

A Thought on 2019 AGM Trends in Korea

Song, Hong Sun *

The 2019 AGM season was the second AGM season after the abolition of shadow voting and the first AGM season following the adoption of the Stewardship Code by the National Pension Service. This year's AGMs can be characterized by the intensified effects of the shadow voting abolition, such as a sharp rise in the number of companies that failed to pass resolutions due to the absence of a quorum, the active exercise of shareholder rights, and the potential for changes in the fundamentals of corporate governance and capital markets despite several trials and errors. Given that the lack of required quorum could be addressed by facilitating the general meetings of shareholders through participation of various types of shareholders, it would be desirable to make electronic voting and general meeting notification to individual shareholders mandatory. Moreover, as for dividend payout which stirred up controversy with respect to the exercise of shareholder rights, guidelines should be revamped from a capital policy perspective to make sure that the Stewardship Code is a soft law on long-term investment. Not only that, the NPS needs to overhaul the relationship between the stewardship committee and the investment committee from the governance perspective so as to minimize conflicts of interest in the exercise of shareholder rights and make the exercise of shareholder rights be consistent with long-term growth of pension assets.

* All opinions expressed in this paper represent the author's personal views and thus should not be interpreted as Korea Capital Market Institute's official position.

* Ph.D., Senior Research Fellow, Fund & Pension Department, Tel: 82-2-3771-0632, E-mail: dna0214@kcmi.re.kr

In Korea, general meetings of shareholders have long been nothing more than a mere formality. With low shareholder participation, general meetings (GMs) heavily influenced by controlling shareholders have been held as a corporate formality without the presence of institutional investors to keep them in check, although GMs are supposed to play a vital role in determining corporate strategy, governance and growth policy in such country as Korea where a great deal of businesses are formed and operated in corporate form. For that reason, not only lucrative Korean firms with solid underlying fundamentals but also the Korean capital markets as a whole have been underestimated for a long time. Trends emerging in the 2019 season for annual general meetings of shareholders (AGMs) show an increase in the number of small and medium-sized listed companies that could not properly conduct their business at the AGM due to the absence of required quorum amid shareholders' apathy towards the meeting. Although the adoption of the Stewardship Code by the National Pension Service (NPS) raises market expectations about better corporate governance, and increases the likelihood of changes in the fundamentals of the capital markets, it poses several challenges as the NPS tends to exercise its shareholder rights targeting large prominent companies and controversies have arisen in the course of exercising its voting power. Against this backdrop, this article examines three major issues among those emerged during the 2019 AGM season, which are considered important in the development of AGMs.

1. Which companies did face lack of a quorum?

The number of AGM agenda items that were rejected due to lack of a quorum increased markedly in 2019. Although there are no accurate statistics, more than 200 out of 1,997 listed firms ending their financial year on December 31 reportedly had at least one rejected voting item on the AGM agenda this year. A failure to pass a resolution is not all that bad if it is the result of shareholders' action to keep company management in check. According to Korea Listed Companies Association, however, 188 of the firms described above failed to obtain approval for one or more items on the AGM agenda from their shareholders due to lack of required quorum. This number is 2.5 fold greater than 76 listed firms with one or more rejected AGM agenda items in 2018. Also, it suggests that almost all rejections were attributed mainly to the absence of required quorum. It can be said that shareholder apathy rather than shareholder monitoring is common in Korean AGMs.

Then, what items did show a sharp rise in rejections? A total of 238 items on the AGM agenda

were not approved by shareholders for the 188 companies with one or more rejected AGM agenda items. Appointment of auditors (audit committee members) accounted for 62.2% (149) of the total disapproved items, amendments to a company's articles of incorporation 21.8% (52), and executive remuneration 10.1% (24). And there were 128 small and medium-sized enterprises (SMEs), taking up the majority of the 188 firms. As one would expect, 84% of the rejected items were comprised of matters regarding auditor election and changes in the articles of incorporation, which are voting items requiring a special resolution (2/3 of the shareholders present at the meeting, representing at least 1/3 of the total issued and outstanding shares). The rest were matters regarding executive remuneration which require an ordinary resolution (1/2 of the shareholders present at the meeting, representing 1/4 of the total issued and outstanding shares). The failure to pass an ordinary resolution implies that, in some cases, shareholders attending the AGM might have represented less than 1/3 of the total issued and outstanding shares.¹⁾ The concentration of SMEs reveals that the abolition of shadow voting system weighs mainly on firms whose equity ownership is not concentrated in institutional investors but dispersed among a large number of retail investors. As the firms failed to draw shareholder attention to AGMs because of the distributed ownership structure, they faced the lack of a quorum to pass resolutions. Following the abolition of shadow voting, the situation calls for new measures which enable listed firms to continuously benefit from desirable ownership structure, i.e., dispersed ownership, and help them draw the attention of individual shareholders to GMs.

Diverse policy options have already been proposed to address the quorum issue. Policy proposals include reduction of required quorum, removal of restrictions on voting rights (the "3% rule") for the appointment of auditors (audit committee members), introduction of unequal voting rights, and mandatory adoption of electronic voting. Which measure or alternative must precede is closely related to perspectives and philosophies towards the absence of a quorum. It would not be desirable to look into the issue in terms of how a required quorum can be reached. Rather, it would be advisable to approach the quorum issue from the perspective of economic democracy to ensure better corporate governance and greater shareholder participation, which is also in line

1) The absence of quorum required for a special resolution may occur when an AGM fails to obtain at least 2/3 approval by votes cast, although at least 1/3 of the total issued and outstanding shares with right to vote are present at the meeting. Or the absence of quorum required for an ordinary resolution may occur when an AGM fails to obtain at least 1/2 approval by votes cast, although at least 1/4 of the total issued and outstanding shares with right to vote are present at the meeting. Given that, more caution is necessary when interpreting data on the lack of a quorum, but there is no way to confirm the data because companies do not publicly disclose them. This calls for broadening the scope of information disclosure about voting rights.

with the original intent of the government to abolish shadow voting. Furthermore, as described above, the fact that the absence of required quorum is more pronounced in SMEs with a large proportion of retail shareholders suggests that a solution to the quorum issue should be geared towards increasing the participation of individual shareholders in GMs. In this respect, the most direct and desirable option may be the compulsory introduction of electronic voting (e-voting). The quorum levels for AGM resolutions are not especially high in Korea. In the case of Delaware, the US, an ordinary resolution requires a majority of the voting rights present at the meeting while a special resolution requires a majority of the total voting rights of the shareholders. These requirements are not a problem thanks to high shareholder attendance at GMs. In Japan, an ordinary resolution is passed by a majority of the voting rights held by shareholders present at the meeting, who represent a majority of the total voting rights of the shareholders, and a special resolution by 2/3 of the votes cast by the shareholders present at the meeting who represent a majority of the total voting rights. The proposed removal of the 3% rule for the election of auditors could not be a universal solution to tackling the quorum issue. As discussed earlier, the elimination of the 3 rule would not be enough for amendments to the articles of incorporation which constitutes over 20% of the agenda items rejected due to the lack of a quorum. In addition, granting unequal voting rights by listed firms is not highly likely because the “one share, one vote” principle is embedded in the voting guidelines of global institutional investors.

Of course, the quorum issue may not be solved immediately even if the adoption of e-voting becomes mandatory. Among those with rejected AGM agenda items in 2019, some companies already adopted e-voting. But the percentage of shareholders participating in e-voting was not high. 564 out of the 1,997 listed firms introduced e-voting, which exhibits a gradual increase in the number of the firms using e-voting for AGMs. Nevertheless, only 5% of shareholders voted electronically in 2019, which shows the very low use of e-voting by shareholders in Korea when compared to the US and the UK where 90-95% of shareholders use e-voting. Where does this difference come from? Small shareholders in Korea and other advanced countries are similarly not much interested in their voting rights. However, a big difference in the e-voting regime between the two sides is made when AGM notice is given. In the US, most firms use electronic means to give a GM notice to their shareholders although electronic notification is not compulsory. More importantly, issuers or financial services firms (nominal shareholders) are required to directly notify all shareholders, even small shareholders who have just one share, of when and where a GM will be held with the meeting agenda. In the UK where the use

of e-voting system at GMs is mandatory, the use of electronic means is also required for the delivery of GM notices to shareholders. Unlike those countries, Korea allows issuers to choose whether to use e-voting in the voting stage. To make matters worse, issuers can be exempt from the requirement to give a GM notice directly to all shareholders. Issuers are legally allowed to publish their notice for shareholder meetings in a local newspaper or on the website of either the Financial Supervisory Service (FSS) or Korea Exchange instead of directly delivering the notice to small shareholders who hold less than 1% of the total issued and outstanding shares. Perhaps, shareholders of SMEs whose AGM agenda items were not approved due to the lack of a quorum would have not known when AGMs were held and what items were put on the AGM agenda. Given that, the best policy solution to the absence of a quorum would be the mandatory use of electronic means for not only voting at GMs but also the delivery of GM notices to ensure that all the shareholders receive a notice of the meeting electronically.

2. What guidance the Stewardship Code provides with respect to dividend policy?

A big issue on the table for Hyundai Motor's AGM this year was Elliott Management's proposal on the distribution of large dividends. While Hyundai Motor proposed a dividend payment of KRW 3,000 per share, US hedge fund Elliott submitted a shareholder proposal to pay KRW 21,967 per share. This sparked controversy over the appropriate level of dividend payout. Meantime, the introduction of the Stewardship Code came under fire because of concerns that activist shareholders would pester their investee firms with demands for excessive dividend payout, thereby weakening the firms' investment base and competitiveness. The dividend payout controversy related to Hyundai Motor's AGM²⁾ provides us with the opportunity to look again at what principles or guidance the stewardship codes adopted worldwide provide with respect to dividends.

As is well known, the distribution of dividends is one of AGM agenda items that require an ordinary resolution of shareholders, alongside annual financial statements. Each year, shareholders vote to approve the dividend amount proposed by company management. Regardless of the stewardship code, therefore, companies determine whether dividends are appropriate on their own and put it to vote. Or shareholders consult with their proxy advisory firms to cast votes on the

2) Hyundai Motor's dividend proposal to pay KRW 3,000 per common share was approved by 86% of the votes cast by the shareholders present (in person or by proxy) at the AGM, corresponding to 82% of the total issued and outstanding shares.

dividend proposals. Proxy advisors use their own optimal dividend payout model to determine whether dividends are too small or too large, and issue recommendations on how to vote on the proposed dividend amount. For reference, Korea Corporate Governance Service unveiled that after analyzing the proposed dividends of 300 listed firms in 2019 AGMs according to its voting guidelines, it issued negative vote recommendations for 21 (6.8%) of 307 dividend proposals submitted by company management because of extremely low dividend payout ratios.

Apart from the exercise of voting rights on dividend distribution,³⁾ informal shareholder engagement, such as correspondence and dialogue about the appropriateness of dividends (dividend policy) paid by an investee firm, and formal shareholder proposals⁴⁾ are classified as the active exercise of shareholder rights (voting rights) when compared to the passive exercise of shareholder rights (voting rights). Then, how are dividends described in stewardship codes? The term, “dividends” cannot be found in the codes. The same is true of stewardship codes in the UK and Japan as well as Korea. This does not mean that stewardship codes are unconcerned about dividends. We can infer from the following two trends that stewardship codes take cautious stance towards dividends. One trend is caution against the distribution of excessive dividends caused by shareholder short-termism, which was raised by the Walker Report. This report is a monumental work that sheds light on the causes and remedies of a financial crisis, and paved the way for the birth of the UK’s Stewardship Code.⁵⁾ As regards dividends, the Walker Report pointed to executive bonus, treasury stock, and dividends as short-term elements that hinder long-term investment when blaming “quarterly capitalism,” i.e., short-termism of institutional investors that led to a financial crisis. The stewardship code is a new investment philosophy that emerged in the wake of the financial crisis, aiming to overcome short-termism and to seek long-term value and long-term returns through constructive dialogues with companies.

Dividends and stock buybacks, of course, are short-term strategies of investors, but, following the financial crisis, heated empirical debates have been continuing among academics about whether dividends or stock buybacks erode a company’s investment base and performance in the long run. One side argues that quarterly capitalism impedes corporate investments and

3) The UK Stewardship Code clearly states that stewardship is more than just voting, and stewardship activities include monitoring and engaging with companies.

4) The FSCMA considers a proposal on dividend amount or dividend policy made by a shareholder who owns 5% or more of a company’s shares (except for the National Pension Service) as shareholder involvement in company management.

5) The Walker review secretariat, 2009, *A review of corporate governance in UK banks and other financial industry entities; Final recommendations*.

innovations (Lipton, Lazonick, Stulz, Brookings Institution, etc.). The other side insists that short-termism, especially hedge fund activism at the center of criticism, has a positive effect on ecosystems in capital markets, and the above argument is exaggerated (Bebchuk, Gilson, Roe, Fried, etc.).⁶⁾ In the empirical debates, dividends together with share repurchases symbolize investment seeking short-term profits.

In this context, stewardship codes state the need for monitoring the capital policies of investee companies and shareholder engagement rather than dividends. Capital policy, aimed to increase capital efficiency, are more consistent with the spirit of the stewardship code than with dividend policy for payouts to shareholders in a narrow sense, when it comes to a tool to improve a company's long-term value. In practice, Japan's Government Pension Investment Fund (GPIF), and the US's CalPERS (California Public Employees' Retirement System) set capital policy as one of major issues for engagement. Japan's Stewardship Code explicitly describes long-term corporate value and capital efficiency as the purposes of its introduction. The UK's Stewardship Code also explicitly lists capital structure as one of matters on which institutional investors need to monitor and engage with companies. Meanwhile, Korea's Stewardship Code lists corporate governance and corporate strategy as matters on which shareholders need to monitor and engage with companies, but does not specify capital policy among them. Here, CalPERS defines capital policy as a 'company's policy on capital allocation that outlines the application of discretionary cash flows for organic growth projects, investments, mergers and acquisitions, debt repayment, dividends and share repurchases.' From a capital efficiency perspective, capital policy means monitoring the appropriateness of capital policy. In this sense, controversy over whether Korean companies hold excessive cash stockpiles should be an important matter on which institutional investors need to engage with companies. In practice, CalPERS requests investee firms to disclose their capital policies. Capital policy is one of key indicators that the US public pension fund monitors with regard to underperforming firms. In its guidelines, Japan's GPIF describes capital policy as a factor that has a material impact on the interests of shareholders and requires investee firms to explain their basic capital structure policies. In this way, Korea's Stewardship Code needs to reflect the importance of capital policy in line with its intended purpose to enhance investee firms' long-term investment and long-term value, in order to reduce unnecessary controversy about dividends and serve as guidance for

6) For further discussion, see Fried, J., Wang, C., 2017, 1. 12, Short-Termism and Shareholder Payouts: Getting Corporate Capital Flows Right, Harvard Law School forum on Corporate Governance and Financial Regulation.

monitoring and engaging with companies on cash flows, dividends, debt structure and so on in terms of capital efficiency.

3. Is the role of the stewardship committee desirable from the governance perspective?

The most controversial at the 2019 AGMs was the stewardship committee of the NPS. The stewardship committee, which is a sub-committee of the NPS Fund Management Committee, is an extended version of the former special committee for the exercise of voting rights to cover the exercise of shareholder rights and environmental, social and governance (ESG) policy. A notable change is the transfer of the authority to make decisions about the exercise of voting rights on individual agenda items from the investment committee of the NPS Investment Management (NPSIM) to the stewardship committee. The stewardship committee is tasked with making decisions on not only thorny issues that are difficult to deal with by the investment committee but also any issue raised by at least three stewardship committee members, publication of an open letter and other matters. The shift in the decision-making structure is due mainly to the independence of the investment committee within the NPSIM. The underlying view is that the investment committee cannot exercise voting powers autonomously and independently unless the independent governance structure of the NPS is not in place. From an investment perspective, the investment committee had sufficient expertise to exercise voting rights but lacked independence to do so.

This year's AGMs seem to reveal that the stewardship committee is more problematic than the previous decision-making mechanism of the NPS. First of all, the stewardship committee runs counter to the basic design principle of the governance that separates implementation from policy making. As the subcommittee of the Fund Management Committee (equivalent to a corporation's board of directors), the stewardship committee is mandated to create stewardship policies, which are guidelines for the implementing body, and to oversee whether the decisions of the implementing body are consistent with the policies. As such, if the policy-making committee for the exercise of shareholder rights has the authority to decide on the exercise of shareholder rights on individual AGM agenda items, the stewardship policies (implementation guidelines) could be affected by individual voting cases, making conflicts of interest difficult to avoid. The Fund Management Committee should not intervene in individual investments for which the NPSIM is responsible. The same goes for the stewardship committee. Second, if the



decision-making structure in which the exercise of shareholder rights on individual agenda items is determined by the stewardship committee is entrenched further in the NPS, voting decisions on individual AGM agenda items are highly likely to be based on political reasons rather than the logic of the trustee's fiduciary duty for long-term growth of pension assets. That is because the stewardship committee aims to represent the needs and views of corporates, workers and the government and reflect their professionalism. The 2019 AGMs confirmed the fact that stewardship committee members made use of their professionalism to serve the interests of their representative group.

Let's turn to other countries and look at CalPERS as an example. CalPERS strictly separates policy making and policy implementation with respect to the exercise of shareholder rights. The Investment Committee is responsible for establishing policies on shareholder rights and ESG guidelines while the implementing body is responsible for exercising shareholder rights including voting rights. Consistent with the voting guidelines, the implementing body must vote "for" or "against" individual management and shareholder proposals, or abstain from voting, and report the voting results to the Investment Committee of the Board of Directors on a periodic basis. Where a particular voting item related to shareholder rights is not covered by the guidelines set forth by the Investment Committee, the implementing body must obtain approval from the Investment Committee. Meantime, the implementing body uses the relevant working group committee to make a voting decision. For example, when a proxy contest for a director election occurs, CalPERS usually has meetings with a director candidate nominated by dissent shareholders, dissent shareholders, and company management, respectively, and holds a working-level meeting attended by the stock investment team, responsible investment team, private fund team, bond investment team, legal team, and IR team to determine whether it is consistent with the CalPERS investment philosophy and guidelines. Then, it makes a final voting decision at a meeting in which its chief information officer (CIO), chief operating investment officer (COIO), stock investment officer and sustainability officer participate. The CalPERS case clearly shows that staff at the implementing body who participate in the markets as part of their daily operations and are able to make professional decisions play a central role in determining whether the direction for the exercise of a certain shareholder right is consistent with the long-term growth of pension assets from the investment perspective and the relevant guidelines. Only if the exercise of shareholder rights is connected with the compensation structure depending on the staff's professionalism and investment performance, the stewardship code

could develop based on the economic logic from the perspective of pension participants.

It seems necessary to adjust the powers of the current stewardship committee to ensure that the NPS exercises its shareholder rights in the sustainable decision-making structure for pension asset growth. The stewardship committee's intervention in individual voting items should be reduced in order to separate policy implementation from policy making under the governance principles. It would not be easy for the committee striving for good representation to make judgments on individual voting items from the perspective of pension asset growth. Furthermore, even if the structure of the NPS Fund Management Committee is reformed to embrace greater professionalism, it would not be desirable for the stewardship committee, which belongs to the Fund Management Committee, to make voting decisions on individual AGM agenda items. Which direction is in line with pension asset growth from the investment perspective can be best determined by the implementing body well designed with professionalism, accountability and rewards system. The well-designed performance compensation system in particular could be the most effective incentive to increase the autonomy and independence of the implementing body. Instead, the stewardship committee needs to make the decisions of the implementing body free of political controversies by providing clear and specific guidelines for the exercise of shareholder rights.