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# **Korea Stewardship Code Guide Book ver. 1**

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**Korea Corporate Governance Service**

## **Disclaimer**

The Korea Corporate Governance Service prepares and publishes this Guide Book as recommended by the Korea Stewardship Code with the aim to offer useful guidelines and real cases that help institutional investors better understand and implement the code.

Any interpretation of the current laws and regulations documented in this Guide Book is the quotation, excerption, summary, and reorganization by the Korea Corporate Governance Service of the review carried out by the Korea Stewardship Code Working Group,<sup>1)</sup> and the Korea Corporate Governance Service does not guarantee the accuracy of such interpretation.

Furthermore, the content documented in this Guide Book may change at any time according to any change in the capital market environment, and any revision in laws and regulations. In the foreseeable future, the Korea Corporate Governance Service will publish an updated version of the Guide Book after a commenting period to receive opinions.

- 1) The Korea Stewardship Code Working Group was founded in February 2017 and has operated since then by the Financial Services Commission aiming to minimize any legal uncertainty around shareholder activities carried out in line with the Korea Stewardship Code. Consisting of staff from the Financial Supervisory Service, Korea Financial Investment Association, Korea Exchange, Korea Corporate Governance Service, and Korea Capital Market Institute, and outside legal experts, etc., the Working Group has been working on how to interpret the Financial Investment Services and Capital Markets Act and other relevant laws in the context of shareholder activities under the Stewardship Code.

## Guidance

**1. The responsibility institutional investors bear in taking care of or managing assets entrusted by others (stewardship responsibilities, hereafter) refers to a sense of responsibility to promote the mid- to long-term interests of their clients and ultimate beneficiaries by pursuing the mid- to long-term value enhancement and sustainable growth of investee companies.**

▪ Institutional investors take on basic responsibilities to act in the best interest of their clients and beneficiaries entrusting assets to them. The gist of such responsibilities is the fiduciary duty, which is manifested in the Financial Investment Services and Capital Markets Act (FSCMA) as institutional investors’ responsibilities for managing assets in good faith. The responsibilities institutional investors bear as a steward of assets entrusted by others are more important in today’s capital market structure characterized by a complex investment chain.

The process where institutional investors invest and manage assets on behalf of clients and beneficiaries consists of several stages, and thus is complex. For example, the assets of clients and beneficiaries are often managed by an external asset manager via a pension fund and its internal investment management team. However, more decision making stages of institutional investors usually mean a likelihood where decisions fail to faithfully reflect the interests of clients and beneficiaries

Under such a complex investment chain, it is hard to have an efficient governance structure that perfectly aligns the concrete management principle and direction with the interests of end clients and beneficiaries sitting in the opposite side of an investment chain. To supplement this, each institutional investor within the investment chain needs to acknowledge and faithfully take on their responsibility as a steward to preserve and promote the interests of clients and beneficiaries.

Stewardship responsibilities pursued by the Principles herein refer to the responsibilities to pursue mid- to long-term development of investee companies as a shareholder and to promote the interests of clients and beneficiaries during the process. Institutional investors are those who manage the assets entrusted by others, and are responsible for not only monitoring their investee companies, but also other basic engagement activities such as a dialogue with a board of directors. Where necessary, they need to exercise their shareholder rights in an aggressive manner. During the process, institutional investors fulfill their stewardship responsibilities for ultimately acting in the long-term interests of clients and beneficiaries and improving the mid- to long-term risk-adjusted performance of their portfolio including the investee companies.

**2. Successful implementation of stewardship responsibilities not only induces the mid- to long-term development of investee companies, and contributes to enhancing investor returns, but also supports the sound and substantial growth and development of capital markets and the overall economy.**

▪ As mentioned above, the primary stewardship responsibilities suggested by the Principles is for institutional investors to aggressively carry out shareholder activities for creating value and minimizing concerns, via which to induce mid- to long-term development of the investee company.

Stewardship responsibilities require such sustainable development in the investee company to be aligned with the interests of clients and beneficiaries. Hence, institutional investors endorsing the Stewardship Code should take into account the mid- to long-term interests of clients and beneficiaries in implementing stewardship responsibilities, so as to contribute to promoting the mid- to long-term interests of the investee company as well as the investors.

Going forward, this is expected to help the Korean capital markets regain investor confidence and their international status, and ultimately support sustainable growth in the capital markets as well as the overall economy.

**3. Institutional investors are responsible for monitoring whether or not the board of directors faithfully exercises the responsibilities bestowed upon it and, where necessary, carrying out constructive engagement such as an active dialogue with the board. The board of directors exercises its responsibilities by supervising management on behalf of the company and shareholders.**

▪ The board of directors appointed and constructed by shareholders is responsible for overseeing whether the investee company is managed for the interests of the company as well as the shareholders. Institutional investors can catch an indirect glimpse of how the company is managed by monitoring whether the board faithfully carries out such responsibilities.

If an investee company's executive makes a decision hardly in line with mid- to long-term value enhancement and sustainable growth, this could possibly be inconsistent with the interests of clients and beneficiaries. In such a case, institutional investors need to carry out constructive engagement activities such as an active dialogue with the board of directors, an internal management oversight body. By making improvements to better align the interests of the company and shareholders, institutional investors should endeavor to enhance the mid- to long-term shareholder value. Certainly, it is desirable, instead of engagement activities, to carry out regular monitoring to ensure that the board of directors executes its management oversight function in a faithful manner.

As such, to promote the creation and improvement of the corporate and shareholder value, and ultimately the mid- to long-term interests of clients and beneficiaries is the responsibility of institutional investors underscored by the Korea Stewardship Code.

**4. The aim of the “Principles on the Stewardship Responsibilities of Institutional Investors” (the Principles, hereafter) is to propose key principles that are crucial for institutional investors to effectively exercise their stewardship responsibilities, and concrete details for these principles.**

▪ The Principles propose each institutional investor to formulate and faithfully comply with its stewardship policy. Institutional investors can implement stewardship responsibilities in diverse ways depending on their own situation, and it is desirable to do so.

However, while implementing stewardship responsibilities according to the Principles, institutional investors could face difficulties due to their lack of experience, uncertainties, etc. To minimize those difficulties, the Principles set out seven primary principles and guidelines that are important to carry out stewardship responsibilities more effectively. This will guide institutional investors in better exercising their shareholder activities and stewardship responsibilities. Of course, the code adopts the “comply or explain” approach to be described hereunder, and therefore, the entire content of the code neither forcefully regulates institutional investors nor undermines their autonomy.

**5. Activities in implementing stewardship responsibilities (stewardship activities, hereafter) have a broad scope, including but not limited to the exercise of voting rights. The activities range from monitoring key management issues such as an investee company's business strategy and outcome, risk management, and corporate governance, to consultation with the board of directors, etc., as well as more proactive activities concerning shareholder proposals, litigations, etc. Engagement activities of institutional investors include a wide spectrum of shareholder activities geared towards "clear and constructive goals" in conducting a dialogue with investee companies.**

▪ Shareholder activities for exercising stewardship responsibilities have a broad scope. Starting from monitoring core management issues that could affect the mid- to long-term corporate value, those activities include a dialogue with the investee company, voting, and more active engagement where necessary.

Institutional investors should, among others, collect and thoroughly analyze sufficient information on core management issues that could affect the investee company's mid- to long-term value and business sustainability. During the process, it is desirable for institutional investors to broaden the scope of their understanding on core management issues via a dialogue with management and the board of directors, etc. Such day-to-day activities including monitoring, dialogues, and voting lay an important foundation of shareholder activities, and carry an important and fundamental meaning as stewardship activities.

When concerns or issues arise, institutional investors can try to address them by actively raising questions and proposing opinions. They can discuss those issues at a shareholders' meeting, or sometimes vote against a resolution. Where necessary, they need to mobilize other tools such as shareholder proposals, litigations, etc. as part of attempts to resolve the problem. It is worth paying heed to the fact that shareholder activities for the interests of clients and beneficiaries are not limited to voting although voting is one of the most fundamental shareholder rights.

However, dialogues with the investee company should take place for concrete purposes, rather than meaningless ones for a mere formality. In addition, shareholder activities for discharging stewardship responsibilities should be built upon mutual understanding and cooperation with the investee company and head in the constructive direction serving the client interests as well as the company's value. It would be better for institutional investors to understand dialogues, voting, and other shareholder activities as a tool for seeking constructive solutions, instead of a one-sided request to investee companies.

**6. Institutional investors are broadly categorized into “asset owners” and “asset managers”. Asset managers routinely implement stewardship responsibilities through investment management and dialogue with investee companies. Asset managers namely include asset management companies. Asset owners can carry out stewardship activities by proposing key principles and mobilizing methods such as instructions, evaluations, etc. to ensure that asset managers effectively implement their monitoring and engagement activities. Pension funds and insurance companies are major types of asset owners.**

▪ In general, “asset owners” refer to institutional investors who own large-scale assets and delegate the management of those assets to external asset managers. Of course, they can directly manage the assets. Asset owners can carry out their stewardship activities via diverse models as listed below depending on what activity is delegated to whom.

- In-house model
- Delegated model (delegation to “asset managers” entrusted to manage the assets)
- Outsourced model (delegation to a third party)
- Hybrid approach

Asset owners can establish an internal division or committee to directly carry out stewardship activities. For higher implementation efficiency, however, there are quite a few cases where all or part of stewardship activities are delegated to external asset managers or proxy advisors.

In some cases, asset owners delegate overall stewardship activities to external asset managers, while directly and proactively carrying out shareholder activities where necessary. Otherwise, they choose to delegate investment management only to several asset managers, but asset owners gather votes of investee companies to directly exercise the voting rights.

Different from asset owners, asset managers are institutional investors who actually manage the assets on behalf of their clients based on their proven investment management expertise. Asset managers often directly discharge stewardship responsibilities by monitoring investee companies and communicating with them for enhancing the value of assets under management.

If the exercise of stewardship activities is delegated to asset managers, asset owners are responsible for monitoring and evaluating the progress of stewardship activities asset managers have actually implemented. That is to say that asset owners discharge their stewardship responsibilities by such ex-post monitoring and evaluations. Conversely, asset managers are responsible for regularly and transparently reporting their actual shareholder activities to asset owners in person or in writing

On the other hand, asset owners should make ex-ante efforts to select external asset managers who are expected to fulfill stewardship responsibilities in a faithful manner. To do so, asset owners should thoroughly review the stewardship policy of the asset managers. In addition, it is desirable to notify the asset owners in advance of the basic principles that must be upheld during the implementation of stewardship activities. For example, asset owners and asset managers need to reach an understanding in advance on the basic principles such as proxy voting policies, the form of active shareholder engagement, etc.

**7. Assuming the burden of the responsibility, duty, and an appropriate level of remuneration in fulfilling stewardship responsibilities is essential to the sound growth of investee companies, the protection and enhancement of mid- to long-term investment returns, and the continuous development and advancement of the capital markets. Investors, asset owners, asset managers, and relevant authorities, etc. need to share a common understanding on this point.**

▪ According to the Principles, it is desirable for institutional investors themselves to fully recognize the importance of stewardship responsibilities and try to discharge them in a faithful manner. However, the exercise of stewardship responsibilities is likely to incur inevitable costs, for example, hiring staff in charge of shareholder activities, or using services from external service providers, etc.

However, institutional investors need to recognize such a burden as an investment for the future, instead of costs because this is ultimately an expenditure for mid- to long-term development of the investee company, and protecting the interests of clients and beneficiaries. Furthermore, public perception should shift toward viewing such costs as preemptive investment essential to the persistent growth and development of the Korean capital markets and economy.

From the same perspective, the remuneration institutional investors including asset owners pay to stewards or advisors for delegating stewardship responsibilities should be seen as an investment instead of costs. In the end, investors, asset owners, and asset managers need to share a constructive view regarding that. Relevant regulatory authorities need to make efforts in building a regulatory framework and a virtuous circle in the capital markets where a proper level of remuneration could strengthen expertise of stewards and advisors, facilitate growth of investee companies, and deliver more to clients and beneficiaries.

**8. Stewardship activities do not signify any undue intervention in day-to-day operations of investee companies. Moreover, institutional investors can consider selling their shares should it be deemed in the best interests of their clients and beneficiaries.**

▪ When there is any abnormal condition or management issue that could damage the mid- to long-term shareholder value or undermine sustainability, institutional investors need to engage in shareholder activities for their clients. Management issues or decision making in normal times should be left to the investee company's management and board of directors for the sake of management efficiency. In that sense, stewardship activities are not intended to interfere or meddle in normal business operations. Rather, those activities are part of the two-way communication process to broaden the understanding about the investee company and to work on constructive solutions with the board of directors, etc.

**9. In order to minimize any legal uncertainties that institutional investors may face during the course of their stewardship activities, institutional investors, relevant authorities, etc. need to make collaborative efforts to categorize shareholder activities in order to make it clear which category of activities is subject to relevant laws and regulations, etc.**

▪ Given the overall practice and culture in the Korean capital markets, institutional investors endorsing Korea Stewardship Code are more likely to engage more actively than before in shareholder activities.

However, shareholder activities inevitably accompany a certain level of legal uncertainty. For example, Korea's FSCMA bans the use of material nonpublic information, and mandates the reporting of large shareholdings (the so-called 5% rule). Under the 5% rule, an institutional investor who has disclosed his shareholding purpose as investment could unintentionally break the rule during the process of shareholder activities. This could pose a challenge to institutional investors' participation in the stewardship code.

Regulatory authorities, institutional investors, etc. should make coordinated efforts in classifying shareholder activities by type and clarifying to what extent the relevant laws and regulations are applied, and what shareholder activities are allowed, etc., which will thereby minimize legal uncertainty. Such efforts will be the basis for facilitating institutional investors and others to participate in and implement the code.

## Guidance

**1. The Principles basically apply to domestic and overseas institutional investors holding the shares of publicly listed companies in Korea, in other words, asset owners and asset managers.**

▪ The Principles basically apply to “stewards” who manage the assets entrusted by others and exercise their best efforts in “shareholder activities” in the interests of clients and beneficiaries. This is why the participants in the Principles are limited to “institutional investors” investing in the “stocks” of publicly listed companies in Korea. The nationality of institutional investors does not matter. More important is whether those institutional investors can engage in constructive shareholder activities to drive mid- to long-term development of Korean companies or not. Shareholder activities of global institutional investors such as pension funds with abundant experience in developed capital markets are expected to offer Korea a diversity of best practices on stewardship responsibilities.

However, as the Principles place no explicit criteria for banning certain participants, institutional investor who wishes to engage in faithful shareholder activities as a steward can freely adopt the code. For example, a domestic institutional investor managing investment in overseas listed companies, or a private equity fund investing primarily in unlisted companies can freely participate in the Principles to share their views on stewardship responsibilities. If those types of institutional investors participate in the stewardship code and discharge the principles, this could benefit clients and beneficiaries.

**2. Institutional investors take on ultimate stewardship responsibilities even when they entrust all or part of their stewardship activities to external investors or other (advisory) service providers. Institutional investors should monitor and supervise to ensure that outsourced activities are executed in accordance with their own stewardship policy. Hence, the Principles apply to proxy advisors, investment advisors, etc. that provide (advisory) services related to the detailed contents of the Principles.**

▪ Institutional investors can select another institutional investor as a steward to delegate stewardship activities. The steward can again seek outside help or outsource the implementation of shareholder activities to a third-party expert such as proxy advisors or investment advisors. Under such arrangements, the steward, proxy advisor, etc. are responsible for providing services in good faith for improving mid- to long-term client benefits, during which acting in line with their clients' policy. Hence, not only institutional investors, but also external experts such as proxy advisors need to participate in the Principles to share their views on stewardship responsibilities. This is the reason why the target of the Principle includes advisors, etc.

Although institutional investors can seek external help or delegate shareholder activities to other institutional investors or proxy advisors in order to effectively carry out their stewardship responsibilities, this does not mean that they can delegate their ultimate responsibility as a steward. Institutional investors are responsible for carefully selecting stewards and advisors, and periodically monitoring and evaluating delegated shareholder activities so as to ensure that the activities promote the benefits of their clients. By doing so, institutional investors need to make their best efforts to take on their ultimate responsibility as a steward even in the case where they do not carry out shareholder activities at first hand.

**3. The Principles are not legally binding. Hence, the Principles apply only to institutional investors, among the aforementioned parties, that agree with the intention and contents of and that voluntarily affirm participation in the Principles by accepting and implementing them (participating institutional investors, hereafter).**

▪ The Principles are not mandatory provisions under relevant laws in Korea. Hence, it is not that they apply to all of the targets including institutional investors, advisors, etc. The Principles apply to only those who voluntarily declare their participation and implementation of the Principles. As such, the participation in and compliance with the Principles are not legally binding. Rather, any steward-like institution or relevant institutions in the Korean capital markets can participate in and be subject to the Principles. If the Principles are embraced and endorsed by a broader range of Korean and foreign institutional investors, this is expected to further facilitate the sound growth of the Korean capital markets.

**4. Participating institutional investors, etc. should comply with the Principles, but when they cannot comply exceptionally, they should explain the reasons (“comply or explain”). When participating institutional investors, etc. cannot adhere to any details set forth in the Principles due to their business model, investment policy, etc., they should provide the reason, sufficiently explain alternatives to stewardship activities to their clients and beneficiaries, and publicly disclose the contents.**

▪ The seven principles and guidance for each principle in the Korea Stewardship Code document the items any institutional investor upholding stewardship responsibilities needs to implement. Hence, it is desirable to carry out all of those where possible.

However, there could be some exceptions depending on the characteristics or conditions of individual institutional investors. It is possible that some institutional investors adopting the Principles do not comply with some part of the seven principles and the guidance for each principle. In such cases, institutional investors should explain why they are unable to follow the principle and guidance, and propose alternatives as follows.

- Explicitly state the reason behind noncompliance given each institutional investor’s condition, business model, etc.
- Explain the alternative chosen to implement stewardship responsibilities

The Korea Stewardship Code does not force to comply with all principles and guidance because it respects each institutional investor’s nature, position, and diversity such as the business model, investment policy, etc.

If we take the discussion a bit further, it is possible for institutional investors endorsing the Principles to set the implementation scope and the level of stewardship responsibilities depending on their asset characteristics, investment period, and management style, etc., and accordingly to choose different implementation tools. For example, institutional investors could prioritize voting rights for a certain type of fund, e.g., passive and active funds, whereas preferring aggressive shareholder activities such as a dialogue with the board of directors, shareholder proposals, etc. for another fund.

The Korea Stewardship Code does not put forward right answer or requirements for stewardship responsibilities. Its primary aims are to encourage institutional investors themselves to faithfully implement stewardship responsibilities in the way fitted for their own philosophy and characteristics, and to create a foundation that helps such investment practices and culture take hold in the Korean capital markets. Taking into account those aims, it is important to understand that the Principles are not an invariable framework. A desirable direction is that institutional investors voluntarily adopt the code and use their creativity to accumulate best practices following the “comply or explain” approach.

- 5. Participating institutional investors, etc. should publicly disclose matters listed below on their website, and periodically review and update the contents where necessary. Should they decide to participate in the Principles or should there be any updates or changes on the website, they should immediately notify these to the Korea Corporate Governance Service with the last updated date, and website address.**
- **Intention to accept and implement the Principles;**
  - **Details on how to implement each Principle and guideline;**
  - **Details that are required to be publicly disclosed by the Principles and guidelines;**
  - **When there are any unimplemented Principle and guideline, or when there is any undisclosed item that is required to be disclosed under each Principle and guideline, the reasons for the failure to apply it and alternatives to stewardship activities; and**
  - **Whether or not the institutional investor applies the Principles across-the-board to all funds it manages, and related details when there are differences in their application, implementation, and standards.**

▪ After deciding to participate in the Principles, institutional investors need to transparently disclose “(Stewardship Code) Statement” (hereinafter, “statement”) that includes concrete details on how they would implement each principle and guidance. The statement is drafted according to the aforementioned “comply or explain” approach. Furthermore, it is necessary to disclose the statement via the channel to which clients, beneficiaries, investors, etc. can easily access. Institutional investors should first post their statement on their website, and notify that to the Korea Corporate Governance Service. After checking that an institutional investor has posted without any omission on its website its intention to endorse the code, the statement, and the contact details of the head and staff in charge, the Korea Corporate Governance Service will finally confirm code participation by listing the institutional investor in its participants list on the stewardship code website.

In the statement, it is desirable to document the concrete details for each principle including the policy, the implementation method, the reason behind noncompliance, alternatives, etc. Especially, if the code applies differently to several funds with diverse characteristics, institutional investors need to clearly state how the Principles are applied and implemented differently across funds.

**6. Participating institutional investors, etc. may concurrently utilize their disclosed policies and implementation report made in adherence to similar overseas stewardship codes (or Principles of Responsible Investment, PRI) to fulfil the disclosure and reporting requirement of the Principles. But if there are differences in the detailed contents of the Principles and overseas codes, these must be reflected.**

▪ Participating in several standards and codes with similar purposes requires institutional investors to devise respective policies, and draft and disclose respective implementation reports, which could add unnecessary burden. To address that inconvenience, institutional investors endorsing the Principles are allowed to use their existing policies, reports, etc. in order to endorse the Principles and exercise the details.

Should the Principles deviate from the details of any overseas code, it is necessary to modify the content of the statement focusing on the Principles and guidance. When an institutional investor has adopted an overseas stewardship code or another code whose purposes are similar to the Principles, the institutional investor needs to clearly indicate the fact, which will desirably bolster confidence and avoid unnecessary misunderstanding.

**7. The Korea Corporate Governance Service should periodically examine trends in participation in and implementation of the Principles in order to gauge the overall level of stewardship activities in the capital markets. Furthermore, it should publicly disclose on its own website the list of participating institutional investors, etc. and the website of each investor. This will enable capital market participants, etc. to easily check information on institutional investors, based on which they will be able to select institutional investors that fit their investment preferences, and monitor how well the investor implements stewardship responsibilities. In addition, the Korea Corporate Governance Service should periodically monitor and improve the detailed contents of the Principles by taking into account best practices and cultures from Korea and overseas related to stewardship activities, capital market development stage, overseas stewardship codes, and domestic and international regulatory trends, etc..**

▪ The introduction and penetration of the Korea Stewardship Code are expected to bolster the perception about stewardship responsibilities among Korean institutional investors. This will not only improve the governance structure of Korea's financial and investment sectors as well as listed companies, but also impose positive impacts on higher confidence and sustainable development of the Korean capital markets. However, it is hard to expect such outcomes unless the Principles win broad support and approval from clients, beneficiaries, institutional investors, etc., and are implemented effectively. Therefore, the Korean capital markets should have a condition that facilitates the Principles and their effective functioning. Toward that end, the Principles set out that the Korea Corporate Governance Service should play a role in helping the code be implemented and penetrated more effectively.

The Korea Corporate Governance Service discloses the list of participating institutional investors classified into pension funds, insurance companies, asset managers (including private equity firms), advisors, and others on its website ([www.cgs.or.kr](http://www.cgs.or.kr)), so that users can select institutional investors from the list to easily access their websites and find their stewardship code statements and other relevant documents.

The Korea Corporate Governance Service website as well as the website of each institutional investor participating in the Principles provide not only the participants list, but also important documents showing the participants' stewardship code statements, policies related to stewardship responsibilities, and stewardship activity reports, etc. Such information helps investors to choose institutional investors to delegate investment, institutional investors to look for an ideal advisor to delegate services, and all of those to check on whether their stewards fulfill their responsibilities in a faithful manner.

In addition, the Korea Corporate Governance Service keeps track of market trends on how institutional investors and others participate in and comply with the stewardship code. More concretely, it monitors the websites and statements disclosed by participating institutional investors to find out the number of participants across types such as institutional investors, advisors, etc., how they implement the code, and what principles in the code are endorsed, etc. This is surely expected to help assess how the Korean capital markets accept and implement the stewardship code, and seek to identify the future directions.

However, the Korea Corporate Governance Service neither confirms nor guarantees that the individual content disclosed by participating institutional investors on their websites is true or has been actually executed. The task of thorough fact checking and evaluation should be left to information users such as clients, investors, etc. What makes participating institutional investors faithfully execute what they voluntarily disclosed is the role of market discipline working in concert with clients keeping a check on the participants.

The strength of the Principles lies in their implementation flexibility that enables institutional investors to reflect their respective conditions. However, the abstract nature of the Principles makes it difficult for each participant to voluntarily devise and follow the range, level, and method of implementation. To address such concerns, the Korea Corporate Governance Service has plans to continuously introduce domestic and overseas best practices, culture, and cases so as to help institutional investors easily comply with the Principles.

Also necessary for the Principles to fully take hold and proliferate is thorough monitoring of the environmental changes surrounding the Korean capital markets so as to reflect them to the Principles in a timely manner. Putting more efforts into periodic revisions to the Principles provides a vital foundation for higher confidence in the Principles among the participants in the Korean capital markets including institutional investors, ordinary investors, investee companies, etc. In this context, the Korea Corporate Governance Service make efforts to take into account many factors such as global trends on the stewardship code; domestic and overseas trends on relevant laws and regulations; Korea's best practices and culture related to the exercise of stewardship responsibilities and dialogue between a company and its shareholders; the level of development of the Korean capital markets, etc., so as to periodically check and improve the concrete details set forth in the Principles.

**8. Participating institutional investors, etc. should designate staff in charge of policies, procedures, and disclosures related to stewardship responsibilities, and publicly disclose the staff's name and contact information.**

▪ The Korea Stewardship Code is primarily purposed to induce participating institutional investors, etc. to do their best for the interests of their clients and beneficiaries. Toward that end, institutional investors, etc. need to maintain close communication with their clients. This is the main intent of the provision to disclose contact details of the head and staff in charge of the code.

Active communication between participating institutional investors and their clients is expected to not only induce the institutional investors to execute shareholder activities more responsibly, but also bolster institutional investors' confidence among clients and beneficiaries.

## Principles

In order to enhance the mid- to long-term value and sustainable growth of investee companies and further the mid- to long-term interests of their clients and ultimate beneficiaries, institutional investors should comply with the Principles stated below.

- 1. Institutional investors, as a steward of assets entrusted by their clients, beneficiaries, etc, to take care of and manage, should formulate and publicly disclose a clear policy to faithfully implement their responsibilities.**
- 2. Institutional investors should formulate and publicly disclose an effective and clear policy as to how to resolve actual or potential problems arising from conflicts of interest in the course of their stewardship activities.**
- 3. Institutional investors should regularly monitor investee companies in order to enhance investee companies' mid- to long-term value and thereby protect and raise their investment value.**
- 4. While institutional investors should aim to form a consensus with investee companies, where necessary, they should formulate internal guidelines on the timeline, procedures, and methods for stewardship activities.**
- 5. Institutional investors should formulate and publicly disclose a voting policy that includes guidelines, procedures, and detailed standards for exercising votes in a faithful manner, and publicly disclose voting records and the reasons for each vote so as to allow the verification of the appropriateness of their voting activities.**
- 6. Institutional investors should regularly report their voting and stewardship activities to their clients or beneficiaries.**
- 7. Institutional investors should have the capabilities and expertise required to implement stewardship responsibilities in an active and effective manner.**

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**Principle 1 | Establish and Disclose a Fiduciary Responsibility Policy**

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**Institutional investors, as a steward of assets entrusted by their clients, beneficiaries, etc, to take care of and manage, should formulate and publicly disclose a clear policy to faithfully implement their responsibilities.**

### **Guidance**

**Institutional investors are responsible for acting in the mid- to long-term interests of their clients and beneficiaries by using their deep understanding of investee companies and the economic, social, and business environment, etc. for active communication and shareholder activities in order to pursue the value enhancement and growth of investee companies.**

▪ Institutional investors take on basic responsibilities for doing their best to manage assets for the interests of clients and beneficiaries who entrusted the assets. This is also confirmed by the FSCMA provision that requires institutional investors to manage client assets in a faithful manner and protect the interests of clients and beneficiaries under their fiduciary duties.

As a professional investor, institutional investors can trade assets in pursuit of the interest of clients and beneficiaries. However, institutional investors today are required to do more than trading assets to do their fair share of duties and responsibilities as a steward. In the modern capital markets, investors are exposed to complexity, frequent volatility, and uncertainty of the capital markets and economic environment. It is impossible to deny the likelihood where unexpected risks could drastically cut the value of assets under management.

Hence, institutional investors need to go beyond focusing too narrowly in asset trading in order to proactively respond to uncertainty and risk factors surrounding the investee company by engaging in active dialogues with the investee company, etc. This helps pursue mid- to long-term development of the investee company, and promote mid- to long-term interests of clients and beneficiaries. This is the stewardship responsibility of institutional investors set out in the Korea Stewardship Code.

**The activities which institutional investors carry out to implement their responsibilities as a manager and steward of the assets entrusted to them should include proactive engagement activities such as monitoring potential problems, constructive dialogue and, where necessary, productive proposals geared towards problem-solving.**

- Institutional investors can go beyond mere asset trading to engage in more proactive shareholder activities for stewardship responsibilities. They need to monitor the investee company for any risk factor leading to negative impacts on the asset value, and if there is any concern, they need to be proactive to talk to the investee company for identifying causes, seeking solutions, presenting constructive alternatives, etc.

**Institutional investors should formulate and publicly disclose a documented policy on how they understand stewardship responsibilities, and what are the effective and concrete methods for exercising their responsibilities, etc. This policy should include the principles and guidelines, investment management philosophy, rights and duties, and organization and procedures related to their stewardship activities.**

- What position institutional investors hold about stewardship responsibilities, and how they fulfill the responsibilities are highly important to clients and beneficiaries. This is also vital when clients, etc. want to evaluate how their assets are managed, or select institutional investors for investing their assets. Hence, institutional investors need to formulate and faithfully implement a comprehensive policy on stewardship responsibilities.

Basically, a stewardship policy should include the basic principles on how institutional investors recognize stewardship responsibilities, how they implement the responsibilities, and what procedures they follow. All of them should be determined in reasonable and reliable manners fully considering institutional investors' respective characteristics such as the business model, fund characteristics, internal resources, and capabilities, etc. For example, it is worth considering the following items for a stewardship policy.

- **Institutional investors' business model, investment philosophy and strategies, and position in the investment chain:** This includes to which category (e.g., asset owners, asset managers, advisors, etc.) an institutional investor belongs; what the investment purpose and philosophy is; what investment strategies are used for investment; whether they outsource investment management or not; the composition of investment assets such as stocks, bonds, etc.; how long their investment horizon is (turnover, etc.); types of funds, e.g., active, passive, etc. It could be useful to link the website with an investment policy including above items and brief explanation. Such information helps investors better understand the basic characteristics of participating institutional investors.
- **How institutional investors understand the key elements and philosophy of stewardship responsibilities:** Taking into account the business model, what responsibilities institutional investors have against their clients and beneficiaries is explained. Institutional investors present

their position on the relationship between stewardship responsibility implementation and the interests of clients and beneficiaries; and the meaning of their participation in the stewardship code and exercise of the principles, etc. This gives investors a glimpse of the motive and philosophy behind institutional investors' code adoption.

- **Matters related to managing non-financial risk factors, etc.:** Non-financial risk factors monitored by institutional investors, the relationship between those risk factors and the value of the investee company, and risk management principles and procedures are specified. This could be replaced by other content disclosed for monitoring and managing risk factors such as environmental, social and governance (ESG) criteria as part of the Principles for Responsible Investment (PRI) or any other stewardship codes except for the Korea Stewardship Code.
- **Range of shareholder activities for implementing stewardship responsibilities:** This part describes the range of shareholder activities institutional investors want to carry out given their business model, capabilities, and other conditions. A diversity of activities are possible, including the analysis and management of non-financial risks; votes; dialogues with the board of directors; speaking at shareholders' meetings where necessary; shareholder proposals, etc. It is desirable to be as clear as possible to define the range of shareholder activities so as to ensure that investors as well as the investee company can better understand and respond to the tendency and nature of institutional investors. However, it is important to note that it is possible to execute any shareholder activity not stated here.
- **Organizational structure and division of rights and responsibilities related to shareholder activities:** This part describes the organizational structure and teams in charge of shareholder activities such as the analysis and management of non-financial risks; voting rights; dialogues with the investee company, etc. By elaborating on the role, division of rights and responsibilities within the team or organization, it is possible to induce each team and the staff to execute shareholder activities in a responsible manner. Furthermore, specifying the qualification for the head or staff of the team helps raise confidence as it tells more about the team's independence and expertise.
- **Guidelines on votes, governance, etc.:** To provide detailed voting instructions, specific guidelines on when to vote in favor or against are disclosed. If there is any other policy, instruction, or guideline that presents any standard for shareholder activities, e.g., a corporate governance policy including desirable governance principles and guidance, this can be disclosed. The policies and guidelines serve as a useful guide for institutional investors to carry out shareholder activities in transparent and consistent manners under clearly defined standards and principles. Furthermore, they help the investee company to better understand institutional investors' philosophy and principles and to have constructive dialogues.
- **Conflicts of interest policy:** This part elaborates on why institutional investors should manage conflicts of interest they may face during their shareholder activities such as votes or dialogues with the investee company; what the policy's purpose is; the actual or potential possibility of conflicts of interest; major plans to prevent conflicts of interest, etc.
- **Reporting and disclosure of voting and shareholder activities:** Overall principles and policies are provided about how voting records and the reasons, and shareholder activity records, etc. are reported to clients or disclosed on the website. If the reporting is for several clients or beneficiaries, it is possible to use the website to disclose shareholder activities and other records.

▪ Among the aforementioned matters, risk management, the range of shareholder activities, the organizational structure, the exercise of voting rights, conflicts of interest, reporting of shareholder activities are closely related to or elaborated in Principle 2 through 6. This means that instead of devising a brief description or overview, the stewardship policy can be replaced by descriptions on implementing Principle 2 through 6.

Institutional investors should always document and disclose the content of the aforementioned stewardship policy. It is efficient to provide a brief description on the stewardship code website, and add a link to the documented policy for details.

▪ Advisors who help institutional investors to exercise votes, shareholder activities, and other stewardship responsibilities should also formulate and disclose the aforementioned stewardship policy. Of course, for Principle 2 through 7 set forth hereinafter, advisors should devise the same policies and guidelines as institutional investors. When advisors devise their stewardship policy, they should be wary of the following two matters.

- Proxy advisors and other advisors help institutional investors to redeem the shortcomings. Hence, advisors are responsible for carrying out such a supplementary role as accurately and fairly as possible based on expertise.
- Advisors acting as an agent or co-agent for institutional investors may make the conflicts of interest problem even more complex. Although this is inevitable in the structure where a certain task is carried out via several steps, advisors should make efforts to minimize the problem.

▪ Caution is necessary about the application target of the stewardship code. Basically, the stewardship code applies to the institutional investors investing in the stocks of listed companies in Korea. However, it is not that those investing in the stocks of unlisted companies are banned from adopting the code.

In principle, the code has been established for calling for “stewards” who manage the assets entrusted by others to faithfully implement their responsibilities for clients and beneficiaries. Therefore, “stewards” can adopt the code regardless of whether their investment is in Korean listed stocks or unlisted stocks. Code adoption will enhance confidence among clients and beneficiaries.

In the same vein, domestic institutional investors investing in the stocks of overseas “listed companies” are not banned from adopting the code. Exercising votes and shareholder activities in overseas listed companies that are the investee company will deliver mid- to long-term benefits to the clients and beneficiaries of the institutional investors. Of course, shareholder activities in overseas listed companies can be carried out using advisory services.

**The stewardship responsibility policy should consider what position institutional investors take in the overall investment chain running from capital suppliers such as clients and beneficiaries to investee companies. In particular, stewardship activities of asset managers such as asset management companies, etc. differ from those of asset owners such as pension funds, insurance companies, etc. that in most cases manage external asset managers. Asset owners can not only directly engage in shareholder activities, but can also utilize indirect means such as selection of competent asset managers, and provision of instructions, evaluations, and feedback. Asset managers' shareholder activities should comply with the standards and requirements set out by their clients who are asset owners. In this regard, close communication between asset owners and asset managers is important, and the relevant matters should be included in the "policy".**

**When an institutional investor entrusts its activities to external service providers, their "policy" should reflect matters related to selection, monitoring, evaluation, and administration of the entrusted investment manager or advisor, and the scope of shareholder activities entrusted, etc.**

▪ Asset owners such as pension funds and insurers and asset managers such as asset management companies are expected to carry out different stewardship activities. Asset managers manage assets on behalf of the principal, asset owners or retail investors, and may carry out shareholder activities by having an active dialogue with the investee company should there be any concern during the process.

On the other hand, asset owners who delegate the management of most of their assets pursue the interest of clients and beneficiaries indirectly via asset managers. In this case, the method and standard to select, administer, and oversee asset managers is inevitably critical to asset owners' execution of stewardship responsibilities.

Hence, a stewardship policy should reflect matters related to this. More concretely, it is desirable for asset owners' policy to include the standards, procedures, and the range of delegated shareholder activities for selecting, hiring, monitoring, and evaluating asset managers.

For example, the selecting criteria may include the asset manager's internal procedures and capabilities for monitoring and managing the risk factors in the investee company; experiences and track records in shareholder activities; detailed voting guidelines and the appropriateness of actual votes; stance in implementing stewardship responsibilities, etc. It is possible for the criteria to include code participation, and the level of compliance as well. Where possible, it is appropriate for the contract to reflect important issues related to those matters.

After a contract is established, a review is necessary to make sure that the asset manager properly monitors the investee company, casts votes, and carries out shareholder activities. This is a responsible activity as an asset owner delegating his stewardship responsibilities. Also desirable for monitoring and close communication with the steward is to call for the asset manager to submit reports on how stewardship responsibilities are discharged to the principal (asset owner).

The aforementioned matters about asset managers can be applied equally to proxy advisors or investment advisors from whom asset owners ask advice related to fulfilling stewardship responsibilities.

**When an institutional investor manages collective investment vehicles in various asset classes and types that are different in terms of the time horizon, investment management philosophy, etc., the “policy” can reflect the consequent differences in the principles, guidelines, procedures, etc.**

- Institutional investors participating in the code can apply differentiated principles, guidelines, and procedures on shareholder activities across fund types depending on individual funds’ investment philosophy and strategies.

For example, they may directly or indirectly extend the scope of shareholder activities in investee companies for active funds, as compared to passive funds. More concretely, for active funds only, they can include shareholder proposals in the scope of shareholder activities, or code adoption in the selection criteria for external asset managers. Conversely, it is certainly possible to broaden the scope of shareholder activities for passive funds.

In the same vein, the aforementioned matter applies to insurers and pension funds as well. If an asset owner manages assets both directly and indirectly, it is possible to minimize the scope of shareholder activities for direct asset management, while including aggressive shareholder activities such as shareholder proposals in the contract with an external asset manager. By contrast, it is possible to consider market conditions and to prioritize direct management over external management in carrying out shareholder activities.

Furthermore, it is possible to be selective in code participation across funds, for example, adopting the code for active funds only, or for passive funds or delegated assets only. Likewise, asset owners can be selective as well, for example, no code adoption for internally managed assets while requiring the external manager to adopt and implement the code, or limited code adoption for internally managed assets only.

If asset owners desire to differentiate the scope and level of code compliance and code adoption across fund types and outsourced investment models, they need to explain the reasons as well as their alternatives or future plans. It is desirable for institutional investors to reflect the explanations to policy to ensure that prospective investors can trust and use them in the future.

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**Principle 2 | Establish and Disclose a Conflicts of Interest Policy**

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**Institutional investors should formulate and publicly disclose an effective and clear policy as to how to resolve actual or potential problems arising from conflicts of interest in the course of their stewardship activities.**

### **Guidance**

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**Institutional investors have the duty to act in the best interests of their clients and beneficiaries.**

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▪ While carrying out shareholder activities for fulfilling stewardship responsibilities, institutional investors place the interests of their clients and beneficiaries ahead of their own to minimize the conflicts of interest. This is the only way for institutional investors to gain confidence in their shareholder activities. Once they opt for Principle 2, they should clarify their stance on this duty. What is stated hereunder is the exception of the “comply or explain” approach, and must be upheld by those who comply with Principle 2.

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**During the course of their stewardship activities, institutional investors may face a conflict-of-interest situation where their own interests with investee companies prevent them from faithfully promoting the best interests of clients or beneficiaries. Such examples namely include when their ownership or governance structure, or their trade and contractual relationships make casting against votes difficult at the investee company’s shareholder meetings.**

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▪ Conflicts of interest could be an issue under the following cases.

- When institutional investors exercise votes at the shareholders’ meeting of their affiliate
- When institutional investors exercise votes at the shareholders’ meeting of a company or its affiliate that has a (potential) business relation with them
- When institutional investors exercise votes at the shareholders’ meeting of a company that has a business relation with their affiliate
- When institutional investors exercise votes at the shareholders’ meeting of an investee company where their top management or the largest shareholder (including specially related persons) is a member of the investee company’s board
- When institutional investors recommend staff of their affiliate or related organizations as a candidate for outside directors

**To effectively address actual conflict-of-interest problems that have arisen or may possibly arise in the course of stewardship activities, institutional investors should review them in minute detail and then formulate and publicly disclose a documented policy. This policy should stipulate matters related to the principles and guidelines, concrete methods, rights and duties, and procedures, etc. for conflict-of-interest monitoring and management.**

▪ Although institutional investors carry out shareholder activities in compliance with stewardship responsibilities, it is hard for institutional investors to gain confidence among investors and beneficiaries if there are conflicts of interest concerns. Institutional investors need to formulate and disclose a comprehensive policy to alleviate conflicts of interest and implement it in a faithful manner.

A conflicts of interest policy should include not only the basic principles for institutional investors about the need to prevent conflicts of interest, but also concrete plans for identifying, monitoring, and preventing any conflicts of interest issue. The followings are examples that should be included in the policy.

- **Needs and purposes for preventing conflicts of interest:** Explanation should be provided about the needs and purposes for preventing conflicts of interest related to stewardship responsibilities, the principles in prioritizing the interests of clients and beneficiaries, etc.
- **Monitoring and disclosing conflicts of interest issues:** Conflicts of interest usually arise from transactions and business relations, ownership governance structures, human relationships, etc. Institutional investors consider all those factors to monitor conflicts of interest issues and disclose the results within the boundary of their shareholder activities. It is worth noting that conflicts of interest issues here refer to not only actual, but also potential problems. If categorized, conflicts of interest issues are made more understandable to clients.
- **Preventive measures:** This part describes the principles, procedures, and guidelines adopted to minimize and prevent conflicts of interest. For details, refer to the last part of the Guidance and the explanation in Principle 2.
- **Matters related to the creation and revision of the conflicts of interest policy, the organizational structure, authority, responsibility, and reporting related to policy implementation:** This part elaborates on designing the organizational structure for dealing with conflicts of interest issues, and division of authority and responsibilities between the head and teams, reporting procedures, etc. Building an effective internal control system is one of the key elements to the effective implementation of the conflicts of interest policy.
- **Matters related to handling conflicts of interest of stewards, advisors, etc.:** If shareholder activities are delegated externally, it is necessary to carry out ex-ante and ex-post monitoring to ensure that the steward has a proper conflicts of interest policy, and that the policy is being actually implemented. It is necessary to describe how conflicts of interest are considered and handled during the overall procedures for selecting and administering the steward.

**To manage conflict-of-interest problems, institutional investors in general can adopt various means, including publicly disclosing the relevant policies and detailed guidelines, working with a third-party organization, adopting other methods set forth in Korea's Financial Investment Services and Capital Markets Act and related regulations. Institutional investors should properly utilize these methods in order to secure enhanced confidence of their clients and beneficiaries.**

▪ As it is difficult to control conflicts of interest issues with one tool, a diversity of tools need to be mobilized for systematic management. The following tools are known to be of help to alleviate conflicts of interest problems.

- The board of directors devises in advance and strictly complies with the procedures, standards, and guidelines for shareholder activities including the exercise of votes, and discloses them in advance where possible.
- Carry out shareholder activities after thorough review on the recommendations from an independent third party with expertise in this area.
- Build an organizational structure with an independent head and team dedicated for conflicts of interest issues, and review shareholder activities including votes according to proper internal control procedures in ex-ante and ex-post manners.
- Disclose the content and result of shareholder activities including the exercise of votes so that (prospective) clients and investors can monitor them.
- Separate the team in charge of shareholder activities such as voting from sales related teams.
- Notify clients and beneficiaries of potential conflicts of interest, and carry out shareholder activities such as exercising votes under their instruction or approval to the extent permitted by law.
- Limit or turn down any contract or transaction if it is difficult to alleviate a substantial level of conflicts of interest.
- Monitor the possibility of conflicts of interest of the staff in charge of executing stewardship responsibilities, and remove the staff from the responsibilities where necessary.

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**Principle 3. Periodic Monitoring on Investee Companies**

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**Institutional investors should regularly monitor investee companies in order to enhance investee companies' mid- to long-term value and thereby protect and raise their investment value.**

### **Guidance**

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**Institutional investors should monitor investee companies on a regular basis and review the effectiveness of their monitoring activities to promote the value enhancement and continuous growth of investee companies.**

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▪ Institutional investors need to periodically monitor their investee companies in order to preserve and protect the value of assets under management. They can start their stewardship responsibilities by reviewing the monitoring results and accordingly selecting investee companies that require shareholder activities such as dialogue.

Moreover, it is desirable to periodically monitor whether or not their monitoring criteria, staff, and frequency contribute effectively to identifying risk factors or mid- to long-term value enhancement opportunities, maximizing the effect of monitoring, and enhancing the asset value. It is appropriate for client reporting and disclosure to include the overall effect of monitoring investee companies on top of the outcome of shareholder activities.

**Institutional investors need to include for monitoring all factors that could affect the value and sustainable growth of investee companies; for example, not only financial factors such as capital structures, business performances, etc., but also non-financial factors such as corporate governance, business strategy, etc.**

**Institutional investors should take into consideration their investment policy and internal capacity to determine the appropriate scope for the monitoring of the aforementioned financial and non-financial factors so as to ensure effective stewardship activities.**

▪ Recently, investment fully considering the impact of non-financial factors such as governance on corporate values has taken hold as a mainstream trend in the international capital markets. The Principles for Responsible Investment (PRI) are a case in point. Monitoring non-financial factors of investee companies is a must to institutional investors who seek to implement stewardship responsibilities in a faithful manner by promoting the interests of clients and beneficiaries via mid- to long-term development of their investee companies.

Institutional investors can monitor their investee companies more efficiently by focusing selectively on matters that appear to gravely affect the investee company's mid- to long-term value among a diversity of non-financial factors such as the governance structure, business strategy, etc.

For example, the monitoring checklist for corporate governance could include multi-faceted aspects, such as board composition and expertise, auditors, remuneration of directors, appropriate disclosure, etc. The standard for evaluating each monitoring item should be established in advance so as to raise the effectiveness of monitoring.

It is worth noting that a proper level of dialogue with investee companies surely helps alleviate concerns and better understand and monitor them.

In view of higher transparency and better understanding about clients, beneficiaries, and investee companies, it is desirable for institutional investors to disclose in advance matters related to the scope, persons in charge, and procedures for monitoring.

**Institutional investors should make due effort to detect in advance any risk factors that may cause material damage to the investee company's value. If they confirm any risk factors or other matters of concern, they should seek appropriate solutions through constructive communication such as prior consultation in advance of shareholders meetings, etc.**

- Ex-post monitoring on risk factors after a decline in the corporate value could possibly make the recovery difficult. It is wise to check the factors that could be negative to the corporate value in periodic and ex-ante manners, and exert utmost efforts if a problem is detected.

- Institutional investors need to provide an outline of potential risk factors, the importance of monitoring on concerning issues, ex-post measures once risk factors are identified, etc.

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**Principle 4 | Internal Guidelines on Stewardship Activities**

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**While institutional investors should aim to form a consensus with investee companies, where necessary, they should formulate internal guidelines on the timeline, procedures, and methods for stewardship activities.**

### **Guidance**

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**Institutional investors must endeavor to form a consensus with investee companies with regard to key financial and non-financial management matters based on their pursuit of the mid- to long-term value enhancement of the investee company and their investment and stewardship policies, etc.**

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▪ The core objectives of stewardship responsibilities are to facilitate institutional investors as a steward to engage in aggressive shareholder activities such as a dialogue with investee companies for mid- to long-term development of investee companies and the interests of clients and beneficiaries.

For shareholder activities to achieve intended outcomes, a mutual trust and consensus between investee companies and institutional investors are essential. With mutual distrust and consequent exclusionary attitude, dialogues between institutional investors and investee companies are hardly likely to lead to mid- to long-term success. Hence, institutional investors need to form a consensus with investee companies first and then create a favorable atmosphere towards establishing and pursuing mutual goals.

**In case concerns remain unresolved after sufficient consultation with investee companies, institutional investors should review whether to step up their engagement within the scope of their internal policies.**

▪ If any concern remains unresolved after a favorable dialogue with the investee company, institutional investors should take into account several situations and conditions including the magnitude of the concern, capital market conditions, the investee company's behavior, internal capabilities, etc. to review whether to step up their shareholder activities within the extent set by themselves.

The followings are examples for additional shareholder activities institutional investors can carry out.

- Request additional information and data for a better judgment.
- Prepare and send a questionnaire on the investee company's position, future plans, etc.
- Hold additional meetings with the board (the chairman), appointed outside directors, or management.
- Prepare and send a statement of position containing their stance about concerns, requests for the investee company, etc.
- Engage actively in speaking and discussion at the shareholders' meeting.
- Vote against an agenda at the shareholders' meeting and disclose the reason behind the decision in ex-ante and ex-post manners.
- Initiate a shareholder proposal to recommend director or auditor candidates, or participate in a proposal initiated by another shareholder.
- Call a shareholders' meeting, or participate in a shareholders' meeting call initiated by another shareholder.
- Publicly express opinions via a press release, etc.
- Initiate or participate in a shareholder litigation.

**Institutional investors should take into account investee companies' circumstances, investment policy, and internal capacity, etc. and devise an internal guideline that sets out the scope, procedures, and standards of their communication and engagement activities.**

▪ Institutional investors need to devise an internal guideline that includes the standard for decision making in shareholder activities, the scope of shareholder activities, and the procedure and organizational structure of those activities, etc. According to the internal guideline, institutional investors can carry out shareholder activities consistently and fairly. The followings are examples that should be included in the internal guideline for shareholder activities.

- Define the target, issues, and timing of shareholder activities. In general, it is possible to limit the target of shareholder activities and monitoring given the investment size and shareholding ratio in the investee company. Also necessary is to define the elements gravely affecting the value of assets under management and investors' interest, and the standard and condition to judge the appropriateness. For example, it is possible to set the standards to initiate shareholder activities such as sending a statement of position to the investee company for certain preset issues including dividend payout, board composition and operation, board remuneration, etc. Where necessary, different standards can be used across different stages of shareholder activities.
- Set the scope of shareholder activities for alleviating concerns. In this case, judgment on the effect of shareholder activities, internal and external resources and capabilities that can be mobilized, etc. should be given full consideration.
- Prescribe the related procedure or the division of roles etc., among teams in charge of decision making and implementation of shareholder activities. In general, it is necessary to review and determine the procedure for decision making and actual implementation; and the division of work within a team dedicated for shareholder activities, among asset management staff and the head, and among internal control staff and the head.

As the standard and condition for initiating shareholder activities are actually sensitive information, it is not that institutional investors must disclose them. However, if institutional investors choose to disclose some of them where possible, this helps the investee company better understand and respond to institutional investors' concrete demand, based on which institutional investors and their investee company can maintain a constructive, productive relationship.

**In their active engagement process, institutional investors should beware of the possibility of breaching the regulation banning the use of undisclosed material information set forth in the Financial Investment Services and Capital Markets Act. In particular, they should not use inside information that could substantially affect the investee company's value by attempting to use privileged information to achieve trading gains.**

#### 1. Measures related to the prohibited use of material nonpublic information<sup>1</sup>

- The use of undisclosed material information is regulated by the Prohibition on Use of Material Nonpublic Information (Article 174) and Prohibition on Market Disturbances (Article 178-2) of the FSCMA.

Institutional investors adopting the code may acquire or receive undisclosed material information during their shareholder activities such as a dialogue with the investee company about its business activities, risk management, etc. For example, when the investee company shows undisclosed earnings data during the dialogue, this could fall under material nonpublic information that is expected to have grave impacts on investment decisions. In this case, they should take extra caution not to use or not to let others use such information.

- When institutional investors acquire material nonpublic information during their shareholder activities, they shall neither use the information to trade stocks nor allow others to use the information.

If institutional investors decide to change their mid- to long-term investment strategy and trade stocks according to their judgment based on the information acquired from the investee company, they should require the investee to disclose the information via fair disclosure, etc., and trade stocks after the information is actually disclosed.

- If the team executing shareholder activities acquires and produces information about a stock, and the asset management team happens to trade the stock without being aware of such information, this is neither the use of material nonpublic information nor market disturbances.

However, should there be any transaction that is hardly regarded as normal or that takes place under any circumstance where the Chinese wall fails to block the transfer of material nonpublic information, such a transaction could be suspected to fall under the transfer or use of material nonpublic information.

Hence, it is desirable for institutional investors to bolster their internal control on their overall business activities related to shareholder engagement, information barriers, asset management, etc.

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<sup>1</sup> The overview of the FSCMA provisions of the prohibited use of material nonpublic information and the prohibited market disturbances is the quotation, excerpt, summary, and reorganization by the Korea Corporate Governance Service of the document released by the Financial Services Commission Working Group mentioned in Disclaimer of this Guide Book, and thus the accuracy of legal interpretation is not guaranteed. For details on the relevant laws and regulations, please refer to Annex 1.

## 2. Measures related to the report on large shareholding (the so-called 5% rule)<sup>2</sup>

▪ In general, the acts listed below fall under the “act intended to exercise influence on the issuer's business administration”, and therefore are excluded from the “short form reporting” provision.

- Shareholder proposals for recommending director or auditor candidates.
- Call an extraordinary general meeting of shareholders or initiate a shareholder proposal for an amendment to articles of incorporation to set up a committee within the board of directors under the Commercial Act.
- Call an extraordinary general meeting of shareholders or initiate a shareholder proposal for increasing dividends.
- Call an extraordinary general meeting of shareholders or initiate a shareholder proposal for submitting a statement of position for increasing dividends to the board with the intention to wield de facto influence.
- Any act of initiating solely or jointly a proxy fight or management feud for disapproving the director appointment or dividend agenda proposed by management.

On the other hand, the acts listed below are highly likely to be subject to “short-form reporting” as they fall outside the “act intended to exercise influence on the issuer's business administration”.

- Request information or data, or forward a questionnaire with the aim to understand the investee company's position and future plans on a specific issue.
- Request a meeting with the board or management, or simply exchange opinions at the meeting.
- Forward a statement of position carrying matters of concern, or explanation of position against the shareholders' meeting agenda.
- Engage in discussion at shareholders' meetings.
- Recommend a director candidate at the investee company's request.

▪ Any act of initiating or participating in a shareholder derivative suit or class suit, demanding a director to stop any unlawful act or practice, filing or participating in a suit to overrule a shareholders' meeting resolution, etc. under shareholders' rights stipulated in the Commercial Act and relevant laws is carried out for the purpose of seeking remedies from the investee company's unlawful act or practice, and therefore could be hardly considered

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<sup>2</sup> The overview of the FSCMA provisions of the report on large shareholdings is the quotation, excerption, summary, and reorganization by the Korea Corporate Governance Service of the document released by the Financial Services Commission Working Group mentioned in Disclaimer of this Guide Book, and thus the accuracy of legal interpretation is not guaranteed. For details on the relevant laws and regulations, please refer to Annex 2.

the “act intended to exercise influence on the issuer's business administration”. However, great caution is necessary because under certain circumstances, the aforementioned act of filing a suit, etc. could be deemed to intend to wield de facto influence on matters such as appointing or dismissing executives, etc., which could be construed as the “act intended to exercise influence on the issuer's business administration”.

However, it is hard to view the acts listed below, although backed by shareholder proposals, as the “act intended to exercise influence on the issuer's business administration”.

- Purchase of treasury stocks
- Amendment to articles of incorporation for setting up a shareholder rights committee, not a committee within the board of directors

- Any institutional investor, specially related persons and joint holders whose combined stake is less than 5% can freely engage in shareholder activities because they are not subject to the large shareholding reporting rule. By contrast, any institutional investor and joint holders whose combined stake is 5% or more is subject to the 5% rule.

It is worth noting that if investors exercise voting rights jointly by verbal or written agreement, or by contract, all of the stakes of such investors are combined to determine whether they are subject to the 5% rule. However, the act of jointly engaging in shareholder activities or exchanging opinions at a jointly established forum, besides “joint exercise of voting rights by agreement, etc.,” is not construed as the act of joint holders of stocks.

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**Principle 5****Establish and Disclose a Voting Policy, and Disclose Voting Activities and the Grounds**

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**Institutional investors should formulate and publicly disclose a voting policy that includes guidelines, procedures, and detailed standards for exercising votes in a faithful manner, and publicly disclose voting records and the reasons for each vote so as to allow the verification of the appropriateness of their voting activities.**

**Guidance**

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**Institutional investors should make an effort to exercise their voting rights on all shares held, and it is not appropriate to automatically vote in favor of management-proposed resolutions.**

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▪ The FSCMA sets forth that institutional investors should exercise their voting rights faithfully to protect the interests of investors and shareholders (Article 87 (1), and Article 112 (1) of the FSCMA). The underlying principle of the FSCMA and the principles and guidance herein requires institutional investors to exercise voting rights on all of their shares. It is desirable for institutional investors to explain their compliance with that principle, as well as non-compliance conditions and the reasons.

Moreover, institutional investors should explain their position or policy with regard to whether they automatically vote for the resolution presented by management or not. Their position should be supported by their actual voting activities in order to gain confidence among clients and beneficiaries.

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**Institutional investors should make their for/against voting decision based on the result of sufficient data collection and analysis, in-depth review, dialogue and engagement, etc., with regard to investee companies, and it is advisable to have a discussion with investee companies concerning their voting decision where necessary.**

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▪ Given the FSCMA’s legislative intent stipulating institutional investors’ duty to faithfully exercise voting rights, and the importance of shareholders’ meetings as a top decision making mechanism, institutional investors should do their best to collect information and carry out in-depth analysis, based on which to exercise their voting rights. This is the fundamental responsibility of institutional investors who must pursue the interests of clients and beneficiaries.

Shareholders’ meetings provide an arena where shareholders and the investee company can exchange their opinions on key management issues. Therefore, it is ideal for institutional investors to discuss with the investee company about the appropriateness of shareholders’ meeting agenda, and the overall direction of their votes. This provides valuable opportunities for the investee company to fine-tune their agenda, and for institutional investors to revisit their voting decisions.

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**Institutional investors should build up internal resources, organizational structures, and professional capacity to ensure that their voting rights are exercised in order to enhance the mid- to long-term value of investee companies and to advance the interests of clients and beneficiaries, while relevant principles and information should be included in the voting policy to be explained hereunder.**

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▪ As described above, institutional investors’ faithful exercise of voting rights is one of the most fundamental elements in their stewardship responsibilities. Hence, they need to inject resources and capabilities to the fullest extent possible, and establish a relevant organizational structure to help voting rights be exercised faithfully. They may review whether to use external resources such as proxy advisors where necessary.

**Institutional investors should formulate and publicly disclose a documented voting policy that includes guidelines, procedures, and detailed standards with regard to the disclosure of their voting activities and records. The detailed standards for voting activities should not solely be comprised of a mechanical checklist, but be designed to contribute to the mid- to long-term value enhancement of investee companies.**

▪ Institutional investors formulate, publicly disclose, and comply with the principles, procedures, and detailed standards for exercising votes so as to promote confidence among clients and beneficiaries as well as to deepen the investee company's understanding about institutional investors. Listed below are examples of the issues that are desirably included in a voting policy.

- **Basic principles on exercising votes:** Institutional investors present the basic principles and position about their responsibility and importance of their faithful exercise of votes.
- **Detailed guidelines:** Minute details of guidelines are disclosed to offer clear standards to vote for and against depending on each agenda. This is not only a basic instruction for institutional investors to exercise their votes in a consistent manner, but also a guide for clients, beneficiaries, the investee company, etc. to better understand institutional investors' position.
- **Measures to prevent conflicts of interest:** Refer to the paragraph below for details.
- **Vote-related organizations, bodies, and procedures:** Descriptions on matters related to relevant organizations, bodies, procedures, and rights are provided to see institutional investors endeavor to faithfully exercise voting rights, prevent conflicts of interest, and maintain expertise and independence with regard to exercise of votes.
- **Matters related to proxy advisory services:** Refer to the paragraph below for details.
- **Matters related to disclosing voting activities:** Details are provided about the range and timing of disclosure on voting activities and the reasons, the website posting the disclosure, etc. If voting activities are compiled, classified, analyzed, and disclosed according to proper standards, clients and beneficiaries can effectively monitor the appropriateness.
- **Guidelines on stock lending, and the recall of lent stocks:** See below for further details.

**The voting policy should include policies on preventing conflicts of interest set out in Principle 2 with regard to any potential conflicts of interest institutional investors may face when exercising their votes.**

- Based on the guidance and descriptions in Principle 2, further details should be provided about matters related to the necessity and objectives of preventing conflicts of interest when voting rights are exercised; monitoring of actual and potential conflicts of interest issues; concrete plans to prevent conflicts of interest; how to manage conflicts of interest with regard to votes exercised by stewards and advisors, etc.

Devising and faithfully implementing a conflicts of interest policy with regard to the exercise of voting rights is one of the core tools that helps institutional investors to enhance fairness of their exercise of votes and to build confidence among clients and beneficiaries.

**Institutional investors can devise a voting policy that provides a different set of detailed standards and guidelines for each type of collective investment vehicles with varying management targets and philosophies.**

- A case in point is a fund pursuing responsible investment or socially responsible investment (SRI) that takes into account ESG criteria in the overall investment process. Such a fund can formulate and apply its voting guidelines that fully consider environmental and social elements.

**Institutional investors should publicly disclose their voting results and concrete reasons for votes for, against, neutral, and abstentions via an appropriate method so that their clients and beneficiaries, etc. can easily check the appropriateness of the voting activity.**

- Institutional investors participating in the stewardship code should in principle disclose how they have exercised or failed to exercise voting rights and the reason in accordance to the guidance. Any non-compliance with the guidance should be explained with the reasons and alternatives pursuant to the “comply or explain” approach.

The rationale behind the disclosure of how institutional investors have exercised or not exercised their votes is to help clients and beneficiaries monitor whether institutional investors have exercised votes properly in compliance with relevant guidelines. This also helps induce institutional investors to exercise their votes faithfully and responsibly. Such rationale is reflected in Article 87 (8) of the FSCMA, prescribing that each collective investment business entity shall disclose to the public the specific details on how it has exercised or not exercised its voting rights and the grounds thereof.

**Institutional investors should publicly disclose whether or not they use proxy advisory services and, if they use them, the service scope, application method, identity of the provider, and the extent of their reliance on the provider's recommendations.**

▪ Institutional investors can work with external experts for faithfully exercising their voting rights. This helps them overcome the difficulties in dealing with hundreds of investee companies, the tight schedule of shareholders' meetings, limited manpower, etc.

■ **Whether they use a proxy advisory service or not**

■ **Service scope and method:** In case of getting help from an advisor about professional analysis as well as working-level advice on exercising votes and disclosing voting records and the reasons, the specific details should be described.

■ **Service provider information**

■ **To what extent they rely on the advisor's recommendations:** For example, institutional investors may choose to or not to follow the recommendation in accordance with their own principle.

**Even in the case where institutional investors use proxy advisory services, they are ultimately responsible for exercising their votes according to their own responsibility and judgment as a steward.**

- Although institutional investors use proxy advisory services, the ultimate responsibility of exercising their voting rights in a faithful manner rests with themselves. This applies to when institutional investors set up a principle to take the advisor's recommendations, or even when they blindly follow the recommendations. Hence, institutional investors need to take due care to select, monitor, and administer the proxy advisor by fully taking into account the advisor's expertise, accuracy, and fairness.

In that institutional investors take on the ultimate responsibility for their voting rights at any circumstance, they must comply with this guidance.

- Proxy advisors that support institutional investors' exercise of votes should make their best efforts to enhance their expertise, accuracy, and fairness in their advisory services. For greater confidence in the capital markets, it is desirable for proxy advisors to participate in the stewardship code and faithfully implement Principle 1 through 7. Certainly, this should be based on advisors' thorough understanding about the stewardship policy of their principal, institutional investors, as well as close cooperation with the institutional investors.

**Institutional investors should reflect in their voting policy information concerning their stock lending and the recall of lent stock if it is deemed to affect matters related to their exercise of voting rights.**

- It is necessary to consider the impact of stock lending and the recall of the rent stocks on the exercise of votes, as well as relevant principles to formulate proper guidelines to be included in a voting policy.

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**Principle 6 | Periodic Reporting of Voting and Stewardship Activities**

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**Institutional investors should regularly report their voting and stewardship activities to their clients or beneficiaries.**

### **Guidance**

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**Institutional investors should keep a record of their stewardship activities, including their exercise of voting rights, and maintain the record for a certain period.**

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▪ Clients and beneficiaries need to keep a check on institutional investors' shareholder activities to ensure that they implement the activities in accordance with their policy, guidelines, standards, procedures, etc. For this purpose, institutional investors need to keep records about and disclose their stewardship activities including the exercise of their votes, the procedures, etc. and preserve those records for a certain period.

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**Asset managers in principle should regularly report their stewardship policy and the implementation of such policy to clients and beneficiaries such as asset owners, etc.**

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▪ Asset managers need to periodically report in proper format sufficient and substantial information on their voting rights and engagement activities delegated by their clients, beneficiaries, or asset owners. This only enables clients, beneficiaries, or asset owners to assess if their asset managers fulfill stewardship responsibilities on a reasonable basis.

It is desirable to report the activities delegated by asset owners on a quarterly basis, and the activities delegated by end clients and beneficiaries on an annual basis. However, institutional investors categorized as the "collective investment business entity" stipulated in the FSCMA should disclose their voting activities during the one-year period starting from April 1 of the immediately preceding year by April 30 of the current year. For documenting the report pursuant to Principle 6, institutional investors can efficiently reuse the content of their previous disclosures under relevant laws.

**Asset owners should report to their clients and beneficiaries their stewardship policy and matters concerning the actual implementation of this policy at least annually.**

- Asset owners also should report periodically, at least annually, their stewardship activities to their clients or beneficiaries. The content of such reporting should desirably include what they have been reported about actual voting and engagement activities delegated to asset managers, etc.

**Institutional investors should make an effort to ensure that their stewardship policy and its actual implementation can be effectively reported, and if there are certain reporting scope and form agreed between them and their clients and beneficiaries, these should be followed. Where appropriate and agreed by their clients and beneficiaries, institutional investors can disclose their shareholder activities on the website or in the annual report as a way to enhance the transparency and accountability of such reporting.**

- Institutional investors should effectively provide qualitatively and quantitatively substantial information on their stewardship policy and the records of actual implementation.

If there are too many clients or beneficiaries, or for other legitimate reasons, institutional investors can choose to disclose the records of their stewardship activities via their website. Otherwise, they can document their shareholder activities and other activities for fulfilling stewardship responsibilities in an annual report to be posted on the website.

- Institutional investors can consult with clients and beneficiaries in advance to individually determine the format of reporting. Basically, it is desirable for institutional investors to report their actual voting and shareholder activities in effective format.

Especially, institutional investors need to faithfully provide information such as how they voted and the reasons, why they failed to vote, etc., all of which attract the attention of clients or the market.

- Classified summaries of shareholder activities across diverse criteria can be effective for communication. For example, shareholder activities can be classified across diverse criteria such as exercising votes, forwarding a questionnaire or a statement of position, meetings with the board, shareholder proposals, policy recommendations for improvements, best practices, etc. This helps clients and beneficiaries easily grasp institutional investors' propensity of shareholder activities.

From the perspectives of clients and beneficiaries, the results or outcomes institutional investors achieved through shareholder activities are more meaningful than the records of

actual activities. Hence, institutional investors provide clients and beneficiaries with information on engagement activities across types, responses from investee companies, and outcomes of shareholder activities.

Successful engagement activities are of great use for prospective institutional investors thinking about code adoption. With that being said, it is desirable to report as specifically as possible the cases of shareholder activities that have either been in progress or achieved successful outcomes. The processes of accumulating, learning, and trying to penetrate best practices is an integral key to making substantial improvements in the Korean capital market practice and culture.

However, institutional investors can carefully consider the negative impacts of their disclosure of shareholder activities on the investee company's value in order to make adjustments on how concrete their shareholder activity reporting should be.

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<b>Principle 7</b>	<b>Build up Capabilities and Expertise for Effective Stewardship Activities</b>
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**Institutional investors should have the capabilities and expertise required to implement stewardship responsibilities in an active and effective manner.**

### **Guidance**

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**Institutional investors need to build up their capacity and expertise that will enable them to deepen their understanding of investee companies and to carry out constructive shareholder activities in order to promote the mid- to long-term development and sustainability of investee companies based on active dialogue and shareholder activities.**

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▪ The ultimate goal of the stewardship code is to help institutional investors to better understand their investee companies to form a consensus, based on which to implement stewardship responsibilities in a constructive direction. To be effective in implementing stewardship responsibilities via shareholder activities such as active dialogues requires professional capabilities to analyze diverse factors affecting the investee company's mid- to long-term value and sustainability, and to successfully carry out shareholder activities.

Without professional skills to analyze investee companies, it is hard to earn necessary confidence among the investee companies' management and the board during the course of shareholder activities such as dialogues. Only based on proven expertise and capabilities, institutional investors can enhance their understanding about investee companies, gain mutual trust, and effectively and constructively carry out shareholder activities.

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**To that end, institutional investors should design an appropriate organizational structure, inject internal resources, and make a continuous effort to develop and improve the capacity and expertise of these resources.**

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▪ It is ideal for institutional investors to design an organizational structure in the direction that simultaneously enhances expertise in shareholder activities and effectively deals with conflicts of interest and other issues. Also necessary is making efforts to recruit capable human resources and enhance their capabilities and expertise.

Also advisable is to participate in a forum, etc. for the purpose of sharing the experiences and useful advice and for providing education and training opportunities for effectively carrying out shareholder activities or monitoring the investee companies.

**An asset owner who entrusts stewardship activities to an asset manager should seek ways to oversee the asset manager and pay an appropriate level of remuneration to allow the asset manager to accumulate the capacity for effective engagement with investee companies through dialogue and shareholder activities.**

- When shareholder activities are delegated externally, extra caution is necessary for selecting and administering the steward. In the end, the outcomes of shareholder activities largely rely on the expertise and capability of the steward. Hence, if the principal seeks to fulfill their stewardship responsibilities by demanding the steward to faithfully implementing shareholder activities, it would be appropriate to create a financial environment to provide the steward proper remuneration for injecting sufficient resources including human resources.

**In light of available internal resources and financial conditions, institutional investors can use external services for professional advice in seeking to implement their stewardship responsibilities.**

- Institutional investors with insufficient internal capabilities can seek help from external service providers in order to faithfully carry out stewardship responsibilities. External service providers with proven expertise in exercising votes and shareholder activities help institutional investors effectively overcome their shortcomings. In this case, however, institutional investors should be careful to note that the ultimate responsibility for stewardship activities rests with themselves.

**Institutional investors can establish forums, etc. with the aim of stimulating debates and discussions and to pursue mutual interests, as well as to share and learn relevant experiences and opinions about successful shareholder engagement cases, to improve their expertise and the quality of their shareholder activities.**

- It is advisable for institutional investors to work together to organize and participate in formal and informal forums, etc. Via such investor forums, institutional investors can enhance their expertise by discussing and exchanging opinions about stewardship responsibility policies, voting standards, effective shareholder activities, legal and regulatory improvements, etc.

Sharing and learning from experience could be of great use for development and capability improvement of small-sized, inexperienced asset managers. Intellectual exchanges between domestic and overseas institutional investors, between large and small players, and between asset owners and managers, etc. help promote mutual benefits. Such cooperative relationships will surely enhance institutional investors' expertise in aggressive shareholder activities, and help create sound capital market practices for faithful stewardship responsibilities.

## **Annex 1. Measures related to the prohibited use of material nonpublic information<sup>3</sup>**

- The use of undisclosed material information is regulated by the Prohibition on Use of Material Nonpublic Information (Article 174) and Prohibition on Market Disturbances (Article 178-2) of the FSCMA. The two articles regulate the act of institutional investors who have acquired or produced material nonpublic information during their shareholder activities trying to use their information advantage over ordinary investors to engage in a transaction or trading. Further details are provided below.

- **[Prohibition on the use of material nonpublic information]** Pursuant to the Prohibition on Use of Material Nonpublic Information provision, an insider, a quasi-insider, and a tippee are prohibited from using material nonpublic information to trade specific securities, etc. or to engage in any transaction, or allowing other persons to use such information. Material nonpublic information herein refers to the information on a listed company's business that could gravely affect investment decisions, but is not yet disclosed to a number of unspecified people.

Institutional investors adopting the stewardship code may acquire or receive material nonpublic information during their shareholder activities such as dialogues with the investee company about business activities, risk management, etc. For example, when the investee company provides undisclosed earnings data, this could be construed as material nonpublic information that could affect investors' investment decisions. They should be careful neither to use the information for trading, nor to allow others to use the information.

- **[Prohibition on market disturbances]** Under the Prohibition on Market Disturbances provision, a first-tier tippee, or a second- or third-tier tippee, etc. who produces or receives second- or third-hand nonpublic information that could affect the trading of a financial investment instrument or the trading conditions can neither use such information for trading specific securities or a transaction, nor allow other people to use such information.

Material nonpublic information herein may include not only inside information of a listed company, but also market information, etc. created outside the company. Caution is necessary as the act of using material nonpublic information for a profit-taking purpose before such information is disclosed publicly overreaches the boundary of legitimate shareholder activities and thus is construed as market disturbances.

- When institutional investors acquire material nonpublic information during their shareholder activities, they shall neither use the information for trading stocks, nor allow other people to use such information.

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<sup>3</sup> The overview of the FSCMA provisions of the prohibited use of material nonpublic information and the prohibited market disturbances is the quotation, excerpt, summary, and reorganization by the Korea Corporate Governance Service of the document released by the Financial Services Commission Working Group mentioned in Disclaimer of this Guide Book, and thus the accuracy of legal interpretation is not guaranteed.

If institutional investors want to change their mid- to long-term investment strategy and trade stocks based on the information acquired from the investee company, they should demand the company to disclose such information via fair disclosure, etc., and trade the stocks after the disclosure.

- Asset management companies benchmarking global pension funds that set up a shareholder activity team that is dedicated for stewardship activities and separated from the investment management team may find out its investment management team trade a stock unaware of the fact that the shareholder activity team has acquired material nonpublic information about the stock. In such a case, the trading itself is not construed as the use of material nonpublic information.

However, it is important to note that a suspicion of probable misuse of material nonpublic information could arise under certain circumstances where the Chinese wall in an asset management company fails to stop material nonpublic information from being shared improperly, or where there is any trading deemed abnormal in terms of the quantity, value, and decision making process.

As there are incentives for a shareholder activity team to request material nonpublic information for the sake of shareholder activities and then to transfer the acquired information to an investment management team, stronger internal controls are necessary such as an information barrier between a shareholder activity division and an investment portfolio management division.

- Institutional investors, whether intended or not, may directly during a dialogue with the investee company or indirectly acquire material nonpublic information and trade stocks, which could be construed as the use of material nonpublic information as a de facto insider.

To prevent such a situation, institutional investors should clearly express that they have no intention to acquire material nonpublic information before meeting with the investee company, and disclose their intention in a policy about material nonpublic information.

For example, such a policy can include an overview of internal controls and information barriers to deal with the use of material nonpublic information, guidelines on personal stock trading of employees, etc.

## **Annex 2. Measures related to large shareholding reporting (the so-called 5% rule)<sup>4</sup>**

▪ The large shareholding reporting system was initially designed to deal with the possibility of any shareholder holding a 5% or larger stake in a company to attempt a hostile takeover, merger or acquisition, or to gain control of the company. The rationale behind the system is that detailed information on large shareholders is material information for management control and investment decisions, and thus should be disclosed in timely and transparent manners.

Any person holding an equity stake of 5% or more must disclose the state and purpose of his shareholding via “ordinary reporting” within five days from the date his shareholding ratio turns not less than 5%, and from the date his stake changes by not less than 1%.

However, institutional investors, etc. whose purpose of holding the stock is not “to exercise influence over the issuer’s business administration” are subject to the special provisions under which to comply with their reporting duty via “short-form reporting” by the 10<sup>th</sup> calendar day of the month subsequent to a shareholding change.

The issue here is what is regarded as the act “to exercise influence over the issuer’s business administration”. Such an act should meet the following two conditions: 1) the exercise of influence for one of the purposes 1 through 10 listed below; and 2) the de facto influence is exercised over the investee company or its management.

1. Appointment, removal, and suspension of an executive
2. Amendment to articles of incorporation related to the board or other bodies
3. Changes in capital
4. Dividend decisions
5. Merger, division, and merger after division
6. All-inclusive exchange/transfer of shares
7. Acquisition or transfer of the entire business
8. Disposal, etc. of the company's entire assets
9. Lease or delegation of the entire business
10. Dissolution of the company

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<sup>4</sup> The overview of the FSCMA provisions of the report on large shareholdings is the quotation, excerption, summary, and reorganization by the Korea Corporate Governance Service of the document released by the Financial Services Commission Working Group mentioned in Disclaimer of this Guide Book, and thus the accuracy of legal interpretation is not guaranteed.

▪ “Exercising de facto influence” herein includes shareholder proposals, and the convocation of an extraordinary general meeting of shareholders under the Commercial Act. However, any specific act intended to actually exercise influence in the future via shareholder proposals, etc. could be construed as holding the stock in order “to exercise influence on the issuer’s business administration” even when the act itself does not fall under shareholder proposals, etc.

In general, the acts listed below are interpreted as an “act intended to exercise influence on the issuer's business administration”.

- Shareholder proposals for recommending director or auditor candidates.
- Call an extraordinary general meeting of shareholders or initiate a shareholder proposal for an amendment to articles of incorporation to set up a committee within a board of directors under the Commercial Act.
- Call an extraordinary general meeting of shareholders or initiate a shareholder proposal for increasing dividends.
- Call an extraordinary general meeting of shareholders or initiate a shareholder proposal for submitting a statement of position for increasing dividends to the board with the intention to wield de facto influence.
- Any act of initiating solely or jointly a proxy fight or management feud for disapproving the director appointment or dividend agenda proposed by management.

On the other hand, even any act for the purposes 1 through 10 listed above is highly likely to be interpreted as falling outside the “act intended to exercise influence on the issuer's business administration” under the following circumstances.

- Request information or data, or forward a questionnaire with the aim to understand the investee company’s position and future plans on a specific issue.
- Request a meeting with the board or management, or simply exchange opinions at the meeting.
- Forward a statement of position carrying matters of concern, or explanation of position against the shareholders’ meeting agenda.
- Engage in discussion at shareholders’ meetings.
- Recommend a director candidate at the investee company’s request.

▪ Any act of initiating or participating in a shareholder derivative suit or class suit, demanding a director to stop any unlawful act or practice, filing or participating in a suit to overrule a shareholders’ meeting resolution, etc. under shareholders’ rights stipulated in the Commercial Act and relevant laws is carried out for the purpose of seeking remedies from the investee company’s unlawful act or practice, and therefore could be hardly considered the “act intended to exercise influence on the issuer's business administration”. However, great caution is necessary because under certain circumstances, the aforementioned act of

filing a suit, etc. could be deemed intended to wield de facto influence for the purposes 1 through 10 listed above which could be construed as the “act intended to exercise influence on the issuer's business administration”.

However, it is hard to interpret the acts listed below as the “act intended to exercise influence on the issuer's business administration” because they fall outside the purposes 1 through 10 listed above.

- Purchase of treasury stocks
- Amendment to articles of incorporation for setting up a shareholder rights committee, not a committee within the board of directors

Any institutional investor, specially related persons and joint holders whose combined stake is less than 5% can freely engage in shareholder activities because they are not subject to the large shareholding reporting rule.

By contrast, any institutional investor and joint holders whose combined stake is 5% or more is subject to the 5% rule.

A joint holder herein refers to a person engaging in one of the acts listed below by “agreement” (verbal agreements included) or by “contract”.

- Joint acquisition or disposal of stocks, etc.
- Joint or sole acquisition of stocks, etc. before assignment among themselves
- Joint exercise of voting rights (including the right to order the exercise of voting rights)

As such, if investors exercise shareholder rights jointly by verbal or written agreement or by contract, all of their stakes are combined to determine whether they are subject to the 5% rule. Hence, the act of jointly engaging in shareholder activities or exchanging opinions at a jointly established forum, besides “joint exercise of voting rights by agreement, etc.,” is not construed as joint holders of stocks. A forum herein refers to a formally arranged gathering where institutional investors and others share their experiences for the purpose of carrying out stewardship and shareholder activities, improving relevant laws and regulations, enhancing their capabilities and expertise, etc., and discuss all the relevant issues toward common interests (see Principle 7).