

# 2019 AGM Review

## Institutional investors' shareholder engagement and implications

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- ▶ Backed by the implementation of the stewardship code and the emergence of activist funds, institutional investors are actively engaging with investee firms.
- ▶ For shareholder engagement, institutional investors employ diverse channels including letters, shareholder proposals, and a proxy fight. These engagement activities are expected to increase in the coming months and years.
- ▶ The shareholder engagement waged by Elliot this proxy season and Hyundai Motor Group's response showed a desirable direction of constructive shareholder engagement.
- ▶ Constructive shareholder engagements, if they continue, will contribute to the development of the local capital markets. In this light, ongoing constructive shareholder engagements should be encouraged.

In the run-up to the 2019 annual general meeting season, the Korea Corporate Governance ("KCGS") Service issued a preview of the 2019 annual general meetings on February 12, 2019. In the report, the agency expected that institutional investors' stewardship activities and the emergence of local shareholder activist funds would lead to a wide range of shareholder engagements.<sup>1)2)</sup>

Behind the 2019 annual general meeting season, KCGS intends to look at different types of shareholder engagements that occurred over the one-year period leading to the 2019 AGM season. It will then provide case studies by each type to help the understanding of the changes the engagement activities brought about in the capital markets.

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1) Shareholder engagement refers to a variety of activities involved by companies and shareholders in the form of private dialogue, letter, shareholder proposal, and proxy fight to name a few.

2) For more details on shareholder engagement, please see 『A practical guide to active ownership in listed equity』 (UN PRI) and 『Recent trends of shareholder engagement and implications on the Korea Stewardship Code』 (Ahn, Soo Hyun, 2018)

### Shareholder letter – increasing communication with companies

As of March 2019, 94 institutional investors have signed up for the Korea Stewardship Code and, between April 2018 and March 2019, five of them sent an open letter to the firms they have ownership. Below is the list:

#### Institutional Investors' Open Letters to Firms<sup>3)</sup>

Institutional Investors	Investee Firms
KB Asset Management	GolfZone, Gwangju Shinsegae Department Store, NEXT EYE, Hyosung T&C
Korea Investment Value Asset Management	KISCO Holdings, NEXEN, Sebang, Youngone Holdings
Mirae Asset Global Investments	Qorient, Pan-Pacific
Merits Asset Management	SK Materials, Ostem Implant
National Pension Service	Korean Air

Investors wrote about a variety of issues faced by investee firms as well as the need for a higher shareholder return, and some of the firms responded in an active manner. The examples include the following:

- Merits Asset Management sent a letter to SK Materials to inquire about the company's plan to prevent the reoccurrence of the toxic gas leakage accident and how to compensate for the victimized community.<sup>4)</sup>
- Mirae Asset Global Investments sent a letter to Qorient asking for a detailed explanation of the capital increase through third-party allocation. It also wrote to Pan-Pacific proposing a governance improvement plan.<sup>5)</sup> In turn, the two firms sent back a response letter and explained the situation they are facing and so on.<sup>6)</sup>
- KB Asset Management wrote to Golf Zone asking for the reduction of the company's brand royalty rate and the Inter Group Service(IGS) fee as well as higher dividend payout. In response, the company disclosed a plan to reduce the brand royalty rate and cut the IGS fee drastically alongside the policy on year-end dividends.<sup>7)</sup>

3) The list only includes the firms who received a letter from an institutional investor and the content of the letter has been disclosed.

4) Annual Report on Fiduciary Responsibility published in January 2019 by Merits Asset Management

5) [shareholder engagement] 『Qorient's decision to increase capital with consideration (third-party allocation)』, September 10, 2018, Mirae Asset Global Investments; [shareholder engagement] 『Request for an increased enterprise value of Pan-Pacific』, January 28, 2019, Mirae Asset Global Investments

6) [shareholder engagement\_response letter] 『Qorient's decision to increase capital with consideration (third-party allocation)』, September 13, 2018, Mirae Asset Global Investments; [shareholder engagement\_response letter] Request for an increased enterprise value of Pan-Pacific』, February 20, 2019, Mirae Asset Global Investments

7) Response: Golf Zone (Response on royalty and IGS fee reduction request), February 15, 2019, KB Asset

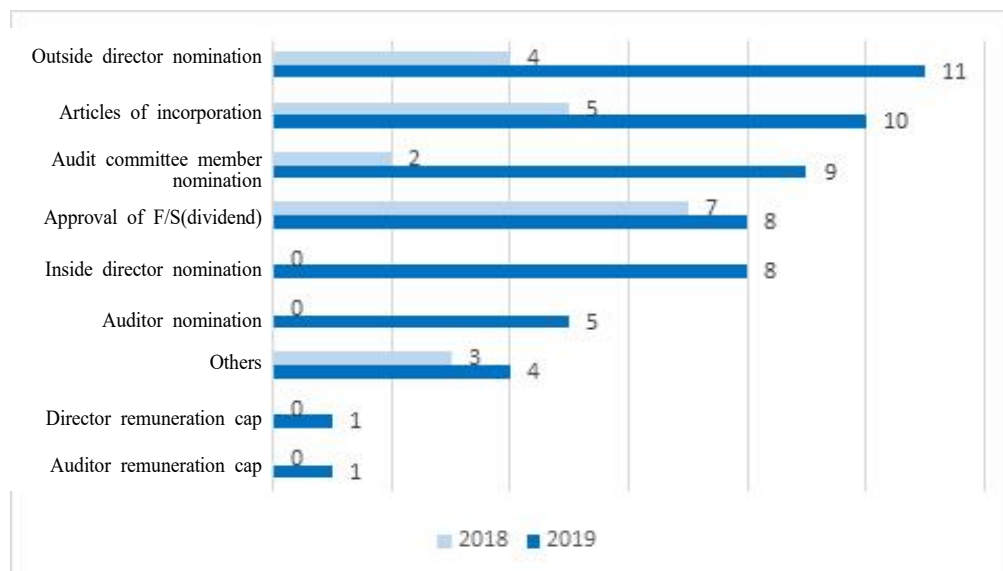
A shareholder letter is an active shareholder engagement channel that an investor turns to when private engagement fails. In this sense, the increase in the shareholder letters testifies that domestic institutional investors began to engage with their investee companies in a more active manner.

### Shareholder proposals of a wider scope

Of the KOSPI-listed firms, 17 firms received a total of 57 shareholder proposals this proxy season. Both numbers jumped big compared to the figures from last year (9 firms and 21 proposals).<sup>8)</sup>

The scope has also widened. In the past, most of the shareholder proposals asked for a higher dividend. This year, the proposals of nominating outside directors took the largest share. It is also noteworthy that there were eight shareholder proposals of nominating inside directors against three firms.<sup>9)</sup>

# of shareholder proposals by theme: 2018 vs. 2019



An increase in the number of shareholder proposals and the diverse themes taken by the proposals have to do with more institutional investors submitting proposals. Last year, only two institutional investors APG and Value Partners Asset Management (“Value Partners”) submitted shareholder proposals. This AGM season, six

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8) The figures also include the proposals withdrawn before AGM.

9) SAEHWA IMC, Hansol Holdings, and Savezone I&C received shareholder proposals of nominating inside directors.

institutional investors including the NPS and Value Partners filed 35 shareholder proposals,<sup>10)</sup> which took up 61.4% of the total shareholder proposals. The concentration happened because the institutional investors filed multiple proposals with an investee firm or a proposal of the same content with multiple investee firms. Except for the NPS, all the institutional investors who submitted shareholder proposals are private equity funds or foreign investors.

### **Proposed Amendments to Financial Investment Services and Capital Markets Act**

Type	Before		After
	Hedge Funds	Private Equity Funds	No distinction
Ownership requirement	N/A	Ownership of 10%+ shares with voting rights	Requirement to be lifted
Voting rights restriction <sup>*1</sup>	Voting rights restricted on the ownership exceeding 10% of the holding	N/A	Restriction to be lifted

\*1: The voting rights restriction continues to apply to the private equity funds that are affiliated with the business group regulated for circular ownership.

If the proposed amendment to the Financial Investment Services and Capital Markets Act aimed at deregulating the private equity fund market<sup>11)</sup> passes through the National Assembly, the entry barrier to the PEF market will get lowered and it will consequently lead to increased shareholder proposals by institutional investors.

When the proposed amendment is approved, PEFs will be categorized under investors and the existing categorization depending on the participation in the management of the investee company will disappear. The ownership requirement and the voting rights restriction shall also be lifted. This means that institutional investors will be able to operate a private equity fund and participate in the management of the invested firms with less investment fund than now.

### **Proxy statements that fit for purpose.**

This AGM season, alongside shareholder proposals, the number of proxy statements filed by the companies and shareholders also jumped. KCGS reviewed the KOSPI-listed companies for their proxy statement filing for this AGM season. 411 companies filed proxy statements showing a modest increase from 337 companies last

10) Value Partners Asset Management, NPS, KCGI, SC Asian Opportunity Fund, L.P., HoldCo Opportunities Fund II, L.P., and Elliot Management

11) Amendment to Financial Investment Services and Capital Markets Act proposed by BW Kim and 14 others, November 2, 2018

year. Shareholders also filed 19 proxy statements, up from 7 last year, and 13 of them were submitted for the approval of their shareholder proposals.

It is noteworthy that shareholders submitted some of the proxy statements to recommend adverse voting against the board proposals even when they did not file a shareholder proposal. For example, although Value Partners and Dalton Investment LLC filed proxy statements concerning Hyundai Home Shopping to recommend an adverse vote against all the proposals except for the one to amend articles of incorporation, they had not filed a shareholder proposal. As for Korean Air, several minor shareholders such as People's Solidarity for Participatory Democracy and MINBYUN-Lawyers for a Democratic Society filed a proxy statement to recommend a negative vote against the proposals made by the company's board of directors.

Meanwhile, an increasing number of listed firms provided a detailed reason why they solicited proxy voting. This was positively received in the market because it helps shareholders make informed voting decisions. Until the last AGM season, listed companies gave a boilerplate comment as the reason for their proxy solicitation - 'for securing the AGM quorum' - regardless of the existence of shareholder proposals. This proxy season, however, of the companies who received shareholder proposals, four companies<sup>12)</sup> provided a detailed explanation about why their proposals were more rational than the shareholder proposals. Moreover, two companies<sup>13)</sup> presented the reasons why they solicited proxy votes even when they did not receive any shareholder proposal or get involved in a proxy fight situation.

Building on these positive changes, both companies and shareholders should make continued efforts to turn the proxy statements into a means that enables informed voting decisions for the betterment of the company, not a means simply aimed at securing a necessary quorum.

### **A head-on proxy fight between activist investor vs. listed firm - Hyundai Motors**

Elliot Management ("Elliot") sent a shareholder proposal to Hyundai Motors and Hyundai Mobis respectively and engaged in a proxy fight. The shareholder proposals

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12) Hansol Holdings, Hyundai Motors, Hyundai Mobis, and Hanjin Kal

13) Shinil Industrial and Daeho AI.

included the items on the financial statements(dividends), amendment of articles of incorporation, and appointment of outside directors and audit committee members.

Until the date of the annual general meeting of the companies, Elliot engaged in a variety of activities in order to persuade other shareholders. Specifically, before making a proposal on the financial statements and dividends, Elliot presented specific figures quoted from an external report<sup>14)</sup> to raise issues with the capital structure and the cash flow allocation of the two companies.

Moreover, Elliot nominated outside director and audit committee member candidates who share a direct interest with it, and this raised confidence in the candidates with the other investors. Also by showcasing through in-writing and video materials how each candidate can contribute to an increased enterprise value of Hyundai Motors or Hyundai Mobis, it provided far more information to investors.<sup>15)</sup>

In response to these shareholder proposals, Hyundai Motors and Hyundai Mobis made diverse efforts to pass through their own proposals. Both companies accepted Elliot's request to amend the articles of incorporation and stipulate the board committees it suggested. This action was received positively by the market because the companies made changes in their governance structure in line with shareholders' request.

With regards to the capital structure issue raised by Elliot, the two firms provided specific details on why they needed a certain level of liquidity by explaining their financial conditions and providing a comparison with industry peers. They also tried to persuade their shareholders against Elliot's dividend proposal by disclosing a long-term shareholder return policy.

As for the outside director and audit committee member nominees, the two companies did not simply oppose the candidates nominated by Elliot. They acknowledged the diversity that may be provided by Elliot's nominees. Yet they tried to persuade the shareholders that their nominations are better choices when it comes to increasing firm value.

In the end, all the shareholder proposals were voted down, except for the one to

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14) Hyundai Motor Group Analysis – Investigation Results Summary, Oct. 29, 2018, Conway Mackenzie

15) Information for shareholders - Candidates, <https://www.acceleratehyundai.com>

stipulate the establishment of the compensation committee and the related-party transaction committee in the articles of incorporation. Nonetheless, the annual general meetings of Hyundai Motors and Hyundai Mobis showcased constructive general meetings of shareholders. Both the companies and Elliot staged diverse forms of shareholder engagement and provided abundant information to support shareholders' informed decision-making.

## **Implications**

A review of the shareholder engagement activities carried out between Q2 2018 through Q1 2019, institutional investors increasingly engaged with the invested firms after their adoption of the stewardship code. As a result, institutional investors will be able to get rid of the stigma of being a rubber stamp.

The institutional investors who joined the stewardship code increased communication with the investee firms by sending letters. Those who operate private equity funds tended to engage in proxy fights through shareholder proposals and proxy statements. In line with these trends, companies also made a faithful response to the shareholder letters and tried to persuade their shareholders based on a rational alternative.

These constructive shareholder engagements should be strongly encouraged because they increase communication between shareholders and firms and bring about positive changes at the companies. The ongoing efforts to amend the capital markets law and the increasing adoption of the stewardship code in the coming months and years will create a market environment that is more conducive to active shareholder engagement and will take the capital markets to the next level.

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