

Remarks

by

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Background to the 2006 Code Report

The Government Commission on the German Corporate Governance Code presented the German Corporate Governance Code in 2002. As well as setting out the main statutory provisions relating to corporate governance, the Code in its current form contains a total of 82 recommendations and 19 suggestions on the management and supervision of exchange-listed companies. Compliance with the recommendations and suggestions is voluntary for companies. However, under Art. 161 of the German Stock Corporation Act (AktG), exchange-listed companies are required to issue an annual declaration of conformity stating which recommendations they do not observe.

Each year the Berlin Center of Corporate Governance (BCCG) is commissioned by the Code Commission to conduct an empirical survey to systematically record the acceptance of the rules of the Code in business practice. To this end all companies listed on the Frankfurt Stock Exchange were asked to what extent they already comply with the individual rules of the Code, intend to do so within the current year, or do not apply the rule (now or in the future). The findings of the survey are published in the annual Code report¹.

The current Code Report (Code Report 2006) is based on the analysis of altogether 200 questionnaires received from all segments of the stock exchange (see Fig. 1). Related to all (671) companies, the response rate was 29.8%, ranging from 15.0% in the general standard segment to 93.3% in the DAX².

¹ See v. Werder, Axel/Talaulicar, Till/Kolat, Georg L. (2003): Code Report 2003: The Acceptance of the Recommendations of the German Corporate Governance Code. In: Der Betrieb, Vol. 56, pp. 1857-1863; v. Werder, Axel/Talaulicar, Till/Kolat, Georg L. (2004): Code Report 2004 – The Acceptance of the Recommendations and Suggestions of the German Corporate Governance Code. In: Der Betrieb, Vol. 57, pp. 1377-1382; v. Werder, Axel/Talaulicar, Till (2005): Code Report 2005: The Acceptance of the Recommendations of the German Corporate Governance Code. In: Der Betrieb, Vol. 58, pp. 841-846.

² For details of the survey and the other findings see v. Werder, Axel/Talaulicar, Till (2006): Code Report 2006: The Acceptance of the Recommendations of the German Corporate Governance Code. In: Der Betrieb, Vol. 59, pp. 849-855.

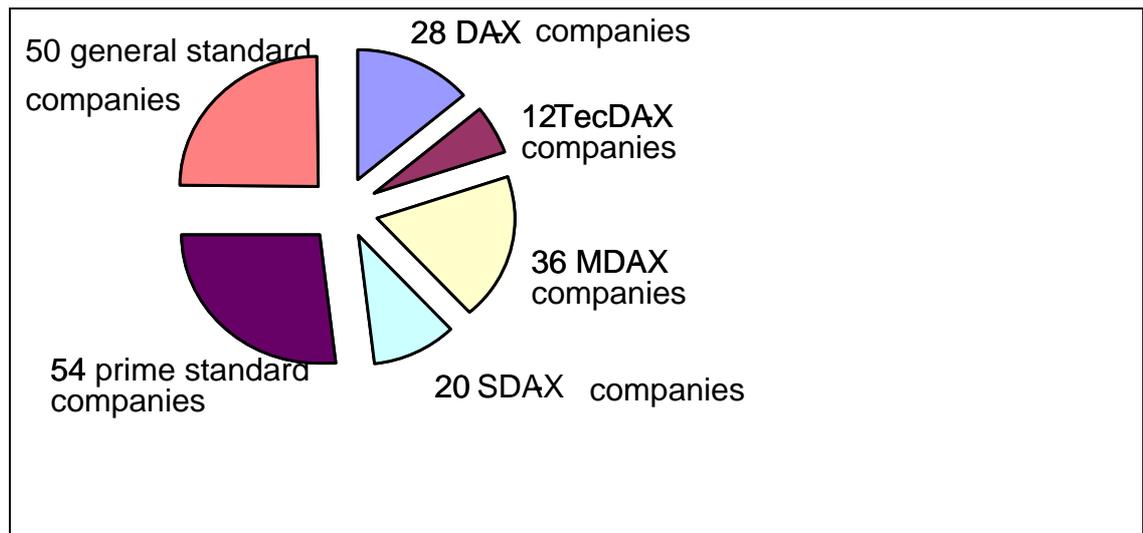


Fig. 1: Sample structure of 2006 Code report

General trends

The Code Report 2006 essentially reflects three main trends which have also been observed in previous years.

Firstly, the rules of the Code meet with a very positive response overall in practice. The 28 DAX companies which participated in the survey already follow on average 78.2 of the 82 recommendations today. In the future – i.e. before the end of 2006 – the number of recommendations implemented on average will increase to 79.3. The implementation rate therefore already stands at 95.3% of all recommendations and is set to rise to 96.7% in the future.

In line with expectations, acceptance is higher for the recommendations than for the suggestions. Nevertheless, before the end of the year the DAX companies will follow on average 16.5 of the 19 suggestions, i.e. 86.8%.

Secondly, the compliance rate tends to depend on the size of the company and the stock exchange segment. Acceptance of the Code is especially high in the DAX segment, and comparatively low in the general standard segment (see Table 1). Here, however, it must be borne in mind that depending on the

specific circumstances of a company (e.g. its size) it may well be expedient to deviate from individual rules of the Code and this by no means signifies bad governance practice.

	<i>DAX</i>	<i>TecDAX</i>	<i>MDAX</i>	<i>SDAX</i>	<i>Prime</i>	<i>General</i>	<i>Total</i>
Recommendations							
followed today	78.2	70.3	74.0	71.0	64.5	56.7	67.2
current share	95.3%	85.7%	90.2%	86.6%	78.7%	69.1%	81.9%
followed in future	79.3	76.1	75.7	72.9	66.9	59.6	69.5
future share	96.7%	92.8%	92.3%	88.8%	81.6%	72.7%	84.8%
Suggestions							
followed today	16.2	13.2	13.4	12.1	10.3	8.4	11.6
current share	85.2%	69.3%	70.5%	63.4%	54.1%	44.4%	60.8%
followed in future	16.5	14.2	13.7	12.5	11.0	9.1	12.1
future share	86.8%	74.6%	72.1%	65.5%	58.0%	48.1%	63.8%

Table 1: Acceptance of the Code's recommendations by stock exchange segment

Thirdly, the Code does indeed contribute to changes in the corporate governance practice of German companies. As a result of the Code's recommendations and suggestions, companies introduce a considerable volume of rules which they had not previously practiced in such a form. Over time this applies not only to the original version of the Code but also to the amendments in 2003 and 2005, both of which have become established to a high degree in practice after a short phase of adjustment.

Main individual findings

For the *DAX companies*, which are traditionally the focus of the corporate governance debate, the main individual findings are as follows. None of the 28 DAX companies surveyed rejects the Code in its entirety. Indeed, five companies already follow all 82 recommendations today. Two further com-

panies will implement all the Code's recommendations before the end of the year, so that then seven companies will comply with all recommendations.

For a more differentiated analysis of the acceptance level, the Code Report distinguishes between three categories:

- generally accepted Code rules applied by an overwhelming majority of the companies (90% and above),
- critical Code rules not observed by more than 10% of companies
- and Code recommendations rejected by a majority.

In the DAX segment only seven *recommendations* will be critical under this definition by year-end. These concern

- an appropriate deductible for D&O insurance for members of the management board and supervisory board (acceptance in the DAX today and in the future: 78.6%),
- discussions in full supervisory board meetings on the structure of the compensation system for the management board (acceptance in the DAX today and in the future: 85.7%),
- individual disclosure of management board compensation (acceptance in the DAX today: 74.1%; in the future: 77.8%),
- the conduct of elections to the supervisory board on an individual basis (acceptance in the DAX today: 57.1%; in the future: 85.7 %),
- the restriction of the move by the former management board chairman or a management board member to the supervisory board chair or chair of a supervisory board committee (acceptance in the DAX today: 70.4%; in the future: 77.8%),

- performance-related compensation for supervisory board members (acceptance in the DAX today and in the future: 85.7%), and
- individual disclosure of compensation or benefits paid by companies to members of the supervisory board for services performed personally (acceptance in the DAX today and in the future: 89.3%).

However, of these seven critical recommendations, none is rejected by the majority of companies.

In respect of the *suggestions* the survey shows that no DAX company completely rejects this section of the Code. Three companies already comply with all suggestions today. A further DAX company intends to implement all suggestions before the end of the year.

On average, 16.2 – or 85.2% - of the 19 suggestions are followed. Today and in the foreseeable future there remain eight critical suggestions. As with the recommendations, however, it must again be borne in mind that although these suggestions are followed by fewer than 90% of the companies, they still may meet with considerable acceptance. Of the eight suggestions, therefore, only one will continue to be rejected by the majority of companies in the future. This is the suggestion that the periods of appointment of supervisory board members should be made more flexible (today and in the future: 39.9%).

Overall it can therefore be stated that of the 101 recommendations and suggestions in the Code, only one suggestion is rejected by a majority of DAX companies. By contrast, the compliance rates for the remaining rules, with one exception, will in the future be high at more than 75% and for the most part more than 90%.

As already explained, the compliance rates for the Code's rules depend among other things on the respective stock exchange segment. Without go-

ing into details on all the various segments, I would like to close with a look at the main *key figures from the overall sample of 200 companies*.

Related to all companies, today 48 (58.5%) and by the end of 2006, 37 (45.1%) of the Code's 82 *recommendations* are classed as critical because they are not followed by at least 90% of the companies. However, of these there are only two recommendations which will continue to be rejected by the majority of companies in the foreseeable future. In concrete terms these are the recommendations concerning

- an appropriate deductible for D&O insurance for members of the management board and supervisory board (today: 44.0%; in the future: 45.1%), and
- individual disclosure of management board compensation (today: 39.4%; in the future: 48.5%).

With these two exceptions it can therefore be stated that the recommendations meet with more acceptance than rejection from the responding companies in all stock exchange segments and are frequently followed by large majorities.

Analogous findings are reached for the *suggestions*. Related to all companies, only three of the 19 suggestions will not be implemented by a majority in the foreseeable future, i.e. before the end of 2006. The rejected suggestions concern

- the transmission of the AGM on the internet (today: 24.1%; in the future: 32.8%),
- the comments on the Code's suggestions (today: 34.7%; in the future: 45.9%), and
- the compensation components for the supervisory board based on long-term company success (today: 32.3%; in the future: 33.9%).

Conclusions

With two recommendations and three suggestions, only five of the Code's total 101 rules are not accepted by a majority of responding companies. On the basis of the current empirical Code survey for 2006 it can therefore be stated that the German Corporate Governance Code is firmly established in the business community as an expression of good corporate governance.