


Corporate governance report including corporate governance declaration in accordance with section 289a HGB



Corporate governance report including corporate governance declaration in accordance with section 289a HGB

Corporate governance stands for responsible management focused on adding long-term value. Efficient cooperation between the Board of Managing Directors and the Supervisory Board as well as openness and transparency in corporate and financial communications are key aspects of the Schaeffler Group's corporate governance that strengthen the confidence of shareholders, business partners, and employees in the company's management and supervision.

The following is a report by the Board of Managing Directors and the Supervisory Board on the corporate governance of Schaeffler AG in accordance with item 3.10 of the German Corporate Governance Code. The corporate governance report also comprises the corporate governance declaration in accordance with section 289a HGB which is a separate component of the management report in accordance with section 315 (5) HGB. However, according to section 317 (2) sentence 4 HGB, this information is not subject to audit; as a result, the audit is only required to determine whether these disclosures were provided.

 Corporate governance report including the corporate governance declaration in accordance with section 289a HGB at: www.schaeffler.com/ir

1.1 Corporate governance principles

Managing the company with integrity and good corporate citizenship are integral components of the Schaeffler Group's long-standing corporate culture. The Schaeffler Group's manner of conducting business is based on integrity, fairness, and mutual respect. The Schaeffler Group wants to be a reliable partner to its business partners, employees, and shareholders. Transparency, trust, and teamwork are the three key success factors for achieving this. Transparency generates trust, and trust is the foundation of good teamwork. The updated Schaeffler Group Code of Conduct approved by the Board of Managing Directors provides guidance in this area. The Code of Conduct defines principles of acting with integrity and in compliance with the law. These principles apply equally to everyone – the Board of Managing Directors, management, and every single employee – and also represent a promise to the company's stakeholders. The Schaeffler Group lives up to its corporate responsibility and is laying the foundation for profitable growth and the company's long-term success. At the core of this success are top quality, outstanding technology, and exceptionally innovative spirit, in doing business with customers as well as in the group's internal processes. Being an innovation and technology leader with extensive expertise, the Schaeffler Group's products and solutions help make the mobility of tomorrow eco-friendly and energy-efficient.

Since the release of its last declaration of conformity in March 2016, Schaeffler AG complies with the recommendations of the “Governmental Commission German Corporate Governance Code” as amended on May 05, 2015 (“Code”) with the exceptions described below and will also comply with the recommendations in the future with the exception described under item 2 below:

1. The Code recommends in item 4.2.5 for the presentation of the remuneration of the Board of Managing Directors the use of template charts, which also provide for the presentation of comparative figures for the preceding year. As Schaeffler AG only has been converted into a stock corporation in October 2014 and the group management has only been transferred to the company at this point in time the remuneration report 2015 deviates from this recommendation. The remuneration report 2016 will show the comparative figures for the preceding year. Hence, Schaeffler AG will comply with the recommendation in item 4.2.5 in the future.
2. The Code recommends in item 5.4.1 para. 2, that the Supervisory Board shall specify concrete objectives regarding its composition and also set an age limit for the members of the Supervisory Board. The Supervisory Board of Schaeffler AG will not set such age limit because it is of the opinion that this criterion is not informative with respect to the suitability of a person to perform as a member of the Supervisory Board.


1.2 Mode of operation of the Board of Managing Directors and the Supervisory Board and membership and mode of operation of their committees

Schaeffler AG’s governance structure follows the two-tier model set out in the German Stock Corporations Act. The Board of Managing Directors has direct responsibility for managing the company. The members of the Board of Managing Directors are jointly responsible for managing the company. The Chief Executive Officer coordinates the activities of the members of the Board of Managing Directors. The Supervisory Board appoints, supervises, and advises the Board of Managing Directors and is involved in decisions that are fundamental to the company. The Chairman of the Supervisory Board coordinates the work of the Supervisory Board.

Board of Managing Directors

The Schaeffler Group is managed by the Board of Managing Directors of Schaeffler AG. Its actions and decisions are guided by the company’s best interest and, therefore, take into account the interests of shareholders, employees and other stakeholders of the company in order to add long-term value. It is directly responsible for managing the company, sets objectives and


the company’s strategic direction, consults on them with the Supervisory Board, manages the implementation of the company’s strategy, and regularly discusses the status of its implementation with the Supervisory Board. It is also responsible for the annual budget and long-range plan and for preparing the company’s quarterly and semiannual financial reports, the separate financial statements of Schaeffler AG, the consolidated financial statements, and the combined management report of the company and the group. The Board of Managing Directors also ensures that the company’s activities are in compliance with legal requirements and internal guidelines (“compliance”).

 See chapter entitled “Governance structure” for further detail on compliance.

The internal rules of procedure of the Board of Managing Directors set out the activities of the Board of Managing Directors, the issues that are the responsibility of the Board of Managing Directors, the majorities required to pass resolutions, and the areas of responsibility of the various members of the Board of Managing Directors. Based on the Schaeffler Group’s organizational structure, the Board of Managing Directors consists of the Group CEO and the CEOs of the divisions and corporate functions. Under the internal rules of procedure, specific management responsibilities are assigned to each member of the Board of Managing Directors. Their responsibility for jointly managing the company remains unaffected. Each member of the Board of Managing Directors is directly responsible for his or her assigned area of responsibility, taking into account the joint responsibility of the Board of Managing Directors. The members of the Board of Managing Directors run the business in accordance with the law, the company’s articles of association, and the internal rules of procedure, taking into account the obligation to obtain approval set out in the Supervisory Board’s internal rules of procedure.


The Schaeffler Group is managed using a three-dimensional matrix consisting of the divisions, the functions, and the regions. The Regional CEOs report directly to the CEO. Together, the Board of Managing Directors and the Regional CEOs represent the Schaeffler Group’s Executive Board.

Consistent with the group’s international stature and wide variety of sectors, the Board of Managing Directors considers diversity when making appointments to leadership positions. It aims to give appropriate consideration to women and has set targets for the proportion of women at the two levels of management immediately below the Board of Managing Directors in accordance with sections 76 (4) and 111 (5) AktG.

 See section “Act on Equal Access for Men and Women to Leadership Positions” for further detail on women in leadership positions.

Members may serve on the Board of Managing Directors until their 68th birthday.


At the reporting date, no member of the Board of Managing Directors held more than three positions on supervisory boards of non-group public companies or similarly demanding positions on supervisory bodies of non-group companies.

 The members of the Board of Managing Directors, their areas of responsibility, and any positions they hold on supervisory boards of other companies are listed in the chapter entitled “Governing bodies of the company”.

Supervisory Board

The Supervisory Board is responsible for advising and monitoring the Board of Managing Directors in managing the company. The Board of Managing Directors has to involve the Supervisory Board in any decisions that are fundamental to the company. The Supervisory Board fulfills its responsibilities in accordance with the requirements of the law, the company’s articles of association, and the internal rules of procedure. The internal rules of procedure of the Supervisory Board govern the Board’s organization and activities. In addition, the internal rules of procedure set out which legal transactions and measures taken by the Board of Managing Directors require approval by the Supervisory Board or the executive committee.

The Supervisory Board appoints the members of the Board of Managing Directors and sets their remuneration.

 See chapter entitled “Remuneration report” for further detail on the remuneration of the Board of Managing Directors.

In addition to considering the relevant technical qualifications, the Supervisory Board also strives for diversity when making appointments to the Board of Managing Directors. Under the “Act on Equal Access for Men and Women to Leadership Positions in the Private and Public Sectors”, Schaeffler AG’s Supervisory Board, being the body responsible for making appointments to the Board of Managing Directors, is required to set a target for the proportion of women on the Board of Managing Directors. Under a resolution passed by the Supervisory Board on September 30, 2015, the Board of Managing Directors has to have at least one female member. The Board of Managing Directors meets the target set by the Supervisory Board, as it has had one female member since January 01, 2016.

Together with the members of the Board of Managing Directors, the Supervisory Board ensures that long-term succession planning is performed for appointments to the Board of Managing Directors.

The Supervisory Board holds a minimum of two meetings during each of the first and second six months of the calendar year to discuss current issues and pass any resolutions required. Additional meetings are held when and if the interests of the company require such additional meetings.

As recommended by the German Corporate Governance Code, the Supervisory Board audits the efficiency of its activities at regular intervals. An efficiency audit was performed in 2016.

Under the requirements of the German Co-Determination Act, the Supervisory Board of Schaeffler AG, which is subject to co-determination on the basis of parity, consists of twenty members. Ten of these members are appointed by the annual general meeting, and ten members are elected by the employees in accordance with the requirements of the German Co-Determination Act. In addition, Schaeffler AG’s Supervisory Board has to consist of at least 30 % women and at least 30 % men (section 96 (2) AktG). This minimum quota is effective for new elections held on or after January 01, 2016, and applies to the Supervisory Board as a whole (joint compliance). Both the shareholder representatives and the employee representatives are entitled to object to joint compliance by a majority resolution; in this case, the quota has to be met separately by the shareholder representatives as well as by the employee representatives (separate compliance). The employee representatives unanimously objected to joint compliance with the gender quota on December 10, 2015. The Supervisory Board currently has four female members, three women are employee representatives and one woman represents the shareholders. As a result, the employee representatives meet the legally required quota. The employer representative’s quota is currently at 10 %.

In addition to the above legal requirements and in accordance with item 5.4.1 of the German Corporate Governance Code, the Supervisory Board has set the following concrete targets for its composition, considering the company’s specific situation and taking into account the company’s international operations, any potential conflicts of interest, the number of independent Supervisory Board members, and a set limit on the length of time a member may serve on the Supervisory Board, as well as diversity:

- Members should have the knowledge, skills and technical experience required to properly perform their duties and be able to devote sufficient time to these duties.
- The Supervisory Board aims to maintain the current proportion of members with an international background.
- Under the assumption that all employee representatives on the Supervisory Board can be considered independent, the Supervisory Board aims to have a minimum of 15 independent members (as defined in item 5.4.2 of the German Corporate Governance Code).
- Members of the Supervisory Board should not serve on the governing body of or in a consulting capacity to significant competitors of the Schaeffler Group.
- The Supervisory Board should not include more than two former members of the Board of Managing Directors.
- Members of the Supervisory Board should not normally serve on the Board for more than three terms of office.

The current Supervisory Board meets these targets. The Supervisory Board as a whole has the knowledge, skills and technical

experience required to properly perform its duties. The Supervisory Board as a whole is familiar with the industries and sectors in which the Schaeffler Group operates. The members of the Supervisory Board ensure that they are able to devote sufficient time to the performance of their duties. The Supervisory Board also has several members experienced in international business or with other international ties. Conflicts of interest related to members of the Supervisory Board must be disclosed to the Supervisory Board immediately; there were no such conflicts of interest in 2016. No member of the Supervisory Board currently serves on a governing body or in a consulting role with respect to a key competitor or is a former member of the Board of Managing Directors.

 See section "Avoiding conflicts of interest" for further detail on conflicts of interest.

The Supervisory Board has not set an age limit for its members, because it is of the opinion that this criterion is not informative with respect to the suitability of a person to perform as a member of the Supervisory Board. This deviation from the German Corporate Governance Code has been included in the declaration of conformity pursuant to section 161 AktG.

Composition and mode of operation of Supervisory Board committees

Under its internal rules of procedure, the Supervisory Board establishes a total of four committees.

The mediation committee established in accordance with sections 27 (3) and 31 (3) of the German Co-Determination Act is responsible for proposing to the Supervisory Board a candidate for appointment to the Board of Managing Directors if the two-thirds majority required for an appointment was not obtained initially. The members of the mediation committee are Maria-Elisabeth Schaeffler-Thumann as well as Norbert Lenhard, Georg F. W. Schaeffler, and Jürgen Wechsler; Georg F. W. Schaeffler is the committee's chairman.

The nomination committee proposes to the Supervisory Board appropriate candidates for election to the Supervisory Board by the annual general meeting. The members of the nomination committee are the Chairman of the Supervisory Board, Georg F. W. Schaeffler, as well as Dr. Holger Engelmann, Prof. Dr. Bernd Gottschalk, and Maria-Elisabeth Schaeffler-Thumann; Georg F. W. Schaeffler is the committee's chairman.

The executive committee consists of Barbara Resch and Maria-Elisabeth Schaeffler-Thumann as well as Norbert Lenhard, Georg F. W. Schaeffler, Jürgen Wechsler, and Prof. KR Ing. Siegfried Wolf; Georg F. W. Schaeffler is the committee's chairman. The executive committee advises and assists the Chairman of the Supervisory Board and his Deputy in their Supervisory Board responsibilities. It prepares the meetings of the Supervisory Board. Another significant responsibility of the executive committee is preparing personnel decisions to be made

by the Supervisory Board. It makes recommendations regarding new appointments or reappointments to and dismissals from the Board of Managing Directors. It also prepares the Supervisory Board's decision regarding the remuneration system and individual remuneration of the members of the Board of Managing Directors. In addition, the executive committee passes resolutions regarding the approval of certain legal transactions and measures specified in the Supervisory Board's internal rules of procedure on behalf of the Supervisory Board, to the extent such delegation is not prohibited by section 107 (3)(3) German Stock Corporations Act.

The audit committee is responsible for preparing the Supervisory Board's decision on adoption of the separate financial statements and approval of the consolidated financial statements. To this end, it is responsible for the preliminary review of the separate and consolidated financial statements, the management report and the group management report, the proposals for the appropriation of earnings, and for discussing the long-form audit report with the auditors. It is also responsible for the preliminary review of the report on relations with affiliated companies and for preparing the Supervisory Board's nomination of the auditors to be appointed by the annual general meeting.

The audit committee has the responsibility and authority to engage the auditors on behalf of the Supervisory Board, determine areas of focus for the audit, and agree the audit fees with the auditors. In addition, the audit committee monitors the independence of the external auditors, and, as such, is responsible for approving engagements for non-audit services. The audit committee also monitors the qualifications and efficiency of the auditors as well as the rotation of audit team members. On behalf of the Supervisory Board, the audit committee monitors the financial reporting process and the effectiveness of Internal Audit, the internal control system, and the risk management system, and addresses compliance within the company. It also regularly obtains information on the areas of focus for the audit as well as audit results from Internal Audit.

The audit committee consists of six members. His position automatically makes the Chairman of the Supervisory Board a committee member. The chairman of the audit committee has to be independent and can neither be a former member of the Board of Managing Directors nor the Chairman of the Supervisory Board; he should be particularly knowledgeable about and experienced in the application of accounting principles as well as internal control procedures. As the former chief financial officer of the Bertelsmann Group, the chairman of the audit committee, Dr. Siegfried Luther, meets these requirements. The remaining members of the audit committee are Georg F. W. Schaeffler, Robin Stalker, Salvatore Vicari, Jürgen Worrlich, and Dr. Reinold Mittag.

Cooperation between Board of Managing Directors and Supervisory Board

The Board of Managing Directors and the Supervisory Board cooperate closely for the good of the company. Thus, the Board of Managing Directors regularly consults with the Supervisory Board on the strategic direction of the company and discusses the status of strategy implementation with the Supervisory Board.

On a regular basis, the Board of Managing Directors provides comprehensive and timely information to the Supervisory Board on all matters of relevance to the company with respect to strategy implementation, planning and budgeting, results of operations, risk management, and compliance. It discusses deviations of results of operations from budgets and targets and the reasons for those deviations. Documents required for decisions, especially the separate financial statements, the consolidated financial statements, and the long-form audit report, are provided to the members of the Supervisory Board in due time before the meeting. The Board of Managing Directors is required to submit any fundamental legal transactions and measures to the Supervisory Board or the executive committee for approval. The cooperation between the Board of Managing Directors and the Supervisory Board is characterized by mutual trust and a culture of open discussion as well as maintaining strict confidentiality.


The Chairman of the Supervisory Board regularly keeps in contact with the Board of Managing Directors and particularly with the Chief Executive Officer between meetings, as well, and discusses with him issues related to the company's strategy implementation, planning and budgeting, results of operations, risk management, and compliance. The Chief Executive Officer immediately informs the Chairman of the Supervisory Board of important events significant to evaluating the company's situation and development as well as for managing the company.

Avoiding conflicts of interest

The members of the Board of Managing Directors and of the Supervisory Board are required to immediately disclose any conflict of interest to the Supervisory Board. Significant transactions between the company and members of the Board of Managing Directors or parties related to them require the Supervisory Board's approval. Consulting and other service contracts as well as contracts for specific deliverables between the company and members of the Supervisory Board also require approval by the Supervisory Board. The Supervisory Board reports to the annual general meeting on any conflicts of interest and their resolution. Neither the members of the Board of Managing Directors nor those of the Supervisory Board have experienced any conflicts of interest in 2016.

Act on Equal Access for Men and Women to Leadership Positions

The Act on Equal Access for Men and Women to Leadership Positions in the Private and Public Sectors prescribes a fixed gender quota of 30 % for Schaeffler AG's Supervisory Board.

 See "Supervisory Board" section for further detail on the gender quota of Schaeffler AG's Supervisory Board.

In addition, it requires the Supervisory Board to set a target for the proportion of women on the Board of Managing Directors and the Board of Managing Directors to set targets for the proportion of women at the two levels of management immediately below the Board of Managing Directors.

The target set by the Supervisory Board for the proportion of women on the Schaeffler AG Board of Managing Directors states that the Board of Managing Directors has to have at least one female member. The Board of Managing Directors meets this target set by the Supervisory Board, as it has had one female member since January 01, 2016.

In order to increase the proportion of women below the level of the Board of Managing Directors, the Board of Managing Directors has set targets for the proportion of women of 5 % at the first level of management and 12 % at the second level of management. These targets must be achieved by June 30, 2017.

1.3 Other information on corporate governance

Shares held by members of the Board of Managing Directors and the Supervisory Board, directors' dealings

Item 6.2 of the German Corporate Governance Code requires the ownership of shares in the company or related financial instruments by members of the Board of Managing Directors and the Supervisory Board to be disclosed if these directly or indirectly exceed 1 % of the shares issued by the company. On December 31, 2016, IHO Verwaltungs GmbH held a 75.1 % interest (500 million common shares) in Schaeffler AG. These shareholdings are attributable to Supervisory Board members Georg F. W. Schaeffler and Maria-Elisabeth Schaeffler-Thumann. The remaining members of the Supervisory Board and the Board of Managing Directors held less than 1 % of the common and common non-voting shares of the company as at that date.

Under article 19 of the Market Abuse Regulation, the members of the Board of Managing Directors and the Supervisory Board as well as persons closely associated with them are legally required to report any acquisition or disposal of shares in or bonds of Schaeffler AG or financial instruments linked thereto once the total amount of such transactions executed within a calendar year has reached EUR 5,000.

 For further detail on securities transactions reported in 2016 is available at: www.schaeffler.com/ir

Transparency

The company provides information on the situation of the company at the same time and on an equal footing to institutional investors, shareholders, financial analysts, business partners, employees, and the interested public by regular, transparent, and up-to-date communication. All significant information, such as ad hoc releases and press releases, as well as presentations given at analysts' conferences, all financial reports, and the financial calendar are published on the Schaeffler Group's website. Investor Relations maintains close contact with shareholders on an ongoing basis.

Relationships with shareholders and annual general meeting

Shareholders exercise their rights at the annual general meeting. The annual general meeting passes resolutions on granting discharge to the Board of Managing Directors and the Supervisory Board, appropriating retained earnings, capital transactions, amendments to the company's articles of association, and appointing auditors. It has to be held during the first eight months of each year.

The company has issued common non-voting and common shares. Common non-voting shares do not convey voting rights, but entitle the holder to a preferred dividend of EUR 0.01 per share.

Shareholders have to register for the annual general meeting in due time in order to attend the annual general meeting. An invitation and other documents (e.g. annual report) containing information on the items on the agenda of the annual general meeting are provided to shareholders before the annual general meeting. This information is also available from the company's website.

Financial reporting and financial statement audit

Schaeffler AG compiles its separate financial statements in accordance with the requirements of the German Commercial Code (HGB) and the German Stock Corporations Act (AktG). The consolidated financial statements are prepared in accordance with the principles set out in International Financial Reporting Standards (IFRS) as adopted by the EU.

It was agreed with Schaeffler AG's auditors that the Chairman of the Supervisory Board and the chairman of the audit committee would be informed promptly of any grounds for disqualification or indications of bias arising during the audit to the extent they are not remedied immediately. It was also agreed that the auditors would report on all findings and events arising during the performance of their audit that are significant to the responsibilities of the Supervisory Board. Under the agreement, the auditors have to inform the Supervisory Board and note in their long-form audit report if, during the course of the audit, they become aware of any facts rendering the declarations on

the German Corporate Governance Code issued by the Board of Managing Directors and the Supervisory Board inaccurate. The audit committee monitors the auditors' independence. In a letter dated March 10, 2016, the auditors have issued a binding independence letter for the year ended December 31, 2016.

1.4 Declaration of conformity pursuant to section 161 AktG

Since the release of its last declaration of conformity in March 2016, Schaeffler AG complies with the recommendations of the "Governmental Commission German Corporate Governance Code" as amended on May 05, 2015 ("Code") with the exceptions described below and will also comply with the recommendations in the future with the exception described under item 2 below:

1. The Code recommends in item 4.2.5 for the presentation of the remuneration of the Board of Managing Directors the use of template charts, which also provide for the presentation of comparative figures for the preceding year. As Schaeffler AG only has been converted into a stock corporation in October 2014 and the group management has only been transferred to the company at this point in time the remuneration report 2015 deviates from this recommendation. The remuneration report 2016 will show the comparative figures for the preceding year. Hence, Schaeffler AG will comply with the recommendation in item 4.2.5 in the future.
2. The Code recommends in item 5.4.1 para. 2, that the Supervisory Board shall specify concrete objectives regarding its composition and also set an age limit for the members of the Supervisory Board. The Supervisory Board of Schaeffler AG will not set such age limit because it is of the opinion that this criterion is not informative with respect to the suitability of a person to perform as a member of the Supervisory Board.

Herzogenaurach, December 2016

For the Supervisory Board For the Board of Managing Directors

Georg F. W. Schaeffler
Chairman of the
Supervisory Board

Klaus Rosenfeld
Chief Executive Officer