



Korea Corporate Governance Service Proposes Revision to the ESG Model Standards

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Recognizing the increasing importance of ESG factors to evaluate companies and countries on how far advanced they are with sustainability, the Korea Corporate Governance Service (KCGS) proposed a revision to the ESG model standards (“Proposed Model Standards”). This reflects the trends in the domestic and foreign markets and in the changing business environment. On March 10, 2021, the KCGS made its Proposed Model Standards public.

This is the first of three newsletters, in which we introduce the key changes and their implications to businesses for each ESG factor under the Proposed Model Standards (environmental, corporate governance, and social).

Key Environmental Factor-related Changes

1. New guidelines on how to identify and manage environmental risks and opportunities have been recommended.

- Consider and reflect various environmental risks and opportunities in establishing the company’s management strategy (recommendation).

Unlike the existing Model Standards, which focuses on prevention of environmental risks (requiring introduction of preventive management system and post-accident control system), the Proposed Model Standards emphasize the importance of how to identify environmental opportunities, and how to establish a management strategy in light of such opportunities.

Specifically, the Proposed Model Standards require companies to consider, among others, the following: (i) how to improve resource efficiency; (ii) switch to low-carbon energy; (iii) develop eco-friendly products and services; (iv) establish a sustainable distribution chain; (v) raise capital through green bonds; and (vi) make investments based on careful consideration of non-financial environmental risks, or obtain environmental insurance. Such factors should then be reflected in establishing a company’s management strategy.

- Consider introducing a system for identifying, assessing, and managing environmental risks and opportunities, and using the assessment results as one of the decision-making factors in formulating an overall management strategy (recommendation).

The Proposed Model Standards treat general environmental risks and climate change risks separately.

As for general environmental risks, the Proposed Model Standards recommend that companies introduce a system for identifying and assessing risks and opportunities, and then based on such assessment, to establish a management strategy, taking into account the assessment results as one of the decision-making factors.

Regarding climate change-related environmental risks, the Proposed Model Standards recommend that companies reassess stranded assets, develop renewable energy for low carbon transition, and develop eco-friendly technology and financial products. Based on the reassessment results, a new management strategy that considers climate change risks should then be established.

- A regular monitoring system should be introduced.

The Proposed Model Standards also recommend that companies introduce a regular monitoring system using the PDCA (Plan-Do-Check-Act) process, and to establish mid-to long-term environmental goals based on the information and results gathered from the regular (and on-going) monitoring.

2. Guidelines on how to communicate with interested parties have been enhanced.

- Scope of the interested parties

Unlike the existing Model Standards, which do not explain who qualifies as an interested party, the Proposed Model Standards provide that interested parties include clients, officers and employees, shareholders, business partners (third parties), local communities, government, civic organizations, as well as domestic and foreign investors.

Also, the Proposed Model Standards recommend that companies actively listen to the opinion and perspectives of the interested parties, and reflect those interests and opinion in the company's management activities.

- Obligation to disclose environmental information

Unlike the existing Model Standards, which only require disclosure of environmental-related information, the Proposed Model Standards provide that any company with a domestic, or domestic and foreign business establishments report environmental-related information on a regular and timely basis. The report must be made at least once a year (i.e., annually or quarterly).

Environmental-related information may be disclosed through different sources to which the interested parties have access, such as a business report, corporate sustainability management report, or on the company's webpage.

3. New guidelines on the control of hazardous chemical substances introduced.

- New guidelines for reduction of use and control of hazardous chemical substances have been introduced under the Proposed Model Standards.
- Under the new guidelines, companies are recommended to: (i) share details of the chemical substances that the company is using; (ii) establish an inventory control system; (iii) come up with measures to reduce the use and emission of hazardous chemical substances (e.g. by replacing with low toxicity raw or supplementary materials or by improving manufacturing facilities or process); and (iv) to step up their compliance efforts (i.e., take proactive measures in response to applicable laws).
- Although the number of chemical accidents have decreased since the Chemical Substance Control Act became effective, the KCGS's proposal to revise the Model Standards appears to be attributable to the seriousness of the extent and scope of damages resulting from a chemical accident.

Schedule

- Interested parties were encouraged to submit their comments or opinion to the proposed revision to the ESG Model Standards by the end of March 2021.
- A public hearing is expected to take place this month (April 2021) to discuss and gather further opinion from the various stakeholders, but the current COVID-19 situation is a factor to consider. Based on the hearing, the KCGS will then prepare a final proposal, containing the opinion collected through both the public comment process and the hearing.
- The ESG Evaluation Committee will finalize its proposal. The revised ESG Model Standards are expected to be made public in April 2021 (including through a press release).

Significance/Implications

In addition to financial factors, non-financial factors, such as environmental impact index, are becoming an important factor to consider in corporate management or investment decisions. This makes it more difficult to separate general and environmental management risks and considerations.

In the past, an environmental regulatory policy change or the cost to reduce environmental damage was merely considered as one of the risk factors to a company. These days, more companies perceive that appropriate management of those risks may lead to new opportunities. In other words, if a company quickly reacts and implements countermeasures, adapting to the new regulatory landscape, a company may be able to convert those risks into business opportunities.

Further, the Proposed Model Standards reflect the trends in the market. They provide guidelines to companies on how to identify environmental risks and opportunities (e.g., through system implementations), and how to make use of such opportunities in establishing its overall management strategy.

There is a possibility that the recommendations and guidelines under the Proposed Model Standards could become mandatory through the amendment of applicable laws. These proposed changes could include strengthened regulation of companies with assets exceeding a certain amount. As such, this requires companies to monitor related developments and regulatory changes.

Should you have any questions regarding the contents of this newsletter, please do not hesitate to contact us.

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