Compensation system for the Board of Management members

Principles and objectives of the compensation system

In fiscal year 2020, the Supervisory Board revised and updated the compensation system for the Board of Management members on the basis of the German Act Implementing the Second Shareholder Rights Directive (ARUG II) and the new version of the German Corporate Governance Code (GCGC) of December 16, 2019. Taking particular account of LANXESS’s sustainable and strategic alignment, significant changes were implemented in the new compensation system as adopted by the Supervisory Board, and effective January 1, 2021. Specifically, the short-term variable compensation as well as the long-term variable compensation will be based on two measurable targets. In addition, the proportions of short-term and long-term variable compensation have been determined such that the long-term compensation components outweigh the short-term ones. The revised compensation system has been in effect since January 1, 2021 with an exception for the current Board of Management contracts. In order to maintain the previously agreed weighting for each compensation element and thus the amount of total compensation, for some of the current Board of Management contracts the recommendation by the GCGC (German Corporate Governance Code) that the proportion of the long-term variable compensation be greater than that of the short-term variable compensation has not yet been implemented. In the case of future (re)appointments of Board of Management members, the Supervisory Board will apply the new compensation system to all new Board of Management contracts to be concluded.

The compensation system for the Board of Management is aimed at compensating the Board of Management members appropriately in accordance with their areas of activity and responsibility, and is meant to take account of the performance of each Board of Management member and the company’s success. The aim of the compensation system is to support successful and sustainable corporate governance. Therefore, the compensation structure of LANXESS is aimed at providing incentives for successful efforts toward sustainable company performance, for achieving strategic company goals, and for creating long-term shareholder value. Both of the long-term variable components are measured according to company performance over several years, thereby setting long-term incentives. Because one of these long-term compensation components measures stock price development compared with an index, the management’s objectives are aligned with the direct interests of the stockholders. In designing the Board of Management compensation, the Supervisory Board is also devoted to ensuring that it largely corresponds to the compensation system for top management levels in order to ensure a uniform incentive effect within LANXESS management.

Methods for defining and reviewing compensation for the Board of Management

Pursuant to Section 87a AktG, the Supervisory Board resolves a clear, comprehensible compensation system for the members of the Board of Management. The resolutions of the Supervisory Board on the compensation system are being prepared by the Supervisory Board's Presidial Committee. The Presidial Committee also prepares the regular review of the system and the amount of compensation for Board of Management members by the Supervisory Board. If needed, it suggests that the Supervisory Board makes amendments.
The Supervisory Board shall submit the compensation system resolved by it for approval following all significant changes, but at least every four years. If the Annual Stockholders’ Meeting does not approve the compensation system for the Board of Management as submitted for agreement, a reviewed compensation system must be submitted for approval by no later than the subsequent Annual Stockholders’ Meeting.

The appropriateness of the compensation will be reviewed by the Supervisory Board on a regular basis. It shall work with independent external personnel consulting companies for this purpose. Such a review was last conducted in fiscal year 2019. In this review, the compensation of the Board of Management was compared with that of the companies listed in the MDAX and with that of a group of selected chemicals companies. This group includes the following companies: AkzoNobel, Beiersdorf, Clariant, Covestro, Evonik, Henkel, K+S, Linde, Lonza, Merck, Royal DSM, Solvay, Symrise, and Wacker Chemie. These companies were selected by the Supervisory Board on the basis of their comparability with regard to business model, sales, market capitalization, total assets and headcount. The criteria for determining the appropriateness of the compensation for an individual Board of Management member include, in particular, his duties, his personal performance, the economic situation, and the success and sustainable growth of the LANXESS Group. In addition, consideration is also given to compensation at comparable companies and the company’s overall compensation structure with regard to the ratio between the compensation of the Board of Management and that of LANXESS’s senior executives and the rest of the workforce, both overall and in terms of time.

To avoid potential conflicts of interest, the members of the Supervisory Board are required to notify the Supervisory Board of all conflicts of interest. In this case, the Supervisory Board members shall not take part in voting on the resolutions for the relevant agenda items. If a conflict of interest results that is permanent and unresolvable, the respective Supervisory Board member shall resign from office.

Under AktG, the Supervisory Board can make temporary exceptions to the compensation system if so required for company's long-term well-being and if the compensation system lists the procedure for exceptions as well as the components of the compensation system that can be deviated from. In terms of procedure, such exception requires an explicit resolution from the Supervisory Board that specifically describes the length of time for the exception and the exception per se, as well as the reason in sufficient form. Objectively, the Supervisory Board can resolve on temporary exceptions in particular for the variable bonus components, as well as exceptions from the basic compensation and the other compensation components if this is in the interest of the company's long-term well being.

Summary of compensation components

Effective January 1, 2021, the compensation system contains the components shown in the illustration below. The compensation system also contains a claw-back provision as well as a share ownership obligation that requires Board of Management members to invest a defined portion of their compensation in shares and to hold the shares for their term of office on the Board of Management (“Share ownership guideline”). The subject of the compensation system is also a limited-term right for extraordinary termination in the event of a change of control with limited severance provision (“Change of control”). The illustration also shows the relative percentage of each compensation component in the total target compensation for the Board of Management members.
Individual compensation components:

The components of the compensation for members of the Board of Management are the base salary and the short-term and long-term variable components, which are the Annual Performance Payment (APP) for the Board of Management, and the Long-Term Incentive Plan (LTI), as well as a retirement pension. The two variable components APP and LTI are linked to LANXESS's annual performance and performance over a number of years and thus reward the sustainable, value-oriented development of the company. The Long-Term Incentive Plan (LTI) is comprised of the Long Term Stock Performance Plan (LTSP) and the Sustainability Performance Plan (SPP). The proportions of short- and long-term variable compensation have been determined such that the long-term compensation components outweigh the short-term ones. Below, each component of the compensation system, which stipulates a maximum limit for the compensation of the members of the Board of Management, and the compensation structure are explained in detail.

Annual base salary and fringe benefits

The fixed compensation comprises the annual base salary and compensation in kind, the latter consisting mainly of the tax value of perquisites, such as the use of a company car. The annual base salary of the members of the Board of Management is performance-based, market-oriented and in line with the above-mentioned benchmark group. It is paid in twelve equal monthly installments. The benefits in kind are limited to 15 percent of the base salary.

Short-term variable compensation

The APP of the Board of Management now takes account of two instead of one measurable target:

- A financial target with a share of 80% of the individual APP and
- A non-financial target with a share of 20% of the individual APP.
The targets and the payment curves for the APP of the Board of Management will be defined annually by the Supervisory Board for all members of the Board of Management before the start of each fiscal year. As a rule, subsequent changes are not permitted.

The financial target is currently the LANXESS Group’s key controlling indicator, EBITDA pre exceptionals. 100% target attainment is achieved in the event of a certain EBITDA pre exceptionals defined by the Supervisory Board before the start of the fiscal year. The payment curve plots a straight line between this target and the upper or lower limit (0% and 200%). On achievement of the financial target set by the Supervisory Board, the APP target attainment equals 100%. The Board of Management’s financial target is published in the compensation report after the end of the fiscal year.

The current non-financial target is the lost time injury frequency rate (LTIFR: accidents per million hours worked) for accidents with days lost. This reflects the high importance of employee and site safety for LANXESS. The payment curve for the LTIFR, which is reported to one decimal place, takes a tiered approach in order to maintain the existing positive incident reporting culture. 100% target attainment is achieved in the event of a certain figure defined by the Supervisory Board before the start of the fiscal year. The lower limit of target achievement is 0%; the upper limit is 200%. The long-term goal is to avoid any accidents. Therefore, LANXESS will always set an ambitious target.

The APP payment percentage for the Board of Management and managers at the first level below the Board of Management relates to the individual underlying APP percentage. For the ordinary Board of Management members, a payment percentage of 100% equals 100% of the annual base salary. For the Chairman of the Board of Management, however, a payment percentage of 100% equals 125% of the annual base salary.

Within the APP, there is the option to grant an ad hoc discretionary bonus. This is used to recognize special performance or to provide an additional incentive and will be granted only as part of the Board of Management’s APP. It is limited to 20% of the annual base salary. The discretionary bonus can be used only in exceptional cases and the Supervisory Board must be transparent about the reason.

The maximum target attainment for the Board of Management’s APP (including discretionary bonus) is capped at 200%.

The Supervisory Board still reserves the right to reduce the APP in the event of serious occupational safety and/or environmental problems.

**Long-term variable compensation**

The Board of Management must be committed for the long term to the company and to promote and achieve sustainability. This means efficient handling of the capital provided by the stockholders and investors. LANXESS considers the heavy emphasis on sustainability as a key aspect of its own competitive advantage, not least because all facets of sustainability is in ever-higher demand by customers and consumers. Through such mechanisms as emissions certificates, sustainable production also has a direct impact on our financial performance. Overall, therefore, sustainability is a key component of our strategy, which is now also reflected in the compensation system.

The LTI is also comprised of two uniform, measurable targets, which apply to all Board of Management members:

- A component based on share price performance in the form of a Long Term Stock Performance Plan (LTSP) with a long-term percentage of individual LTI of 60 % and
A sustainability component in the form of the Sustainability Performance Plan (SPP) with a long-term percentage of individual LTI of 40%.

The LTSP is based on the price performance of the LANXESS share compared with a benchmark index, currently the MSCI World Chemicals Index. The existing LTSP has four tranches; performance is determined each year and at the end of each four-year term of the tranches, the payout rate is calculated on the basis of the annual individual values. When the tranche is due after four years, the rights are converted immediately into any payment amount. The payment curve plots a straight line between the target of 100% and the upper or lower limit (0% and 200%). Maximum target attainment is capped at two times the individual LTSP target percentage. The SPP is an incentive to achieve long-term sustainability targets. The assessment period of these components is also four years. On the basis of LANXESS’s published interim goal for 2025, the Supervisory Board adopted a CO₂ target for the first time for 2024, which is included in the SPP. In subsequent years, a different target criterion can be selected to reflect the company’s current focus. This mechanism is meant to place an emphasis on different aspects of sustainability. The target and the payout curve for the SPP shall be defined annually before the start of the fiscal year by the Supervisory Board. Subsequent adjustments are permitted only in the case of the CO₂ targets to take M&A transactions into account. The payment curve plots a straight line between the target of 100% and the upper or lower limit (0% and 200%). Maximum target attainment is capped at two times the individual SPP target percentage.

The reference value for the LTSP and SPP is the annual base salary.

Retirement pensions

The retirement pensions for the members of the Board of Management are a contribution plan that provides company pension benefits after the members of the Board of Management end their employment relationship. These benefits are paid when the beneficiary reaches the age of 60 or 62 or if the beneficiary is permanently unable to work. They are paid to surviving dependents in the event of the beneficiary’s death.

The retirement pensions stipulate a contribution to be made by the company equal to 50% of the annual base salary or 56.25% for the Chairman of the Board of Management. Moreover, the members of the Board of Management must themselves pay an amount from deferred compensation amounting to 12.5% of the APP of the Board of Management. The members of the Board of Management may increase their personal contribution to up to 25% of the APP. The calculation of the personal contribution is based on the APP to be paid, but is limited to a maximum of 100% target attainment. The sum of the contributions is capped. From the date of entitlement, up to 30% of the accumulated capital – including the interest thereon – may be converted to a pension benefit. If the service contract ends before the beneficiary reaches the age of 60 or 62, the company pays certain additional benefits up to a defined ceiling.

Maximum compensation

In accordance with Section 87a Para. 1 Sentence 2 No. 1 AktG, the Supervisory Board has determined an absolute amount in euros as the maximum compensation that can be granted to the Board of Management in a fiscal year. The maximum compensation was determined individually for each Board of Management member and includes all fixed and variable compensation components. The maximum compensation is EUR 9.4 million per year for CEO Matthias Zachert, EUR 3.5 million per year each for the ordinary Board of Management members Dr. Anno Borkowsky and Dr. Stephanie Coßmann and EUR 4.1 million per year each for the other ordinary Board of Management members currently Michael Pontzen and Dr. Hubert Fink.

Share Ownership Guideline
The Share Ownership Guideline (SOG) as introduced in 2018 and amended in 2020 defines the amount that the Board of Management members must invest in LANXESS AG. Over a period of four years, the members of the Board of Management are obliged to invest a defined percentage of their compensation in shares of LANXESS AG and hold the shares until the end of their employment contract (SOG target). The acquisition and holding are reviewed annually. The SOG target, as is the market standard for German companies, is 150% of annual base salary for the Chairman of the Board of Management and 100% of annual base salary for the other members of the Board of Management.

Compliance with this obligation must be documented annually during the four-year setup phase and then every three years thereafter. Any dividends from the LANXESS shares acquired belong to the Board of Management members. Otherwise, the dividend payment will not have an effect on the compensation for the Board of Management members.

**Claw-back provision**

There is a claw-back provision for the variable compensation. If a Board of Management member commits a serious breach of his duties to the company, the provision enables the Supervisory Board to demand that some or all of the variable compensation be withheld or that he be required to refund any payments already received.

This notwithstanding, if the Board of Management members cause harm by a breach of duty, the law provides that payments can be reduced or must be refunded.

**Term of contract and termination of Board of Management activity**

With regard to appointing members of the Board of Management or the term of the Board of Management contracts, the Supervisory Board shall observe the requirements under stock law and the recommendations of the GCGC. For a first-time appointment to the Board of Management, the term of office and of the employment contract is generally three years. For reappointments, the maximum term of the employment contracts is five years.

The employment contracts are concluded on a temporary basis and end on the deadline without requiring separate notice of termination. In the event of a change of control, the Board of Management members have a temporary, special right of termination as described in the section below. This is without prejudice to the right of both parties for termination without notice for due cause.

The employment contracts of all Board of Management members provide for a general limit on any severance pay ("severance cap"): in the event of early termination of activity on the Board of Management, payments to a Board of Management member cannot exceed the value of two annual base salaries including the variable compensation components, but for a maximum of the remaining term of the contract. No severance payment shall be granted if the Board of Management member himself resigns, or if the company terminates him for due cause.

**Change of control**

Payments in the event of a termination of employment contract following a change of control are capped at two annual base salaries plus the Board of Management’s APP and the SPP at 100% target attainment, accounting pro rata for the remaining term at the date of contract termination.

**Signing bonus**

As a rule, LANXESS does not pay a signing bonus.
Post-contractual non-compete agreement

No post-contractual non-compete agreements have been made. However, for the term after the end of the employment contract, an agreement can be made on a post-contractual non-compete agreement. In the event of a post-contractual non-compete agreement, in accordance with the GCGC the severance payment should be counted toward the compensation for this agreement.

Compensation from additional employment

If members of the Board of Management hold Supervisory Board mandates or similar offices in subsidiaries in which LANXESS holds a direct or indirect stake, or in associations and similar organizations that the company belongs to or is affiliated with on the basis of its business activities, the agreed annual base salary represents full and final compensation for this activity. Compensation paid for the aforementioned offices must be reported to LANXESS and will be deducted from the agreed payments.

Supervisory Board mandates and mandates in comparable controlling bodies of commercial enterprises outside the LANXESS Group can be held only with the prior consent of the Supervisory Board. In these cases, the Supervisory Board will also decide whether and to what extent the compensation will be counted.