

20 December 2024

To : Members of the National Assembly of Korea

Re: Issues Regarding the Commercial Law Amendment

Dear Members of the National Assembly of Korea,

We are writing on behalf of the institutional investor members of the Korea Working Group of the Asian Corporate Governance Association (ACGA), a membership-based corporate governance research and advocacy organisation based in Hong Kong with over 100 members globally that together have assets under management of over US\$40 trillion. Representing longstanding capital market investor members, we firmly believe that robust laws and a regulatory framework including effective implementation and enforcement constitute the backbone of good governance crucial to the long-term success and economic value of companies and vibrancy of the market. With this in mind, we wish to share our concerns in relation to the delayed process of the Commercial Law amendment.

The National Assembly and financial regulators of Korea have made substantial efforts to enhance the standards of corporate governance regulations/rules to be on a par with those of other markets. Nonetheless, such efforts as yet appear to have failed to bring significant fundamental changes in observed governance practices of major companies and the treatment of minority shareholders. Repeated value-destroying governance breaches including group restructuring, mergers and acquisitions (M&A), misuse of treasury shares, appear often to be designed primarily benefit incumbent management and/or controlling families and have been to the detriment of minority shareholders.

Our members, as long-time investors in Korea, have over decades found various corporate practices disappointing and generally come to the conclusion that there needs to be a clearer understanding of the role of directors. In this regard, the current provision of Article 382-3 of the Commercial Law stipulating that 'directors' duties of loyalty' shall be performed for the interest of the company and is not explicit to include fiduciary duty to all shareholders is a concern. The board and all directors need to address this issue and practices that have become part of the norms unfortunately associated with Korea Inc, in particular: 1) out-sized power exercised by founding families even when their shareholding size might be relatively small; 2) disproportionate decision-making authority given to corporate boards that often appear to be not independent of the company and its founding families / management; 3) limited authority provided to shareholders with respect to agenda items that require shareholder approval; and thus 4) lack of effective measures for minority shareholders to hold management and the board accountable. As a result of (4) the alternative left to investors is often divestment which leads to suppressed valuations affecting the market generally.

The board of directors plays a critical role in holding management accountable and providing essential checks and balances. To enhance this function, it is crucial to have an effective and independent board that understands its responsibilities and commitment to all shareholders. Amending the Commercial Law as proposed to explicitly include a duty of loyalty to all shareholders is a significant step to guide independent directors, particularly in decisions where controlling and minority shareholder interests may diverge. Thus we also support renaming "Outside Directors" as "Independent Directors" to better reflect their responsibilities and promote accountability. Additionally, increasing the required number of independent directors on boards can strengthen their influence and ensure more effective management oversight.

The Korean market is at a crossroad: it could advance market and corporate norms or alternatively continue with out-dated practices. Persistent corporate governance issues over the years have manifested the ‘Korea Discount’ that remains unaddressed, preventing meaningful recovery in the market value of major Korean companies. This is reflected in Korea’s weight in the MSCI Emerging Markets Index which has fallen below 10%: a symbolic level to maintain significance of the market for global institutional investors. Korea’s MSCI EM Index weight fell from 16.1% in 2014 now to 9.1% at time of writing. Any further decline would diminish the perception of Korea as a dynamic, innovative market. To address this, we are in favour of the amendments to the Commercial Law for directors’ responsibilities not just to the company but to all shareholders be explicit and for stronger and more effective boards to deliver shareholder value. As this bill is now with the legislature, we urge the National Assembly of Korea to take decisive action to amend the relevant articles of the Commercial Law (382-3) which would be an important step for Korea Inc to regain confidence of international investors.

MSCI EM Index Weight - 10 years												
(%)	10/12/2013	10/12/2014	10/12/2015	10/12/2016	10/12/2017	10/12/2018	10/12/2019	10/12/2020	10/12/2021	10/12/2022	10/12/2023	10/12/2024
China	16.5	18.6	23.0	23.8	26.2	27.1	31.2	35.6	29.8	29.2	23.6	25.1
India	6.3	7.2	8.7	8.3	8.8	9.4	8.6	9.3	12.5	14.4	16.7	19.8
Taiwan	11.7	12.6	12.1	12.2	11.3	11.4	11.7	12.7	15.8	13.7	15.9	19.2
Korea	16.1	14.7	15.6	14.4	15.4	13.8	11.7	13.5	12.8	11.3	13.0	9.1
Brazil	10.7	8.9	5.5	7.7	6.8	7.5	7.5	5.1	4.0	5.3	5.8	4.4
Rest of EM	38.6	38.1	35.2	33.6	31.6	30.9	29.3	24.0	25.2	26.1	25.0	22.5

Source: Bloomberg

We appreciate having the opportunity to provide our views and would welcome a follow-up meeting or call to discuss our proposal in the near future. Please contact Yoo-Kyung (YK) Park at APG (yk.park@apg-am.hk or 852-3769 0339) or Amar Gill at ACGA (amar@acga-asia.org or 852-2160 1788) for any queries or to advance this discussion. Thank you.

Yours sincerely,

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