

Remarks

by

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Chairman of the Government Commission

German Corporate Governance Code

on the

publication of the draft

German Corporate Governance Code

December 18, 2001

in Düsseldorf

Ladies and Gentlemen,

I am grateful that so many of you have been able to accept our invitation, despite the fact that it was issued at such short notice, for which I request your understanding.

As chairman of the Government Commission on the German Corporate Governance Code, I am pleased to inform you that yesterday evening the Commission adopted the draft of the German Corporate Governance Code. The draft will be published shortly on the internet and thus made available to the general public.

The Corporate Governance Code provides a clear and concise summary of the principles of good corporate governance in Germany.

To begin, allow me to explain what the **aim** of our work was: The aim of introducing the corporate governance code is to make Germany more attractive to international - and national - investors by addressing all the major **criticisms** - especially from the international community - leveled against German corporate governance and providing suitable solutions. These criticisms are:

- inadequate focus on shareholder interests;
- the two-tier system of executive board and supervisory board;
- inadequate transparency of German corporate governance;
- inadequate independence of German supervisory boards;
- limited independence of financial statement auditors.

We addressed each of these five points in the provisions and rules of the code and of course also took into consideration the legal framework. The code provides capital market observers - including journalists such as yourselves - with a **catalogue for evaluating good corporate governance**. Of course the code cannot cover every detail of every single issue, instead it provides a framework which the individual companies will have to fill in.

Further, the following should be noted:

At national and international level, the principles of good corporate governance are evolving continuously. We will therefore need to constantly review the code and adapt it to the latest national

and international developments. So the mission of the code commission is not over with the draft corporate governance code we are presenting to you today. In the future the commission will meet at least once a year to carry out the changes required to adapt the code to new developments.

I will shortly be looking at each point of criticism in detail, but first I would like to make one or two remarks on the reasons why the commission was appointed, our mission and the accompanying legislative measures:

- **Appointment of the commission/predecessor commissions**

The Government Commission on the German Corporate Governance Code was appointed on September 6, 2001 in Berlin by the Justice Minister Prof. Dr. Herta Däubler-Gmelin. The commission is made up of institutional and private investors, executive and supervisory board members of listed corporations, employee representatives, stock exchange representatives, auditors and academics (a list of members is provided as an appendix to this manuscript). As you can already see from the composition of the commission, it functioned independently of the Justice Ministry.

The government commission on “Corporate Governance - Corporate Management - Corporate Monitoring - Reform of German Stock Corporation Law”, set up by the German Chancellor and chaired by Prof. Dr. Theodor Baums, performed important preparatory work for the code commission. The recommendations and proposals contained in its final report, submitted in July 2001, formed the basis of our work. We owe express thanks to the members of this commission, in particular its chairman Prof. Baums.

The outcome of our consultations in the code commission shows that we were able to follow the recommendations of the Baums commission to a large extent. The broad agreement between our commission and the commission led by Prof. Baums is not surprising given that a number of members of the code commission were also members of the Baums commission.

The Code of Best Practice for German Corporate Governance, drawn up by the Frankfurt Panel on Corporate Governance in July 2000, and the proposals of the Berlin-based German Code of Corporate Governance initiative, drawn up in June 2000, provided further important groundwork which was also included in our discussions.

The draft code was completed by the commission yesterday and is being published today. Once it enters into force, the German Corporate Governance Code will replace these predecessors and set general standards of good corporate governance for listed companies in Germany.

- **Mission of the Code Commission**

The appointment of the Code Commission gave German business an opportunity to develop a Corporate Governance Code in an act of self-organization. The Code aims to

- summarize key statutory requirements on the governance of listed companies,
- provide recommendations taking account of nationally and internationally recognized standards, and
- give individual companies ideas for good and responsible corporate governance.

- **Legislative measures accompanying the code**

Other tasks fall not to the Code Commission, but primarily to legislators. These include in particular the rules governing company takeovers, the reform of stock corporation law, and the improvement of investor protection.

Some of these legislative tasks have now been tackled with the introduction of the government bill on the 4th Financial Market Promotion Law and the draft bill of the Transparency and Disclosure Law. Speed is of the essence in implementing the Transparency and Disclosure Law as it lays the legal foundations for the Corporate Governance Code and the German parliament will shortly be entering the critical phase of the election campaign.

The Transparency and Disclosure Law requires the executive and supervisory boards of listed companies to declare once a year whether they comply with the recommendations of the German Corporate Governance Code. This declaration should then be announced to the shareholders.

Companies therefore have the choice:

- they can either comply with the recommendations of the Corporate Governance Code, in which case they are required “only” to declare this

- or they must explain their reasons for not complying with the Code's recommendations. The recommendations of the Code are therefore not fully binding.

Under the draft Transparency and Disclosure Law, the notes to the annual financial statements must state that executive board and supervisory board have issued the Code declaration and have made it accessible to stockholders.

As part of the audit of the annual financial statements, the auditor then examines whether these disclosures have actually been made. An audit of corporate governance, whether it complies with the provisions of the code, does not take place. This will be left for those concerned, in particular the capital market participants, to judge for themselves.

- **Criticism of German corporate governance from an international viewpoint**

However, for the code to succeed, it must not limit itself to a clear presentation of German corporate governance rules, it must also address and substantially invalidate the criticism leveled by international investors against German corporate governance. I would now like to deal in detail with the five main points of criticism I listed earlier. We have addressed all of them in the code and, we believe, found a solution which makes clear that in practice at least, corporate governance rules in Germany and in the Anglo-Saxon countries are not so very different.

- **Stronger focus on stockholder interests**

The very first section of the code is dedicated to shareholders and the annual shareholders' meeting. The rights of shareholders, who are the beneficial owners of the company, are explained here.

The individual rights of shareholders at the annual shareholders' meeting and in particular the voting right based on the principle of one share, one vote, are described, as are the competencies of the annual shareholders' meeting. This is important particularly for the understanding of foreign capital market participants.

The aim is to make it easier for shareholders to exercise their rights, in particular their voting rights. To this end the company should ensure that a proxy, bound by instructions, is made available for the annual shareholder's meeting (draft code, section II., item 3.3). It should also allow shareholders to follow the annual shareholders' meeting on the internet (draft code, section II., item 3.4).

With regard to the question of "defensive action by the executive board to avert takeover bids" currently under intensive discussion, the code also emphasizes the rights of shareholders and advocates in appropriate cases the convening of an extraordinary shareholders' meeting at which shareholders can discuss the takeover bid and if necessary resolve on legal action (draft code, section III., item 6).

- **Two-tier system of executive board and supervisory board**

You are familiar with the German system: The executive board is responsible for managing the company; the chairman coordinates its work. The supervisory board supervises and advises the executive board and is directly involved in fundamental decisions. Here, too, the supervisory board chairman coordinates the work. Under codetermination law, depending on the size of the company, up to half the supervisory board members are employee representatives.

In the international sphere there is a widespread system of corporate governance by a single administrative organ, the "board of directors" in Anglo-Saxon companies and the "conseil d'administration" in French companies. The members of these administrative bodies hold regular meetings to deal intensively with company affairs and discuss important matters. However, these differences must not be over-estimated. In practice, the executive board chairman of a German stock corporation and the CEO of an Anglo-Saxon company have basically similar functions. The board of directors, too, consists of executive and non-executive directors. In France, more and more companies are making use of the possibility provided by the law to entrust their management to an executive "directoire" and a supervisory "conseil de surveillance". All of this indicates that in practice the two systems, the two-tier system and the board of directors system, are converging.

To support this, the code sets out to promote cooperation between executive and supervisory boards and in particular to foster open and intensive discussion of corporate issues in the supervisory board and in the exchange between the executive board and supervisory board (draft code, section III.).

The code addresses the supply of information to the supervisory board and advocates extensive, up-to-date written reporting by the executive board. The code emphasizes that for a supervisory board to work effectively it must not rely solely on the reports of the executive board. Rather, the supervisory board and executive board should jointly determine the information and reporting requirements of the executive board. This therefore calls for a more active role of the supervisory board (draft code, section III., item 4.).

Another aim of the code is to improve the discussion culture in the supervisory board. To this end the Commission proposes the increased use of committees (draft code, section V., item 3.1) and regular shareholder and employee discussions in advance of actual supervisory board meetings (draft code, section III., item 7).

Strict observance of confidentiality is of utmost importance for open discussions in the supervisory board and for an open exchange of opinions between executive board and supervisory board. Nobody will openly disclose information if he can expect to find that information supplied in confidence is published in the next day's papers. The code calls for confidentiality to be observed in full (draft code, section III., item 5.).

The code clearly specifies the duties and powers of the supervisory board chairman: The supervisory board chairman maintains regular contact with the executive board and in particular the executive board chairman or speaker and discusses with him the strategy, business development and risk management system of the company. The supervisory board chairman is informed immediately by the executive board of extraordinary events of major importance for assessing the situation and for the running of the company (draft code, section V., item 7).

If the executive board and supervisory board keep to the rules described, in practice the differences between the two-tier management structure and the widespread international system of the board of directors should no longer be so significant.

- **Greater transparency of German corporate governance**

Ladies and Gentlemen,

Creating transparency is one of the code's guiding principles.

In practice, companies have quite specific management mechanisms, resulting from their own specific situation. The aim of the code is not primarily to change these mechanisms. Rather the code sets out to create clarity about the decision-making processes so that the capital market can obtain a clear picture of the company.

The code aims to make companies and their governance as well as the remuneration of board members and performance reviews transparent to investors.

Shareholders are to be kept informed throughout the fiscal year in a series of interim reports, in particular quarterly reports. The consolidated financial statements and the interim reports should be prepared in accordance with internationally recognized accounting principles (draft code, section VII., item 1.1).

The consolidated financial statements and interim reports should be made available to shareholders and investors in good time. For the consolidated financial statements a period of 90 days after the end of the fiscal year and for interim reports 45 days after the end of the reporting period are recommended (draft code, section VII., item 1.2).

The company is to treat shareholders equally in terms of information and provide them with relevant information quickly, also using the internet (draft code, section VI. item 4).

Performance incentives for executive and supervisory board members are to be disclosed.

The variable compensation is to include components having a long-term incentive effect. These include stock options and similar forms of incentive such as phantom stocks (draft code, section IV, item 2.3). Executive board compensation is to be disclosed in the notes to the consolidated financial statements, broken down individually by fixed salary, performance-based compensation and long-term stock-based components (draft code, section IV, item 2.4).

Executive board member compensation is to be determined by the supervisory board on the basis of a performance assessment. Criteria for the appropriateness of the compensation will be the board member's duties and his performance, as well as the business situation, success and future prospects of the company benchmarked against others (draft code, section IV. item 2.2).

The supervisory board compensation system also includes performance-related components; for our code demands a stronger and more time-intensive commitment on the part of supervisory board members.

We therefore recommend that special compensation be provided not only for the chairman and vice chairman of the supervisory board but also for the chairman and members of the committees. This will make committee work more attractive. In addition the code proposes that supervisory board members receive performance-based compensation which also takes into account long-term company success (draft code, section V. item 4.5).

- **Independence of supervisory board members**

At several points the code contains rules to ensure the independence of the supervisory board. A supervisory board is not to include more than two former members of the executive board, and supervisory board members are not to perform any board functions or consulting functions with major competitors of the company (draft code, section V. item 4.2). The post of chairman of the audit committee is not to be filled either by the supervisory board chairman (draft code, section V. item 2) or by former executive board members (draft code, section V. item 3.2). This will strengthen the independence of financial statement preparation and auditing by the supervisory board.

To ensure that the supervisory board members have enough time to fulfil their mandates, the code recommends that executive board members of listed companies should have no more than five supervisory board seats with other, non-affiliated listed companies (draft code, section V. item 4.3). This, too, goes far beyond current statutory requirements.

With regard to the subject of conflicts of interest the code again follows the principle of transparency and disclosure:

All supervisory board members must disclose to the supervisory board chairman any conflicts of interest which could arise as a result of a consulting or board function carried out for customers, suppliers, lenders or other business partners. The purpose of this is to ensure that the supervisory board is aware of the relevant conflicts and can take them into account in its consultations (draft code, section V. item 5.2).

- **Auditor independence**

The code aims to ensure efficient auditing.

With regard to the selection of the auditor, the code recommends complete disclosure of the professional, financial and other relations between the financial statement auditors on the one hand and the company on the other. In addition, conflicts of interest are to be identified at an early stage. The auditor will be required to disclose the extent to which he has provided consulting services for the company and what consulting services are already agreed for the following year (draft code, section VII. item 2.1).

The auditor will be required to inform the supervisory board chairman immediately of any grounds for exclusion or prejudice occurring during the audit which cannot be eliminated (draft code, section VII. item 2.1).

- **Transparent presentation of German corporate governance**

Ladies and Gentlemen,

Those are the main points dealt with by our code. At the beginning I stated that the aim of the Corporate Governance Code is to make Germany a more attractive place for international investors.

To achieve this aim the Corporate Governance rules must be made transparent for foreign investors. We must present German Corporate Governance convincingly and highlight the advantages of the two-tier system of executive board and supervisory board. This will create confidence in German corporate governance.

German corporate governance is already of a high standard. This has been achieved not least through the 1998 Law on Control and Transparency in Business. This law – called the KontraG – significantly improved the statutory provisions regarding corporate governance.

However the problem for foreign investors so far is that they are not fully aware of all the German regulations because they are scattered throughout a number of laws. As well as the stock corporation law we also have the securities trading law, the commercial code and the codetermination law.

In developing the individual provisions of the code, therefore, we set ourselves the goal to summarize major statutory corporate governance rules and to supplement them with standards of good corporate governance that businesses can fulfil in practice. The code brings together both types of provision in a concise, concrete and understandable way.

The draft code adopted by the commission yesterday describes the corporate governance rules on 12 pages. They will be published in German and English.

- **Next steps**

The present version of the Corporate Governance Code is a discussion draft agreed by the commission. The commission wishes to give all interested parties the opportunity to examine the draft and send any comments to the commission. For this a deadline of January 18, 2002 has been set. This is a short but appropriate period. The relevant issues have been known for some time through the report of the Baums commission. The results of our consultations are in broad agreement with the recommendations and proposals of the Baums commission. Our commission is under severe pressure of time since the final version of the code is to be presented to the Federal Ministry of Justice at the end of February 2002. We will therefore swiftly evaluate the comments received and finalize our consultations in plenary meetings at the end of January and end of February 2002.

Subsequently the Corporate Governance Code is to be published in the Federal Gazette and made known to all parties involved.

That was my brief look at the code.

Do you have any questions?

List of members

Government Commission on the German Corporate Governance Code

Dr. Gerhard Cromme

Supervisory Board Chairman, ThyssenKrupp AG

- **Chairman of the Code Commission** -

Dr. Paul Achleitner

Financial Director, Allianz AG

Dr. Rolf-E. Breuer

Executive Board Speaker, Deutsche Bank AG

Dr. Hans-Friedrich Gelhausen

Auditor, Lawyer, Executive Board Member, PwC Deutsche Revision AG

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