

# Explanations of the Supervisory Board regarding Agenda Item No. 7 for the Annual General Meeting 2014

Principles of the Management Board Remuneration System



**Aareal Bank**

## Explanations of the Supervisory Board regarding Agenda Item No. 7 for the Annual General Meeting 2014:

### Principles of the Management Board Remuneration System

The Supervisory Board determines the structure and amount of remuneration for members of the Management Board. Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board.

Against the background of the German Act on the Appropriateness of Management Board Compensation dated 31 July 2009 (Gesetz zur Angemessenheit der Vorstandsvergütung – "VorstAG"), and the German Regulation on Remuneration in Financial Institutions (Instituts-Vergütungsverordnung – "InstitutsVergV") and using the support of external advisers, the remuneration system for members of the Management Board of Aareal Bank AG was examined and adjusted with effect from 1 January 2012. A further adjustment took place with effect from 1 January 2014 in relation to the amended version of the InstitutsVergV dated 16 December 2013.

Besides their fixed annual salary, Management Board members receive a performance-related remuneration that is determined using an assessment basis extending over several years. The level of this performance-related remuneration is determined by reference to the personal performance of each Management Board member which is measured by the degree to which targets set in advance by the Supervisory Board are achieved, based on contractually agreed initial values for a 100 % target achievement. The targets which are relevant for performance-related remuneration include annual targets and multiple-year targets. The weighting of annual to multiple-year targets is fixed for each financial year, in line with regulatory requirements; with a weighting of 45 % (annual target) to 55 % (multiple-year target) taken as a guideline. Until now, the target system envisaged a weighting of 60 % for the annual target and 40 % for the preceding three-year target periods. The measurement of the multiple-year target is now undertaken retrospectively over a time period of three years.

Annual targets and multiple-year targets are integrated into the Bank's overall strategy and are geared toward achieving the objectives set out in the Bank's business and risk strategies. The targets comprise quantitative components and qualitative components, which are also related to non-financial parameters. In this context, the Bank's overall performance, the performance of the section the Management Board member is responsible for, and the individual performance contributions of the Management Board member concerned are all taken into consideration. The Bank's overall performance is determined using the categories of operating profit/loss before taxes and risk-weighted assets. For each financial year, the Supervisory Board sets a target level for the Common Equity Tier I ratio and liquidity, the latter starting with the 2015 financial year. No variable remuneration will be determined for any financial year where these two targets have not been achieved.

The initial value of the performance-related remuneration may increase – depending on the Management Board member's degree of target achievement – up to a maximum of 150 % (previously 200 %) of the target value. If the overall target achievement level exceeds 150 %, the initial value of the performance-related remuneration will not increase any further (cap). If the overall target achievement level is 0 %, no performance-related remuneration will be awarded for the financial year concerned. Unconscionable behaviour or behaviour in breach of duties cannot be balanced out by positive performance contributions in other areas and will automatically lead to an appropriate reduction in the variable remuneration.

To ensure that the remuneration system provides long-term incentive effects, variable remuneration is awarded at the end of the financial year, according to the following principles:

- 20 % of the initial value of variable remuneration is disbursed as a cash bonus after the Supervisory Board has determined the overall target achievement level.
- A further 20 % of the initial value of variable remuneration is awarded as a share bonus subject to a holding period (and forms part of the share-based bonus plan), in the form of phantom shares, also after the Supervisory Board has determined the overall target achievement level.

- 30 % of the initial value of variable remuneration is retained (cash deferral) and disbursed in equal proportions over a three-year period.
- The remaining 30 % of the initial value of variable remuneration is credited, as a cash amount, to a virtual account maintained on behalf of each Management Board member, and forms part of the share deferral plan.

With regard to the portion of the variable remuneration that is deferred initially as a cash deferral or a share deferral, the Supervisory Board makes a decision regarding the granting of one third of the amount, as well as the associated interest, in the three years following the determination of the performance-related remuneration (retention period). Until the end of the retention period, there is no right to the relevant remuneration components. Once the deferred remuneration components for Management Board members are vested, the cash deferral is paid out in cash and the share deferral is converted into phantom shares, subject to a two-year holding period.

In making its determination about the amount to be awarded, the Supervisory Board particularly takes into account any negative aspects of the Management Board member's performance, that of his section, as well as any weakness in the performance of Aareal Bank Group (backtesting). The existence of a negative aspect in the performance of a Management Board member is to be assumed, in particular, if serious breaches of duty and/or performance deficiencies are discovered, which lead to the performance contributions, –which were initially assumed to be positive – being later shown to have not been sustained. A negative performance contribution on the part of the section within the respective Management Board member's responsibility, or of Aareal Bank Group, is to be assumed if significant assumptions which formed the basis of the calculation of the variable remuneration are later proven to be incorrect or unsustainable. The Supervisory Board may award the deferred variable remuneration components in full, partially, or not at all. If the full amount of the bonus is not awarded, the remaining sum is forfeited, i.e. it is not carried forward into subsequent years. An award of the deferred variable remuneration components will not be made insofar and for so long as the German Federal Financial Supervisory Authority ("BaFin") forbids this according

to section 45b (2) sentence 1 nos. 5a and 6 of the German Banking Act (Kreditwesengesetz – "KWG"). The entitlement no longer exists if the BaFin so orders by way of a final and conclusive decision pursuant to section 45 (5) sentences 5-8 of the KWG.

A performance-related remuneration component for a previous financial year may not be disbursed or, in the case of the directly preceding financial year, credited to pending remuneration components at all if the Supervisory Board believes that the Management Board member's performance on the whole was so poor that it would make awarding performance-related remuneration inappropriate. In particular, this is to be assumed if significant breaches of the duty of care have been determined, which would give rise to an extraordinary termination of the appointment to the Management Board contract. Further, this is to be assumed if the member of the Management Board was causally and negligently actively involved in behaviour which has led to considerable losses, or for which losses the Management Board member was causally and negligently responsible.

Members of the Management Board may not undertake to limit or hedge the risk orientation of the performance-related remuneration themselves (hedging ban).

The amount to be paid for the entire performance-based remuneration permissible during a single financial year is henceforth a maximum of 300 % of the initial determined value for the respective financial year.

### Remuneration

The fixed annual salary of the Chairman of the Management Board, Dr Wolf Schumacher, was raised to € 1.35 million; the fixed annual salary of ordinary members of the Management Board to € 880,000. At the same time, the initial value of variable remuneration (to be awarded in case of a 100 % overall target achievement level) was reduced to € 1.4 million for the Chairman of the Management Board, and to € 800,000 for the ordinary Management Board members. The target remuneration of the Management Board members (fixed annual salary and variable remuneration, given a 100 % target achievement) has remained unchanged. The maximum remuneration possible (fixed annual salary plus variable remuneration,

given a 150 % target achievement) has been decreased by 22 % for Management Board members, due to the restriction of the overall target achievement level from 200 % to 150 %.

These amendments ensure that the maximum achievable variable remuneration does not exceed 100 % of the fixed remuneration in the sense given in section 25a (5) of the KWG (that is, the fixed annual salary, benefits, and the contribution to the company pension scheme).

#### **Pensions, retirement benefits and severance pay**

The benefit regulations as agreed in the employment contract apply to the members of the Management Board. Pursuant to these provisions, they are entitled to claim pension benefits upon completion of their 60th year of age. In the event of permanent disability, a Management Board member may be entitled to claim benefits prior to turning 61. For members of the Management Board appointed on or after 1 November 2010, this rule applies only from the beginning of the second term of office, and they are only entitled to pension payments after completion of their 62nd year of age. Dagmar Knopek was awarded a currently non-vested pension commitment.

The pension claims are adjusted to take account of the development of standard wages within the private banking sector as from the beginning of actual payments of pensions, to the extent that these are based on defined benefit plans. If the payments refer to defined contribution plans, the guaranteed amount is adjusted by 1 % p.a. The pension paid to widows amounts to 60 % of the pension of the member of the Management Board, while pensions to half-orphans and orphans amount to 10 % and not more than 25 %, respectively.

The agreements concluded with members of the Management Board do not include any obligation to make severance payments in case of an early termination of employment relationships. However, severance payments may be included in individual termination agreements.

In the case of a termination of a Management Board position due to a "Kontrollwechsel" (change of control), the following provisions are applicable: in the case of

a compulsory loss of a Management Board position, the Management Board members are to be paid the fixed remuneration component, the performance-based remuneration, and the contractually-agreed benefits for the remainder of the term of the contract. The performance-related remuneration is subject to the above-mentioned conditions, that is, in particular the deferral periods, the holding periods and the penalty rules are applicable. In the case of a voluntary termination of the Management Board position following a change of control, the members of the Management Board merely receive the fixed remuneration and the contractually agreed benefits. In this case, there is no entitlement to the variable remuneration component.

The total sum of the payments to be made in the case of a resignation due to a change of control is limited to three annual remunerations.

During the term of a SoFFin stabilisation measure, Management Board members are not entitled to any severance pay in the event of resignation due to a change of control. The fulfilment of a Management Board member's contractual remuneration claims arising from the employment contract are not limited by the framework agreement entered into with SoFFin.

#### **Share Bonus Plan**

According to the rules for the share bonus plan, a portion of the variable remuneration will be converted into an equivalent number of phantom shares and credited to the beneficiary. The calculation of the number of phantom shares is henceforth based on the weighted average price on the basis of five (Xetra) exchange trading days after publication of the preliminary results for the respective financial year (subscription price). The date of publication of the preliminary results is used as the reference date. The phantom shares (tranche) so determined are paid into a virtual account and are automatically and without delay converted into a cash amount and paid out following the Supervisory Board meeting which resolves to accept the annual financial statements for the third financial year following the financial year for which the phantom shares were granted. The conversion will be effected using the weighted average price calculated on the basis of the five exchange trading days (Xetra) following

the publication of the preliminary business figures for the year preceding the payout. The payout amount for the phantom shares of a tranche which was granted for the financial year 2013 and the subsequent financial years, is capped at a maximum of 300 % of 20 % of the initial value set for the respective financial year.

The phantom shares granted or to be granted for the financial years prior to the 2014 financial year will continue to have as the applicable subscription price the weighted average price on the basis of the five exchange trading days (Xetra) following publication of the annual financial statements for the respective financial year. The conversion and payment of these phantom shares to a cash amount occurs using a weighted average price on the basis of the five exchange trading days (Xetra) following the Supervisory Board meeting which resolves to confirm the annual financial statements for the third financial year which follows the financial year for which the phantom shares were granted. The ceiling is not applicable to these phantom shares, with the exception of those phantom shares granted for the 2013 financial year.

If dividends are paid on the Company's shares during the time period between the reference date and the date of conversion into the Company's shares, a payout is made as a salary component in an amount equivalent to the dividends and the proportion of the phantom shares.

### Share Deferral Plan

Under the Share Deferral Plan, a portion of the variable remuneration is converted into an equivalent number of phantom shares and credited to the beneficiary. This credit, however, does not convey an entitlement or a claim regarding a later payout or grant of phantom shares. Interest accrues on the amount credited in the form of a share deferral. The reference rate is the interest rate of the European Central Bank for deposits from private households with a term of up to one year. As above, the credit of interest does not convey an entitlement or a claim regarding the interest amount. In the three years following the credit (retention period), the Supervisory Board decides whether in each case a third of the share deferral, including interest, should be converted.

The question as to whether a third of the phantom shares is converted and, if yes, in which amount, is based on the principles set out above. In particular, the Supervisory Board applies the penalty rules set out above when examining this. Equivalent provisions to the share bonus plan are applied in the calculation of the amount of the phantom shares – except for the holding period, which is reduced from three year to two years. The ceiling value is applicable for the conversion of the phantom shares which were granted for the 2013 financial year and the following financial years, with the proviso that the payout amount following the conversion of the phantom shares of a tranche (plus interest) into a cash payment must not exceed 300 % of 30 % of the initial value set for the respective financial year (which may have been reduced following the application of a penalty rule or as a result of an instruction by BaFin). The payout amount for phantom shares which were granted for prior financial years or are yet to be granted, respectively, are not subject to any ceiling.

### Supplemental agreements

In the context of adjustments designed to bring the remuneration system into line with changed regulatory requirements, supplemental agreements were entered into for phantom shares which were granted, or are yet to be granted, respectively, as variable remuneration for previous financial years.

Phantom shares which were no longer subject to holding or retention periods on 26 March 2014 were redeemed with a one-off payment to the Management Board members. With this payment, all rights, claims and contingent remainders arising from and in connection with these phantom shares are extinguished. Those phantom shares granted for previous financial years which were subject to a holding or retention period on 26 March 2014 or which resulted on this date from a monetary sum held on a virtual account due to a share deferral, will be automatically converted and paid out following the expiry of the respectively applicable holding or retention period on the basis of the weighted average price (Xetra) of the five exchange trading days following the expiry of the period.

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