Remarks

by

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Chairman of the Government Commission

on the German Corporate Governance Code

at the

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Check against delivery

Ladies and Gentlemen,

Today we are presenting the results of the current survey of acceptance of the German Corporate Governance Code for 2004. This is the third time the Berlin Center for Corporate Governance has been commissioned by the Government Commission on the German Corporate Governance Code to conduct an empirical survey of acceptance of the Code's recommendations and suggestions for good corporate governance. Professor Axel von Werder, member of the Government Commission and academic head of this very extensive analysis, will look into the individual findings in detail after my remarks.

As Chairman of the Government Commission, I would like to take this opportunity to make a few remarks about (1) the key findings of the survey and then (2) the current status of the corporate governance discussion and the work of the Government Commission.

(1) Key findings of the survey:

Ladies and Gentlemen,

As you know, the German Corporate Governance Code is a voluntary business code aimed at improving corporate governance through transparency. The Code currently contains 72 recommendations and 19 suggestions.

Companies are under no obligation to follow any of the 72 recommendations; but they are obliged to declare whether they comply with the recommendations or explain why not. This "comply or explain" rule is based on Section 161 of the German Stock Corporation Act (Aktiengesetz) which integrates the Code, first issued in February 2002, into the German stock corporation law.

The results of this year's survey again show continuously increasing acceptance for the Code's recommendations. On average, 97.3% or 70 of the 72 recommendations will be followed in the DAX segment by the end of 2005. This is even better than last year's outstanding achievement of 96% or 69 of 72 recommendations. In particular the recommendations concerning the individual disclosure of management board compensation, the subject of intense public debate, show a much higher level of

acceptance (improved transparency). There has thus been a qualitative improvement. After three years the Code remains on a successful course. Professor von Werder will go into this after my remarks.

(2) Current corporate governance discussion and work of the Government Commission

Ladies and Gentlemen,

Now to current corporate governance issues also influencing the work of the Government Commission: Firstly management board compensation and secondly important supervisory board issues. Key questions here concern the independence of supervisory board members and in this context the handling of the switch from management board chairman to supervisory board chairman.

The discussion surrounding these questions has received added impetus from the EU Commission in Brussels. In the fall of last year the Commission published two far-reaching recommendations on compensation for board members of listed companies and the duties of non-executive directors and supervisory board members. Like the German Code Commission, the EU Commission sees transparency and disclosure as important means of improving corporate governance. This will without doubt have a significant impact on the work of the Code Commission.

Transparency of management compensation

Ladies and Gentlemen,

While the public corporate governance debate centers on the question of transparency and individual disclosure of management compensation, it should not be forgotten that this is just <u>one</u> of the Code's 72 recommendations. It is a key issue, but it should not be overvalued and it should not distort our view of the Code's other recommendations and the great success that has been achieved with their implementation.

In recent months much has happened with regard to the individual disclosure of management compensation. Last year only 9 of the 30 DAX companies followed the recommendation to disclose management compensation on an individual basis. The

analysis we are looking at today shows that significant progress has been made. 20 DAX companies have already announced that before the end of 2005 they intend to make public the compensation paid to individual management board members broken down according to fixed compensation, bonuses and other long-term variable compensation components.

This means that two thirds of all DAX companies disclose individual executive pay, setting the trend for all listed companies in Germany. The trend among M-DAX and S-DAX companies is also positive. By the end of 2005 37.5% of M-DAX companies and 27.3% of S-DAX companies intend to make individual disclosures. While these figures are not satisfactory, there can be no mistaking the positive trend in these stock market segments.

But whether this will be enough to avoid a legislative solution, for which public calls are growing, is another question. For example, in the United Kingdom, France and the Netherlands, laws have already been introduced to enforce the individual disclosure of management compensation after the voluntary codes in these countries failed to achieve the required success.

Supervisory board questions: Independence and the switch from management board chairman to supervisory board chairman

Ladies and Gentlemen,

Let us look now at the supervisory board questions. The debate here focuses on the independence of supervisory board members and the transparency thereof. In this context, the switch from management board chairman to supervisory board chairman is the subject of particularly intense discussion.

You will not be surprised to hear that suggestions on this key corporate governance issue have also been received from Brussels. I am thinking here in particular of the recommendation concerning the position of non-executive directors and supervisory board members. In this matter Brussels faces a considerable dilemma.

One-tier-board/two-tier board

In most member states of the EU, companies are governed by a single board – the one-tier board system. Companies in other member states – e.g. German companies – are governed by the two-tier system with a management board and a supervisory board. The different legal structures result in different governance problems. I would like to highlight one or two examples.

In the one-tier board, the functions of management and management control are combined in a single body. In general, the one-tier board supervises itself.

Experience shows that self-monitoring is not always the most efficient form of oversight. That is why it is particularly important that the non-executive directors on a one-tier board are independent of the executive directors, so the basis for management control is laid.

In the two-tier board system we have in Germany, the separation of the management and oversight functions is prescribed by law. Against this background, the question of independence of supervisory board members in the two-tier system is in some areas different from the question of independence of non-executive directors in the one-tier system.

Another difference between the board systems lies in the remuneration of board members. In the one-tier system the remuneration of board members is decided by the board itself. To prevent abuse it is clear that directors' remuneration must be disclosed individually. In our German system of management board and supervisory board, the supervisory board decides on management board remuneration and the annual general meeting on supervisory board remuneration. These structural differences limit the potential for self-enrichment. But even under the conditions of the two-tier system it is good and correct to prevent excesses and disclose management board remuneration individually. The key reason for disclosing directors' remuneration in both (one-tier and two-tier) systems is that only individual disclosure allows shareholders as owners of the company to relate the performance of individual board members with their remuneration.

Another typical example of the differences between the board systems is in the rules concerning ad-hoc disclosures (stock market announcements) under the Investor Protection Improvement Act (Anlegerschutzverbesserungsgesetz). In the one-tier system it is taken for granted that stock exchange announcements are made as soon as the board of directors makes a decision requiring disclosure.

In Germany this legal situation means that a decision of the management board has to be disclosed even if the supervisory board has not yet approved it. This makes it very difficult for the supervisory board to change a decision by the management board, e.g. on dividends or major transactions, once it has been made public. To do so would represent a major loss of face for the management board. The German practice does not support the aim of the legislator in increasing the involvement of the supervisory board in key company decisions and should therefore be changed.

Ladies and Gentlemen,

The examples show clearly that solutions which are right for the one-tier system are not automatically right for the two-tier system. The EU Commission has recognized this and is now no longer recommending that a majority but only a sufficient number of supervisory board members should be independent.

In implementing the EU recommendations, we have the choice of either using the Corporate Governance Code for this or letting the legislator decide. Alternatively, we can ignore the recommendations – after all they are not binding – and hope that Brussels takes its time in adopting binding rules. The best way for Germany is to implement the recommendations through the Corporate Governance Code rather than by law. The Government Commission will therefore have to concern itself closely with the definition of independence and with the independence criteria.

At this point I would like to reiterate that even if a supervisory board member is classed as non-independent, this does not call into question his qualification as a supervisory board member. It only means that the supervisory board member in question is somehow close to the company, according to a definition we have to establish more precisely. However this does not mean that a “dependent” supervisory board member would be a “second-class” member and would therefore have to perform inferior control functions.

Switch of management board chairman to supervisory board chairman

The issue of independence also arises in the much-discussed question of the switch from management board to supervisory board chairman. Here, too, it is not the case that the EU recommendation is generally against an immediate switch. Rather it

refers to such a switch merely as an option, the implementation of which should be accompanied by information about the precautions taken.

A number of proposals for the handling of this switch are currently being discussed. They extend from the requirement for transparency and explanation of the reasons for the choice of a candidate for the supervisory board chair, to the principle that a management board chairman should not as a rule be allowed to become supervisory board chairman, to the requirement for a cooling-off period of up to five years. We will discuss these proposals in the Commission and find an appropriate solution.

Final remarks

Ladies and Gentlemen,

I believe that we have made great progress in the service of investors and other company stakeholders. If we consider the remuneration issue as well as the other changes I have mentioned, we have taken a major step towards modernizing the German corporate governance system.

At the next full meeting of the Government Commission on the German Corporate Governance Code in June, we will assess all the aspects I have mentioned as well as others, and, if a new basis for decision making exists, also look at amendments to the Code. The maxim is that the Code must remain as concise as necessary and as clear and transparent as possible.

I would like to thank you for your attention and ask Professor von Werder to present the further details of his empirical survey.