

PRESS RELEASE

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Code reform 2019 – draft revised Code published: enhanced relevance, clearer and more compact wording

- **New recommendations on Management Board remuneration**
- **Specification of the independence requirement regarding shareholder representatives on the Supervisory Board**
- **German Corporate Governance Code to remain the most compact of its kind on an international level**
- **More transparency and clarity, plus a focus on essential issues**

With the beginning of the consultation process on 6 November 2018, the Government Commission on the German Corporate Governance Code (the "Code") published and explained the proposed changes for amendments to the Code for German listed companies on the Code website (www.dcgk.de).

"Sixteen years after the first version coming into force, and following twelve amendments, our intention is to give the German Corporate Governance Code a new push – and especially, to enhance its relevance. The objective of the Code reform is to ensure that the Code better fulfils its ambition to promulgate standards that are essential in the view of as many stakeholders as possible. This is the only way to prevent an unmanageable situation where a legally justified Code coexists with a plethora of voting guidelines for investors and proxy advisors. With the present draft, we are providing a strong, modern, clearly-worded, compact and relevant Code for discussion, which reflects the status quo of international corporate governance discussion", said Prof. Dr Rolf Nonnenmacher, Chairman of the Government Commission – German Corporate Governance Code.

Re-statement of the rules regarding Management Board remuneration

Accordingly, the Commission has developed new recommendations regarding Management Board remuneration (chapter D. of the new Code), addressing an issue which is on the corporate governance agenda – both nationally and internationally.

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 also complies with the requirement set out in the EU Shareholder Rights Directive, pursuant to which the remuneration contributes to the promotion of the business strategy and of the company's long-term development.

The target total remuneration comprises all remuneration components, and represents the amount granted in case of full target achievement. The target total remuneration is supplemented by a maximum remuneration (cap).

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. The correlation between achieving objectives and variable remuneration must therefore be determined beforehand, and may not be changed subsequently.

Operational metrics in particular – which may include both financial and non-financial parameters – are the focal point concerning short-term variable remuneration. 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 granted in a reporting year.

However, the success of strategic initiatives and measures does not emerge until much later. The amounts granted shall therefore be disbursed after the period, in shares of the company, which are then valued by the market: a restriction of at least four years should be imposed on the sale of the shares.

Contracts are set to be worded in a manner to ensure that remuneration may be reclaimed in justified cases, and that the Supervisory Board should have the option to take appropriate account of circumstances in both directions. All accrual and blocking periods should also remain in place after retirement/resignation from the company.

Indicators for lack of independence of shareholder representatives

The Government Commission has determined a second focal point in specifying requirements for the independence of shareholder representatives on the Supervisory Board. This is another issue which has gained in importance, both in Germany and internationally, over recent years. Through a catalogue of criteria (set out in recommendation B.8 of the new Code), the Commission aims to provide guidance as to when a shareholder representative on the Supervisory Board can no longer be regarded as independent. It is worth noting that the

Supervisory Board member concerned may still be considered independent even if an indicator has been fulfilled, in which case this needs to be substantiated in the Corporate Governance Statement.

From the Commission's perspective, indicators to be taken into account are given if the Supervisory Board member:

- was a member of the company's Management Board in the two years prior to appointment;
- maintains a material business relationship (supplier, customer, lender, advisor, etc.) with the company;
- receives other material variable remuneration from the company;
- is in a close family relationship with a member of the Management Board;
- is a controlling shareholder; or
- has been a member of the Supervisory Board for more than twelve years.

More detailed specifications, and transparency as a basis for assessment

Furthermore, in the interests of enhancing transparency, the Commission wants to recommend that the Supervisory Board discloses detailed information regarding individual members' attendance of meetings (recommendation A.14 of the new Code). In line with international best practice, shareholder representatives on the Supervisory Board shall only be appointed for a period not exceeding three years (recommendation B.1 of the new Code). To date, such appointments were usually made in Germany for up to five years. The same recommendation is issued regarding the appointment of Management Board members (recommendation C.2 of the new Code).

Supervisory Board members who are members of an executive governing body shall not exercise more than two mandates in the future (recommendation B.6 of the new Code). Supervisory Board members who are not members of an executive governing body shall not exercise more than five mandates in the future (recommendation B.5 of the new Code). For this purpose, the Chair of a Supervisory Board shall count twice. Management Board members shall not chair supervisory bodies of non-group entities (recommendation D.17 of the new Code).

Setting principles instead of recitals of legislative texts

In the interests of establishing a modern, clear and compact Code, the Government Commission will henceforth refrain from quoting legislative texts in detail. Instead, its recommendations will be preceded by principles which set out the essence of the most important legal rules in a few words only. Within the scope of "apply and explain", supplementing the concept of "comply or explain" for Code recommendations, companies will be called upon to explain how they implement the principles of the Code. This is designed to enhance transparency, which forms the basis for a well-founded governance assessment.

Finally, the Government Commission has re-structured the Code: the new structure is aligned to the tasks of the executive bodies, rather than to the system of applicable legal texts. Moreover, easier-to-understand language as well as detailed explanations regarding the recommendations and suggestions are designed to enhance understanding – and hence, acceptance – of the Code.

Consultation procedure launched

The interested public is invited to comment in writing upon the proposed Code amendments between now and 31 January 2019. Statements received on time will be considered in the final consultancy of the Government Commission. The plan is to submit the revised wording of the Code to the German Federal Ministry of Justice and Consumer Protection, for publication in April 2019. Comments received will be published on the Government Commission's website, unless consultation participants object to such publication.

Note to editors:

Government Commission on the German Corporate Governance Code

The members of the Commission are as follows: Prof. Dr Rolf Nonnenmacher (Chairman), Prof. Dr Dres h.c. Theodor Baums, Dr Joachim Faber, Mr Michael Guggemos, Dr Margarete Haase, Dr Thomas Kremer, Claudia Kruse, Dr-Ing Michael Mertin, Prof. Dr Klaus-Peter Naumann, Prof. Dr Wulf von Schimmelfmann, Dr Stefan Schulte, Marc Tüngler, Daniela Weber-Rey, Mr Jens Wilhelm.

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