

Reborn after the crisis:

Board process and conduct at KB Kookmin Bank

“The Asian crisis of 1997, was the most severe to hit Korea in its thirty-five year history of rapid economic development. It was triggered by the loss of the credibility of the Korean economy among international investors following the earlier crises in Southeast Asia. However, at the root of the crisis lay more fundamental causes; over-borrowing and over-investment by the corporate sector, imprudent provision of loans by financial institutions funded by short-term borrowings in international markets, lack of transparency in the accounting and management of corporate and financial institutions, etc. These structural problems were dramatically laid bare amid a prolonged economic slowdown coupled with the contagion effect of the south-east Asian crisis. In 2001, the Korean government undertook a national corporate restructuring, and self-regulating agencies such as the Korea Stock Exchange strengthened their surveillance of listed companies, contributing to accounting transparency.” (BIS report, 1999)

To regain investors confidence and be listed on major stock exchange markets, KB Kookmin Bank, one major South Korean Bank, initiated a corporate restructuring by enhancing management transparency, board oversight and shareholder interests. Identifying an optimal use of board committees and independents, developing a system based on performance and information disclosure through the constitution of a qualified board of directors and a clear vision were the bank’s means of success.

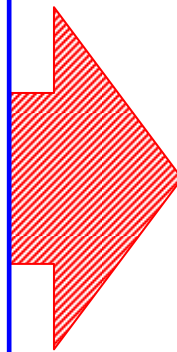
[KB Kookmin Bank](#) –KB- is one great success stories in South Korean banking. Established in South Korea in 1963, the bank is seeking to become one of the world top 30s banks by 2005. Operating with a USD 25-billion market capital and a 25% ROE rate in 2003, it has offices in six countries from the United States to New Zealand. Listed on the [Korean Stock exchange](#) and the [NYSE](#) in 2001, the bank had to comply with listing requirements. One of the main management ideologies is transparency in order to succeed in being a “World class personal financial services provider” by having an “Exemplary Corporate Governance, an Obligated Management/Transparency in decision-making and an Advanced business system”. These goals are achieved along with maximization of shareholders’ values, customer satisfaction and performance based rewards.

Rated BBB+ on the long-term (A-2 on the short term) by [Standard & Poors](#) in 2003, KB’s credit is considered to be of adequate credit quality and with currently low expectation of investment risk. The bank takes corporate governance to be a crucial element to credit rating and shaping of its stock price.

Rating agencies and other capital market intermediaries play a key role in the performance of corporate governance functions. They provide information and analysis to investors while securities firms make stock and bond recommendations to their customers. Investment banks, such as KB, perform a

Steps for Good Corporate Governance in the Banking Sector

- **Guaranteeing** the independence of banking supervisors;
- **Avoiding** concentration of corporate ownership by encouraging more diverse financial structures;
- **Improving** governance by promoting Openness: Foreign Direct Investment brings new corporate governance standards associated with sound foreign banks;
- **Complying** with Stock exchange listing requirements of corporate governance best practice;
- **Representing** institutional investors and minority shareholders rights by



- ◆ **Board oversight**
 - ◆ Use of board committees
 - ◆ Board size
 - ◆ Independent Directors
- ◆ **Shareholder rights**
 - ◆ Anti-takeover defenses
 - ◆ Notice of annual general meetings
 - ◆ Ownership transparency
- ◆ **Transparency**

Issue

How did KB review its corporate governance procedures, in order to provide transparent management information to its stakeholders and serve its shareholders' rights and interests?

TRANSPARENCY IN MANAGEMENT

Transparent governance should ensure a timely and accurate formulation and disclosure of all the Bank's material. This is important in satisfying shareholders and all stakeholders, but also in giving a strong and reliable image to the organization.

MISSION AND STRATEGY

The management's responsibility is to compile and present the company's mission, vision statement and management objectives. The use of workshops and consulting services helps in achieving such tasks. The results are combined with implementation measures coming from a special department in the company responsible for strategic planning. The outcome is then discussed at the Board of Directors meeting and a feasible or plausible agenda is developed before coming to a conclusive decision.

The company's mission and vision are integrated into the company's business and action plans. These plans are then posted on electronic bulletin boards and

PERFORMANCE MEASUREMENT

The management will select various Key Performance Indicators –KPI– numbers to evaluate management performance.

To clearly communicate to shareholders, other stakeholders and the media the objectives pursued by the board, the results of management performance are posted on the bank's web site and included in the annual report.

FINANCIAL REPORTING

To support financial reporting, KB established an internal control system that pinpoints even the lowest layer of transactions and reports it to the top management. Thus, the CEO and the CFO can easily identify irregular transactions and control issues.

On a daily basis, a designated staff inspects balance sheets, Profit and Losses (P/L) statements, Payment Order slips, etc. for each branch. The current quality of service is checked every month to make sure that no KB clients are treated unfairly. To improve customer service, KB also established a special unit

Internally, some transactions may fall under the criteria of irregular transaction. The Inspection Department runs a non-stop audit system to pick out any inappropriate transactions. At the top level, KB's external auditor will study all major transactions during the regular audit and determine whether financial reports are deemed appropriate at a reasonable level. Financial information compiled using this system is announced to the public when the bank's CEO and CFO have signed off on it as a display of confidence on information accuracy.

DISCLOSURE OF INFORMATION

KB regularly discloses key information regarding its corporate governance. The information is also distributed to non-executive directors. The Board of Directors and its Subcommittees approve changes when needed. Such measures allow the Board of Directors to control governance reforms. Actions regarding internal control issues including compliance and audit activities are regularly reported to the Board of Directors and its Subcommittees so that they can

Focusing on its shareholders, the bank has strengthened its disclosure efforts. Shareholders were given not only detailed activities of management and the Board of Directors but also the business results in a timely manner, the bank was able to maximize shareholder satisfaction. Subsequently, KB gained its reputation as an exemplary bank in corporate governance. This is evidenced by the selection of KB as the best company in corporate governance, by [Corporate Governance Service](#) in 2003.

KB's top Management believes that legal investigations may be conducted. Indeed, as a listed and registered corporation, the bank is evaluated on its governance system and makes the results public. Timely and appropriate disclosure enhances shareholder confidence in the top management and improves management transparency. By being independent, directors and auditors can better represent shareholder rights. By diversifying ownership structure, major shareholders will be kept in check from abusing their power.

The bank reviews its principles of corporate governance on a regular basis to improve and to establish an efficient governance structure. Against its shortfalls, KB launched a study to see how effective the approach has been, and improve from there. Both the shareholders and customers can take the initiative and present ideas for new business

opportunities and new products.

By doing so, KB believes that it expands shareholders' chance to get indirectly involved in management affairs. The management of the bank believes that its executives and employees are not the only ones to initiate new ideas. Rather, the bank is convinced that it can be further enriched by useful and key advice coming from its shareholders and other stakeholders.

PROTECTING SHAREHOLDERS' RIGHTS

KB operates in a highly competitive and dynamic domestic market, but moderately regulated. In 2001, the Kim Dae-jung administration has addressed a wide range of structural reforms to overcome then 1997 Asian economic crisis and lay the foundation for a free market mechanism in South Korea. Therefore, the government undertook a national corporate restructuring, and self-regulating agencies such as the Korea Stock Exchange strengthened their surveillance of listed companies, contributing to accounting transparency. The function of outside directors was reinforced, and minimum requirements for cumulative voting were eased to advance proper corporate governance. Often encountered problems that stop the board from having an independent and transparent tasking include:

- ✘ Allowing the CEO unconscionable income.
- ✘ Permitting too much executive income.
- ✘ Undertaking too little of its rightful legal responsibility.
- ✘ Individual directors don't own enough company stock.
- ✘ Directors are too cozy with management or have family/business links to company.
- ✘ Not enough outsiders are on the board.

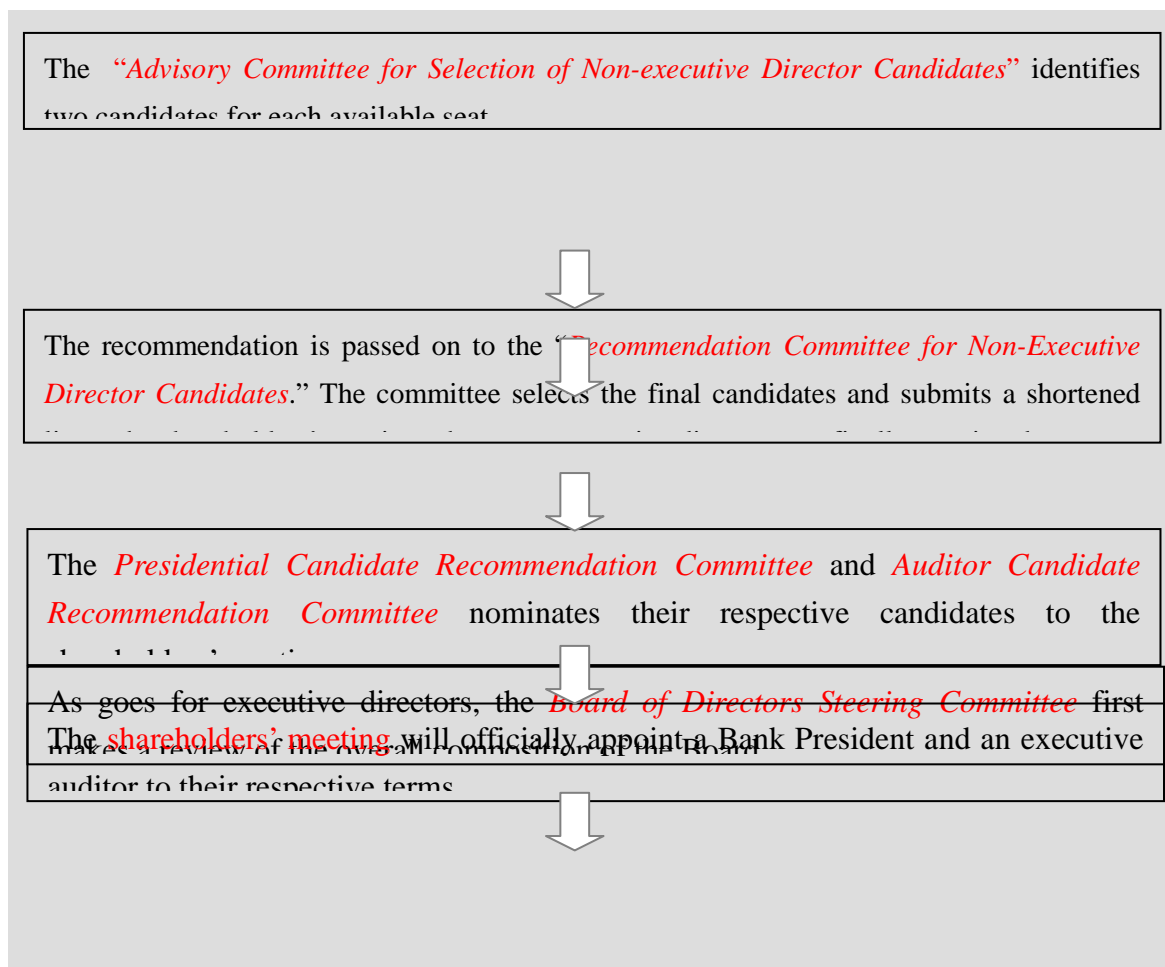
In order to avoid these common problems facing directors from companies of all sectors and sizes, KB's top management follows a broad range of techniques:

AN INDEPENDENT BOARD

Following this reform, KB board of directors includes 16 members composed of 12 non-executive directors and 4 executive directors. The Board meetings were held 9 times in 2002 and 7 times from January to July 2003. No voting right is

INSURING TRANSPARENCY IN THE SELECTION PROCESS OF INDEPENDENTS

A transparent selection process of non-executive directors at KB is done in six steps:



Board members are carefully selected to ensure shareholder protection, compulsory ratio for non-executive directors and fast decision-making process.

After discussion, the *Board of Directors Steering Committee* concludes the overall agenda related to composition of the Board for a given year, including the adequate number of director ratio as specified in the *Banking Act* and *Regulation on Banking*

SEPARATING THE CEO AND PRESIDENT FUNCTIONS

The Board of Directors chairman’s position was separated from the CEO function, in an attempt to separate management and supervisory functions. The bank supports collective voting system by deliberately avoiding the phrase “exclusion of collective

voting system” in the company charter.

TRAINING & PERFORMANCE ASSESSMENT

New members of the Board of Directors are provided with the “Director Activity Handbook”. Supplementary training is also provided to them on what directors are expected to do. Should it be necessary, the bank pays for new members to participate in external training programs.

Executive directors are assessed on financial performance and management capability with an objective set of evaluation criteria. The results are used as reference data for compensation review. As goes for non-executive directors, their activities at the Board of Directors and its subcommittees are cross-evaluated among themselves. The results are used for consideration when the

REMUNERATION

Within the range approved at the shareholders’ meeting, *the Compensation Committee* first makes evaluation and sets compensation level for directors. The Board of directors gives the ultimate approval, although evaluation criteria for executive and non-executive directors may vary. The common approach to remuneration at KB is as following:

- **The compensation package includes a basic salary, bonus salary and stock options.**
- **Other forms of expense compensation including business expense were scrapped. Basic salary is expected to cover all expenses incurred. Meanwhile, bonus salary is paid to the executive directors from a scale of 0% to 200% of their basic salaries, depending on their performance outcome**
- **In principle, non-executive directors purchase KB stocks with their monthly salaries at their self-determination. The bank provides no bonus salary.**
- ***The Compensation Committee’s* review of compensation packages for Board members are presented to and approved by the Board of Directors.**
- ***The Compensation Committee’s* role is to review 1) the content and level of**

The number of non-executive directors has been increased to 12, to invite individuals representing specific expertise and to facilitate Board of Directors Subcommittees.

SUCCESSION PLANNING

The bank compensates the succession planning process by a Career Development Planning system that aims to bring out management from its resource pool.

DECISION MAKING ON THE BOARD: HOW TO BETTER SERVE SHAREHOLDER INTERESTS

KB board of directors is entitled to make long-term decisions, to assess general lines of management at the bank and to handle crisis.

BOARD OF DIRECTORS AGENDA

Assesses the long-term strategy of the bank regarding a wide range of issues.

KB's board agenda for the year 2003 included matters as:

- ✓ Merger and Acquisition resolutions;
- ✓ Ratification and issuance of specific bonds and other securities;
- ✓ Revision of ratification on board of directors – i.e. in reflection with Korean government recommendations regarding a specific issue;
- ✓ Appointment of Committee members under the Board of Directors: Members of Board Steering Committee, Management, strategy Committee, Risk Management Committee, Audit Committee, Compensation Committee, Non-Executive Director Nomination Committee;
- ✓ Amending of the standards for the payment of annual salary of directors;
- ✓ Granting the stock options to directors and employees;
- ✓ Revision of the internal control standards;
- ✓ Approving financial statements and operation reports for the passed fiscal year;
- ✓ Paying the annual performance salary of directors;
- ✓ Examining the appraisal results of Board of Directors and non-executive directors;
- ✓ Examines or agrees on the strategy to comply with international standards – i.e. the BIS capital adequacy ratio.

REPRESENTING ALL SHAREHOLDERS ON THE BOARD

All major shareholders are represented on the board and the respect of minority shareholders interests is ensured by the presence of 12 non-executives on the board. These include both Korean and foreign independents, experts in different

For instance, KB appointed Goldman Sachs to a director position on its board following the \$500 million principal investment led by the leading US based global investment banking and securities firm in KB Bank. This appointment is unusual since very few foreign executives serve on the boards of major corporations in Korea. A global team of Goldman Sachs professionals with expertise in principal investing, research, corporate finance, financial institutions, and equity and fixed income markets evaluated and implemented the investment, working closely with KB. Goldman Sach's Investment Management Division is now advising KB Bank on risk management strategies.

Independence from political influences, from the regulated banks, and from the bank's customers are the key in crisis management.

CRISIS MANAGEMENT

A recent financial scandal of the major Trade firm in South Korea, SK Global, involving KB as a major creditor, has shown how KB could react to a major financial crisis by preserving its stakeholders' interest. Indeed, SK Global started to founder under an unsustainable debt burden of \$7.2 billion, largely owed to Korea's banks. Keeping in mind shareholders' interest, KB's board of directors decided to seize whatever collateral it legally can and write off any debt that cannot be recovered. Such a move would reassure the bank's shareholders that it could disentangle itself from a major mess. KB

GOOD GOVERNANCE IN A SUPPORTIVE ENVIRONMENT

STOCK EXCHANGE LISTING REQUIREMENTS

By being listed on different stock exchanges in the world including the Korean stock exchange and the NYSE, KB agreed to comply with the US GAAP and the New

SEC rules requiring audit compliance with Sarbanes-Oxley Act 2002 on auditing reports and transparency.

The above-mentioned measures, among many others, can bring together the shareholders, management, staff and other stakeholders, to pursue a coherent management strategy. KB believes that corporate governance plays a key role in the success of a corporate strategy

LINKS

Kookmin Bank http://young.kbstar.com/quics?page=s_kbe

Korean Stock Exchange www.koreanstockexchange.com

NYSE www.nyse.com

Standard & Poor's rating

[http://www2.standardandpoors.com/NASApp/cs/ContentServer?GXHC_gx_session_id
=e582c10c48191557&pagename=sp/Page/FixedIncomeFindRatingsPg&r=1&l=EN&b
=2&s=142](http://www2.standardandpoors.com/NASApp/cs/ContentServer?GXHC_gx_session_id=e582c10c48191557&pagename=sp/Page/FixedIncomeFindRatingsPg&r=1&l=EN&b=2&s=142)

Corporate governance service <http://www.cgs.or.kr/eng/index.asp>

Financial Accounting Standards Board for information on US GAAP

<http://www.fasb.org>

SEC Rules www.sec.gov/about/rulesofpractice.shtml

Sarbanes Oxley Act 2002 <http://www.sec.gov/spotlight/sarbanes-oxley.htm>

National reports on Corporate governance

<http://www.worldbank.org/html/fpd/privatesector/cg/codes.htm>