

Government Commission on the German Corporate Governance Code

Draft of an amended German Corporate Governance Code

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A. Draft of the Government Commission dated 25 October 2018

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Foreword

Corporate Governance is understood as the legal and factual regulatory framework for the management and supervision of an enterprise. The German Corporate Governance Code (the “Code”) contains principles, recommendations and suggestions for the Management Board and the Supervisory Board that are intended to ensure that the company is managed in its best interests. The Code highlights the obligation of Management Boards and Supervisory Boards – in line with the principles of the social market economy – to take into account the interests of the shareholders, the enterprise's employees and the other groups related to the enterprise (stakeholders) to ensure the continued existence of the enterprise and its sustainable value creation (the enterprise's best interests). These principles not only require compliance with the law, but also ethically sound and responsible behaviour (the “reputable businessperson” concept, *Leitbild des Ehrbaren Kaufmanns*).

With their actions, the enterprise and its governing bodies must be aware of the enterprise's role in the community and its responsibility vis-à-vis society. Social and environmental factors influence the enterprise's success. In the enterprise's best interests, Management Board and Supervisory Board ensure that the potential impact from these factors on company strategy and operating decisions is identified and addressed.

The objective of the Code is to make the German corporate governance system transparent and understandable. The Code includes principles, recommendations and suggestions governing the management and monitoring of German listed enterprises that are accepted nationally and internationally as standards of good and responsible governance. It aims to promote confidence in the management and supervision of German listed companies by investors, customers, employees and the general public.

The **principles** reflect both significant legal requirements and fundamental standards of good and responsible governance. The explanation by the governing bodies in which way they apply the principles (the concept of “apply and explain”) is in accordance with good corporate governance. **Recommendations** of the Code are indicated in the text by using the word “**shall**”. Companies may depart from recommendations, but in this case they are obliged to disclose and explain any departures each year (“comply or explain”). This enables companies to take into account sector- or company-specific special characteristics. Well-justified departures from recommendations of the Code may be in the best interests of good corporate governance. Additionally, the Code contains suggestions from which companies may depart without disclosure; suggestions are indicated in the text by using the word “**should**”.

Code stipulations covering not only the listed company itself but also its group entities use the word “enterprise” rather than “company”. Enterprises outside the group are referred to as “third-party entities”.

Shareholders generally exercise their membership rights at the General Meeting. The General Meeting adopts resolutions in particular on the appropriation of net profit, approves the actions of the Management Board and the Supervisory Board by way of discharge, and elects the shareholder representatives to the Supervisory Board and the external auditors. The Gen-

eral Meeting also adopts resolutions on the company's legal principles, including, but not limited to, amendments to the Articles of Association, corporate actions, inter-company agreements and transformations. The General Meeting adopts advisory resolutions on the remuneration system for the Management Board, resolutions on the remuneration of the Supervisory Board, and advisory resolutions on the remuneration report for the preceding financial year.

Institutional investors are of particular importance to enterprises. They are expected to exercise their ownership rights actively and responsibly, in accordance with transparent principles that also respect the concept of sustainability.

The Code is addressed to listed companies and companies with access to capital markets pursuant to section 161 (1) sentence 2 of the German Stock Corporation Act. **Non-publicly-traded companies** may use the Code's recommendations and suggestions as guidelines.

Listed credit institutions and insurance undertakings are subject to the applicable prudential requirements, which are not reflected in the Code.

A. Management and supervision

I. Tasks and responsibilities

Principle 1. The Management Board is responsible for managing the enterprise in its own best interests. Its members are jointly accountable for managing the enterprise. The Chair or Spokesperson of the Management Board coordinates the work of the Management Board members.

Principle 2. The Supervisory Board appoints and discharges the members of the Management Board; it supervises and advises the Management Board in the management of the enterprise and has to be involved in decisions of fundamental importance to the enterprise. The Articles of Association and/or the Supervisory Board stipulate that transactions of fundamental importance are subject to approval.

Principle 3. The Supervisory Board chair is elected by the Supervisory Board from among its members. The Chair coordinates the activities of the Supervisory Board and represents the interests of the Supervisory Board externally.

Recommendation and suggestion:

- A.1 The Supervisory Board shall adopt its own rules of procedure and shall publish these on the company's website.
- A.2 The Supervisory Board Chair should be available – within reasonable limits – to discuss Supervisory Board-related issues with investors.

Principle 4. The Management Board develops the enterprise strategy, coordinates it with the Supervisory Board and ensures its implementation.

Principle 5. The Management Board and the Supervisory Board cooperate on a trust basis to the benefit of the enterprise. Good corporate governance requires an open dialogue between the Management Board and Supervisory Board, as well as between the members of these individual Boards. Comprehensive observance of confidentiality is of paramount importance in this regard.

Principle 6. A responsible management of risks arising from business activities requires an appropriate internal control and risk management system.

Principle 7. The Management Board ensures that all provisions of law and internal policies are complied with, and endeavours to achieve their compliance by the group entities.

Recommendation and suggestion:

- A.3 The Management Board shall institute an appropriate compliance management system reflecting the enterprise's risk situation, and disclose the main features of this system. Employees shall be given the opportunity to report, in a protected manner, breaches of the law within the enterprise; third parties should also be given this opportunity.

Principle 8. When appointing the enterprise's executives, the Management Board considers diversity and lays down targets for increasing the share of women in the two management levels below the Management Board.

II. Supervisory Board committees

Principle 9. The establishment of committees generally supports the effectiveness of the Supervisory Board's work for larger enterprises.

Recommendations:

- A.4 Depending on the specific circumstances of the enterprise and the number of Supervisory Board members, the Supervisory Board shall form committees of members with relevant specialist expertise.
- A.5 The Supervisory Board should establish an Audit Committee that – provided no other committee or the plenary meeting of the Supervisory Board has been entrusted with this work – addresses in particular the review of the accounting, the monitoring of the accounting process, the effectiveness of the internal control system, the risk management system, the internal audit system, the audit of the financial statements and compliance. The accounting particularly comprises the consolidated financial statements and the group management report (including CSR reporting), interim financial information and the single-entity financial statements in accordance with the German Commercial Code (*Handelsgesetzbuch, HGB*).
- A.6 The Chair of the Audit Committee shall have specific knowledge and experience in applying accounting principles and internal control procedures as well as the audit, and

shall be independent. The Chair of the Supervisory Board shall not chair the Audit Committee.

- A.7 The Supervisory Board shall form a Nomination Committee, composed exclusively of shareholder representatives, which names suitable candidates to the Supervisory Board for its proposals to the General Meeting.

III. Conflicts of interest

Principle 10. The members of the Management Board and Supervisory Board are bound to observe the enterprise's best interests. In all their decisions, they must neither pursue personal interests nor exploit for themselves business opportunities to which the enterprise is entitled. Management Board members are subject to comprehensive non-compete clauses throughout the duration of their appointment.

Recommendations:

- A.8 Each member of the Supervisory Board shall inform the Chair of the Supervisory Board of any conflicts of interest without undue delay. In its report, the Supervisory Board shall inform the General Meeting of any conflicts of interest that have arisen and how they were addressed. Material conflicts of interest involving a member of the Supervisory Board that are not merely temporary shall result in the termination of that member's Supervisory Board mandate.
- A.9 Each Management Board member shall disclose conflicts of interest to the Chair of the Supervisory Board and to the Chair or Spokesperson of the Management Board without undue delay and shall inform the other members of the Management Board.
- A.10 Members of the Management Board shall only assume sideline activities, especially Supervisory Board mandates outside the enterprise, with the approval of the Supervisory Board.

Principle 11. Material transactions with related parties are subject to prior approval of the Supervisory Board.

IV. Provision of information

Principle 12. The Management Board is responsible for keeping the Supervisory Board informed. Nevertheless, the Supervisory Board must itself ensure that it obtains sufficient information. The Management Board informs the Supervisory Board regularly, without delay and comprehensively about all issues that are relevant to the enterprise – in particular, regarding strategy, planning, business development, the risk situation, risk management and compliance. The Management Board addresses departures in the current business development from its existing projections and agreed targets, indicating the reasons for any such departures. The Supervisory Board may at any time require the Management Board to provide additional information.

Principle 13. The Management Board Chair or Spokesperson informs the Supervisory Board Chair without undue delay of major events that are of material importance for the assessment of the enterprise's status and performance, and for the management of the enterprise. The Supervisory Board chair subsequently has to inform the Supervisory Board and, if required, convenes an extraordinary Supervisory Board meeting.

Recommendation:

A.11 Between meetings, the Supervisory Board Chair shall be in regular contact with the Management Board – in particular, the Management Board Chair or Spokesperson, in order to discuss with them issues of strategy, planning, business development, the risk situation, risk management and compliance of the enterprise.

V. Training and professional development

Principle 14. The members of the Supervisory Board take responsibility for undertaking any training or professional development measures necessary to fulfil their duties.

Recommendation:

A.12 The company shall adequately support Supervisory Board members regarding continuous training and professional development measures.

VI. Meetings and adoption of resolutions

Recommendations and suggestion:

A.13 The Supervisory Board shall also meet on a regular basis without the Management Board.

A.14 It shall be noted in the report of the Supervisory Board how many meetings of the Supervisory Board, and of the committees, the individual members attended. Participation by telephone or video conference also counts as attendance, but this should not be the rule.

VII. Self-assessment of the Supervisory Board

Recommendations:

A.15 The Supervisory Board shall assess, at regular intervals, how effective the Supervisory Board as a whole and its committees fulfil their tasks. This self-assessment shall be supported by external resources after not more than three years.

VIII. Transparency and external reporting

Principle 15. All other things being equal, the company will ensure equal treatment of all shareholders in respect of information.

Principle 16. Shareholders and third parties are kept informed by the consolidated financial statements and the group management report, as well as by interim financial information.

Recommendations:

- A.16 The company shall disclose to shareholders, without undue delay, all material new facts made available to financial analysts and similar addressees.
- A.17 The consolidated financial statements and the group management report shall be made publicly accessible within 90 days from the end of the financial year, while mandatory interim financial information shall be made publicly accessible within 45 days from the end of the reporting period.
- A.18 If the company is not required to publish quarterly statements, it shall still inform shareholders during the course of the year in an appropriate way – in addition to the half-year financial report – about business developments, and in particular about material changes to the business outlook and the risk situation.

Principle 17. **Supervisory Board and Management Board provide information about the company's corporate governance in their Corporate Governance Statement, on an annual basis.**

Recommendations:

- A.19 Supervisory Board and Management Board shall explain in which way they apply the principles of the Code (“apply and explain”).
- A.20 The company shall keep previous Corporate Governance Statements and Declarations of Compliance regarding the recommendations of the Code available on its website for a period of five years.

IX. Cooperation with the external auditors

Principle 18. **The external auditors support the Supervisory Board and – where applicable – the Audit Committee in monitoring the management, particularly in relation to the review of the accounting and the monitoring of the accounting-related control and risk management systems. The external auditors' audit opinion informs the capital market about the compliance of financial reporting with generally accepted accounting principles.**

Recommendations:

- A.21 The Supervisory Board shall arrange for the external auditors to inform the Supervisory

Board, without undue delay, about all findings and issues of importance for its tasks which come to the knowledge of the external auditors during the performance of the audit.

- A.22 The Supervisory Board shall arrange for the external auditors to inform it and note in the long-form audit report if, during the performance of the audit, the external auditors identify any facts that indicate an inaccuracy in the Declaration of Compliance regarding the recommendations of the Code issued by the Management Board and Supervisory Board.
- A.23 The Audit Committee shall conduct an evaluation of the effectiveness of the audit on a regular basis.

B. Composition of the Supervisory Board

Principle 19. The Supervisory Board normally comprises members appointed by the shareholders as well as, depending on the number of employees, members that are determined by the employees based on the rules of the co-determination acts. Shareholder representatives and employee representatives are obliged in equal measure to act in the best interests of the enterprise.

Recommendation:

- B.1 Supervisory Board members elected by the shareholders shall be appointed for a period of not more than three years.

Principle 20. The composition of the Supervisory Board has to ensure that its members collectively have the knowledge, skills and professional expertise required to properly perform all duties as well as the requisite diversity and independence.

Recommendations:

- B.2 The Supervisory Board shall determine concrete objectives regarding its composition, and shall prepare a profile of skills and expertise for the entire Board. Proposals by the Supervisory Board to the General Meeting shall take these targets into account, while simultaneously aiming at fulfilling the overall profile of required skills and expertise of the Supervisory Board. The implementation status shall be published in the Corporate Governance Statement. This statement shall also provide information about what the Supervisory Board regards as the appropriate number of independent Supervisory Board members representing shareholders, and the names of these members.
- B.3 An age limit shall be specified for members of the Supervisory Board.
- B.4 The term of Supervisory Board membership shall be disclosed.

Principle 21. Each Supervisory Board member ensures that they have sufficient time available to discharge their duties.

Recommendations:

- B.5 A Supervisory Board member who is not a member of any executive governing body of a third-party entity shall not accept more than five Supervisory Board mandates at listed companies or comparable functions, with an appointment as Chair of the Supervisory Board being counted twice.
- B.6 Members of the executive governing body of a third-party entity shall not have, in aggregate, more than two Supervisory Board mandates in non-group listed companies or comparable functions, and shall not accept the Chairmanship of a Supervisory Board.

Independence

Recommendations:

- B.7 The Supervisory Board shall include what it considers to be an appropriate number of independent members from the group of shareholder representatives, thereby taking into account the shareholder structure.

Within the meaning of this recommendation, Supervisory Board members are to be considered independent if they have no personal or business relationship with the company, its governing bodies or a controlling shareholder that may cause a substantial – and not merely temporary – conflict of interest.

- B.8 When assessing the independence of its members, the Supervisory Board shall take into consideration, in particular, if the individual Supervisory Board member (or a person having a close family relationship with him/her):
- was a member of the company's Management Board in the two years prior to appointment;
 - currently is maintaining (or has maintained) a material business relationship with the company or one of the entities dependent upon the company (e.g. as customer, supplier, lender or advisor) in the year up to his/her appointment, directly or as a shareholder, or in a leading position of a third-party entity;
 - along with his/her remuneration as a member of the Supervisory Board, receives other material variable remuneration from the company, or one of the entities dependent upon the company;
 - is in a close family relationship with a member of the Management Board;
 - is a controlling shareholder, is a member of the executive governing body of the controlling shareholder or maintains a personal or business relationship with a controlling shareholder,
 - has been a member of the Supervisory Board for more than twelve years.
- B.9 If one or more of the indicators set out above are met and the Supervisory Board member concerned is still considered independent, the reasons for this shall be given in the

Corporate Governance Statement.

- B.10 The Chair of the Supervisory Board, the Chair of the Audit Committee as well as the Chair of the committee that addresses Management Board remuneration shall be independent from the company and the Management Board. The Chair of the Audit Committee shall also be independent from the controlling shareholder. More than half of the shareholder representatives shall be independent from the company and the Management Board.
- B.11 Save for Supervisory Boards that are composed of only three members, at least two representatives of the shareholders shall be independent from the controlling shareholder.
- B.12 No more than two former members of the Management Board shall be members of the Supervisory Board.
- B.13 Supervisory Board members shall not be members of governing bodies of, or exercise advisory functions at, significant competitors of the enterprise, and shall not hold any personal relationships with a significant competitor.
- B.14 In its election proposals to the General Meeting, the Supervisory Board shall disclose the personal and business relationships of every candidate with the company, the governing bodies of the company, and any shareholders with a material interest in the company. The disclosure recommendation is limited to information and circumstances that, in the opinion of the Supervisory Board, an objectively judging shareholder would consider decisive for their election decision. A material interest in the meaning of this recommendation refers to shareholders who directly or indirectly hold more than 10% of the voting shares in the company.
- B.15 The proposal for a candidate shall be accompanied by a curriculum vitae, providing information on the candidate's relevant knowledge, skills and professional experience; it shall be supplemented by an overview of the candidate's material activities in addition to the Supervisory Board mandate, and shall be updated annually for all Supervisory Board members and published on the enterprise's website.
- B.16 Supervisory Board members shall be elected individually. Where an application is made for the appointment of a Supervisory Board member by the Court, the term of that member shall be limited until the next General Meeting.

C. Appointments to the Management Board

Principle 22. The Supervisory Board resolves upon the number of Management Board members, the allocation of responsibilities, the required qualifications as well as the appointment of individual positions by suitable candidates, and takes into account the required diversity.

Recommendations:

- C.1 Together with the Management Board, the Supervisory Board shall ensure that there is long-term succession planning.
- C.2 The first-time appointment of Management Board members shall be for a period of not more than three years.
- C.3 Any re-appointment prior to one year before the end of an appointment period at the same time as termination of the current appointment shall only happen if special circumstances apply.
- C.4 An age limit shall be specified for members of the Management Board.

D. Remuneration of Management Board and Supervisory Board members

Principle 23. The Supervisory Board determines a generally comprehensible system on the remuneration for the Management Board members and, on this basis, determines the total remuneration for each Management Board member. The General Meeting adopts advisory resolutions on the approval of the remuneration system for the Management Board members suggested by the Supervisory Board, as well as on the remuneration report for the preceding financial year.

Principle 24. The remuneration system helps to achieve the enterprise's strategic goals and the sustainable development of the enterprise. The target and maximum total remuneration are appropriately related to the tasks and performance of the Management Board member, as well as to the situation of the enterprise. The variable remuneration components create an incentive to support sustainable growth of the enterprise.

Principle 25. The remuneration system determines:

- how the target total remuneration is determined for each Management Board member;
- the relative share in the target total remuneration of fixed remuneration on the one hand, and short-term variable and long-term variable remuneration components on the other hand;
- which financial and non-financial objectives are relevant, and what kind of relationship exists between achieving previously-agreed objectives and variable remuneration; and
- what relative ranges are applicable for the variable remuneration components.

Recommendations:

- D.1 The share of long-term variable remuneration shall exceed the share of short-term variable remuneration.

- D.2 The amount of remuneration shall be capped by annual maximum expense levels, both in aggregate and as regards variable remuneration components.
- D.3 If pension benefits are granted, the service cost or any pension contributions shall be allocated to the fixed remuneration category. The same applies to fringe benefits that are not related to operating activities.
- D.4 The ratio between fixed remuneration and variable remuneration components shall take into account the various requirements related to the tasks of the respective Management Board members.
- D.5 The amounts of all variable remuneration components granted shall depend solely upon the achievement of the pre-determined objectives for the period concerned.

Principle 26. The remuneration system describes how to ensure that the remuneration does not exceed the usual remuneration without specific reasons.

Recommendation:

- D.6 In order to determine whether remuneration is in line with usual levels, the Supervisory Board shall take into account the relationship between Management Board remuneration and the remuneration of senior managers and the workforce as a whole, and how remuneration has developed over time.

Principle 27. The remuneration system determines the manner in which variable remuneration is granted.

Recommendation:

- D.7 Short-term variable remuneration shall be disbursed in cash. The long-term variable remuneration shall be granted (after deduction of taxes) in the form of shares in the company that must not be sold for a period of at least four years.

Principle 28. Based on the remuneration system, the Supervisory Board determines in advance for each Management Board member the specific target and maximum total remuneration as well as the allocation to fixed and variable remuneration components. Depending on the target achievement, the Supervisory Board subsequently determines the specific amount of the variable remuneration components.

Recommendations and suggestions:

- D.8 When determining the specific target total remuneration of each Management Board member, the Supervisory Board shall use an appropriate peer group of other third-party entities and shall disclose the composition of such group. The peer-group comparison must be applied with a sense of perspective, in order to prevent an automatic upward trend.

- D.9 Long-term variable remuneration shall primarily act as an incentive for implementing strategic measures. Therefore, the corresponding objectives shall be derived from current strategic planning for the financial year concerned. Short-term variable remuneration shall be based on targets set out in the operating annual planning.
- D.10 The Supervisory Board shall determine to what extent individual targets for each Management Board member on the one hand – or targets for the entire Management Board on the other hand – are decisive for the variable remuneration components.
- D.11 The target achievement shall be comprehensible in terms of both its rationale and amount. Subsequent changes to the targets or comparison parameters shall be excluded.
- D.12 The Supervisory Board shall have the possibility to account for extraordinary developments to an appropriate extent. It shall be permitted to retain or reclaim variable remuneration (clawback) if justified.
- D.13 After the termination of a Management Board contract, any existing regulations regarding remuneration and the inflow of funds shall remain in force.
- D.14 Payments made to a Management Board member due to early termination of their Management Board activity shall not exceed twice the annual remuneration (severance cap) and shall not constitute remuneration for more than the remaining term of the employment contract. Calculation of the severance cap shall be based on the total remuneration paid for the previous financial year and, if appropriate, shall also take into account the expected total remuneration for the current financial year. Payments made in return for possible post-contractual non-compete clauses shall be offset against the severance payment.
- D.15 Benefit commitments made in connection with the early termination of a Management Board member's activity due to a change of control should not be agreed upon.
- D.16 If Management Board members have intragroup Supervisory Board mandates, the remuneration shall be offset against the fixed remuneration. If Supervisory Board mandates are assumed at non-group entities, the Supervisory Board shall decide whether and to what extent the remuneration shall be taken into account.
- D.17 Management Board members shall not chair supervisory bodies of non-group entities.
- D.18 If the Supervisory Board calls upon an external remuneration expert to evaluate the appropriateness of the remuneration, it shall ensure that the expert is independent from the Management Board and the enterprise.

Principle 29. The members of the Supervisory Board receive remuneration that is appropriate to their tasks and the situation of the company. Remuneration is specified by resolution of the General Meeting or in the Articles of Association.

Recommendations:

- D.19 The remuneration of Supervisory Board members shall take into account, in an appropriate manner, the higher time commitment of the Chair and the Deputy Chair of the Supervisory Board as well as of the Chair and the members of committees.
- D.20 If members of the Supervisory Board are granted performance-related remuneration, it shall be linked to sustainable growth of the enterprise.

Principle 30. The Management Board and the Supervisory Board prepare an annual remuneration report, in accordance with statutory provisions.

B. Rationale

I. Objective for the revision of the Code

- (1) One of the objectives of the German Corporate Governance Code “is to make the German corporate governance system transparent and understandable. It aims to promote confidence in the management and supervision of German listed companies by international and national investors, customers, employees and the general public.”¹ The Code's objective is to make the dual governance system – along with its institutional separation of management (Management Board) and supervision (Supervisory Board) as well as the co-determination in the Supervisory Board – understandable to international investors who are often less familiar with this system².
- (2) On the other hand, it is the Code’s objective to present “internationally and nationally accepted standards of good and responsible governance”³ as recommendations and suggestions, and “to (further) improve the quality of corporate governance of German enterprises by incorporating nationally and internationally accepted best practices into the set of corporate governance rules.”⁴
- (3) Institutional investors – whether passively managed index funds, active investors or so-called activist investors – are showing increasing interest for corporate governance specifically implemented in the enterprises. Such investors recognise the benefit of standards for good and responsible corporate governance for the performance of their investments; they establish dedicated own ideas regarding corporate governance, and use these as the basis for their voting behaviour in the General Meeting.

¹ Foreword, section 1 of the GCGC 2017 = Foreword, section 3 of the GCGC draft.

² Cf. v. Werder, in Kremer/Bachmann/Lutter/v. Werder, Deutscher Corporate Governance Kodex, 7th ed. 2018, no. 102.

³ Foreword, section 1 of the GCGC 2017 = foreword, section 3 of the GCGC draft

⁴ Cf. v. Werder, in Kremer/Bachmann/Lutter/v. Werder, Deutscher Corporate Governance Kodex, 7th ed. 2018, no. 103.

- (4) Standards of good and responsible corporate governance, which are referred to in the Foreword to the Code, are not only included in the Code, but also in the voting guidelines of investors and proxy advisors. Self-regulation, for the purposes of the Code, presumes that the Code promulgates standards that are essential in the view of as many stakeholders as possible. Otherwise, there is the risk of an unmanageable situation of a legally justified Code on the one hand, and a number of voting guidelines of institutional investors (especially large institutional investors) and of proxy advisors on the other hand.
- (5) The voting guidelines of institutional investors reflect the views of only one – yet particularly important – group of stakeholders. If and to what extent they represent suitable best practices for German listed companies depends on whether the individual rule in question is in line with the German corporate governance system, and to what extent the application of the rule concerned is actually in the best interests of the enterprise and promises to make a contribution to sustainable value creation.
- (6) Recommendations regarding Management Board remuneration and the independence of the Supervisory Board were the focus of the Commission's work during the past year. Management Board remuneration is something that particularly and consistently attracts the attention of investors and the general public. The amended Shareholder Rights Directive (Second SRD)⁵ not only results in new rules regarding "Say on Pay" by the General Meeting (section 120a of the Draft Amended German Stock Corporation Act ("Draft AktG")) and the reporting on Management Board remuneration (section 162 of the Draft AktG), but also leads to new requirements for the remuneration systems (section 87a of the Draft AktG)⁶.
- (7) The Code has yet to determine a positive or negative definition of the independence of Supervisory Board members as well as a catalogue of individual criteria for the assessment of independence⁷. This approach did not correspond to the request of the issuers or to international code practice.
- (8) In addition, the readability of the Code shall be improved by not making references to detailed legal requirements that are not fundamental to the understanding of the German corporate governance system, and (as repeatedly done in the past) by omitting recommendations to which neither enterprises nor investors or other stakeholders attach value. The readability shall be supported by a Code structure that is based on the individual functions of management and supervision of enterprises.
- (9) The timing for a reform of the Code must be in line with the schedule for the transposition of the Shareholder Rights Directive 2017 into German law. This requires that the

⁵ Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, OJ L 132 dated 20/05/2017, p. 1.

⁶ The "AktG-E" denotes the bill to implement the Second Shareholder Rights Directive (SRD II) dated 11 October 2018.

⁷ Cf. Kremer, in Kremer/Bachmann/Lutter/v. Werder, Deutscher Corporate Governance Kodex, 7th ed. 2018, no. 1377.

amended Code becomes effective at around the same time that the implementing act enters into force (not later than on 10 June 2019).

II. Material content of the draft

1. Supplementing the “comply or explain” approach by an “apply and explain” approach for the new category of the principles

Important corporate governance codes of other countries have supplemented the tried-and-tested “comply or explain” approach by an “apply and explain” approach. In this context, provisions or practices are preceded by principles – the application of which has to be explained pursuant to the relevant code or, as in the UK for example, pursuant to the Listing Rules⁸. It is proposed to adopt this approach into the Codex. The following considerations support this:

- Emphasising principles that reflect essential legal requirements and fundamental standards of good and responsible corporate governance strengthens the Code's informational function.
- The recommendation to enterprises to explain in which way they apply the principles shall help to structure in a deliberate way, and fully present, the specific corporate governance.
- The new category of the principles also necessitates desisting from making references to non-essential legal requirements in the Code, which ultimately makes the Code shorter.

The explanation regarding the application of the principles in the enterprise is intended to enable shareholders and other stakeholders to assess the corporate governance structure within the enterprise. The use of standardised texts would not give proper consideration to this intention.

The new category of the principles and the “apply and explain” approach are introduced in the Foreword. The recommendation to explain how the principles are applied can be found in recommendation A.19 of the GCGC draft.

2. Specification of the independence requirement regarding shareholder representatives on the Supervisory Board

The Supervisory Board shall include what it considers to be an appropriate number of independent members, thereby taking into account the shareholder structure (section 5.4.2 of the GCGC 2017 = recommendation B.7 of the GCGC draft). This is intended to ensure that supervision is based on the enterprise's best interests. The number of Supervisory Board members that are subject to a potential conflict of interest – where there is the risk of a loyalty or role conflict – shall be limited.⁹

⁸ Cf. UK Corporate Governance Code 2018, Introduction, para. 6.

⁹ Cf. Kremer, in Kremer/Bachmann/Lutter/v. Werder, Deutscher Corporate Governance Kodex, 7th ed. 2018, no. 1369.

Potential conflicts of interest for Supervisory Board members may result from the proximity to the company or its Management Board, from own interests (e.g. as customer, supplier, lender, or by virtue of a close personal relationship), from the position as controlling shareholder, or by reference to the term of Supervisory Board membership. In this respect, independence is only an issue for the shareholder representatives, since only the shareholder representatives are elected by the General Meeting upon the proposal of the Supervisory Board. Therefore, recommendation B.7 of the GCGC draft, which corresponds to section 5.4.2 sentence 1 of the GCGC 2017, only applies to shareholder representatives.

It is common practice internationally to link the definition of independence with a catalogue of specific circumstances which rule out independence, that represent a rebuttable presumption or that merely represent indicators for the lack of independence which are subject to a due consideration. The Commission prefers the indicator-based solution, since evaluation of the independence of Supervisory Board members is necessarily a subjective assessment which requires an overall view. The catalogue criteria in recommendation B.8 of the GCGC draft may help in this context, but cannot replace exercising due discretion.

The Commission supports the view that, in the determination of an appropriate number of independent shareholder representatives and in the appointment of candidates for various Supervisory Board functions, it has to be considered whether the issue evolves around the independence of the company and its Management Board, or the independence of the controlling shareholder.

3. Restatement of the rules regarding Management Board remuneration

The objective of Management Board remuneration is to create the right incentives for the actions of the Management Board, to pay adequate remuneration for the performance rendered, to respect social acceptance and to explain clearly and understandably how much the individual Management Board member receives, and for what performance the remuneration is paid. A remuneration system should therefore define the individual total remuneration target, the relative share of fixed and variable remuneration components, and the correlation between the targets agreed upon beforehand, together with the variable remuneration to be paid in this respect. Also, long-term variable remuneration should be variable at the time it is granted; above all, it should act as an incentive for implementing strategic measures. This represents the transposition of the requirement set out in section 87a (1) sentence 2 no.1 of the Draft AktG, pursuant to which the remuneration contributes to the promotion of the business strategy and of the company's long-term development.

The concept provided for in chapter D. of the Code draft follows a top-down approach. The target total remuneration comprises all remuneration components and represents the amount granted in case of full target achievement. The target total remuneration largely depends on what is necessary to attract or retain the Management Board member concerned. The target total remuneration is supplemented by a maximum remuneration (cap). Total target remuneration and maximum remuneration should be communicable overall in comparison to the remuneration of other senior managers and the employees, and should be explainable to the general public.

Total remuneration packages usually comprise fixed and variable performance-related components. The fixed components include the fixed salary, the pension contributions and non-operational fringe benefits. The performance-related components comprise short-term (bonus) programmes and long-term variable remuneration. It is the task of the Supervisory Board to decide in each single case on a market- and task-specific basis as to what share the variable remuneration should have in the total remuneration.

Variable remuneration is the key material incentive for pursuing the objectives of business policy. It acts as the decisive motivation and reward for specific actions, for operating performance, for a strategic orientation that promotes the long-term sustainability of the company, and for responsible behaviour. While the achievement of the objectives does not necessarily have to be measured precisely, it must be verifiable in any event. The correlation between achieving objectives and variable remuneration must therefore be determined beforehand, and may not be changed subsequently.

Operational metrics in particular are the focal point of the short-term variable remuneration. They can include financial (e.g. EBITDA, margins, productivity) as well as non-financial (e.g. net-promoter score, employee commitment) parameters. The amounts granted on the basis of target achievement shall be disbursed in cash after the period.

Implementing the corporate strategy is the focal point of long-term variable remuneration. Each strategic plan is broken down into important milestones and initiatives for the individual years, implementation of which shall determine the amount of the amount granted in a reporting year. The strategic plan is based on a specific scenario. To the extent that the scenario changes, the enterprise will also need to change its strategic agenda – and hence the milestones – for the next periods.

Performance pertaining to the strategic initiatives and measures is rendered in the year under review, and also remunerated for this year. In most cases, success in performance does not emerge until much later. The amounts granted shall therefore be disbursed at the end of the period, in shares of the company (granting equals inflow), which are then valued by the market. To ensure there is ample opportunity, a restriction of at least four years should be imposed on the sale of the shares.

4. Simplification of corporate governance reporting

A full, true, fair and understandable corporate governance reporting is a prerequisite to strengthen the trust of shareholders and other stakeholders in the management and supervision of the enterprise.

The obsolete parallel existence of the Corporate Governance Report pursuant to section 3.10 of the GCGC 2017 and the Corporate Governance Statement in the management report in accordance with section 289f of the German Commercial Code ("HGB") did not contribute to clarity and comprehensibility of corporate governance reporting. Several companies have started to combine the Corporate Governance Report and the Corporate Governance Statement.

A corresponding solution can be found in principle 17 of the GCGC draft: “Supervisory Board and Management Board provide information about the enterprise’s corporate governance in the Corporate Governance Statement on an annual basis.” The objective of this principle is to abolish the previous Corporate Governance Report pursuant to section 3.10 of the GCGC 2017 and to turn the Corporate Governance Statement into the core instrument of corporate governance reporting.

The Commission is aware of the fact that the Corporate Governance Statement as part of the management report is primarily the responsibility of the Management Board. The distribution of responsibilities between Management Board and Supervisory Board may be maintained by preparing a Corporate Governance Statement that is issued jointly by both governing bodies, provided that each governing body is responsible for its own components of the report.

5. No references to legal requirements that do not have the quality of principles

In 2012, in parallel to the Commission's deliberations, the 69th German Jurists’ Forum (“Deutscher Juristentag”, held by the Association of German Jurists) argued already for streamlining the Code and recommended the elimination of references to legal requirements in the Code¹⁰. This does not have to be detrimental to the informational function of the Code when, as suggested here, the most important legal requirements are highlighted as principles. In contrast, the Code will become more clearly structured and more concise. An argument for this proposal is that in future, the Code will no longer need to be amended so frequently to track changes of less significant legal requirements.

6. Structure of the Code based on the functions of Management Board and Supervisory Board

The Code has previously been structured in its core elements based on Management Board and Supervisory Board. This is supplemented by chapters on shareholders and the General Meeting, the cooperation between Management Board and Supervisory Board, transparency, accounting and auditing. For the sake of readability, in particular for Management Board and Supervisory Board members, the Code shall be structured from a functional perspective. The core elements are the tasks of management and supervision, supplemented by the no less important issues of composition of the Supervisory Board, appointment of candidates to the Management Board, and the remuneration for the members of the Management Board and the Supervisory Board. The new structure is set to improve readability, clarity and comprehensibility of the Code. In addition, such a function-based structure corresponds to international practice.

III. Explanations regarding the individual new regulations set out in the draft

Foreword

In the Foreword, paragraph 1 sentence 1, the Code now includes a definition of the term “corporate governance”. Accordingly, the objectives of the Code are management and supervision

¹⁰ Cf. Discussions of the 69th German Jurists’ Forum, Volume II/1, Munich 2013, N 86.

tasks of the Management Board and the Supervisory Board, the composition of and the appointment of members to both governing bodies, as well as the structure of their remuneration.

Paragraph 2 highlights the corporate social responsibility of the enterprises and their governing bodies, the importance of social and environmental factors for the company's success, and the requirement to consider risks and opportunities in the strategy. Corporate social responsibility also comprises taking into consideration the acceptance of Management Board remuneration in the general public.

Please refer to section B.II.1 regarding the category of principles newly introduced in paragraph 4.

Paragraph 6 addresses the function of the General Meeting, and also comprises the material statements that were previously included in section 2.2.1 of the GCGC 2017.

Recommendation A.1

The publication of the rules of procedure of the Supervisory Board on the company's website corresponds to a justified interest on the part of many investors, and has become common practice in the meantime. In contrast, a corresponding recommendation for the rules of procedure of the Management Board is not required since, in this context, any checks and balances already exist due to the primary competence of the Supervisory Board for implementing rules of procedure of the Management Board.

Principle 6

This principle corresponds to the requirements with regard to audit committees set out in section 107 (3) sentence 2 of the German Stock Corporation Act (*Aktiengesetz, AktG*). As stated in section 171 (1) sentence 2 of the AktG, the term used here comprises the internal control and risk management system as well as internal audit.

Principle 8

The Management Board's intention to take into account diversity aspects when appointing the enterprise's executives was previously included as a recommendation (section 4.1.5 sentence 1 of the GCGC 2017). This is accommodated by the fact that taking diversity into consideration when appointing the enterprise's executives represents a principle.

Recommendation A.5

In accordance with section 7.1.2 sentence 2 of the GCGC 2017, financial information shall be discussed by the Management Board and the Supervisory Board or its Audit Committee before being published. This recommendation is already included in section 5.3.2 (1) of the GCGC 2017 = recommendation A.5 sentence 1 of the GCGC draft, when the term "accounting" also comprises interim financial information and the single-entity financial statements pursuant to the German Commercial Code, which is made clear in recommendation A.5 sentence 2. Accounting moreover comprises the non-financial statement in the (group) management report

or the separate non-financial report (sections 289b, c, 315b, c of the HGB), which are required to be reviewed by the Supervisory Board pursuant to section 171 (1) sentence 1 or sentence 4 of the AktG, and which are summarised in recommendation A.5 under the heading of "CSR Reporting".

Recommendation A.8

The recommendation set out in section 5.5.2 of the GCGC 2017 already clarified that the Chair of the Supervisory Board is the person to contact in the case of a disclosure of conflicts of interest in relation to Supervisory Board members; the Chair then informs the entire Supervisory Board¹¹. Hence, in practice, such conflicts of interest have *de facto* rightly been disclosed to the Chair of the Supervisory Board. It should be self-evident that conflicts of interest must be disclosed without delay; a corresponding obligation regarding the Management Board was already included in section 4.3.3 sentence 1 of the GCGC 2017.

Recommendation A.9

Likewise, the recommendation set out in section 4.3.3 sentence 1 of the GCGC 2017 was clearly based on the view that the Chair of the Supervisory Board is the person to contact in the case of a disclosure of conflicts of interest in relation to Management Board members; the Chair then decides whether and when other Supervisory Board members have to be informed¹². In terms of providing information to other members of the Management Board, it would appear appropriate, but at the same time sufficient, that the Chair or Spokesperson of the Management Board (like the Chair of the Supervisory Board) is informed and that he/she decides, exercising his/her due discretion, whether and when other Management Board members have to be informed.

Principle 11

Principle 11 takes into account the new regime of related-party transactions based on sections 111a to 111c of the Draft AktG (introduced by the Second SRD), waiving an explicit reference to the duty of disclosure set out in section 48a of the Draft Securities Trading Act ("Draft WpHG") and legal thresholds and exemptions.

Principle 12

Principle 12 reflects the basic rules of informing the Supervisory Board pursuant to section 90 of the AktG, which were laid down in section 3.4.1 (2) of the GCGC 2017. A possible information policy – based on the authorities set out in the rules of procedure – can have benefits. However, there is no need for a related recommendation in the Code; as a result, the former recommendation ("The Supervisory Board shall therefore specify the Management Board's information and reporting duties in greater detail.") has been removed.

¹¹ Cf. Kremer, in Kremer/Bachmann/Lutter/v. Werder, Deutscher Corporate Governance Kodex, 7th ed. 2018, no. 1468.

¹² Cf. Bachmann, in Kremer/Bachmann/Lutter/v. Werder, Deutscher Corporate Governance Kodex, 7th ed. 2018, no. 1106.

Recommendation A.13

In accordance with section 3.6 (2) of the GCGC 2017, the Supervisory Board shall meet without the Management Board, if necessary. However, it would better reflect the supervisory authority of the Supervisory Board if its meetings were regularly held even without the Management Board.

Recommendation A.14

Pursuant to section 5.4.7 of the GCGC 2017, the report of the Supervisory Board shall disclose when a Supervisory Board member attended less than half of its respective meetings. As an incentive to a meeting attendance of considerably more than 50%, and for the purpose of providing comprehensive information concerning the attendance at Supervisory Board meetings for the shareholders, a comprehensive disclosure of individual meeting attendance is more suitable than the use of a transparency threshold.

Recommendation A.15

The recommendation included in section 5.6. of the GCGC 2017 regarding the so-called efficiency review is amended to the extent that (1) the term “efficiency review” (which can be misunderstood) is replaced by the wording “self-assessment of effectiveness” and “effectiveness of the Supervisory Board’s work”, (2) self-assessment expressly extends to committee work and (3) self-assessment shall be supported externally in intervals of three years. The interpretation of the term “regular” continues to be left in the discretion of the Supervisory Board by the Code. A three-year interval is recommended only for external support.

Principle 17

As explained in section B.II.4., the objective of this principle is to abolish the previous Corporate Governance Report pursuant to section 3.10 of the GCGC 2017, and to turn the Corporate Governance Statement into the core instrument of corporate governance reporting.

Recommendation A.19

Recommendation A.19 of the Draft GCGC addresses the application of the Code principles in relation to the implementation of the “apply and explain” approach described in section B.II.1. The recommended explanation as to how the principles are applied particularly refers to how the recommendations and suggestions related to each respective principle are complied with. The explanation should largely correspond to the “relevant disclosures regarding corporate governance practices” and the “description of Management Board and Supervisory Board work processes and of the composition and the work processes of their committees”, which are to be included in the Corporate Governance Statement in accordance with section 289f (2) nos. 2 and 3 of the HGB.

Principle 18

Principle 18 of the GCGC draft sets out the basic functions of the audit, i.e. supporting the monitoring of the management and providing information to the capital market about the outcome of the audit.

Recommendation A.23

The Audit Committee is also responsible for monitoring the audit pursuant to section 107 (2) sentence 2 of the AktG. In line with international standards¹³ it is recommended that the Audit Committee regularly assesses the effectiveness of the audit.

Principle 19

Principle 19 of the GCGC draft replaces paragraph 7 of the Foreword to the GCGC 2017. The previous version addressed the types of co-determination in a very detailed manner, however primarily referring to legal requirements. Principle 19 does not do this, but instead clarifies that the composition of the Supervisory Board is determined, on the one hand, by the General Meeting and on the other hand by co-determination rules. Since the Code uses the wording “rules of the co-determination acts”, it makes a reference to the German Co-determination Act (*Mitbestimmungsgesetz*), the One-third Participation Act (*Drittbeteiligungsgesetz*) and the Co-determination Act for the Mining and the Iron and Steel Producing Industries (*Montan-Mitbestimmungsgesetz*).

Recommendation B.1

Pursuant to section 102 (1) of the AktG, the maximum length of term of office for Supervisory Board members is five years. Internationally Germany is at the high end of the range in this respect. The recommendation to appoint Supervisory Board members representing shareholders for terms of no longer than three years takes into account international developments. A shorter term of office increases the flexibility in order to better meet a developing profile of skills and expertise, and to take into consideration changes in the ownership structure. The Code shall not include any statements regarding the employee representatives’ term of office. The requirements of the co-determination acts apply to the elected employee representatives.

Principle 20

Principle 20 of the Draft GCGC adopts section 5.4.1 (1) of the GCGC 2017 and adds diversity and independence to the list of requirements regarding the composition of the Supervisory Board, which had already been provided for in section 5.4.1 (2) of the GCGC 2017.

¹³ Cf. for example the UK Corporate Governance Code 2018, Provision 25: “reviewing the effectiveness of the external audit process”

Recommendation B.4

The Code does not provide any statement in relation to the cap for length of membership in the Supervisory Board and, in the restated version, also desists from recommending a corresponding regular limit provided for in section 5.4.2 (2) of the GCGC 2017. Instead, it is recommended to disclose the length of membership in the Supervisory Board. Please refer to recommendation B.8 of the GCGC draft for details regarding the length of membership as an indicator for the lack of independence.

Recommendations B.5 and B.6

In accordance with section 5.4.1 (5) of the GCGC 2017, when making its proposals concerning the election of new members to the Supervisory Board, the Supervisory Board should satisfy itself that the respective candidates are able to devote the expected amount of time required. The reason given for this recommendation is that the workloads of the individual mandates and other offices and the personal situation of the candidate might be very different¹⁴. In contrast, the administrative efforts of this individual solution were highlighted. Above all, the individual solution did not succeed in providing a convincing protection against so-called “overboarding”. Instead, the Code now recommends a limitation of five (respectively, two) mandates, taking into account the mandate of Supervisory Board chairs. The limitation of the maximum number of Supervisory Board mandates set out in section 100 (2) no. 1 of the AktG of ten mandates per person, and in section 5.4.5 (1) of the GCGC 2017 of three mandates for members of the Management Board, does not meet today’s requirements in relation to Supervisory Board activities.

Recommendation B.7

Paragraph 1 corresponds to section 5.4.2 1st half-sentence of the GCGC 2017, however it is supplemented by the insertion “from the group of shareholder representatives”. The recommendation regarding the reporting of the number and the names of the independent members of the shareholders (section 5.4.1 (4) sentence 3 of the GCGC 2017), as amended in 2017, already clarified that the requirement of independent members was limited to the group of shareholder representatives, since the employee representatives are not proposed by the Supervisory Board.

Paragraph 2 includes a positive definition of independence that is strongly based on section 5.4.2 sentence 2 of the GCGC 2017.

Recommendation B.8

Recommendation B.8 is addressed to shareholder representatives, as can be deduced from recommendation B.7.¹⁵ It includes a list of criteria that are suitable to negate the independence of Supervisory Board members, but cannot necessarily rule out independence.

¹⁴ Cf. Kremer, in Kremer/Bachmann/Lutter/v. Werder, Deutscher Corporate Governance Kodex, 7th ed. 2018, no. 1348.

¹⁵ Sections 107 (3) sentence 4, 111 (2) of the Draft AktG remain unaffected.

The composition of the Management Board in the two years prior to the appointment as Supervisory Board member should take into account of the so-called two-year cooling-off period between an individual's Management Board membership and Supervisory Board membership (section 100 (2) no. 4 of the AktG). Business and personal relationships are also set out in section 5.4.2 sentence 2 of the GCGC 2017, but are specified in recommendation B.8. Forms of material other variable remuneration components provided by the company that might be detrimental to independence are, in particular, variable remuneration components for a previous activity in the company that depends upon the realisation of certain targets in the current period. Internationally, the duration of Supervisory Board membership is widely accepted as a criterion for independence. The position as a responsible auditor two years prior to appointment as a Supervisory Board member need not be taken into account in this respect, since membership is prohibited according to section 73 (3) sentence 1 of the German Public Accountant Act (*Wirtschaftsprüferordnung*; "WPO").

Recommendation B.9

If independence is not given in individual cases, a decision has to be made by the shareholder representatives on the Supervisory Board based on due discretion, taking into account the criteria set out in recommendation B.9 of the GCGC draft. If independence is confirmed despite one or more of the indicators set out above indicating otherwise, reasons for this shall be given in the Corporate Governance Statement. This is not about "comply or explain", but about transparency on a discretionary decision.

There may well be justified reasons to confirm independence although one or, under particular circumstances, even more indicators included in recommendation B.8 of the GCGC draft are met. Such reasons should be taken into account in the decision concerning independence in individual cases, and should be made transparent in the reasons provided to confirm independence.

Recommendations B.10 and B.11

The Commission supports the view that, in the determination of an appropriate number of independent shareholder representatives and in the appointment of candidates for various Supervisory Board functions, it has to be considered whether the issue evolves around the independence of the company and its Management Board, or the independence of the controlling shareholder. More than half of the shareholder representatives shall be independent from the company and from the Management Board, and at least two shareholder representatives shall be independent from a controlling shareholder. The Chair of the Supervisory Board and the Chair of the committee responsible for Management Board remuneration only have to be independent from the company and from the Management Board, whereas the Chair of the Audit Committee has to be independent from the company and the Management Board as well as from any controlling shareholder.

Principle 22

Principle 22 of the GCGC draft specifies the responsibilities of the Supervisory Board as regards the appointment of members to the Management Board.

Recommendation C.2

While section 5.1.2 (2) sentence 1 of the GCGC 2017 merely included the suggestion that the maximum term of office of five years in the case of first-time appointments of Management Board members should not become the rule, the Code now recommends, in line with common practice, a limitation for first-time appointments of three years.

Section D.

The principles, recommendations and suggestions in relation to Management Board remuneration in section D. of the Code draft have been revised to a large degree. Specifically, the new legal requirements brought about by draft implementing Act of the second Shareholders Rights Directive (*Entwurf zum Umsetzungsgesetz der zweiten Aktionärsrechterichtlinie – ARUG II*) had to be taken into account. The objective of this revision, as well as its focus in terms of content, are explained in sections B.I. (6) and B.II.3. In addition, the following explanations are provided.

Amendments to the Code need not be taken into account in current Management Board contracts¹⁶. To the extent that the recommendations in this section are followed, related amendments to existing employment contracts are required only after the revised version of the Code has entered into force.

Principle 23

Principle 23 sets out the two remuneration-related tasks of the Supervisory Board to determine a system for Management Board remuneration (see principles 24 to 27 as well as the relevant recommendations) and on that basis to determine the specific Management Board remuneration (see principle 28 as well as the relevant recommendations).

The remuneration system has to be generally comprehensible, so that shareholders, the other stakeholders and the general public may understand the amounts and the reasons of the intended remuneration for Management Board members, as well as the remuneration actually paid in the end. The role of the enterprises in society, which is mentioned in paragraph 2 of the Foreword, requires that the social acceptance of Management Board remuneration is duly accounted for.

Principle 24

Sentences 1 and 3 of principle 24 are in line with section 87a (1) sentence 2 no. 1 of the Draft AktG, which requires that remuneration shall contribute to the company's business strategy and to its long-term development.

Sentence 2 introduces the concept of target total remuneration, which indicates the sum of all remuneration components in case of a full target achievement. The requirement of the appropriateness of the target total remuneration corresponds to the provision in section 87 (1) sentence 1 of the AktG. The appropriateness requirement also applies, to the same extent,

¹⁶ Cf. Hüffer/Koch/Koch AktG section 87 no. 17.

to the relative ranges of the variable remuneration components (see principle 25 of the Draft GCGC).

Principle 25

Principle 25 describes the key features of the remuneration system: the determination of the target total remuneration of the individual Management Board members, the share of variable remuneration components in target total remuneration, the relevant target measures and the relationship between target achievement and variable remuneration or total remuneration (“pay for performance”) as well as the relative ranges of the variable remuneration components (e.g. between 0% and 200%).

Recommendation D.1

Since the remuneration system has to be focused on a sustainable company development, it is recommended that the long-term variable remuneration exceeds the short-term variable remuneration in the case of full target achievement. Pursuant to the recommendation D.7 sentence 2 of the Draft GCGC, the long-term variable remuneration shall be granted in the form of shares in the company that must be held for a period of at least four years. Hence, the recommendation of a multi-year measurement basis set out in section 87 (1) sentence 3 first half-sentence of the AktG is complied with.

Recommendation D.2

The recommendation of maximum amounts (“caps”) in section 4.2.3 (2) sentence 6 of the GCGC 2017 is specified insofar as the relevant factor is the expense of the company regarding the year for which the remuneration is granted. Since “true” shares shall be granted as long-term variable remuneration, the date of grant is also relevant in this regard¹⁷.

The cap for the total remuneration is calculated on the basis of the sum of fixed remuneration and the upper end of the range for variable remuneration components.

Recommendation D.3

Fringe benefits are related to operating activities when they are granted by the company. This should be the case, for example, in relation to security equipment installed at the private home of a Management Board member.

Recommendation D.4

The recommendation D.4 is based on the assumption that various requirements related to the tasks of individual Management Board members require a different ratio between fixed remuneration and variable remuneration components.

¹⁷ Cf. Bachmann, in Kremer/Bachmann/Lutter/v. Werder, Deutscher Corporate Governance Kodex, 7th ed. 2018, no. 1016.

Recommendation D.5

The “pay for performance” approach set out in principle 25 requires that any variable remuneration has to be determined on the basis of the targets pre-determined for the period. Recommendation D.12 of the GCGC draft includes the possibility to account for extraordinary circumstances.

Principle 26 and recommendation D.6

Principle 26 corresponds to the requirement regarding remuneration based on common practice pursuant to section 87 (1) sentence 1 of the AktG; in this context, the remuneration shall be assessed horizontally in comparison with other enterprises (see recommendation D.8 of the Draft GCGC) and vertically in comparison with senior managers in the enterprise and with the workforce as a whole (see recommendation D.6 of the Draft GCGC, in conjunction with section 87a (1) sentence 2 no. 7 and section 162 (1) sentence 2 no. 2 of the Draft AktG). In this context, the assessment in accordance with recommendation D.6 continues to be made by reference to section 4.2.2 (2) sentence 3, second half-sentence of the GCGC 2017, to the extent that the Supervisory Board determines how senior managers and other relevant employees are to be differentiated for the comparison.

Principle 27 and recommendation D.7

The manner of granting variable remuneration refers to the procedures related to the inflow and the control over funds received. In recommendation D.7, the Code recommends that the short-term variable remuneration shall be disbursed in cash and that the long-term variable remuneration shall be granted in shares that must be held for a period of at least four years.

It is no violation of the recommendation to pay short-term variable remuneration in cash, or to defer such payout and to link it to the realisation of corresponding targets over several years.

The long-term variable remuneration shall reward strategic performance (cf. recommendation D.9 of the GCGC draft) where the success can be determined only in subsequent years. Therefore, the long-term variable remuneration (after deducting payable taxes) shall be disbursed in shares subject to a holding period. Hence, the evaluation of the success of strategic measures does not lie in the hands of the capital market.

Principle 28

The remuneration system is resolved by the General Meeting in accordance with Article 120a of the Draft AktG and represents the foundation for the design of the employment contracts. A distinction has to be made to the determination of the specific individual remuneration.

For this purpose, the Supervisory Board shall initially decide and make transparent how much each individual Management Board member can receive as target and maximum remuneration in aggregate, i.e. the sum of all remuneration components, in every single contract year.

The maximum remuneration corresponds to the maximum expenditure for the company. Depending on the target achievement, the Supervisory Board subsequently determines the specific amount of the variable remuneration components.

Recommendation D.8

To ensure that the remuneration is in line with common practice (principle 26 of the Draft GCGC), the Supervisory Board, in determining the specific individual target and maximum total remuneration, shall also pay due regard of the amount of the target and the maximum total remuneration at comparable enterprises. The decisive factor for comparability is the market position of the enterprise (primarily in terms of industry and size).

Recommendation D.9

The long-term variable remuneration shall be an incentive to implement strategic initiatives and measures that are planned for the financial year concerned due to the current strategic agenda. Such strategic initiatives and measures affect the overall enterprise (e.g. digitisation objectives) or individual divisions (e.g. specific market goals).

The amounts granted shall be determined based on the extent to which the strategic initiatives and measures planned for the relevant financial year have been actually implemented. This represents the transposition of the requirement set out in section 87a (1) sentence 2 no.1 of the Draft AktG, pursuant to which the remuneration contributes to the promotion of the business strategy and of the company's long-term development.

Operating performance shall be remunerated on a short-term and variable basis (annual bonus). Therefore, short-term variable remuneration shall be based on targets set out in the operating annual planning. These targets may differ from enterprise to enterprise, but they have to be in line with financial communications.

Recommendation D.10

The Supervisory Board may in its discretion determine individual targets or targets for the Management Board as a whole in relation to the variable remuneration components.

Recommendation D.11

Target achievement must be comprehensible for shareholders, other stakeholders, and the general public. It is sufficient when the target values determined by the Supervisory Board are reported on an ex-post basis.

Recommendation D.12

Variable remuneration shall be able to pay due regard to extraordinary developments. This may result in an increase or a decrease of the short or long-term variable remuneration that would have been determined otherwise. This discretionary element shall take into consideration special situations that were not sufficiently captured in the pre-determined targets (as

opposed to unfavourable general market developments, for example); reasons must be stated specifically for such a discretionary element in the remuneration report.

In addition, the Supervisory Board shall agree in the employment contracts that it may retain or reclaim variable remuneration components (clawback) if justified. The corresponding clauses as well as their utilisation shall be made transparent (cf. section 87a (1) sentence 2 no. 4 of the Draft AktG).

Recommendation D.13

According to the recommendations provided for in the Code, variable remuneration (both short and long-term) is disbursed promptly following the end of the financial year, either in cash or in shares (see recommendation D.7 of the Draft GCGC). Recommendation D.13 of the Draft GCGC only refers to the holding period for shares granted. To preserve the long-term character of this remuneration component, the holding period shall not be shortened by termination of the Management Board contract.

Recommendation D.14

Recommendation D.14 sentence 1 governs the severance cap and is in line with section 4.2.3 (4) sentence 1 of the GCGC 2017. The recommendation in section 4.2.3 (4) sentence 3 – in which it is determined in detail which annual remuneration shall be the basis for the calculation of the severance cap – is omitted as it is deemed too detailed.

The objective of the recommendation in sentence 2 is to clarify that a compensation for any post-contractual non-compete clauses for the period for which the retired Management Board receives a severance is already settled by such severance.

Suggestion D.15

The recommendation of a cap on benefit commitments made in connection with the early termination of a Management Board member's activity as a result of a change of control in accordance with section 4.2.3 (5) of the GCGC 2017 was widely mistaken for the recommendation to promise such benefits. In fact, this was never the purpose. In suggestion D.15 of the GCGC draft, the Government Commission supports the view that such benefits should not be agreed upon. Accordingly, there is no recommendation regarding the maximum amount.

Recommendation D.16

The remuneration for being a member of an intra-group Supervisory Board shall be taken into account in the fixed remuneration. If a Management Board member is a member of a non-group supervisory board, the Supervisory Board shall decide whether this activity is primarily in the interest of the company or of the Management Board member, and to what extent the corresponding remuneration has to be taken into account in the fixed remuneration for Management Board activities.

Recommendation D.17

The workload associated with being the Chair of the Supervisory Board is normally not manageable together with the membership in a Management Board.

Recommendation D.19

Recommendation B.19 clarifies, in comparison with section 5.4.6 (1) sentence 2 of the GCGC 2017, that the differentiation of the remuneration for special functions in the Supervisory Board shall depend upon the different time commitment.

Principle 30

Since section 162 of the Draft AktG contains comprehensive and detailed requirements for the remuneration report, there is no need for specific recommendations to this effect in the Code; accordingly, the sample tables pursuant to section 4.2.5 (3) of the GCGC 2017 are no longer applicable.

IV. Rationale for deleted recommendations and suggestions

Section	Recommendation/suggestion of the GCGC dated 7 February 2017 to be deleted
2.2.4	<p><i>² In this context, the Chair should take into account that the Annual General Meeting be completed after four to six hours.</i></p> <p>The suggestion set out in section 2.2.4 sentence 2 of the GCGC 2017 has not turned out to be a suitable instrument to achieve a swift execution of the General Meeting.</p>
2.3.2	<p><i>¹ The company shall facilitate the exercise of shareholders' rights in person or by proxy. ² The Management Board shall be responsible for the appointment of a proxy to exercise shareholders' voting rights in accordance with their instructions; the proxy should also be reachable during the General Meeting.</i></p> <p>The recommendations in section 2.3.2 sentences 1 and 2, as well as the suggestion in sentence 2 second half-sentence of the GCGC 2017, may be deleted in order to streamline the Code. To the extent that they go beyond the wording of section 134 (3) of the AktG, the appointment of a proxy holder to exercise shareholders' voting rights in accordance with their instructions has become common practice in the meantime. Please refer to sections 67a-c, 118 and 129 of the Draft AktG for the implementation of Article 3b, c of the SRD.</p>
2.3.3	<p><i>The company should make arrangements to allow shareholders to follow the General Meeting using modern means of communication (e.g. via the internet).</i></p>

	<p>The partial broadcast of the General Meeting has become common practice in the meantime. A Code suggestion cannot contribute to the legal issues surrounding a full broadcast. Therefore, the suggestion set out in section 2.3.3 of the GCGC 2017 can be omitted.</p>
3.4	<p>(1) ³ <i>The Supervisory Board shall therefore specify the Management Board's information and reporting duties in greater detail.</i></p> <p>The basic rules to be derived from section 90 of the AktG in relation to information to be provided to the Supervisory Board are reflected in principle 12 of the GCGC draft. A possible structure of information flows – based on the authorities set out in the rules of procedure – can have benefits. However, there is no need for a corresponding Code recommendation.</p>
3.7	<p>(3) <i>In the event of a takeover offer, the Management Board should convene an Extraordinary General Meeting at which shareholders will discuss the takeover offer and, if appropriate, decide on corporate actions.</i></p> <p>The suggestion has been met with criticism in terms of legal practice and legal politics¹⁸.</p>
3.8	<p>(3) <i>A similar deductible shall be agreed in any D&O policy for the Supervisory Board.</i></p> <p>There is widespread deviation from the recommendation of a deductible in any D&O policy for Supervisory Board members, since a deductible (of at least 1.5x of fixed remuneration, cf. section 93 (2) sentence 3 of the AktG for Management Board members) does not represent a suitable instrument to increase the sense of responsibility and the motivation of the Supervisory Board members. The Commission has responded to the criticism and deleted the recommendation.</p>
3.10	<p>¹ <i>The Management Board and Supervisory Board shall report annually on Corporate Governance (Corporate Governance Report), and shall publish this report in connection with the Corporate Governance Statement.</i></p> <p>The Corporate Governance Report is abolished in order to make the Corporate Governance Statement the core instrument of corporate governance reporting.</p> <p>² <i>Comments should be provided on the suggestions made in the Code.</i></p> <p>The explanation as to how the principles are applied refers to how the suggestion related to each respective principle are complied with (cf. explanation A.19). Therefore, the suggestion can be deleted.</p>

¹⁸ Cf. Bachmann, in Kremer/Bachmann/Lutter/v. Werder, Codex Commentary, 7th ed. 2018, no. 596–598a.

4.2.1	<p><i>The Management Board shall consist of several members and shall have a Chair or Spokesperson. Rules of procedure shall govern the work of the Management Board, in particular the allocation of duties among individual Management Board members, matters reserved for the Management Board as a whole and the required majority for Management Board resolutions (unanimity or resolution by majority vote).</i></p> <p>The three recommendations regarding the organisation of the Management Board set out in section 4.2.1 are simple matters of course. Therefore, they can be deleted.</p>
4.2.3	<p><i>(2) ² Monetary remuneration shall comprise fixed and variable components. ³ Variable remuneration components generally have multiple-year assessment bases that shall have essentially forward-looking characteristics. ⁴ Both positive and negative developments shall be taken into account when determining variable remuneration components.</i></p> <p><i>⁷ Both positive and negative developments shall be taken into account when determining variable remuneration components. ⁸ Subsequent amendments to the performance targets or comparison parameters shall be excluded. ⁹ Early disbursements of multiple-year, variable remuneration components should not be permitted.</i></p> <p>Replaced by principle 28, recommendations D.8 to D.12.</p> <p><i>(3) The Supervisory Board shall establish the target level of pension benefits for every pension commitment – including based on the duration of membership of the Management Board – and shall consider the resulting annual and long-term expense incurred by the enterprise.</i></p> <p>Replaced by recommendation D.3 of the Draft GCGC.</p> <p><i>(5) Benefit commitments made in connection with the early termination of a Management Board member’s activity due to a change of control shall not exceed 150% of the severance cap.</i></p> <p>The recommendation of a cap on benefit commitments made in connection with the early termination of a Management Board member’s activity as a result of a change of control was widely mistaken for the recommendation to promise such benefits. This was not the Commission's intention, as clarified by the Commission (suggestion D.15); it deleted this recommendation.</p> <p><i>(6) The Chair of the Supervisory Board shall outline to one General Meeting the salient points of the remuneration system, and shall inform subsequent General Meetings about any amendments.</i></p> <p>Replaced by section 87a (1) in conjunction with section 120 (1) of the Draft AktG.</p>

4.2.5	<p>(1) ³ <i>The description shall be made in a generally comprehensible way.</i></p> <p>(2) <i>The remuneration report shall also include information on the nature of the fringe benefits provided by the company.</i></p> <p>(3) ¹ <i>In addition, the remuneration report shall present the following information pertaining to every Management Board member:</i></p> <ul style="list-style-type: none"> - <i>the benefits granted for the reporting period, including fringe benefits, supplemented in the case of variable remuneration components by the maximum and minimum remuneration achievable;</i> - <i>the benefits received for the reporting period, consisting of fixed remuneration, short-term variable remuneration and long-term variable remuneration, broken down by the relevant reference years;</i> - <i>the service cost incurred in/for the reporting period for pension benefits and other commitments.</i> <p>² <i>The model tables provided as appendices to this document shall be used to disclose this information.</i></p> <p>Replaced by principle 30 and section 162 of the Draft AktG.</p>
4.3.3	<p>⁴<i>Significant transactions with a Management Board member's related parties should be subject to Supervisory Board approval.</i></p> <p>Replaced by principle 11.</p>
5.1.2	<p>(2) ¹ <i>For first-time appointments, the maximum permissible appointment period of five years should not be applied as a rule.</i></p> <p>Replaced by recommendation C.2</p>
5.3.2	<p>(3) ² <i>[...] and shall not be a former member of the Management Board of the company whose term of office ended less than two years ago.</i></p> <p>In accordance with recommendation A.6, the Chair of the Audit Committee shall be independent pursuant to section 5.3.2 (3) sentence 2 of the GCGC 2017. In accordance with B.8 of the GCGC draft, membership of the Management Board in the two years prior to appointment as a Supervisory Board member is an argument against the independence of this member. The original wording has thus been reflected.</p>
5.4.1	<p>(2) ² <i>Within the company-specific situation the composition of the Supervisory Board shall appropriately reflect the international activities of the enterprise, potential conflicts of interest, the number of independent Supervisory Board members within the meaning of section 5.4.2, [...] and a regular limit to Supervisory Board members' term of office, both to be specified, as well as diversity.</i></p> <p>This recommendation is incorporated into principle 20 of the Draft GCGC. The recommendation of a regular limit for the membership in the Supervi-</p>

	<p>sory Board can be omitted since the length of membership now shall be disclosed (recommendation B.4 of the GCGC draft) and represents a criterion for the assessment of independence (recommendation B.8 of the GCGC draft).</p> <p><i>(5) ¹ When making its proposals to the General Meeting concerning the election of new members to the Supervisory Board, the Supervisory Board shall satisfy itself that the respective candidates are able to devote the expected amount of time required.</i></p> <p>This recommendation was meant to be an alternative for the limitation of the maximum number of Supervisory Board mandates, and should permit taking into account the different workloads from the individual mandates and other offices held, as well as the candidate's personal situation (cf. pronouncement 2015). In contrast, the administrative efforts of this individual solution to determine the time commitment were highlighted. The limitation of the maximum number of Supervisory Board mandates (recommendations B.5 and B.6 of the GCGC draft) pays due regard to this objection.</p>
5.4.3	<p><i>³ Proposed candidates for the Supervisory Board Chair shall be announced to the shareholders.</i></p> <p>Maintaining the existing recommendation is contradicted by the fact that this is a decision by the newly-constituted Supervisory Board, whereby publication of a proposal for a candidate by the previous Supervisory Board might prejudice the new Supervisory Board.</p>
5.4.4	<p><i>² In the latter case, appointment as Chair of the Supervisory Board shall be an exception that has to be justified to the General Meeting.</i></p> <p>The changeover to the Chairmanship of the Supervisory Board within the waiting period of two years requires a proposal of shareholders combining more than 25% of voting rights (section 100 (2) sentence 1 no. 4 of the AktG). There is no need for giving additional reasons beyond this proposal and a rationale of the proposal for election by the Supervisory Board following the recommendation B.2 of the GCGC draft.</p>
5.4.5	<p><i>(1) ² Members of the Management Board of a listed company shall not accept more than a total of three Supervisory Board mandates in non-group listed companies or on supervisory bodies of non-group entities that make similar requirements.</i></p> <p>The recommendation in section 5.4.5 (1) sentence 2 of the GCGC 2017 is replaced mainly by recommendation B.6 of the GCGC draft. The recommended maximum limit for non-group Supervisory Board mandates is reduced from three to two.</p>
5.4.6	<p><i>(3) ¹ The remuneration of Supervisory Board members shall be disclosed individually in the notes to the financial statements or the management report, classified by remuneration components. ² Payments made or benefits granted</i></p>

	<p><i>by the enterprise to Supervisory Board members for personal services, particularly advisory or agency services, shall also be disclosed separately on an individual basis.</i></p> <p>Replaced by principle 30 and section 162 of the Draft AktG.</p>
5.4.7	<p>¹ <i>[...] in any given financial year, [...] attended half or less than half of the meetings of the Supervisory Board or the committees of which they are a member, [...].</i></p> <p>This recommendation is replaced by recommendation A.14 of the Draft GCGC.</p>
5.5.2	<p><i>[...] particularly if they could arise as a result of an advisory or governing body function at clients, suppliers, lenders or other third parties.</i></p> <p>Conflicts of interest shall also be disclosed in future. However, conflicts of interest that may arise as a result of an advisory or governing body function are no longer highlighted. This shall avoid misunderstandings.</p>
5.6	<p><i>The Supervisory Board shall review the efficiency of its activities on a regular basis.</i></p> <p>Replaced by recommendation A.15 of the Draft GCGC.</p>
6.2	<p><i>As part of regular information policy, and providing sufficient advance notice, the company shall disclose publication dates of the annual reports and interim financial information (as well as the dates of the General Meeting, the annual report press conferences, and analyst conferences) in a “financial calendar” on its website.</i></p> <p>Publication of this so-called “financial calendar” has become a matter of course; i.e. a Code recommendation is no longer needed.</p>
7.1.2	<p>² <i>The Management Board shall discuss interim financial information with the Supervisory Board or its Audit Committee before being published.</i></p> <p>Pursuant to recommendation A.5 of the GCGC draft the review of the accounting by the Audit Committee also comprises interim financial information. Therefore, section 7.1.2 sentence 2 of the GCGC 2017 is no longer required.</p>
7.1.3	<p><i>The Corporate Governance Report shall contain specific information on stock option programmes and similar securities-based incentive systems of the company, unless this information is already provided in the annual financial statements, the consolidated financial statements or the remuneration report.</i></p> <p>Specific information on stock option programmes and similar securities-based incentive systems for the benefit of members of the governing bodies shall be disclosed in the remuneration report (cf. section 162 (1) sentence 2</p>

	no. 3 of the Draft AktG). Corresponding disclosures on employee programmes are not within the scope of corporate governance.
7.1.4	<p><i>Relationships with shareholders classified as related parties within the meaning of the applicable financial reporting requirements shall be explained in the consolidated financial statements.</i></p> <p>This recommendation can be deleted because of sections 285 no. 21, 314 no. 13 of the HGB, the requirements of IAS 24 for consolidated financial statements, the new transparency regime in sections 111a to c of the Draft AktG, ad-hoc disclosure duties pursuant to section 48a of the Draft WpHG, and the voting rights notification duties pursuant to sections 33 et seqq. of the German Securities Trading Act (WpHG).</p>
7.2.1	<p>(1) ¹ <i>Prior to submitting a proposal for election, the Supervisory Board or the Audit Committee shall obtain a statement from the proposed external auditors stating whether and, where applicable, which business, financial, personal or other relationships exist between the external auditors and their governing bodies and lead auditors on the one hand, and the enterprise and the members of its governing bodies on the other, that could call their independence into question.</i> ² <i>This statement shall also include the extent to which other services were provided for the enterprise over the past financial year, especially in the area of consulting, or that have been contracted for the following year.</i></p> <p>(2) <i>The Supervisory Board shall agree with the external auditors that the Chair of the Supervisory Board or the Audit Committee will be informed, without undue delay, of any grounds for exclusion or disqualification due to impairment of the external auditors' independence that occur during the audit, unless any such grounds are eliminated immediately.</i></p> <p>Section 7.2.1 (1) of the GCGC 2017 is no longer needed, due to the required annual confirmation of independence from the Audit Committee as set out in Article 6(2) of EU Regulation 537/2014 (on specific requirements regarding statutory audit of public-interest entities) and the case-specific reporting obligation of the external auditors towards the Supervisory Board and the Audit Committee in accordance with section 171 (1) sentence 3 of the AktG. A recommendation corresponding to section 7.2.1 (2) of the GCGC 2017 to include the legal reporting obligation of the external auditors as a part of the audit engagement seems unnecessary.</p>