

Deutscher Corporate Governance Kodex

PRESS RELEASE

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Code reform 2019 adopted:

- **Strengthening trust in governance**
- **Re-statement of the rules regarding Management Board remuneration**
- **Specification of the independence requirement regarding shareholder representatives on the Supervisory Board**
- **Developed in a dialogue process**

The Government Commission "German Corporate Governance Code" adopted a new version of the German Corporate Governance Code ("GCGC", or the "Code") on 9 May 2019. Only after the Act for Implementing the Second EU Shareholder Rights Directive ("ARUG II") enters into force will the new Code be handed in for publication at the Federal Ministry of Justice and Consumer Protection. Thus, potentially necessary amendments to the final new version of the German Stock Corporation Act (*Aktiengesetz* – "AktG") – due to the ARUG II – can be implemented. The new Code will then come into force with the subsequent publication by the Ministry in the German Federal Gazette, thus superseding the hitherto valid Code in its version dated 7 February 2017.

The Government Commission will already present the new Code today, in order to help enterprises and capital market participants prepare for the new recommendations and suggestions. Within the meaning of best practice, enterprises may adopt individual new recommendations and suggestions prior to the official adoption date. The GCGC version dated 7 February 2017 acts as the basis of the Declaration of Compliance until the new Code has been published in the electronic German Federal Gazette.

During a period of three months, the Commission had put the Code reform draft dated 6 November 2018 up for discussion in the usual written consultation process – as well as, for the first time, at a conference and at more than 30 individual events in Germany and abroad.

"After one and a half years of preparation, three months of consultation and a further three months of thorough deliberation, we can now present a new Code fulfilling the objectives of the most comprehensive reform to date. The new Code adheres to international standards and remains the most compact of its kind. Since transparency is the basis for sound decision-making on the part of stakeholders, the former continues to be the main focus. The consultation has shown that the Code is highly relevant for German enterprises and investors. However, it has also emphasised the fact that the debate about standards of

good corporate governance is mostly led in a defensive manner by enterprises. The Code provides the opportunity to shape new structures. Market participants should make use of this opportunity more actively than they have been doing until now, before others set the standards for German enterprises", says Rolf Nonnenmacher, Chairman of the Government Commission "German Corporate Governance Code".

Recommendations regarding Management Board remuneration adjusted

The recommendations made regarding Management Board remuneration were a focal point during consultation. Comments made especially targeted the proposals according to which long-term variable remuneration shall be solely granted in company shares, the volume of which shall depend on the execution of strategic initiatives and measures during the year under review. The now-resolved recommendations regarding Management Board remuneration take the comments into account.

The concept provided for in chapter G. of the Code still 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 is supplemented by a maximum remuneration (cap). Total target remuneration and maximum remuneration shall be communicable overall in comparison to the remuneration of other senior managers and the employees, and should be explainable to the general public.

In general, total remuneration comprises fixed and variable performance-related components. Variable remuneration is the key material incentive for pursuing the objectives of business policy. It acts as the motivation and reward for specific actions, for operating performance, for a strategic orientation that promotes the long-term development of the company, and for responsible behaviour. Accordingly, the performance criteria also comprise sustainability targets. Moreover, the Code will include a recommendation that going forward, the share of long-term variable remuneration shall exceed the share of short-term variable remuneration. The long-term variable remuneration amounts of Management Board members shall be largely invested in company shares by the respective Management Board member, or shall be granted by the company as share-based remuneration.

Catalogue of indicators for lack of independence of shareholder representatives

The Government Commission has determined a second focal point in specifying requirements for independence of shareholder representatives on the Supervisory Board.

In recommendation C.6 of the GCGC, the Commission determines that the recommendations for independence only apply to shareholder representatives, seeing as they are the only ones to be elected by the Annual General Meeting due to proposals made by the Supervisory Board.

In recommendation C.7 of the GCGC, the Commission mentions indicators determining lack of independence of Supervisory Board members for the first time. The Commission has decided on the indicator-based solution, since

evaluation of the independence of Supervisory Board members is necessarily a subjective assessment which requires an overall view. Whilst these criteria may provide assistance in the assessment of independence, the Commission believes that the criteria cannot replace exercising due discretion.

The Commission considers as indicators for lack of independence from the company and Management Board if the Supervisory Board member

- 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 non-group entity;
- is a close family member of a Management Board member, or
- has been a member of the Supervisory Board for more than twelve years.

If one or more of the indicators are met and the Supervisory Board member concerned is still considered independent, the reasons for this shall be given in the Corporate Governance Statement (C.8 of the GCGC).

Furthermore, the shareholder structure shall be considered in the independence assessment, while a specific number of Supervisory Board Members shall be independent from the controlling shareholder.

Simplification of corporate governance reporting decided

Furthermore, the Government Commission has decided to simplify corporate governance reporting. The parallel existence (now obsolete) 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 thus already started to combine the Corporate Governance Report and the Corporate Governance Statement.

A corresponding solution can be found in principle 22 of the GCGC: "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.

Recommendation regarding the limitation of Supervisory Board mandates

The existing recommendation (in accordance with section 5.4.1 (5) of the GCGC 2017), according to which 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, is removed. Instead, the Code recommends that a Supervisory Board member who is not a member of any Management Board of a listed company shall not accept more than five Supervisory Board mandates at non-group listed companies or comparable functions, with an appointment as Chair of the Supervisory Board being counted twice (C.4 of the GCGC). Members of the Management Board of a listed company shall not have, in aggregate, more than two Supervisory Board mandates in non-group listed companies or comparable functions, and shall not accept the Chair of a Supervisory Board of a non-group listed company (C.5 of the GCGC).

In line with common practice, the Code now also recommends limiting the first-time appointment of Management Board members to three years.

Suggestion for Extraordinary General Meeting in the event of a takeover remains in place

As a result of the consultation process, the Code will not contain any new recommendation concerning the term of office of Supervisory Board members. In addition, section 2.2.4 (2) of the GCGC 2017 was re-included in the new Code (under section A.4); according to this the Chair should take into account that the Annual General Meeting be completed after four to six hours.

Finally, as a result of further discussions, the Commission followed the argument that the new Code should also contain a suggestion for the Management Board to convene an Extraordinary General Meeting in the event of a takeover offer, at which EGM shareholders will discuss the takeover offer and, if appropriate, decide on corporate actions. (section 3.7 (3) of the GCGC 2017; new A.5 of the GCGC).

However, after the deliberations it was considered unnecessary to include in the new Code a specific recommendation requiring the Management Board and the Supervisory Board to describe in the Corporate Governance Statement how the principles and recommendations applied by the company were applied ("apply and explain"). According to section 289f (2) no. 2 of the HGB, companies are obliged to provide – in their Corporate Governance Statements – relevant disclosures regarding corporate governance standards applied at the respective entities above and beyond legal requirements. Moreover, individual Code recommendations already incorporate separate recommendations concerning transparency. In order to improve the information flow for investors, the Commission is now continuing along this path with the revised version.

Within the consultation period, maintaining the sample tables according to section 4.2.5 of the GCGC 2017 was also suggested. Given that section 162 of the Draft AktG now provides for a meaningful remuneration report, the Commission nonetheless decided to no longer include the sample tables. In fact, the details to be included in the remuneration report exceed the content of the sample tables. The Government Commission does not consider it its duty to compile recommendations regarding the reporting format of Management Board and Supervisory Board remuneration; however, should benefits be granted to Management Board members in a subsequent year, the Commission

recommends that this disbursement be reported. The sample tables will continue to be deemed best practice until the new Code comes into force.

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 Guggemoos, Dr Margarete Haase, Dr Thomas Kremer, Claudia Kruse, Dr-Ing Michael Mertin, Prof. Dr Klaus-Peter Naumann, Prof. Dr Wulf von Schimmelmann, Dr Stefan Schulte, Mr Marc Tüngler, Daniela Weber-Rey, Mr Jens Wilhelm.

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