

Korea Institute of Corporate Governance and Sustainability

Preview of 2023 Annual General Meetings

(Feb. 28, 2023 by Responsible Investment Team)

Sixth Revision of the 『KCGS Proxy Voting Guidelines』

- Korea Institute of Corporate Governance and Sustainability (KCGS) established its guidelines on proxy voting 『KCGS Proxy Voting Guidelines』 (“Guidelines” hereafter) in March 2012 and has been regularly reviewing and updating them, reflecting changes in corporate governance trends and related laws and regulations to enhance the validity of the Guidelines and promote the interests of clients and investors.
- Through the sixth revision announced in February 2023, the institute aims to enhance the legal consistency of the Guidelines by reflecting changes in local laws, such as the Financial Investment Services and Capital Markets Act (FSCMA) and the Commercial Act, which affect the agenda items of general shareholder meetings. It also intends to raise the consistency of voting standards by adding clarity to the existing provisions.
 - Below are some of the key changes made in the Guidelines:

< Updates in KCGS Proxy Voting Guidelines >

Category		Amendments		
New entries (8)	To align with changes in law	<ul style="list-style-type: none"> • Diversity of the Board (Ⅰ-1-1.4) • Breach of Law Concerning Gender Diversity (Ⅰ-1-1.4.1) • Record of Breach of Law Concerning Gender Diversity (Ⅰ-1-1.4.2) • Breach of Law Concerning the Separate Election of Audit Committee Members (Ⅱ-4-4.4.1) • Record of Breach of Law Concerning the Separate Election of Audit Committee Members (Ⅱ-4-4.4.2) • Number of Directors Separately Elected to Serve the Audit Committee (Ⅱ-4-4.4.3) 		
	To reflect latest corporate governance trends	<ul style="list-style-type: none"> • Standards for Evaluating CEO Nomination Procedure, Etc. (Ⅲ-3-3.1.1) • Dividend Predictability (Ⅳ-3-3.6) 		
Updates (22)	To clarify voting recommendation standards	<table border="0"> <tr> <td> <ul style="list-style-type: none"> • Disqualifications of Director Candidates (Ⅱ-1-1.1) • Disqualifications of Independent Director Candidates (Ⅱ-2-2.1) • Voting Principle in the Election of Directors (Ⅱ-6-6.1) • Detailed Disclosure of Compensation Structure and </td> <td> <ul style="list-style-type: none"> • Mergers and Acquisitions (Ⅵ-1-1.1) • Division and Merging Through Division Expected to Harm the Long-Term Firm Value (Ⅵ-2-2.1) • Shareholder Proposals (Ⅶ-1-1.5) • Director Nomination by </td> </tr> </table>	<ul style="list-style-type: none"> • Disqualifications of Director Candidates (Ⅱ-1-1.1) • Disqualifications of Independent Director Candidates (Ⅱ-2-2.1) • Voting Principle in the Election of Directors (Ⅱ-6-6.1) • Detailed Disclosure of Compensation Structure and 	<ul style="list-style-type: none"> • Mergers and Acquisitions (Ⅵ-1-1.1) • Division and Merging Through Division Expected to Harm the Long-Term Firm Value (Ⅵ-2-2.1) • Shareholder Proposals (Ⅶ-1-1.5) • Director Nomination by
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	<ul style="list-style-type: none"> Breakdown (III-1-1.3.4) • Dividend Payout (IV-3-3.1) • Criteria of Issuing New Shares to a Third Party (V-1-1.3.1) • Issuing Class Shares (V-2-2.1) • Capital Reduction (V-3-3.1) • Share Repurchase for the Purpose of Management Control Protection (V-4-4.1.1) 	<ul style="list-style-type: none"> Employee Shareholders (VII-1-1.5.1) • Changing the Company Name (VII-2-2.1) • Changing the Fiscal Year (VII-2-2.2) • Method of Exercising Voting Rights (VII-4-4.4)
Others	<ul style="list-style-type: none"> • KCGS name change, amended provisions of laws, etc. 	

Source: 「KCGS Proxy Voting Guidelines」(Feb. 2023)

- **(Board Diversity)** In line with Article 165-20 of the FSCMA¹⁾, KCGS recommends voting against all director candidates of the majority gender if a large listed company whose total assets amount to not less than KRW2 trillion has a board of directors made up of just one gender.
 - As an international trend, there are stronger requirements for board gender diversity (e.g., the EU’s 33% statutory requirement²⁾ and the NASDAQ diversity rule for listed firms³⁾). In the local market as well, the FSCMA was amended in August 2020, and the board gender diversity requirement took effect from August 2022 after a two-year grace period⁴⁾, targeting companies with a certain level of assets.
 - In response to these changes in the market and regulatory environment, the Guidelines were amended to provide a basis for voting against a proposal that undermines diversity in the board seriously without reasonable and adequate justification.

1) Article 165-20 (Special Cases concerning Gender Composition of Board of Directors) No stock-listed corporation that holds not less than two trillion won in total amount of assets as at the end of the preceding business year [total amount of capital (referring to the total amount of assets less the total amount of liabilities on its statement of financial position) or capital, whichever is the greater, in the case of a corporation engaged in a financial or insurance business] shall have a board of directors made up of just one gender. <Amended on Apr. 20, 2021> [This Article Newly Inserted on Feb. 4, 2020]; Translation by Korea Law Translation Center, Korea Legislation Research Institute.

2) In November 2022, the European Commission approved a bill mandating that at least 40% of non-executive director posts or 33% of all director posts are occupied by the under-represented sex in a large-sized listed firm with not less than 250 employees by the end of June 2026. (Source: Commission Welcomes Political Agreement on Gender Balance on Corporate Boards, European Commission, Jun. 7, 2022; Parliament approves landmark rules to boost gender equality on corporate boards, European Commission, Nov. 22, 2022)

3) For increased diversity in the board and improved transparency in related statistics, the US Securities and Exchange Commission (SEC) approved a board diversity rule in August 2021, which mandates NASDAQ-listed firms to appoint at least two directors of the under-represented sex and disclose a board diversity matrix, among others, in a phased manner from 2022 till 2026. The rule was amended in December 2022. (Source: NASDAQ’S BOARD DIVERSITY RULE: WHAT COMPANIES SHOULD KNOW, Nasdaq, Jan. 26, 2023)

4) Article 2 of the Addenda of the FSCMA (Transitional Measures concerning Gender Composition of Board of Directors) A stock-listed corporation that fails to meet the amended provisions of Article 165-20 as at the time this Act enters into force, shall comply with the amended provisions within two years from the date this Act enters into force.

- According to a study of total assets and board gender diversity statistics based on Q3 2022 reports, among those subject to the amended law, 16.9% of the companies (31 out of 183) did not have women directors on the board.
 - In addition, in the case where a company is found to have violated Article 165-20 of the FSCMA, the new Guidelines also recommend voting against a director candidate who was serving the company at the time of the violation as the chair of the board or the independent director (or executive) nomination committee, if he/she is nominated for the company as well as other companies within five years from the violation.
- **(Separate Election of Audit Committee Members)** Pursuant to Article 542-12(2) of the Commercial Act⁵⁾ or Article 19(5) of the Act on Corporate Governance of Financial Companies⁶⁾, if a large-sized listed company with total assets worth not less than KRW2 trillion or a listed financial company with total assets worth not less than KRW100 billion, which has established an audit committee in lieu of a full-time auditor, has yet to adopt a system to elect at least one (two or more if determined as such by the articles of incorporation) director who will serve as an audit committee member separately from other directors, the Guidelines recommend voting against all audit committee member nominees of the company concerned.
- The aforementioned provision of the Commercial Act was introduced in December 2020 to be applied with the 3% voting right restriction rule⁷⁾ for the purpose of limiting the largest shareholder's influence on the appointment of audit committee members and enhancing the independence of audit committee members.
 - In response to these regulatory changes and to protect the voting rights of minority shareholders, the Guidelines added a new provision to guide a vote against a proposal in violation of the requirement to elect audit committee members separately.

5) Article 542-12 (Composition, etc. of Audit Committees) (2) A listed company under Article 542-11(1) shall appoint members of its audit committee from among directors appointed by a general meeting of shareholders. It is provided that one of the audit committee members (the number of the members for the purpose of this provision may be determined by the articles of incorporation as two or more, and if determined by the articles of incorporation as such, the number of the members shall be in accordance therewith) shall be separately elected as the director who will also serve the audit committee by the resolution of the general meeting of shareholders, apart from other director candidates. <Amended on Dec. 29, 2020>; Translation by KCGS for convenience.

6) Article 19 (Composition of Audit Committee and Appointment, etc. of Audit Committee Members) (5) Every financial company shall appoint at least one outside director who will serve as an audit committee member separately, apart from other directors.

7) Article 542-12 of the Commercial Act (4) When appointing or dismissing an audit committee member under paragraph (1), any shareholder who has stocks in excess of three percent of the total number of issued stocks excluding non-voting stocks of a listed company shall not exercise his/her voting rights on the stocks in excess (a lower shareholding ratio may be determined in the articles of incorporation, and if a lower shareholding ratio is determined in the articles of incorporation, the percent shall be in accordance therewith, and as for the largest shareholder, the number of shares held by his/her related parties and other persons determined by the Presidential Decree shall be added up, when appointing or dismissing an audit committee member who is not an outside director). <Amended on Dec. 29, 2020>; Translation by KCGS for convenience.

- In addition, in the case where a company is found to have violated Article 542-12(2) of the Commercial Act or Article 19(5) of the Act on Corporate Governance of Financial Companies, the Guidelines recommend voting against a director candidate who was serving the company at the time of the violation as the chair of the board or the independent director (or executive) nomination committee, if he/she is nominated for the company as well as other companies within five years from the violation.
- **(CEO Nomination Procedure)** The Guidelines recommend voting against proposals of nominating a CEO when the nomination procedure is deemed inappropriate or adequate information necessary for judging the appropriateness of the nomination procedure is not provided, in full consideration of the composition of the CEO nomination committee under the board, transparency of the operation of such committee, and objectivity of the standards and methods to verify the qualification of the candidate, among others.
 - The existing guidelines had a provision on the criteria to assess the qualification of individual CEO candidates, such as expertise and professional ethics.
 - The amended guidelines added a new provision to guide a conditional negative vote for the purpose of promoting the appropriateness of the nomination procedure and its transparent disclosure, apart from the qualification of individual candidates.
- **(Improvement in Dividend Payout Procedure)** The Guidelines recommend voting for proposals of enhancing the predictability of dividend amounts by moving the record date for dividend payment to a date that comes after dividend resolution.
 - In January 2023, government authorities and relevant institutions, including the Financial Services Commission (FSC) and the Ministry of Justice (MOJ), jointly announced a plan to improve rules regarding dividends in line with global standards, enabling companies to designate shareholders who will receive dividends after dividend amounts are determined⁸⁾.
 - As a general practice, listed companies in Korea prescribe the last day of the settlement period as the dividend record date under the articles of incorporation, and the size of the dividends is determined at the general meeting of shareholders, which makes it hard for shareholders to predict dividend amounts.
 - The FSC plans to propose an amendment to the FSCMA⁹⁾ within Q2 2023 to make the same change for quarterly dividends. Korea Exchange has a plan to revise its guidelines on corporate governance reports during Q1 2024 to include whether the dividend payout process has been improved in the corporate governance report as a key item.

8) 'authorities will make improvements to the current procedure for distributing dividends to enable investors to invest after checking dividend amounts to receive - Plan to Improve Rules Regarding Dividend in Line with Global Standards -', press releases by the FSC and the MOJ, Jan. 31, 2023

9) Article 165-12(1) & (2) of the FSCMA

- To align with these changes, among the listed companies whose dividend record date is set as the last day of the settlement period under the articles of incorporation, KOSPI-listed firms with assets amounting to KRW500 billion that will become subject to corporate governance reporting starting from 2024 are expected to propose amendments to their articles of incorporation concerning the dividend record date from 2023 general shareholder meetings and afterward to improve their dividend payout procedure. Against this backdrop, KCGS made necessary changes in its proxy voting guidelines preemptively to provide the basis to recommend a ‘for’ vote.

Regulatory Changes Concerning Corporate Governance

- Policy authorities in Korea are making regulatory changes in capital markets: since 2022, the FSC has adopted a diversity of improvement measures to promote the development of capital markets and protect minority shareholders¹⁰⁾, and the MOJ also unveiled its plan to amend the Commercial Act as part of its 2023 work plan¹¹⁾.
- This section focuses on the matters that affect the general meeting of shareholders of listed companies, among the announcements made by the FSC and the MOJ.

< FSC Work Plan for 2022 - 2023 >

When	Details
Q1 2022	Adopted a principle for shareholder protection concerning split-off under the corporate governance reporting guidelines
Q3 2022	Introduced measures to promote the interests of minority shareholders regarding the listing of the split-off subsidiary Adopted measures for tougher responses to unfair trades in capital markets
Q4 2022	Prepared a measure to adopt a system that requires prior disclosure of insider dealings
2023 (tentative)	(Further from Q3 2022) To work for the prompt institutionalization of measures to strengthen sanctions on the actors involved in unfair trades (e.g. restriction on the appointment as executives in a listed firm) (through an amendment to the FSCMA)
2023 (tentative)	To improve the dividend system so that shareholder-friendly dividend decisions are made ※ (Regulatory) Amendment of the FSCMA and authoritative interpretation of the Commercial Act by MOJ to enable companies to designate shareholders who will receive dividend payouts after they determine dividend amounts (Market practice) To reflect the improvement measure in the standard articles of incorporation published by the Korea Listed Companies Association, etc., and require companies to disclose whether they improved their dividend practice in the corporate governance report

* Source: Press release by the FSC - organized by KCGS

10) ‘Work Plan for 2023’, Press Release of the FSC, Jan. 30, 2023

11) ‘Work Plan for 2023’, Press Release of the MOJ, Jan. 26, 2023

< 2023 MOJ Plan for Amending Commercial Act >

When	Details
H1 2023	To introduce a rule on ‘electronic general meetings of shareholders (to enable an electronic general meeting based on electronic notice and voting)’ ¹²⁾
	To strengthen shareholder protection in case of corporate restructuring (recognizing appraisal rights, etc.)
H2 2023	To reorganize dividend procedures and methods to promote in-kind and stock dividends ※ To allow “pre-dividend resolution and post-dividend record date” (authoritative interpretation in November 2022) so that investment decisions are made after the actual dividend amounts are confirmed

* Source: Press release by the MOJ - organized by KCGS

- **(Split-off)** As problems have recently been pointed out that listed companies split off high-growth business units and list the split-off subsidiaries again, the FSC has implemented a series of regulatory measures¹³⁾.

< FSC Measures Regarding Split-Offs >

Measure	Details
Corporate governance reporting guidelines revised	Corporate governance reporting guidelines to include detailed reporting guidance that requires companies to explain their policy to protect shareholders, including collecting minority shareholders’ views and protecting the rights of the dissenting shareholders, in case the corporate ownership structure is changed due to business division and merger, transfer of business, all-inclusive exchange and transfer of shares, etc. and provide the reason and a plan if such policy is not in place yet
Material information report requirements strengthened	Company disclosure form revised to require companies planning to carry out a split-off of their business to disclose the purpose and anticipated effects of the split-off along with direct and indirect impacts on the company and the shareholders of any corporate restructuring plan, such as a post-split-off IPO of a subsidiary, in their material information report . In particular, if there are plans for a post-split-off IPO of a subsidiary, detailed disclosure should be made on shareholder protection measures, expected schedule, etc., and if there are any changes to the IPO plan, a corrective disclosure should be filed.
Appraisal rights granted to dissenting shareholders	The Enforcement Decree of the FSCMA revised to require companies to grant appraisal rights to the shareholders opposing a split-off so that such shareholders have the right to sell their shares at a price from prior to the board resolution of the split-off

12) The MOJ has not announced any specific plan for the introduction of electronic general shareholder meetings, and thus this topic will be discussed in the next year’s AGM preview.

13) ‘Revised Guidelines on Corporate Governance Disclosure to Strengthen Shareholder Protection’, press release by the FSC, Mar. 4, 2022;
 ‘Measures to Improve Protections for General Shareholders in IPO of Split Off Subsidiary’, press release by the FSC, Sept. 2, 2022

Split-off subsidiary listing review process bolstered	Korea Exchange's listing regulation revised to adopt a qualitative review where Korea Exchange (KRX) evaluates parent companies if they have made sufficient efforts to protect minority shareholders, such as collecting shareholders' views and communicating with shareholders, in case of a plan to list their subsidiaries within five years after the split-off
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Source: Press release by the FSC - organized by KCGS

- The regulatory measures have been adopted to protect minority shareholders effectively with regard to split-offs by encouraging listed companies to establish policies to protect minority shareholders, having minority shareholders informed sufficiently about planned changes in the corporate ownership structure, and requiring companies to grant appraisal rights to the shareholders opposing the corporate restructuring plan.
- However, there are concerns that significant amounts of costs may be incurred to listed companies due to the appraisal rights among the prospective regulatory measures, and thus it is difficult to rule out the possibility that listed companies will try to avoid the granting of the appraisal rights.
 - If a large number of minority shareholders leave due to the split-off of a material business unit, it is expected to act as a significant burden on the company in the form of a large-scale outflow of cash or the risk of split-off being canceled.
- Instead of choosing a split-off, a company that wants to reorganize its ownership structure may spin off the company by transferring its business to a subsidiary or investing its operations/assets in kind. Of these, some methods such as in-kind investment of assets may be used to evade regulatory requirements and procedures such as appraisal rights and the resolution at a general meeting of shareholders.
 - As for the transfer of a material business, a special resolution at the general meeting of shareholders is required¹⁴⁾ and appraisal rights are recognized for dissenting shareholders¹⁵⁾. However, the criteria for determining a material business are ambiguous¹⁶⁾ because the Commercial Act and related precedents do not provide criteria for 'materiality'. Moreover, in-kind investment of assets is possible with the resolution of the board of directors only.
 - Recently, some large listed companies established subsidiaries through investment in kind following controversies over split-offs. In the sense that they evaded the approval process at the general shareholder meeting, it can be considered as a serious violation of shareholder rights.

14) Article 374(1) of the Commercial Act

15) Article 374-2 of the Commercial Act

16) Annotated Commercial Act - Company (3) (Sixth Edition), Korean Society of Judicial Administration (2021), 123-124.

- Unlike a split-off, which comprehensively succeeds the rights and obligations of assets, the establishment of a subsidiary in the form of an in-kind investment requires an individual transfer of rights and obligations of each asset¹⁷⁾. However, the ‘qualifying’ requirement for the inclusion of transfer difference¹⁸⁾ in deductible expenses in an in-kind investment, that is, the tax deferral rule for investment in kind under the local Corporate Tax Act is similar to that of the split-off¹⁹⁾.
 - In the case of a split-off, the qualifying requirements are deemed to be slightly strict, evidenced by the fact that the ‘independent business units’ should be separated; joint ventures are not allowed; and there is the transferred employee ratio requirement.

< Requirements for Qualifying Split-offs VS Qualifying In-Kind Investment²⁰⁾ >

Category	Split-off	Investment in Kind
Business purpose	Where a domestic corporation which has continuously operated business for at least five years as on the registration date of the division is divided upon meeting the following requirements (a) That it divides an independent business division which can be operated after division; (b) That the assets and liabilities of a divided business division shall be comprehensively succeeded: Provided, That those prescribed by Presidential Decree, such as assets and liabilities that are indivisible, including the assets jointly used and the liabilities, the debtor of which cannot be changed, shall be excluded; (c) That it shall be divided upon investment only by a divided corporation, etc.	The investing corporation that has operated business for at least five consecutive years as on the date of investment in kind; ※ Inclusion in deductible expenses is possible even if it is not an independent business division.
Continuity of equity	Where the total costs of a division received from a corporation established through division, etc., by the stockholders of a divided corporation, etc. are in stocks , and such stocks are allocated in proportion to the stocks held by each stockholder of the divided corporation, etc. and the stockholders of the divided	The investing corporation and a person who makes a joint investment with the investing corporation as prescribed in subparagraph 3 holds at least 80/100 of the total number of issued stocks or the total investment amount of the invested corporation as on the date following the date of investment in kind and hold such

17) Registration of real estate rights, delivery of movable items, consent of the debtor or notification to the debtor, etc.; Annotated Commercial Act – Company (3) (Sixth Edition), Korean Society of Judicial Administration (2021), 527.
 18) The difference between the book value of the assets transferred to the new company and the market value of the new company's shares received in return
 19) There are two theories on split-offs - the theory of the succession of juridical personality and the theory of investment in kind. The current corporate tax law follows the theory of investment in kind and the essence of the taxation system is the same; Byung-Wook Jun, ‘Practical Plans to Improve Qualified Spin-Off and Qualified In-Kind Contribution Taxation’, NARS Legislation and Policy Studies(2011), 3(2), 49-74.
 20) Byung-Wook Jun, the above-mentioned paper

	corporation, etc., prescribed by Presidential Decree hold such stocks until the last day of the business year in which the division is registered;	stocks, etc., until the end of the business year in which the date of investment in kind falls; ※ Where a person makes a joint investment with another Korean or foreigner, the person shall not be a related party to the investing corporation.
Business continuity	Where a corporation established through division, etc., continues to operate the business succeeded to from the divided corporation, etc., until the last day of the business year in which the registration date of the division falls;	The invested corporation shall continuously operate the business that the investing corporation operated with assets invested in kind , until the end of the business year in which such investment in kind is made;
Others	Where the ratio of the employees transferred to the corporation established through division, etc. to the employees specified by Presidential Decree as employees of the divided business division as at one month before the date of registration of the division is at least 80/100 and the ratio remains unchanged until the last day of the business year in which the division is registered.	-

Source: Article 46, 47, and 47-2 of the Corporate Tax Act; Byung-Wook Jun(2011)

- As such, the establishment of a subsidiary through in-kind investment is highly similar to a split-off and thus it could be used as an alternative to a split-off. Hence, a company that expects a negative response from minority shareholders to the separation of a business unit has the incentive to circumvent regulations by seeking in-kind investment. Accordingly, it can be expected that split-off disclosures may decline in the future.
- **(Response to Unfair Trading)** The FSC plans to seek the revision of the FSCMA to introduce a regulation restricting the appointment as executives in listed companies as part of its plan to diversify the sanctions against unfair traders under the FSCMA²¹⁾.
 - Those designated by the Securities and Futures Commission of Korea as violators of any type of unfair trading practices, including the use of non-public information, market manipulation, illegal transactions, disrupting market orders, and short selling without leverage, are subject to sanctions.
 - Those subject to the sanctions cannot be appointed as executives of listed companies or financial companies (including executive directors and executives not sitting on the board, such as executive officers). Those already in office lose their positions.

21) Measures to Strengthen Capacity to Respond to Unfair Trade Practices in Capital Markets, Press release by the FSC, Sept. 23, 2022

- If the planned amendment is passed by the National Assembly, the persons subject to sanctions for unfair trade practices fall under statutory disqualification. It is expected to lead to a decrease in the appointment of those responsible for damaging long-term firm value and violating shareholder rights in the executive director posts, even if they are proposed as candidates.

Spin-offs and Holding Company Conversion

- **(Spin-off)** In addition to the split-off discussed above, many corporate spin-offs are scheduled for 2023 as another means of ownership restructuring.
 - As of the record dates of the spin-off, there were five spin-offs in 2020, seven in 2021, and two in 2022. For 2023, ten are scheduled as of the day when this paper is written²²⁾.
 - Spin-offs are carried out for diverse purposes, including converting to a holding company, centralizing businesses, and improving the financial structure²³⁾. In recent spin-off cases, however, converting to a holding company accounted for the largest share (58.3%).
 - Of a total of 24 spin-offs disclosed since 2020, 14 (58.3%) were conducted to convert to a holding company, and ten (41.7%) to separate business divisions.
- During the period, 13 out of 14 companies converting to a holding company through a spin-off had held treasury stocks. In 11 of these companies, the controlling shareholders' controlling power was reinforced by means of treasury shares and in-kind contributions of the operating company's shares while minority shareholders' voting rights were diluted.
 - In the case of converting to the holding company structure through a spin-off, the so-called 'Treasury Stock Magic'²⁴⁾ happens where new shares issued by the newly spun-off subsidiary are allotted to the treasury shares of the parent company, which strengthens controlling shareholders' grip over the subsidiary and dilutes minority shareholders' voting rights on the new subsidiary's shares.
 - Among the 14 companies converting to a holding company via a spin-off, six companies (42.8%) had a treasury shareholding of 10% or more, seven (50%) had between 1% and less than 10%, and one company had less than 1%.
 - In particular, two companies with a spin-off plan in 2023 have treasury stock holdings of 20% and 24.67%, respectively, a cause of concern that minority shareholders will have their voting rights considerably diluted if the treasury shares are utilized in the spin-off.

22) Limited to KOSPI- and KOSDAQ-listed firms

23) Chun-Gwang Park, Spin-offs and Physical Divisions, The Korean Journal of Financial Engineering, Vol. 1, No. 0, Dec. 2002

24) Sang-Hoon Lee, Company Split and 'Treasury Shares Magic' in Korea, Commercial Law Review, Vol. 39, No. 2, Aug. 2020

- In addition, if the controlling shareholder makes a contribution in kind using a large number of shares, he or she can reinforce their control over the holding company without incurring additional costs, unlike minority shareholders. Meanwhile, minority shareholders will have to stand even more dilution of their voting rights on the shares of the holding company.
- Therefore, in the case of companies holding a high proportion of treasury shares and having disclosed a plan to make a contribution in kind after a spin-off, the shareholders need to carefully monitor the dilution of their voting rights caused by the use of treasury shares and contribution in kind in the spin-off process.
- With regard to the tax benefits granted to encourage the adoption of a holding company structure at the government level²⁵⁾, 1) the grace period for special taxation under the Act on Restriction of Special Taxation is expected to end, and 2) the provisions related to the ratios of non-inclusion in gross income under the Corporate Tax Act have been revised. Under the circumstances, it is expected that the related benefits and conditions will be an important consideration for the companies set to decide on a spin-off and conversion to a holding company.
- 1) The grace period for special taxation of stocks invested in kind for the establishment of or conversion to a holding company under the Act on Restriction of Special Taxation is scheduled to expire at the end of 2023. As such, many companies with plans to convert to a holding company are expected to carry out a spin-off in early 2023 to receive existing tax benefits²⁶⁾.
- Under Article 38-2 of the Act on Restriction of Special Taxation, if stocks are invested in kind by meeting certain requirements for the establishment of or conversion to a holding company by December 31, 2023, the imposition of capital gains tax or corporate tax on an amount equivalent to the gains accruing from such investment in kind may be deferred.
- Considering that it takes several months for a corporate spin-off and the investment in kind for holding company conversion, companies with a spin-off plan are expected to carry out the spin-off and in-kind investment in early 2023 to benefit from the special tax deferral for stocks invested in kind.

25) Seung-Young Yoon and 2 others, The Process of Spin-off into a Holding Company and Corporate Governance Risk - Focused on the Mando Case -, Korea Economic Law Journal, Vol. 13, No. 3, Dec. 2013

26) NG Choi, One stitch at a time to address Korea Discount, Yuanta Securities Korea, Dec. 5, 2022

- 2) For holding companies, dividend income is their main source of income. As such, companies that can meet the high investment ratio requirement for subsidiaries are expected to convert to a holding company, considering the change in the ratios of non-inclusion of dividend income in gross income²⁷⁾ under the amended Corporate Tax Act that will take effect from this year.
 - **(Before Amendment)** Under the Corporate Tax Act (Articles 18-2 and 18-3), different ratios apply to general companies and holding companies for the non-inclusion in the gross income of the dividend income that a domestic corporation receives from other corporations invested by the relevant domestic corporation. → As for a holding company that is a stock-listed corporation, a 100% ratio of non-inclusion in gross income is applied when the investment ratio in a subsidiary is 40% or more.
 - **(After Amendment)** Under the Corporate Tax Act (Article 18-2 revised and Article 18-3 deleted), regardless of the company status, whether it be a general company, holding company, or listed firm, a uniform non-inclusion ratio is applied. → As for a holding company, a 100% ratio of non-inclusion in gross income is applied when the investment ratio in a subsidiary is 50% or more.
 - Prior to the revision of the law, a holding company could benefit from a non-inclusion ratio of 100% only if the investment ratio in a subsidiary was 40% or higher. When the amendment takes effect, a holding company must have a 50% or higher investment ratio in its subsidiary in order to benefit from a 100% non-inclusion rate for dividend income as before.
 - For example, if a listed company with a 40% investment ratio in a subsidiary converts to a holding company, 100% of dividend income from the subsidiary is not included in gross income before the law is amended. Then, no corporate tax is imposed. When converted to a holding company after the amendment, only 80% of the dividend income is not included in the gross income, and corporate tax is imposed on 20%, resulting in a tax burden for the company.
 - Therefore, it is anticipated that companies that can meet the high investment ratio requirement in their subsidiaries will have a high incentive to convert to a holding company through a spin-off if they want to benefit from the non-inclusion of dividend income in gross income as before.

27) “Profit or gross revenue” under the corporate tax law means the revenue generated by transactions that increase the net assets of a corporation. Non-inclusion in gross income herein means even if it increases the net assets of the corporation, it is not included in the gross income under the corporate tax law. (Source: Glossary of the National Tax Service)

< Before and After Amendment of Corporate Tax Act²⁸⁾ >

Category	Before Amendment				After Amendment	
	General company		Holding company		No distinction between general & holding companies	
Listed Firm	Ownership	Non-inclusion in gross income	Ownership	Non-inclusion in gross income	Ownership	Non-inclusion in gross income
		100% 30~100% ~ 30%	100% 50% 30%	40~100% 30~40% ~ 30%	100% 90% 80%	50% ~ 30~50% ~ 30%
Non-listed firm	100% 50~100% ~ 50%	100% 50% 30%	80~100% 50~80% ~ 50%	100% 90% 80%		

- Some companies may plan to convert to a holding company even if a lower non-inclusion ratio will be applied in a situation where it is impossible to increase the stake in subsidiaries. It is deemed that such companies will be conducting a spin-off for purposes other than tax benefits.
- An example is Hyundai Green Food, which converts to a holding company through a spin-off this year. It cannot enjoy the existing corporate tax benefits because its largest stake in the subsidiaries is less than 50% even if it makes an investment in kind.
- Hyundai Green Food (38.44% ownership by the owner's family) and its subsidiary Hyundai Catering System (80.2% ownership by Hyundai Green Food) are currently subject to the regulation on undue private benefits. If a spin-off is carried out, however, Hyundai Green Food becomes a subsidiary of the holding company, and Hyundai Catering System becomes a sub-subsidiary. Then, both companies are no longer subject to the regulation on undue private benefits.
- Hyundai Green Food is currently under investigation by the Korea Fair Trade Commission regarding the suspicion of unfair support for in-house catering by Hyundai Motor Group²⁹⁾. Under the circumstances, the company can enjoy the effect of escaping from the surveillance of regulatory authorities around the background of the planned spin-off, even if it cannot enjoy tax benefits.
- Institutional investors should examine whether additional undue benefit-taking effects occur as a result of the spin-off. It is advisable that they exercise their voting rights in anticipation of such effects that may come along with the spin-off.

28) 'Double taxation on dividends' on domestic and overseas subsidiaries will be adjusted, Sejung Ilbo, Jul. 21, 2022

29) Hyundai Green Food rolls up its sleeves to expand its overseas operation, 'tightrope walk' of tunneling regulation, Business Post, May 27, 2022

Expanding Proactive Shareholder Engagement

- Last year's proxy season witnessed more active shareholder engagement and success cases that brought about substantial changes in the company based on institutional changes, such as the separate election of audit committee members³⁰⁾, among others.
- In particular, there were cases where activist funds, which have the ability to collect and analyze information and the financial power compared to individual investors, succeeded in the adoption of the shareholder proposals through public campaigns and the use of the 3% rule.

① SM – Align Partners

- SM had signed production contracts for a long time with Like Planning, a company personally owned by the largest shareholder. In June 2019, KB Asset Management sent a shareholder letter that included a request for a merger between the two companies, but SM expressed its intention to reject it.
- Later, in March 2022, Align Partners (Align hereafter) sent an open letter to SM requesting the termination of the service contract with Like Planning, and subsequently filed a shareholder proposal on the appointment of an auditor. Align carried out an aggressive campaign, and the shareholder proposal was approved. In response to an additional open letter, SM announced the early termination of the contract with Like Planning last October.
- Later, last December, Align sent a private letter to SM focusing on the composition of a majority-independent board and the establishment of a compensation committee. In response, the company announced that it would appoint a person affiliated with Align as a non-independent non-executive director and nominate new outside directors via a provisional outside director nomination committee that includes a person recommended by Align.
- In February this year, however, SM disclosed its decision to issue new shares and convertible bonds to a third party, and it is confirmed that an auditor affiliated with Align attended the board meeting to resolve the decision over the phone³¹⁾³²⁾³³⁾.
- In response, the largest shareholder Soo-Man Lee applied for an injunction to prohibit the issuance of new shares and convertible bonds. Hybe disclosed on February 10 that it would acquire the 14.8% stake held by Soo-Man Lee and begin a tender offer for SM's shares held by minority shareholders³⁴⁾³⁵⁾.

30) In December 2020, the so-called 'three fair economy bills' were approved by the National Assembly, making it mandatory to appoint at least one audit committee member in a separate election and apply the 3% rule from the stage of appointing 'a director who will become an audit committee member,' which increased the likelihood that the candidates supported by minority shareholders are elected. (Related Ministries' Joint Briefing on '3 Fair Economy Bills, FSC, Dec. 15, 2020)

31) Material information report (Decision to issue convertible bonds), SM, DART, Feb. 7, 2023

32) Material information report (Decision on capital increase with consideration), SM, DART, Feb. 7, 2023

33) Decision to acquire shares and investment securities of another corporation (Voluntary disclosure), Kakao, DART, Feb. 7, 2023

- As the dispute over management control is intensifying, there is a possibility of the dilution of minority shareholders' shareholding ratios and a change in the controlling relationship in the future³⁶⁾.

② Sajo Oyang – Tcha Partners

- In December 2020, Sajo Industries announced a merger between its subsidiary Castlex Seoul and Castlex Jeju, and the minority shareholders filed a shareholder proposal that included the dismissal of Chairman Jin-Woo Joo and the appointment of a new audit committee member and an outside director, citing potential damage to the long-term firm value of Sajo Industries that might occur by the transfer of the insolvency of Castlex Jeju, which was in a state of full-scale capital erosion, to Castlex Seoul, an affiliate of Sajo Group.
 - Later, Sajo Oyang acquired about KRW10.2 billion of shares of Sajo Industries, and at the extraordinary general meeting of Sajo Industries held in August 2021, the shares served favorably to the parent company(Sajo Industries). As a result, all shareholder proposals from minority shareholders were turned down.
 - Citing that Sajo Oyang suffered a valuation loss of KRW3 billion during the stock purchase process and that the company's board of directors could make decisions in the interests of the controlling shareholder in the future, Tcha Partners filed shareholder proposals for the appointment of an audit committee member, share repurchase, etc. for shareholder vote at the 2022 annual general meeting of the company. With the 3% rule in effect, the shareholder proposal for the appointment of an audit committee member was approved with the support of minority shareholders.
- Until now, active shareholder proposals and campaigns are being carried out by some asset managers, and disputes over management control are expected for some companies. As such, relevant shareholders are advised to be proactive in monitoring and they need to keep an eye on whether or not shareholder proposals are presented at the upcoming annual general meetings, among others.

① KT&G – FCP & ANDA Asset Management

- In a shareholder proposal filed in October 2022, a Singaporean activist fund Flashlight Capital Partners (FCP) demanded that KT&G carry out the spin-off and separate listing of Korea Ginseng Corporation (KGC) and expand shareholder return. Later, in November, ANDA Asset Management also sent an open letter to KT&G with similar requests.

34) Tender offer report, Hybe, DART, Feb. 10, 2023

35) Stock transfer contract signed that accompanies the change in the largest shareholder, SM, DART, Feb. 10, 2023

36) Soo-Man Lee "It is illegal to sell SM shares to Kakao...Will file for an injunction", Yonhap Informax, Feb. 7, 2023

- In response, KT&G practically rejected the separate listing proposal by citing in its IR meeting held in January this year that ① KT&G's financial power is necessary for the global growth of KGC, ② that it is difficult to raise investment due to reduced market capitalization that would come with an independent listing, and ③ that tax burden would be incurred in the separate listing process, among others. With regard to the request for increased shareholder return, the company announced that it would repurchase its own shares (KRW300 billion) in 2023 and increase dividend payouts (KRW590 billion) in line with its mid-to-long-term shareholder return policy for 2021~2023. The company also said that it would announce a new shareholder return policy for the mid-to-long term at the end of this year that includes a continued expansion of per-share dividend payouts.
- KT&G has two outside directors whose terms in office expire at the upcoming annual general meeting. Under the circumstances, FCP and ANDA Asset Management announced that they would recommend candidates for the vacancies. For this, each company started a respective campaign for soliciting proxies from minority shareholders and filed an injunction request for accessing and copying the shareholder list. As of now, the combined shareholding of the two funds is around 1%, which is not a direct threat to management control of the company. Still, it is necessary to keep an eye on the matters at issue since outside shareholders and the company are sharply conflicting in their positions.

< FCP & ANDA Asset Management's Requests for Governance Improvements and Company Responses >

FCP	ANDA Asset Management	Response from KT&G
Spin-off and separate listing of KGC		Not considering
Expanded investment in HNB business		-
Dividend per share and share repurchase – KRW10,000 each	80% increase in cash payout ratio	Announced a mid-to-long-term shareholder return policy (KRW300 billion worth of share repurchase and KRW590 billion worth of total dividends), To begin semi-annual dividend payouts (From 2023)
To amend the articles of incorporation (cancellation of treasury shares upon the resolution by the general meeting of shareholders, etc.)	To cancel treasury shares	Not considering
Nominated two outside director candidates	To increase the number of outside directors, nominated a global market expert	Not considering. The company has a high proportion of outside directors.
To prescribe compensation committee in the articles of incorporation	To adopt a management incentive system linked with share price	-
To sell non-core businesses (including investment in real estate)	-	-

Source: Company websites of FCP and ANDA Asset Management, KT&G IR materials, related press releases – organized by KCGS

② Osstem Implant – KCGI Fund

- In December 2022, KCGI Fund acquired a 6.57% stake in Osstem Implant and became the third largest shareholder. The announced purpose of the equity holding is ‘to influence management control’³⁷⁾. In its shareholder letter disclosed in January this year, KCGI Fund pointed out that Founder and Chairman Choi can virtually control the decision-making process in the company based on his 20% shareholding, and such backward governance is the reason for the way undervaluation of the company compared to global competitors³⁸⁾.
- In the meantime, domestic private equity funds Unison Capital Korea (UCK) and MBK Partners joined hands to form a consortium Dentistry Investment, which announced on January 25 that it would go for a tender offer to buy off around a half of the shares held by Chairman Choi (1.44 million shares) and acquire management control. The consortium seems in effect to have stepped up as a white knight against KCGI Fund, which is demanding the resignation of Chairman Choi.
- In response, KCGI announced a statement that it can be positively evaluated if independence is established in the board composition and decision-making structure with the participation of external investors in management.

③ Seven Financial Holding Companies – Align Partners

- On January 12 this year, Align Partners Capital Management (Align hereafter) sent a public shareholder letter to seven financial holding companies (KB Financial Group, Shinhan Financial Group, Hana Financial Group, Woori Financial Group, JB Financial Group, BNK Financial Group, and DGB Financial Group), calling for a mid-to-long-term shareholder return policy that returns excess capital exceeding target Common Equity Tier 1 (CET1) ratio of 13% to shareholders in principle to make the total shareholder return ratio (including dividends and share buybacks and cancellation) reach 50%.
- In response, all seven financial groups presented capital ratio management and target mid-to-long-term shareholder return ratios that took into account the requests from Align through their respective FY2022 earnings presentations. Of these, Align said that JB Financial Group’s capital allocation and shareholder return policy were not acceptable and submitted shareholder proposals on the increase in cash dividends and the appointment of an additional outside director.

37) Report on large holdings of shares, etc. (General), Apricot Holdings. DART, Dec. 21, 2022

38) Shareholder letter titled [Proposing a Trust Recovery Program for Global Corporation “Osstem Implant”], KCGI Website, Jan. 19, 2023

④ Taekwang Industries – Truston Asset Management

- Truston Asset Management, the second largest shareholder of Taekwang Industries, expressed its opposition to the company's plan to participate in KRW400 billion worth of capital increase with consideration of Heungkuk Life Insurance. Truston points out that the announced participation in the capital increase is against the interests of the shareholders of Taekwang Industries and constitutes a breach of trust, given that the majority shareholder and his family, including the former chairman of Taekwang Group, own 100% of the insurance company, while Taekwang Industries does not own any stake in Heungkuk Life Insurance.
- In response, Taekwang Industries withdrew its participation in the capital increase with consideration of Heungkuk Life Insurance on December 14, 2022, but Truston announced its intention to actively participate in the company's management activities in the future, including by changing the purpose of holding shares to 'influence management control' the next day on the 15th³⁹⁾40). It is worth paying attention to the company's response and Truston's shareholder engagement activities in the future.

⑤ RaemongRaein – P&I

- RaemongRaein announced on January 16 that its early investor P&I Investment (P&I Culture Creation Investment Association and P&I Culture Technology Association) filed for an injunction for the perusal and copying of the account books of the company on the 5th with Seoul Central District Court⁴¹⁾.
 - P&I Investment pointed out that RaemongRaein's issuance of convertible preferred shares (CPS) to a third party worth KRW9 billion, which was carried out last December, was unnecessary and only favored the controlling shareholder. It also announced that, if necessary, it would consider filing a shareholder proposal for the appointment of an outside director or auditor for the upcoming annual general meeting in March. RaemongRaein responded that P&I owns less than 5% of shares as of Q3 2021, and thus it is not a management rights dispute practically.
- With active discussions on the protection of the rights of minority shareholders underway more recently, shareholder proposals, among others, which were recognized as the domain of institutional investors and hedge fund activist investors, are expanding even among minority shareholders in the form of a coalition of minority shareholders.
- Generally, minority shareholders have not taken direct action to resolve the agency problem of management due to their inherent free-rider problem. Rather, they have waited until other shareholders take action and shared the benefit if the action led to long-term firm value enhancement⁴²⁾.

39) Truston's statement on the change in investment purpose for Taekwang Industries to 'participation in management', Truston Asset Management's company website, Dec. 15, 2022

40) Report on large holdings of shares, etc. (General), Truston Asset Management, DART, Dec. 15, 2022

41) Filing for lawsuits, etc. (Litigation for management right disputes), RaemongRaein, DART, Jan 16, 2023

- Recently, however, there is a phenomenon where minority shareholders are joining forces. The phenomenon that started with the opposition to the split-off of DB HiTek spread to several companies and expanded to form Shareholder Alliance for Corporate Governance Innovation.
- The shareholder alliance is collecting shareholders' voting rights to express their views on DB HiTek, Poongsan, Korea Shipbuilding & Offshore Engineering, SK Innovation, Foosung, NHN, Hyundai Mobis, Alteogen, Helixmith, and OCI, among others.

① DB HiTek – Minority shareholder alliance

- In July 2022, DB HiTek announced a plan to split off its chip-designing (fabless) business, and shareholders took collective action immediately, including filing for an injunction for accessing and copying the shareholder list⁴³⁾⁴⁴⁾. Minority shareholders pointed out that DB Group approached the issue of holding company conversion in a way that diminishes the value of DB HiTek through the separation and listing of a new subsidiary. In response to this collective action of shareholders, DB HiTek announced last September that it called off its separation plan⁴⁵⁾.
- As for DB HiTek, the minority shareholder alliance is expected to demand the appointment of an independent audit committee member at the annual general meeting in March since one of the four audit committee members of the company ends his term in March. Minority shareholders explained that they demand the appointment of an audit committee member mainly to secure an official communication channel with the company, considering that the holding company transition issue remains and negatively affects the share price, although they succeeded in deterring the split-off plan.

② Poongsan – Minority shareholder alliance

- In September 2022, Poongsan disclosed a plan to split off its defense business, stating that it had no plan to list the new subsidiary established with the split-off and would seek a special resolution by the general meeting of shareholders if it goes for listing. Despite the shareholder protection measures proposed by the company, minority shareholders joined forces to pursue a business separation in the form of a spin-off and have it inspected by the National Assembly. In the face of strong opposition from shareholders, Poongsan withdrew its split-off plan in October⁴⁶⁾.

42) Grossman, S. and O. Hart (1980) "Takeover bids, the free rider problem, and the theory of the corporation", Bell Journal of Economics, Vol.11, No.1, pp.42-64.

43) [Correction] Response to disclosure request (rumor or report) (Not decided). DB HiTek, DART, July 12, 2022

44) Filing for lawsuits, etc. (Litigation for management right disputes), DB HiTek, DART, Aug. 29, 2022

45) Response to disclosure request (rumor or report) (Denied). DB HiTek, DART, Sept. 26, 2022

46) [Attachment Correction] Material information report (Decision on corporate division), Poongsan, DART, Oct. 11, 2022

③ Gwangju Shinsegae – Gwangju Shinsegae Department Store Minority Shareholder Rights Movement

- In September 2021, Vice-Chairman Yong-Jin Jung sold his entire stake (around 830,000 shares) in Gwangju Shinsegae to Shinsegae to finance his gift tax, etc. With the sale, Gwangju Shinsegae had to see its stock price nosedive around 15%. Minority shareholders of Gwangju Shinsegae Department Store argued that while the majority shareholder benefited from a management premium in the process of selling the shares, minority shareholders had to suffer the infringement upon the protection of shareholders' proportional interest due to the share price crash. Around 90 minority shareholders formed an alliance and announced that they would file shareholder proposals for the March annual general meeting to increase cash dividends and nominate an outside director candidate⁴⁷⁾.
- It is viewed that institutional investors are taking more mature approaches to shareholder engagement since the adoption of the stewardship code, carrying out proactive shareholder engagement activities themselves. As a result, substantial improvements in the corporate governance structure of the companies and other benefits driven by specific shareholder engagement activities are observed.
- Minority shareholders are also continuously engaging companies, while there is an increased awareness of minority shareholder rights protection across the capital market along with a strong commitment from the financial authorities. In this sense, there will be even greater demands for corporate governance improvements.
- However, as in the case of Sajo Industries from 2021⁴⁸⁾, it is possible to circumvent the 3% rule by securing voting rights through stock lending and borrowing and exercising empty voting⁴⁹⁾. In this sense, it is advisable to pay attention to shareholder engagement methods in the future and how companies respond.



47) Press release on shareholder proposal by Gwangju Sinsegae Minority Shareholder Rights Movement, Jan 26, 2023

48) At the extraordinary general meeting where a shareholder proposal to dismiss Chairman Jin-Woo Joo from the inside director post and appoint an audit committee member was presented, Chairman Joo exercised his voting rights by lending his shares to two people – 3% each – and received his shares back after the record date of the shareholder list passed. As such, he utilized empty voting for the purpose of defending management rights. Resultingly, the shareholder proposal was turned down.

49) Empty voting is acquired by making use of stock lending, securities swap, short selling, stock-linked derivatives, record date capture, etc. Regardless of the methods to reach empty voting, a shareholder who exercises his or her voting rights at the general meeting does not bear any economic risk. A Study on the Types & Regulations of Empty Voting, Journal of Business Administration & Law, Vol. 30, No. 1, 2019)

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