

Remarks

by

Prof. Dr. Axel v. Werder

Head of the Berlin Center of Corporate Governance
Technische Universität Berlin

at the

Press Conference

on May 23, 2007

Berlin

Check against delivery

Contact: Berlin Center of Corporate Governance
Prof. Dr. Axel v. Werder
Lehrstuhl Organisation und Unternehmensführung
Technische Universität Berlin
Wilmsdorfer Str. 148, D-10585 Berlin
Tel.: 030/314-22583 • Fax: 030/314-21609
A.Werder@ww.tu-berlin.de • www.bccg.tu-berlin.de

Background to the 2007 Code Report

As well as setting out the main statutory provisions relating to corporate governance, the German Corporate Governance Code in its current form as amended on June 12, 2006 contains a total of 81 recommendations and 20 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.

Since the Code was adopted in 2002, the Berlin Center of Corporate Governance (BCCG) has been commissioned by the Code Commission to conduct a regular empirical survey to systematically record the acceptance of the Code in business practice. To this end all companies listed on the Frankfurt Stock Exchange are 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 (2007 Code Report) is based on the analysis of altogether 213 questionnaires received from all segments of the stock exchange (see Fig. 1). Related to all (601) companies, the response rate was 35.4%, ranging from 22.7% in the general standard segment to 96.7% in the DAX². The analyzable feedback was therefore higher than in previous years.

¹ See v. WERDER, AXEL/TALAUICAR, TILL/KOLAT, GEORG L. (2003): 2003 Code Report: The Acceptance of the Recommendations of the German Corporate Governance Code. In: *Der Betrieb*, Vol. 56, pp. 1857-1863; v. WERDER, AXEL/TALAUICAR, TILL/KOLAT, GEORG L. (2004): 2004 Code Report – The Acceptance of the Recommendations and Suggestions of the German Corporate Governance Code. In: *Der Betrieb*, Vol. 57, pp. 1377-1382; v. WERDER, AXEL/TALAUICAR, TILL (2005): 2005 Code Report: The Acceptance of the Recommendations and Suggestions of the German Corporate Governance Code. In: *Der Betrieb*, Vol. 58, pp. 841-846; v. WERDER, AXEL/TALAUICAR, TILL (2006): 2006 Code Report: The Acceptance of the Recommendations and Suggestions of the German Corporate Governance Code. In: *Der Betrieb*, Vol. 59, pp. 849-855.

² For details of the survey and the other findings see v. WERDER, AXEL/TALAUICAR, TILL (2007): 2007 Code Report: The Acceptance of the Recommendations and Suggestions of the German Corporate Governance Code. In: *Der Betrieb*, Vol. 60, pp. 869-875.

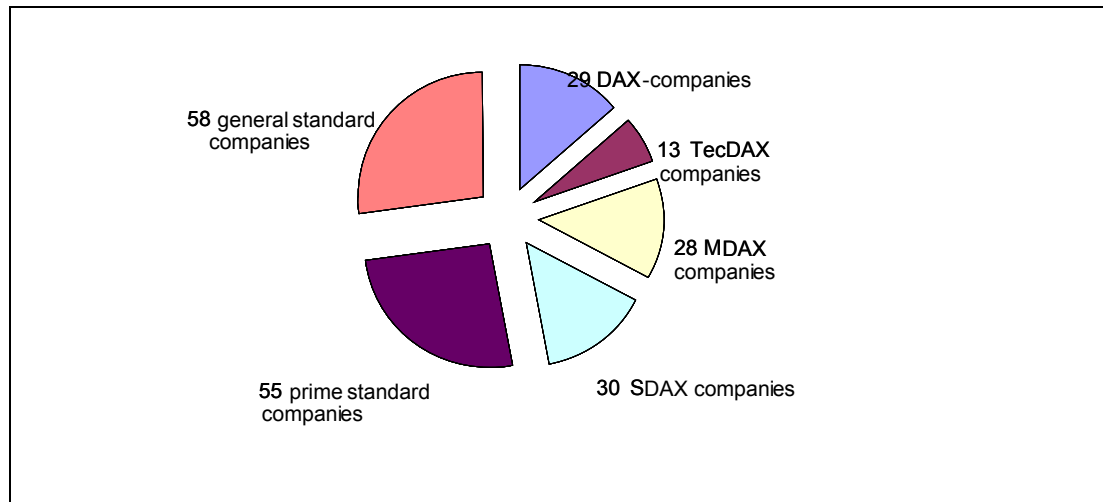


Fig 1: Structure of sample used in 2007 Code Report

General trends

The 2007 Code Report essentially confirms 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. Starting from an already high level, acceptance of the Code showed a further slight increase in the past year.

Secondly, the acceptance level for the recommendations and suggestions increases with the size of the company and varies accordingly between the various stock exchange segments. Acceptance of the Code is especially high in the DAX segment, and comparatively low in the general standard segment. 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.

Thirdly, typical patterns of behavior show that the Code, both in its original version and with the amendments made to date, contributes to changes in the corporate governance practice of German companies. As a result of the Code's recommendations and suggestions, companies introduce a consider-

able volume of rules which they had not previously practiced in such form. It has also been observed that most of the Code's rules have become established to a high degree in practice after a relatively short phase of adjustment. This was also the case for the new rules added to the Code in June 2006.

The trends described are illustrated in the following on the basis of the key indicators of the companies' average compliance rate and the acceptance level for the individual rules of the Code. The *average compliance rate* expresses what share of the Code's rules a company (from the overall sample or the individual stock exchange segments) implements on average. The *acceptance level* relates to each individual rule of the Code and thus indicates what percentage of all companies (from the overall sample or individual stock exchange segments) implement the recommendation or suggestion in question.

Average compliance rates

The companies in the overall survey sample currently practice on average 67.2 of the Code's *recommendations*. With the Code containing 81 recommendations, this corresponds to an overall compliance rate of 82.9%. As expected, the corresponding figures for the DAX companies are higher. These companies comply on average with 77.6 recommendations, i.e. 95.7% of the Code's 81 recommendations.

In the previous year the corresponding compliance rates were 81.9% for all companies and 95.3% in the DAX. According to the information provided by the companies in the questionnaires, these figures will increase further by the end of 2007 to reach 85.9% for all companies and 97.3% for the DAX.

On average 61.2% of the *suggestions* are currently followed by all companies and 83.6% by the DAX. By the end of 2007 these figures are expected to rise to 64.4% for all companies and 85.5% for the DAX.

Fractional movements in the compliance rates over time should not generally be over-interpreted, because obviously the effects of changes in the composition of the sample and the number of Code rules have to be taken into account. Regardless of these details, however, the findings of the survey clearly confirm the trend towards a generally high level of acceptance for the Code.

Level of acceptance for the Code's rules

For a differentiated analysis of the acceptance levels for the individual recommendations and suggestions of the Code, the Code Report distinguishes between three categories of acceptance:

- *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 overall sample, 38 *recommendations* are now and 34 will in the future be *critical* under this definition. In the previous year the figure was 48 recommendations. In the DAX the corresponding figures are 10 for the previous year, 12 today and 4 in the future. The increase which took place between 2006 and today is attributable to the three new recommendations introduced last year to define the disclosure of management board compensation in more concrete terms. These recommendations will be implemented by significantly more than 90% of the DAX companies by year-end and will therefore lose their critical status.

The 4 recommendations which will continue to be critical in the DAX in the future 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: 85.7%),
- 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: 86.2%),
- the restriction on the move by a former management board chairman or management board member to the supervisory board chair or chair of a supervisory board committee (acceptance in the DAX today: 72.4%; in the future: 79.3%) and
- performance-related compensation for supervisory board members (acceptance in the DAX today: 86.2%; in the future: 89.7%).

Even the critical recommendations already achieve a remarkably high level of acceptance in the DAX today and none of them is rejected by the majority of companies.

The rejection of critical recommendations by a majority of companies is a very rare occurrence even when all companies are included in the analysis. In the future there are expected to be no recommendations which are not followed by at least half the companies. By contrast, in the previous year three recommendations still fell below the 50% acceptance threshold, these being the two recommendations on the individual disclosure of management board and supervisory board compensation and the recommendation on an appropriate deductible for D&O insurance.

The rule concerning the individual disclosure of management board compensation has since become law. The recommended disclosure of supervisory board compensation is currently implemented by a majority of companies (57.5% of all companies) and the level of acceptance will increase (to 65.6%) in the future.

In contrast, the Code's recommendation concerning the agreement of a deductible is still rejected by a small majority of companies. By the end of the year, however, the level of acceptance is expected to increase because by then half of the companies intend to follow this recommendation.

The number of *critical suggestions* related to the overall sample is relatively high, because today only one and in the future two of these rules will exceed the 90% acceptance threshold. However, among the suggestions, too, rejection by a majority of companies is the exception. As in the previous year, four rules are not implemented by the majority of companies. These include the suggestions

- to allow shareholders to follow the AGM via modern communication media (acceptance today: 24.5%, in the future 28.8%),
- to include comments on the Code's suggestions in the corporate governance report (acceptance today 38.3%, in the future 45.5%),
- to specify by resolution the components of supervisory board compensation related to the long-term performance of the enterprise (acceptance today 30.8%, in the future 33.3%) and
- to elect or re-elect members of the supervisory board at different dates and for different periods of office (acceptance today 48.0%, in the future 54.5%).

The final rule on the so-called "staggered board" remains the only suggestion which is now and in the foreseeable future will be implemented by less than half of the DAX companies. By contrast, a (small) majority of all companies plan to follow this suggestion in the future. Taking in the overall sample, the number of suggestions rejected by a majority of companies would then decrease from 4 to 3.

Conclusions

Of the Code's total 101 recommendations and suggestions, only one suggestion is rejected by a small majority of companies in the DAX. The other rules – with two exceptions – will achieve a high level of acceptance of more than 75% and in the majority of cases more than 90% in the future. Even when all companies are included in the analysis, none of the recommendations and only 3 suggestions are expected to fall below the 50% threshold in the future. It can therefore be stated that five years after it was first adopted the German Corporate Governance Code is firmly established in the German business community as the key reference for good corporate governance standards.