

Government Commission on the German Corporate Governance Code

Press release

March 11, 2005

Corporate Governance Code now firmly established in Germany:

- **Good scorecard after three years of Code**
- **Transparency of business decisions improved**

The Corporate Governance Code has become firmly established in Germany, resulting in a significant improvement in the transparency of business decisions. This is shown by the latest study by the Berlin Center of Corporate Governance (BCCG), said Dr. Gerhard Cromme, Chairman of the Government Commission on the German Corporate Governance Code, in Berlin today.

Key findings of the survey by the Berlin Center of Corporate Governance

The BCCG study, which was presented today by Professor Dr. Axel von Werder, Head of the Berlin Center of Corporate Governance at Berlin Technical University, again shows increased acceptance by companies of 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, following the outstanding level already achieved in 2004 of 96% or 69 of 72 recommendations.

Current corporate governance discussion and work of the Government Commission

Current issues influencing the work of the Government Commission are the individual disclosure of management board compensation, the independence of supervisory board members and in this context the handling of the switch from management board chairman to supervisory board chairman. On these matters the EU 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 in the fall of 2004.

Significant progress with the transparency of management compensation

Significant progress has been made with 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. Today 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. 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.

However, it is questionable whether this share is high enough to avoid a legislative solution. For example, in Switzerland, the United Kingdom, France, Luxembourg 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.

Independence of supervisory board members and the switch from management board chairman to supervisory board chairman

The debate surrounding the supervisory board focuses on (1) the independence of supervisory board members and the transparency thereof and (2) the switch from management board chairman to supervisory board chairman. The mentioned recommendations of the EU Commission deal with these issues, too. Structural differences between the one-tier and two-tier board systems have to be taken into account.

(1) One-tier-board versus 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 on the two-tier system with a management board and a supervisory board. The different legal structures result in different governance problems. The following examples highlight this:

Independence:

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. However, experience shows that self-monitoring is not always the most efficient form of oversight. In the two-tier board system 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.

Remuneration questions:

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 the 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. Cromme: "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."

Stock market announcements:

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.

These examples show clearly that solutions which are right for the one-tier system are not automatically right for the two-tier system.

Cromme: "The Government Commission will have to concern itself closely with the definition of independence and with the independence criteria."

(2) 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. The EU recommendation on this matter is not 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. The Government Commission will discuss these proposals and find an appropriate solution.

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The speeches by Dr. Gerhard Cromme and Professor Axel von Werder are also available for downloading at <http://www.corporate-governance-code.de>