

Korea Corporate Governance Service

Preview of 2020 Annual General Meetings

February, 2020

KCGS Analysis Team 2

Background

With the 2020 annual general meeting season for the firms having a December year-end fast approaching, the Korea Corporate Governance Service (KCGS) selected the following themes as a preview.

Controlling Shareholder's Board Attendance and Multiple Directorships

67 controlling shareholders or family members (“controlling shareholders”) of a large business group¹⁾ are currently serving the board of a listed issuer affiliated with the business group as an inside director (90 firms under 35 business groups). Among them, 33 come to the end of their respective term in the 2020 annual meetings of shareholders. On average, they attended 81.3%²⁾ of the board meetings in 2019. While a majority (about 74%) showed good attendance at 75% or higher, some had poor attendance.

In general, from the perspective of responsible business conduct, the controlling shareholders serving as an inside director are positively viewed because they may be held accountable for their management judgment. If they have not attended the board meetings and thus have not participated in the major decision-making processes of the company, however, one may say that they neglected their duty of care of a good manager and duty of loyalty. That is, when a board member is absent from the meetings in the first place, it is difficult to call him/her to account. Thus, investors need to pay heed to the controlling shareholders whose board attendance is markedly low.

Concerning the controlling shareholders sitting on the board, a trend is witnessed that the more companies they serve, the lower their average board attendance gets. This

1) Directors of the firms affiliated with a large business group as of 2019. Retrieved in May 2019 from eGroup, a portal run by the Korea Fair Trade Commission (<https://www.egroup.go.kr/egps/ps/io/mai/mainList.do>)

2) Source: Q3 2019 quarterly reports.

may say that some of the controlling shareholders are holding an excessive number of positions, which keep them performing a director's role properly. How institutional investors will vote on the reappointment of these directors merits attention.

<Table 1> Board Attendance³⁾ of Controlling Shareholders & Number of Concurrent Positions⁴⁾

Average Attendance	# of Directors	# of Concurrent Directorships
0~25%	5	3.8
25~50%	4	3.67 ⁵⁾
50~75%	8	2.5
75% +	48	2.21
Not disclosed*	2	-

* Controlling shareholders serving as an inside director only at a single company and their attendances are not disclosed.

Increasing Cash Dividends

Amid the rising market demand for shareholder return, cash dividends are preferred to share repurchasing by the local market. Data show that 213 issuers bought back shares and 16 performed share cancellation in 2017 and the respective numbers for 2018 stood at 306 and 18. In the same two years, the numbers of firms paying out cash dividends were significantly higher at 1,081 and 1,098, respectively.⁶⁾

The following graphs illustrate the average dividend, payout ratio, dividend yield ratio, and adjusted dividend per share(DPS) of the issuers on the KRX300 Index⁷⁾ over the period from 2016 through 2018:

3) In four cases, some of the firms affiliated with a large business group where the controlling shareholder is an inside director did not disclose board attendance data. For these cases, the board attendance was averaged based only on the data disclosed by the other affiliated firms.

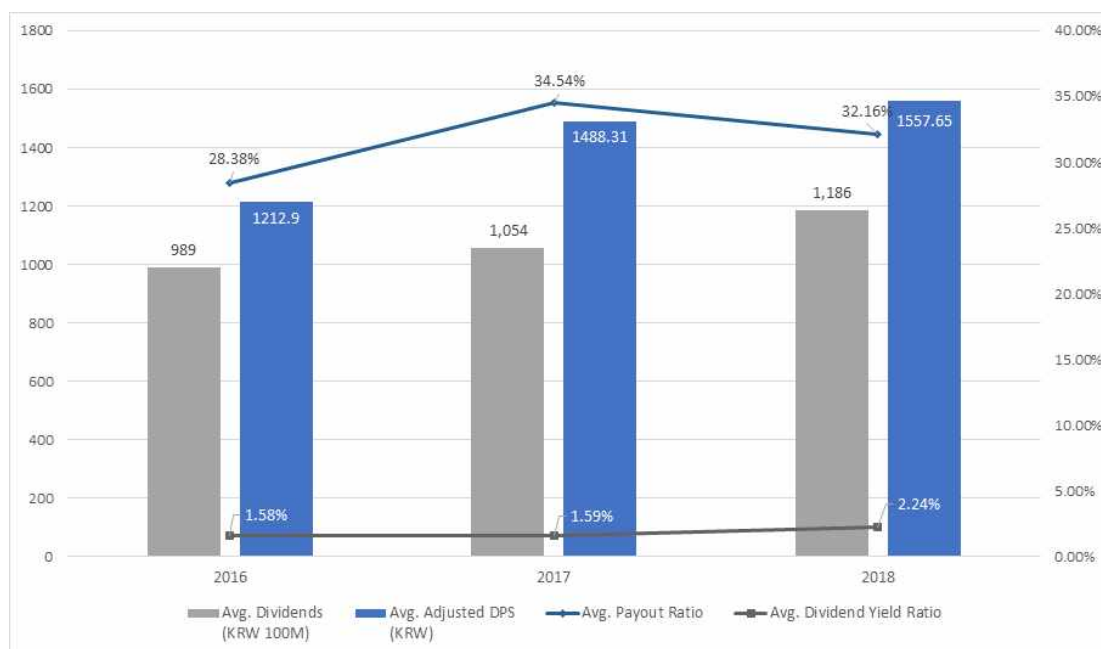
4) Either listed or non-listed. Only when the controlling shareholder is an inside director.

5) An outlier where the director served 28 firms concurrently was excluded from the averaging.

6) A simple sum of the firms who performed shareholder return in 2017 and 2018. "The State of Play of Share Repurchasing and Cancellation" from KCGS REPORT Vol. 9(9) dated October 23, 2019

7) The index was constructed by Korea Exchange by screening the KOSPI and KOSDAQ-listed stocks. Only the top 700 firms in terms of market capitalization and top 85% in trading value are eligible for the screening. Of 300, 225 are listed on KOSPI and the other 75 are on KOSDAQ. KRX300 is a benchmark index that includes minimum 90% of the KOSPI200 stocks.

〈Figure 1〉 Dividend Data of KRX300 Firms from 2016 to 2018

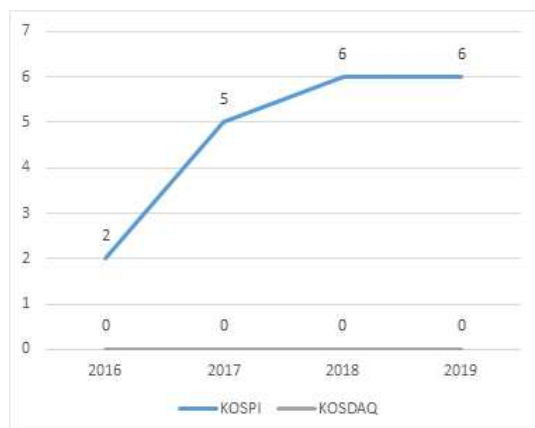


Over the three years from 2016 to 2018, the averaged dividend, adjusted DPS, and dividend yield ratio rose every year. If the KOSPI-listed companies are segregated from KRX300, they show a clear upward trend where the dividends rose 22.2% in 2018 compared to 2016. The growing dividend payouts by listed firms, both in number and volume, came in response to the rising demand for larger shareholder returns since the launch of the Korea Stewardship Code in December 2016 and the adoption of the Code by major asset managers and large pension funds⁸⁾.

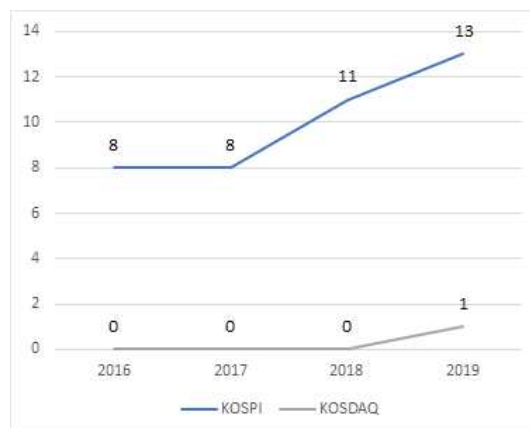
The volume of year-end dividends for 2019 is also expected to grow. Depending on the size of the dividends determined by the 2020 annual general meetings, shareholder engagement on dividends will increase. Fewer companies are choosing not to pay year-end dividends: 93 firms in 2016 to 79 in 2017 and 70 in 2018. In the meantime, an increasing number of companies has paid quarterly or semiannual dividends. These data say that the size of the payouts will rise overall.

8) The National Pension Service adopted the code in August 2018, and the Teachers' Pension in December 2019.

〈Figure 2〉 # of KRX300 Firms Paying Quarterly/Semiannual Dividends



〈# of firms paying quarterly dividends〉



〈# of firms paying semiannual dividends〉

After the year-end dividends are paid out for FY2019, shareholder engagements asking for a dialogue and a dividend policy are expected to increase.

Shareholder proposals demanding larger dividends are likely to follow as for the firms paying no or small size of dividends without a reasonable investment plan or dividend policy. Not all shareholder proposals seeking larger dividends, however, are supported by the market.⁹⁾ Since there is also a concern on excessive DPS, it is desirable to propose an appropriate payout policy and a reasonable size of dividends taking into account the firm's capital allocation policy and financial conditions, among others.

Changing Pension Funds

Following the Teachers' Pension who signed up to the Korea Stewardship Code in December 2019, the Government Employees Pension Service is about to adopt the Code, a sign of change among the key pension funds in Korea. After signing up to the stewardship code, the Teachers' Pension specified the principles of responsible investing and fiduciary responsibilities in its asset management policy. The Government Employees Pension Service has established detailed voting guidelines for specific issues like worker relations, social issues, and environmental issues.

The National Pension Service(NPS) made public in December 2019 its guidelines on active ownership in a move to take a more active role as a fiduciary following the

9) In the 2019 annual general meeting of Hyundai Motor Company, the board proposed KRW3,000 per share compared to KRW21,967 proposed by one of the shareholders Elliott. The board proposal was approved in the end.

adoption of the stewardship code.¹⁰⁾ Based on the new guidelines, the NPS aims to fulfill its fiduciary responsibilities faithfully and raise the market predictability of its activities as a shareholder. According to the guidelines, the NPS will engage with the companies on the focus list and the firms who are faced with an unexpected concern and fail to address the issue at hand despite a private dialogue. With the guidelines in place, in the upcoming AGM season, the NPS is expected to exercise its shareholder rights through filing shareholder proposals and sending letters as well as casting votes.

Overall, pension funds including the NPS are expected to take more active roles in the coming general meetings of shareholders, in line with the stewardship code they adopted and their updated guidelines on shareholder activities.

Institutional Investors' Shareholder Activities

The 2019 annual general meeting season witnessed active shareholder engagements by institutional investors driven by the increased adoption of the stewardship code and the rise in the number of activist funds.¹¹⁾ The mode of engagements included not only the letters but also shareholder proposals and open solicitation of proxy voting.

While some of the firms showed positive changes in response to the engagement by the institutional investors, others did not execute any substantive change at all. A case in point is SM Entertainment who received a letter from KB Asset Management. While the entertainment firm replied publicly on the issues of shareholder return, lifestyle business, and producing services, it lacked a detailed action plan on shareholder return. It neither showed any substantive improvement that can convince shareholders about the producing agreement with Like Agency, a key concern raised by KB Asset Management.¹²⁾ Another example is KISCO Holdings.

While institutional investors including Value Partners Asset Management have engaged with KISCO Holdings in an ongoing manner since 2018 by sending letters and filing shareholder proposals, the firm has not taken any actions publicly yet.¹³⁾

Excluding Value Partners and KB Asset Management, however, no institutional investor is observed to have been engaging with the invested firms publicly in such

10) [Decision 19-18] Activism Guidelines (draft), NPS Investment Management, January 10, 2020

11) KCGS, "2019 AGM Review - Institutional Investors' Shareholder Engagement and Implications", April 24, 2019

12) Response to Shareholder Letter - Tireless Journey Towards a Cultural Powerhouse, KB Asset Management, July 31, 2019

13) "Press Release on 2019 AGM of KISCO Holdings" Value Partners Asset Management, February 26, 2019

a manner witnessed by 2018.

In the meantime, the Enforcement Decree of the Financial Investment Services and Capital Markets Act has been amended recently to segment the ownership disclosure rule(See <Figure 3>). The new rule took effect on February 1, 2020. The amendment clarifies the scope that is referred to by the phrase ‘influencing management.’ That is, if an institutional investor engages with the invested firm concerning dividend raises, amendments of the articles of incorporation for improving corporate governance targeting all portfolio companies, or to exercise its rights allowed by the Commercial Act against the directors illegally damaging corporate value, such an engagement is no longer interpreted as having an intention to influence company management. Further, the investors without the intention to influence management are also required to specify their investment purpose between ‘general’ and ‘simple,’ and become subject to different reporting requirements depending on their choice of investment purpose.

Notable is the fact that an institutional investor with a shareholding of 5% or more can file a shareholder proposal in a facilitated manner following the change that moved the shareholder proposals on dividends, amendment of articles of incorporation for improved corporate governance, and the dismissal of directors under the applicable law to be categorized under ‘not seeking to influence management.’ Previously, the institutional investor who submitted an official document indicating no intention to influence company management was not allowed to file a shareholder proposal.

With the amendment, more active shareholder engagements are expected to follow since the institutional investors without the intention to influence management are newly allowed to file a proposal albeit within a limited scope. The pension funds, who are asset owners, getting active in their stewardship responsibilities by adopting the stewardship code, among others, can also catalyze institutional investors’ shareholder activities.

Also interesting is what kinds of engagement activities institutional investors will perform other than exercising their voting rights against the firms failing to show substantive changes despite their last year’s engagement.

<Figure 3> New Reporting Rule for 5% Ownership¹⁴⁾

< Existing >

	Influencing management	Not seeking to influence management
Shareholder activities	De facto influencing through shareholder proposals on the election and dismissal of directors, etc.	Others except the left
Reporting requirement	Detailed reporting within 5 days	- General institutional investors: Monthly summary reporting (within 5 days for new ownership) - Public pension funds Quarterly summary reporting



< Amended >

Investment purpose	Influencing management		Not seeking to influence management			
			General investment		Simple investment	
Shareholder activities	De facto influencing through shareholder proposals on the election and dismissal of directors, etc., exclusive of the shareholder activities for dividend raises, corporate governance enhancement targeting all portfolio companies, etc.		Active shareholder activities without the intention of influencing management, such as for dividend raises, corporate governance enhancement targeting all portfolio companies		Only exercise the most basic rights of shareholders, such as voting rights and preemptive rights	
Reporting requirement	General institutional investors	Unchanged	General institutional investors	Summary reporting within 10 days (5 days for new ownership)	General institutional investor	Unchanged
	Public pension funds	Summary reporting within 5 days	Public pension funds	Monthly summary reporting	Public pension funds	

Limited Terms of Independent Directors

On January 21, 2020, the Cabinet meeting approved the amendment to the Enforcement Decree of the Commercial Act proposed by the Ministry of Justice.¹⁵⁾ The new Decree took effect starting on January 29, 2020. With the amendment, shareholders are now able to change or withdraw their votes if they voted electronically. Under the new rule, firms are now subject to stricter disclosure requirements for the matters about director nominees, tighter qualifications of independent directors, and the requirement to provide the annual report at the time of

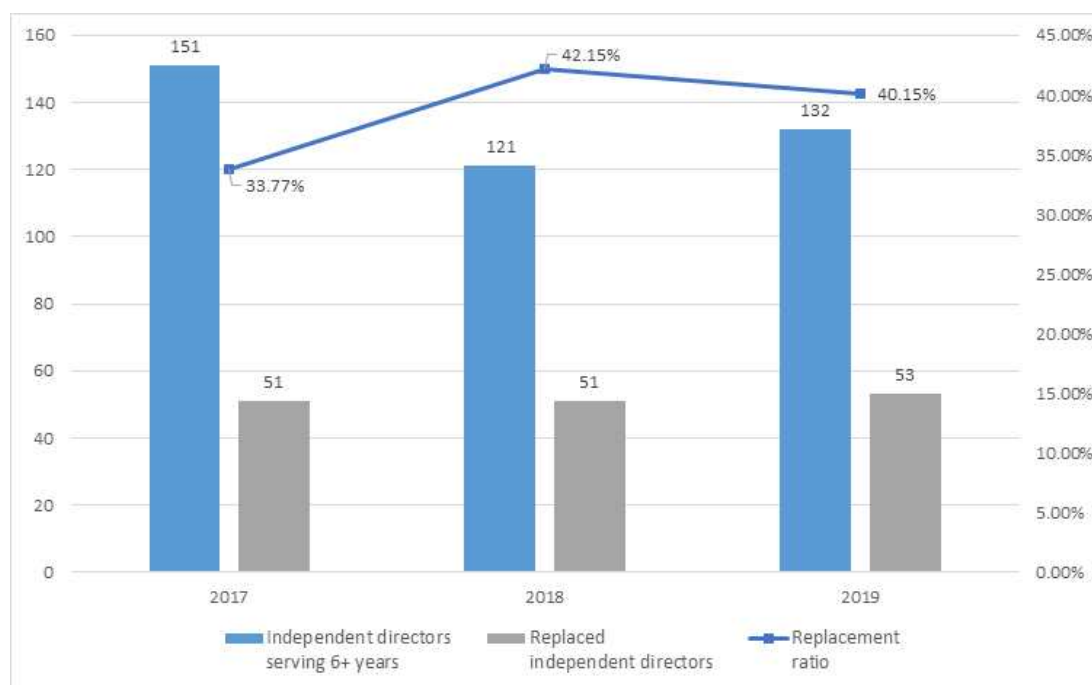
14) “The Cabinet Meeting Approved the Amended Enforcement Decrees of the Commercial Act, the Financial Investment Services and Capital Markets Act, and the National Pension Act,” Ministry of Justice, January 21, 2020

15) “The Cabinet Meeting Approved the Amended Enforcement Decrees of the Commercial Act, the Financial Investment Services and Capital Markets Act, and the National Pension Act,” Ministry of Justice, January 21, 2020

notifying a general shareholders meeting. Except for the provision requiring an annual report be provided before an annual general meeting, the amendment came into force with immediate effect starting on the date of promulgation upon approval by the President.

Of the changes, what captures investors' attention ahead of the AGM season is stricter qualifications of independent directors. Under the new rule, independent directors of a listed firm involved in the non-financial business become subject to the same terms as required by the Act on Corporate Governance of Financial Companies. Specifically, an independent director of a listed firm cannot serve the board of the firm for more than six years. The term may be extended to nine years if he/she serves the firm's affiliated company additionally.

< Replacement of Independent Directors in Recent 3 Years >



As for the KOSPI-listed firms, 591 independent directors of 361 companies come to the end of their respective term in February and March 2020. 208 of them from 161 firms cannot serve the firms another term under the new rule.¹⁶⁾ Of these directors, 75 cannot serve an affiliated company either because they will have already served nine years.

¹⁶⁾ The 208 directors include those serving as an independent director for a period exceeding six years or the ones whose remaining term of office is less than six months as of the end of March 2020.

In the recent three years, an average of 52 directors was newly elected to the board of a KOSPI-listed firm, replacing the independent directors who served more than six years. Against this trend, there will be a radical increase in the number of newly appointed independent directors in this AGM season.

Looking at the specific data, out of the 158 KOSPI-listed firms with KRW2+ trillion in assets, 12 firms have to replace a majority of their independent directors and audit committee members. Two others have to replace their independent directors and audit committee members entirely.

With stricter qualifications applying to the independent director of a listed firm, the doubts about the independence of the “independent” directors serving more than ten years are absolutely tackled.

Investors are advised to scrutinize the firms that are expected to undergo a significant change in their independent directors driven by the new rule, whether the new nominees have experience as a board member as well as expertise expected in an independent director.

