2019.

We believe Supervisory Board members should be held accountable for the level of oversight provided on governance matters. We voted against the discharge of Supervisory Board members H.D. Pötsch, H.A. Al Abdulla, H.P. Fischer, L. Kiesling, P. Mosch, B. Osterloh, H.M. Piëch, F.O. Porsche, W. Porsche and S. Weil who were already serving at the time of the emissions incident. This is consistent with our approach since VW's 2016 AGM.

Item 5: Election of a member of the Supervisory Board (AGAINST)

BIS voted against the re-election of Supervisory Board member H.A. Al Abdulla, who will reach a tenure of 12 years during the course of this new mandate, if approved, further reducing the level of independence on the Supervisory Board.

BIS voted in favour of all other management proposals.

Additional vote considerations

VW is governed by a special German federal legislative act from 1960 known as *the Volkswagen Act* (the Act), which came into effect when the company was privatized. Only two aspects of this Act remain intact today, one of which relates to proxy voting and states that proxies are required in written form. The result is that shareholders voting by proxy (most of the company's minority shareholders and all of BlackRock's clients on whose behalf BIS is voting) are required to complete individual paper proxy forms for each shareholder account to be submitted to the company. In our view, this additional operational requirement serves to further limit the ability of minority shareholders to advocate for better governance practices and increased independent oversight as it makes it unusually difficult for shareholders to voice their concerns through the exercise of their voting rights.

BIS encourages the company to adopt practices that provide shareholders with more options for participation, particularly in the current environment where there are clear challenges to participation in person, and where we see many companies providing shareholders with additional options for expressing their views through a vote.

Discussion on climate risk

We believe that as companies face material climate risks, they must demonstrate that management has assessed how climate may impact operations and have determined an appropriate business strategy. As we describe in our commentaries, BIS' Approach to Engagement on Climate Risk and Emissions, Engagement, and Transition to a Low-Carbon Economy, we expect robust disclosures of climate-related risks and opportunities in line with the recommendations of the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-related Financial Disclosures (TCFD). Greater transparency will contribute to improved market-level data, better engagements with shareholders, and more informed voting decisions aligned with long-term value creation.

As a fiduciary on behalf of our clients, BIS has engaged with VW over the past several years on a range of governance and material sustainability topics, including climate-related disclosures. In December 2017 we wrote a letter to the then Chairman of VW's Board of Management asking the company to closely review the TCFD framework and to consider reporting in alignment with its recommendations.[4] As part of our engagement and voting process, we reviewed relevant company disclosures ahead of this year's annual general meeting. VW makes comprehensive climate-related disclosures and implements the recommendations of the TCFD in its 2019 Annual Report[5] and its 2019 Sustainability Report.[6]

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[4] In Q4 2017, we sent letters to the CEOs and General Counsels at over 100 of the most carbon-intensive companies globally in BlackRock's equity portfolio. We asked them to review the TCFD's recommendations and consider reporting in alignment with them, and to engage with us so we can better understand the changes in reporting that might be necessary for them to achieve alignment and any obstacles the company anticipates

[5] See https://www.volkswagenag.com/presence/investorrelation/publications/annual-reports/2020/volkswagen/Y_2019_e.pdf

[6] See https://www.volkswagenag.com/presence/nachhaltigkeit/documents/sustainability-report/2019/Nonfinancial_Report_2019_e.pdf

A key pillar of VW's current strategy is the decarbonization of its portfolio. Targets include:

- One in four new Volkswagen Group vehicles worldwide having a purely electric drive by 2025
- Customers worldwide being offered up to 75 completely battery electric vehicles and approximately 60 hybrid models by 2029
- Electrification of entire model portfolio by 2030
- Completely carbon neutral vehicle fleet by 2050[7]

VW's disclosures are consistent with our expectations of large carbon emitters with a previous history of engagement with BIS on the topic. We will continue to engage with the company and closely monitor the delivery against the targets it is has set out to date. We will hold Management and Supervisory Board members to account for progress on their delivery, through future voting on director elections, where appropriate.

[7] See https://www.volkswagenag.com/presence/investorrelation/publications/annual-reports/2020/volkswagen/Y_2019_e.pdf, p. 137