

PLAN TO IMPROVE CORPORATE GOVERNANCE OF FINANCIAL COMPANIES AND RELEVANT REGULATIONS

The FSC announced its plan to amend the Act on Corporate Governance of Financial Companies and its subordinate regulations, aimed to address problems found in the actual practice of implementing corporate governance rules by financial companies.

Background

Corporate governance of financial companies calls for greater scrutiny than that of non-financial companies because financial companies run their businesses with the people's money; and their management failures could impact the national economy as a whole.

After the global financial crisis, international organizations including OECD, FSB and G20 have made proposals to improve corporate governance of financial companies.

Korea has also made progress in financial companies' corporate governance. In the wake of the Asian financial crisis in 1997, financial companies adopted outside directors and an audit committee within their board to keep the management in check. After the global financial crisis in 2008, best practice guidelines on outside directors and compensations schemes were established. All these efforts paved the way for the enactment of the Act on Corporate Governance of Financial Companies in July 2015, which came into force in August 2016.

Despite these improvements, corporate governance of financial companies in practice still falls short of expectations of shareholders and financial consumers in ensuring transparency and accountability.

The management often exerts undue influence on nomination of its chief executive officer (CEO) and outside directors, undermining independence and fairness in the nomination process. Such practice hinders outside directors from holding the management in check and making independent decisions.

The current fit-and-proper test for majority shareholders also has more room to improve. The Act on Corporate Governance of Financial Companies introduced a periodic test into non-banking financial companies to assess their largest shareholders' fitness and propriety; however, the fit-and-proper test is currently limited to a person who made the biggest investment, out of largest shareholders, regardless of actual influence on the company's management matters.

Key Changes

Against this backdrop, the FSC plans to strengthen corporate governance rules for financial companies, with focus on the following four areas:

1. Fitness and propriety of major shareholders

The FSC will tighten the fit-and-proper test for largest shareholders of a financial company to verify whether those actually controlling the company are eligible to own a financial company.

The scope of shareholders subject to the test, currently limited to the single largest investor, will be widened to include all largest shareholders and major shareholders with actual influence over the financial company's management.

Those sentenced to imprisonment or heavier punishment for violating the Act on the Aggravated Punishment, etc. of Specific Economic Crimes will be disqualified as major shareholders.

2. Transparency in CEO nomination

To enhance transparency in the nomination of its CEO by a financial company, it will be required to strengthen its criteria and procedure for screening candidates, evaluate a pool of CEO candidates on a periodic basis, and report the results to shareholders.

To encourage minor shareholders' participation in nominating its CEO and directors, the threshold that allows minor shareholders to exercise their voting rights will be eased.¹

To ensure the role of outside directors, the incumbent CEO will be banned from joining an internal committee to recommend candidates for outside directors. If an outside director is to serve consecutive terms, an external evaluation on the nominee must be conducted.

To give outside directors more independence and stronger responsibility, financial companies will be asked to include those recommended by various stakeholders such as financial consumers, minor shareholders and external experts into their pool of candidates for outside directors.

3. Effectiveness in compliance and internal controls

Full-time auditors and audit committee members will be restricted from serving for more than a certain period of time - e.g. six years - at the same company.

¹ For a listed financial company with a capital of KRW100 billion or more, minor shareholders who hold at least 0.1% of voting shares or whose shares exceeds KRW100 million in face value will be allowed to exercise their voting rights. Currently, rights to vote on nominations by minor shareholders are allowed only for those who own more than 0.1% of voting shares.

To make sure audit committee members concentrate on their duty, they will be prohibited from holding concurrent positions in any sub-committee within the board of directors.

To strengthen internal controls and compliance with risk management, financial companies' executives and employees including CEO, compliance officer and risk management officer will be held accountable for poor compliance.

5. Public disclosure of remuneration schemes

Financial companies' remuneration schemes will come under greater scrutiny by shareholders and financial consumers to prove whether their executives and employees deliver performance and values that correspond to their remuneration.

Financial companies will be required to disclose remuneration of executives and employees that exceed certain thresholds.² Modelled on the 'say-on-pay' policies in the U.S. and the U.K., financial companies must report their compensation schemes for registered executives to a shareholders' meeting at least once a year.

Timetable

The FSC will submit its proposal for amendments to the Act on Corporate Governance of Financial Companies to the National Assembly within the first half of 2018.

#

For any inquiry, please contact Foreign Press & Relations Team at fsc_media@korea.kr

² e.g. (i) executive pay that exceeds KRW500 million in total; and executives and employees whose pay makes top 5 and exceeds KRW500 million; and (ii) executives and specific employees whose contingent payments exceeds KRW200 million