

Korea Corporate Governance Service

# 2021 AGM Preview (1)

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(Feb. 4, 2021 by Responsible Investment Team)

## **Background**

With the 2021 AGM season for the issuers having a December year-end fast approaching, Korea Corporate Governance Service (KCGS) selected the following themes as a preview. This year, the preview comes in two parts. Part 1 - this subject paper - covers the legal environment enhancements for the exercise of voting rights, the appointment of women directors, and the revised laws governing the environment, health, and safety(EHS). Part 2 looks into the impact of the separate election of audit committee members and reviews the foreseen fights over management rights.

## **Improved Legal Environment for the Exercise of Voting Rights**

Effective from 2021, all listed companies are required to disclose annual reports prior to their respective annual general meetings. With Article 31(4)4 of the Enforcement Decree of the Commercial Act coming into force, companies are expected to attach their business report and audit report to the notice of the shareholder meeting, or to send the reports electronically or post them on the company website one week before the meeting. With the new rule in place, the existing practice of making public an audit report one week before the shareholder meeting and the business report right after the meeting is anticipated to improve albeit marginally.

The new rule is still a limited change in that the minimum statutory notice period is two weeks before the general meeting of shareholders, which is not sufficient time for shareholders to review the reports. Companies are even allowed to disclose the reports one week before the meeting via other channels. As for institutional investors, in particular, they have to go through numerous agenda items at the same time during the peak AGM season. In this light, what should precede is an environment where institutional investors are given sufficient time to review.

Although the legal environment has been created to give a push to the de-concentration of annual

shareholder meetings with an amendment to the Commercial Act, the clustering of meetings in March is still foreseen this year. Annual general meetings are highly concentrated around the end-March in Korea due to the company practice of setting the book closure and record date as the last day of the business year. In the articles of incorporation, issuers can set the record date of closing the shareholder register to determine which shareholders are entitled to vote and receive a dividend, and shareholders should exercise the rights within three months from the record date. Article 350(3) of the previous Commercial Act, however, makes a premise that, with respect to dividends of profits as to the new shares, the record date for the receipt of dividends is the end of the business year. For this reason, aligning the book closure and record date to the end of the business year has been established as a company practice.

Although such a practice has been mainstream, companies could still set the record dates for voting and dividends differently and call a general shareholder meeting after the March peak season if the articles of incorporation had a provision that allows the board to approve financial statements. This method, however, is not encouraged because shareholders' right to the dividend decision may be restricted.

With the deletion of Article 350(3) of the Commercial Act, a legal foundation has been laid where issuers can set the record date as they wish and call a general shareholder meeting in April or afterward. The March peak season is expected to continue for a while, however, because not many companies propose to update the articles of incorporation regarding the book closure and record date. In the example below, the record date has been changed from December 31 to the date decided by the board resolution.

**< Amending Articles of Incorporation to Set a Record Date by Board Resolution(Example) >**

Before	After
Article 13 (Book Closure and Record Date) ① The Company suspends the entry of a change as to the rights contained in the register of shareholder for the period from January 1 through January 15 each year.	Article 13 (Record Date) <Deleted>
② The Company deems any shareholder having voting rights as appearing on the register of shareholders as of December 31 each year to be a shareholder who is entitled to exercise voting rights at the ordinary general meeting of shareholders for the corresponding accounting period.	<Deleted>

<p>③ For the purpose of convening an extraordinary general meeting of shareholders and others, the Company may, by resolution of the board of directors, suspend the entry of a change as to the rights contained in the register of shareholders for a specified period of time not exceeding three 3 months or set a record date when deemed necessary. The board of directors may, when deemed necessary, both suspend the entry of a change in the register of shareholders and set a record date. Two 2 weeks prior notice of suspension or fixing of a record date should be given to the shareholders.</p>	<p><b>For the purpose of convening a general meeting of shareholders and others, the Company may deem any shareholder having voting rights as appearing on the register of shareholders as of the record date set by the resolution of the board of directors to be a shareholder who is entitled to exercise voting rights.</b> The Company should give two 2 weeks prior notice of the same.</p>
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## Increasing Nomination of Women Directors

On February 4, 2020, a new rule was promulgated under Article 165-20 of the Financial Investment Services and Capital Markets Act that the board of directors should not comprise members of the same gender only. Accordingly, issuers are required to form their board of directors in compliance with the new rule within two years of the enforcement date (August 5, 2020). Listed companies with KRW2 trillion or more in total assets as of the separate financial statements are subject to the prospective requirement. As for financial institutions or insurers, the larger amount between total equity and capital stock applies.

As part of its 'aggressive measures to improve employment', the Ministry of Employment and Labor has been monitoring the ratios of women's employment and women at management positions, demanding improvement measures for the companies falling short of the standard rate of female employment. Yet, there has not been any regulation on gender diversity on the board.

Overseas, tighter laws and regulations are being introduced to promote gender-diverse boards. When voting and issuing vote recommendations, asset managers and proxy advisors also take gender balance on the board seriously. In the United States, the world-second-largest stock exchange NASDAQ filed a proposal with the Securities and Exchange Commission (SEC) in December 2020 that a new listing requirement should be adopted regarding gender diversity on the board of directors (to appoint at least one female director and at least one racial or sexual minority on a comply-or-explain basis). Germany has a regulation requiring at least 30% representation of women on the supervisory board of a listed company employing 2000 or more staff. Even more, the coalition government approved a 'women quota' legislation on January 6, 2021, making it mandatory to have a female director on the management board consisting of three or more members.

Institutional investors and proxy advisors are also moving in the same direction. BlackRock, for example, has joined the US 30% Club, a program launched to promote gender diversity on boards and C-suites. The asset manager recommends that US companies appoint a minimum of two women directors. As part of its proxy voting guidelines for 2021 and 2022, global proxy advisor ISS expanded the regions where it recommends voting against the nomination committee chair when the prospective board does not meet the gender diversity criteria. The proxy voting guidelines of KCGS recommend a positive vote for a resolution increasing board diversity including but not limited to gender diversity.

Going back to the newly introduced requirement in Korea, only about 30% of the issuers are ready for the enforcement of the new diversity regulation. As such, a growing number of companies are expected to nominate women directors at the annual general meetings held this year and in 2022. According to our analysis, 151 companies are subject to the new rule and 48 of them have female executive board members as of Q3 2020. More specifically, 40 companies have one such board member, seven companies have two, and the other one company has three.

**< Listed Companies Having At Least One Female Director >**

# of female directors	Companies
1 (40 issuers)	<p><b>(NonFI)</b> SK Hynix, Korea Gas Corporation, Samsung C&amp;T, SK Telecom, KT, Lotte Shopping, Korean Air, SK Innovation, Samsung SDI, Lotte Chemical, Samsung Heavy Industries, KT&amp;G, Hanwha Solutions, Posco International, <b>NAVER*</b>, Samsung SDS, Samsung Biologics, Samsung Electro-Mechanics, Amorepacific, Amorepacific Group, Netmarble, Kangwon Land, Hanon Systems, CJ E&amp;M, NC Soft, LotteChilsung Beverages, <b>Hotel Shilla*</b>, Kumho Tire, SeAH Besteel, Hanjin Heavy Industries, Hankook Capital, <b>Daesang*</b>, Hyosung</p> <p><b>(FI)</b> Mirae Asset Daewoo, Hyundai Marine &amp; Fire Insurance, Mirae Asset Life Insurance, Tongyang Life Insurance, Shinhan Financial Group, Hana Financial Group, Kiwoom Securities</p>
2 (7 issuers)	<p><b>(NonFI)</b> Samsung Electronics, KEPCO, S-Oil, Kakao, OCI</p> <p><b>(FI)</b> <b>KB Financial Group, Samsung Card*</b></p>
3 (1 issuer)	Korea District Heating Corporation

\* The companies having a female director who is not independent are bold lettered.

Source: DART Quarterly Reports (3Q 2020), Annual Reports (FY2019)

103 issuers (about 70%) who have yet to meet the requirement of having a gender-diverse board are highly likely to be approached by institutional investors for engagement. As such, within about a year and a half, at least 103 women directors are to be additionally appointed. Also considering that the new requirement is in its initial days, there doesn't seem to be a wide talent pool having expertise qualified to serve the board of a listed company. Thus, companies are advised to identify candidates in a preemptive manner to recruit a female director right for the company. It is anticipated that institutional investors with a high interest in board diversity will monitor if the board of directors or the nomination committee goes through a skills matrix review and appoints a female director having the right capabilities who can contribute to the composition of the existing board, or if a woman director is appointed just to meet the legal requirement despite lack of expertise. Based on the monitoring results, they are expected to carry out engagement activities if necessary.

In the meantime, our analysis indicates that most of the women directors already sitting on the board are outside directors or non-independent non-executive directors. From the long-term perspective, it is highly feasible that increasing female inside directors becomes the focus of shareholder engagement discussion. Of 57 women directors on the board as of Q3 2020, most (48) are outside directors. The remainder includes inside directors (4) and non-independent non-executive directors (5). Of the four female inside directors, two are affiliated with the controlling shareholder's family. This leaves only two women inside directors who overcame the glass ceiling barriers. For the substantive expansion of the role of women leaders beyond simply meeting the legal requirement, institutional investors are likely to pile pressure on issuers by monitoring the ratio of female leaders at management positions on an ongoing basis and demanding a measure to nurture management-level women leaders.

### **Increasing Shareholder Engagement in line with Revised EHS Laws**

On January 26, 2021, a law on punishment for serious industrial accidents was promulgated and will become effective on January 27, 2022. The new law prescribes that ① if a business owner or chief executive officer violates the obligation to secure safety and health and ② if a grave industrial or civil accident occurs, he or she may be punished with a fine on the corporation. ③ The same applies to such relationships as contracting, service provision, and entrustment. ④ Further, damages are payable by up

to five times when a serious accident is caused on purpose or due to gross negligence.

Compared to the Occupational Safety and Health Act, the new regulation applies tougher regulations for the accountability of the contractors with potential punishment for CEOs. With the new law, it is noteworthy that CEO risk is likely to increase and punitive damages can also be claimed.

**< Severity of Punishments Under Serious Industrial Accidents Law >**

Category	Accident Scale	Individual	Corporation
<b>Serious industrial accidents</b>	1+ fatality	Imprisonment for 1+ year or a fine of KRW1 billion or less*	A fine of KRW5 billion or less
	2+ injured persons from the same accident, who need treatment for at least six months	Imprisonment for 7 or less years or a fine of KRW100 million or less*	A fine of KRW1 billion or less
	3+ cases of an occupational disease prescribed by the applicable presidential decree within a year, such as acute intoxication caused by the same hazardous materials		
<b>Serious civil accidents</b>	1+ fatality	Imprisonment for 1+ year or a fine of KRW1 billion or less	A fine of KRW5 billion or less
	10+ injured persons from the same accident, who need treatment for at least two months	Imprisonment for 7 or less years or a fine of KRW100 million or less	A fine of KRW1 billion or less
	10+ cases of a disease due to the same cause, which requires at least three months of treatment		

\*Those who commit the same offense within five years after being sentenced and the sentence is finalized are subject to aggravated punishment by up to a half of the original sentence.

Note 1) 'Serious industrial accidents' refer to the industrial accidents defined by Article 2(1) of the Occupational Safety and Health Act that cause casualties falling under any one of the categories above.

Note 2) 'Serious civil accidents' refer to the accidents caused by certain raw material or manufactured article, or by the flaws in the process of designing, manufacturing, installing, and managing a public facility or public transportation, which cause casualties falling under any one of the categories above. The accidents categorized as 'serious industrial accidents' are excluded.

The Occupational Safety and Health Act has also added tougher provisions. With the enforcement of Article 14 of the Act, the CEO of a listed company meeting certain criteria should establish a safety and health plan and report the same to the board of directors for approval. Furthermore, the sentencing committee under the Supreme Court approved revised sentencing guidelines allowing up to 10 and a half years of imprisonment when an employee dies due to the violation of the obligation to take safety and health measures.

In line with these legal amendments, institutional investors are expected to exclude or withdraw investments in companies with high EHS risk or to engage actively with such companies for practice improvements. For instance, they may ask the board of directors, in writing or verbally, to reinforce EHS management systems or to disclose review details for periodic monitoring. When the practice does not improve, they may consider voting against the re-election of the directors or conduct shareholder engagement for the adoption of an EHS-related program or recruitment of an expert outside director. Therefore, companies involved in construction, shipbuilding, and other industries with a high probability of industrial accidents need to respond aggressively to regulatory risk such as by building a systematic safety system and strengthening supply chain management, and expand communication with stakeholders including shareholders through information disclosure.

Overseas, the UK financial company Federated – Hermes has engaged with G4S, a global integrated security company, for 10 years by monitoring employee safety accidents in an ongoing manner, having dialogues, and conducting site visits. Specifically, Federated - Hermes asked the outside directors appointed to the board in the year of numerous fatalities, the CSR committee chair, the CEO, and the safety and health officer about safety and health-related performance and disclosure. Later, Federated – Hermes visited the site for reviewing the issues raised. In the end, these engagement efforts achieved a great deal - the security company started to report safety and health performance to the board of directors periodically, disclosing lost time injury (LTI) and adopting safety and health KPIs for the leadership group.

In the domestic market, APG Asset Management managing the Dutch pension fund has conducted engagement activities for years against workplace safety accidents in the shipbuilding industry such as Samsung Heavy Industries and Hyundai Heavy Industries. According to the annual report, APG recommended the investee companies to recognize the importance of the safety of the employees and take improvement measures. The report further explains that after tightening its safety policies, the

company has taken further steps to improve safety. In particular, the report stresses that it is important for the ship buyers to act aggressively when issues arise and it is necessary to bring about changes in a way buyers take an interest in safety matters.

This AGM season, the National Pension Service (NPS) of Korea is also considering a shareholder proposal to nominate public interest directors for the issuers suffering controversy over industrial accidents such as POSCO and CJ Logistics. For this, the special committee on stewardship responsibilities of the NPS is known to gather on February 9. It is uncertain, however, whether the pension fund will file such shareholder proposals considering differing voices of diverse stakeholders of the fund.



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