March 08, 2016

New Legislation Will Mandate Strengthened Corporate Governance Standards on Financial Companies

The long-awaited legislation, the Act on the Corporate Governance of Financial Companies (the "Act") will finally come into effect on 1 August 2016 after its promulgation on 31 July 2015. As its title suggests, the Act was introduced in an effort to improve and strengthen the current financial corporate governance regime and provide for uniform and systematic standards for the corporate governance of financial companies in Korea. Whilst the Enforcement Decree of the Act which outlines the specifics as to how the Act will apply is yet to be announced, financial companies should take time to review their policies and compliance programs to ensure they are adequate in responding to the new requirements mandated under the Act. The Act contains the following key measures.

1. Applicability of the Act

The Act introduces new corporate governance standards that must be satisfied by all Korean financial companies. However, domestic branches of foreign financial companies will only be affected by selected provisions relating to executive qualification and reporting requirements, internal control and risk management, and sanction enforcement procedures. The Act also contains waivers of certain requirements with respect to various financial companies considering their main business and size of assets and they will be specified in the Presidential Decree of the Act.

2. Largest Shareholder Eligibility Tests

Whereas only banks and savings banks were required to conduct periodic largest shareholder eligibility tests under the current Banking Act and Mutual Savings Banks Act, the largest shareholders of all non-banking financial companies (e.g., securities companies, insurance companies, credit card companies, asset management companies, funds, etc.) will now be required to conduct such tests under the Act.

This means that the largest shareholders of non-bank financial companies must be in compliance with certain provisions under the financial regulations as well as the Punishment of Tax Evaders Act and the Monopoly Regulation and Fair Trade Act as failure to meet the test requirements could subject them to various penalties including corrective measures by the Financial Services Commission, voting restrictions, etc., the specific details of which will be announced by the Enforcement Decree of the Act.

As non-bank financial companies will be subject to periodic largest shareholder eligibility tests for the first time under the Act, it is anticipated that these tests will cause substantial confusion and burden to such financial companies.

3. Strengthening of Board Rights and Outside Directors Driven Board

The Act will expressly list out matters to be subject to resolutions of boards of directors of financial companies. These matters include an approval of a CEO succession plan, corporate governance policy making, management targets and evaluations, and appointment of key management positions such as a CFO or a CRO.

Further, the Act now makes it mandatory for financial companies to establish an executive candidate recommendation committee, an audit committee and a remuneration committee. This marks a shift towards the bolstering of deliberative functions of the financial companies' boards of directors as establishment of such committees was merely recommended, not mandated, under the current Model Code of Financial Corporate Governance which lacks the capacity to enforce such recommendations.

The Act also promotes greater management independence by requiring (a) the board to comprise of three or more outside directors, (b) a majority of the board members to be outside directors, and (c) chairperson of the board to be an outside director (with certain exceptions).

4. Strengthening of Executive Responsibilities

Under the Act, those with actual management control over a financial company's affairs (e.g., presidents, honorary presidents, vice-presidents, etc.) will be subject to the identical eligibility requirements which apply only to the executives of financial companies under the current regime. Depending on the circumstances, a breach of these requirements may lead the relevant person to be subject to certain management restrictions. The Act also obliges the financial companies to publicly disclose appointment and removal of executives.

5. Strengthening of Internal Corporate Governance Standards

Under the Act, financial companies must establish internal corporate governance standards on matters relating to composition and operation of the board, board committee, executive performance review, CEO succession, etc., and publicly disclose their establishment and amendments on their webpages.

6. Remunerations

Financial companies must also establish a remuneration committee under the Act to determine the amount and payment method of the remuneration of their executives and employees, and publicly disclose the remuneration of its key executives. Further, the Act requires a certain portion of the remuneration to be based on performance subject to such performance payment being paid in deferred installments to discourage executives and employees from making risky short-term investments.

The Act imposes obligations that financial companies (especially non-banking financial companies) should carefully consider and begin making provisions for before it comes into effect. Once the Enforcement Decree of the Act is announced, both domestic financial companies and foreign financial companies with domestic branches would be prudent to seek legal advice to ensure standards are in place to comply with the new requirements under the Act.

Should you have any questions regarding any of the foregoing, please feel free to contact us.

- Michael Chang, Senior Foreign Attorney TEL : +82 2 316 4653 E-Mail: mchang@shinkim.com
- Tae-Yong Seo, Partner TEL : +82 2 316 4096 E-Mail: tyseo@shinkim.com
- Bom Sok Baek, Associate TEL : +82 2 316 1624 E-Mail: bsbaek@shinkim.com
- Mikkeli Han, Foreign Attorney TEL : +82 2 316 4685 E-Mail: mhan@shinkim.com