

## PRIORITY AREA

# Governance

## 2019 CASE STUDY

## Establishment of the Governance Committee

KT&G revamped and strengthened the function and role of committees under the board of directors in 2019 to realize the responsible management. The Governance Committee established from the decision made by the board on April 30, 2019, oversees the decision making of the entire governance. The committee decides on operational standards and corrective actions for the board of directors and committees, as well as deliberating establishment and amendment of governance-related regulations. Moreover, the committee is given authorities for proposing CEO and outside director candidate deliberation standards, along with the decision making and qualification inspection for executive directors, thereby enhancing transparency in nomination processes for the executives and board.

As of the end of May 2020, the Governance Committee is composed of 3 outside directors and 1 executive director, and the outside director, Youn, Hai-su is the chairman of committee. To secure independence of the committee, the majority of the members shall be constituted by outside directors in accordance with the Article 15 of the Board of Directors Regulation. Through the Governance Committee, we will proactively identify governance-related risks and continue making decisions to prevent any risks.

## 1. Board of Directors

According to the 'KT&G Charter of Governance' which reflects principles and visions of governance that satisfy global standards, KT&G established a stable governance centered on the board run by outside directors and continue to develop the organization relentlessly up to the global standard. The board is a top decision-making body for company's key agenda such as recommending candidates for CEO and approving business plans. Specific roles of the board are indicated in the articles of association and the board regulation.

\*KT&G website, [www.ktng.com](http://www.ktng.com)

 Articles of Incorporation

 Board of Directors

 Corporate Governance

\*Data Analysis, Retrieval and Transfer System, [dart.fss.or.kr](http://dart.fss.or.kr)

 Corporate Governance Report

## 2. Board Structure

KT&G operates the board of directors constituting the majority with outside directors so that the board effectively executes the managerial supervisor's role and make independent decisions. According to the Article 25 of the articles of association, 9 executive directors including the CEO can be nominated, and more than half of members should be composed by outside directors.

In 2019, we enhanced fairness and transparency of the director nomination process by establishing the Governance Committee. The Governance Committee participates in the process of establishing deliberation standards for executive and outside directors and performs the qualification assessment for executive directors. For the nomination of the CEO, we added strengthen by the Governance Committee before the 2-step verification process by the CEO Candidates Recommendation Committee and the board of directors. Accordingly, we have secured maximum independence and transparency in the CEO Candidates recommendation process.

Outside directors are recommended based on their independence and expertise, and their experiences in risk management or specified risk management are also considered. Outside director, Lee, Eun-Kyung, who has been an executive director of the finance and operation risk management at Calvin Klein of the PVH Korea since 2012, is in charge of the financial risk examination at KT&G. Outside director, Baek, Jong-Soo is a legal expert who has served as a director of Busan District Public Prosecutor's Office and he manages legal risks in the business activities of KT&G.

As of the end of May 2020, KT&G's board is composed of 7 directors, and 5 are outside directors to exceed legal and regulatory requirements.

Category	Name	Gender	Date of Birth	Full-time	Major Career	Current Position	Term
Executive directors	Baek, Bok-In	Male	Sep. 1965	Yes	Director of Strategy Planning HQ, KT&G Director of Marketing HQ, KT&G	CEO, Management Committee Chairman	Mar. 17, 2018 - Ordinary General Meeting of Shareholders in 2021
	Kim, Heung-Ryul	Male	Mar. 1961	Yes	Director of Management Support HQ, KT&G Head of Key Market Office of Global HQ, KT&G	Chief Vice President	Mar. 17, 2018 - Ordinary General Meeting of Shareholders in 2021
Outside directors	Baek, Jong-Soo	Male	Nov. 1960	No	Lawyer, Dongin Law Group Director, Busan District Prosecutor's Office	Board Chairman, Evolution Committee Member	Mar. 17, 2018 - Ordinary General Meeting of Shareholders in 2021
	Youn, Hai-Su	Male	Feb. 1952	No	President, Seoul University of Foreign Studies Assistant member, Presidential 21st Century Committee	Governance Committee Chairman	Mar. 30, 2019 - Ordinary General Meeting of Shareholders in 2022
	Lee, Eun-Kyung	Female	May 1963	No	Financial/Operational Director, Calvin Klein of PVH Korea Financial Director, Reebok Korea		Mar. 30, 2019 - Ordinary General Meeting of Shareholders in 2022
	Kim, Myung-Chul	Male	Feb. 1956	No	Advisor, Space Entertainment Enterprise (SEE) President, Shinhan Bank America		Apr. 1, 2020 - Ordinary General Meeting of Shareholders in 2023
	Koh, Yun-Sung	Male	Sep. 1973	No	Professor, Business School of Hankuk University of Foreign Studies	Audit Committee Chairman	Apr. 1, 2020 - Ordinary General Meeting of Shareholders in 2023

\*Outside directors Youn, Hai-Su and Lee, Eun-Kyung were renominated at the 32nd Ordinary General Meeting of Shareholders (Mar. 29, 2019)

\*\*Terms of outside directors Song, Op-Kyo, Lee, JuneQ and Rho, Joon-Hwa have been terminated, and Kim, Myung-Chul and Koh, Yun-Sung were newly nominated at 33rd Ordinary General Meeting of Shareholders. (Mar. 31, 2020)

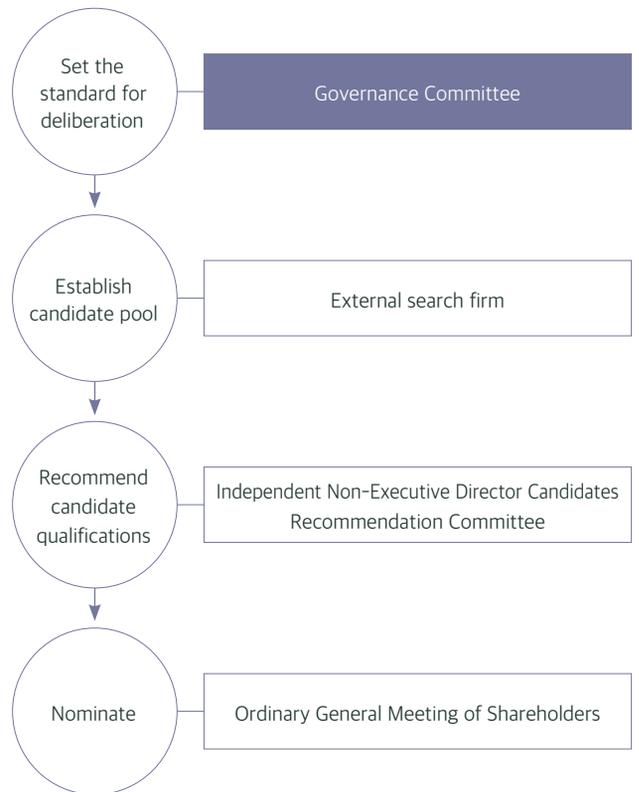
### CEO Nomination Process



●: Newly established in 2019



### Outside director Nomination Process



■: Newly established in 2019

### 3. Key Discussion Agenda

In 2019, KT&G board meeting has been held 10 times, and the outside director participation rate is 98.3%. 30 items were discussed at the meeting, and among them, 23 items were decided, and 7 were reported. During the year, governance-related risks were reviewed by the board including the amendment of the Charter of Governance and governance sophistication strategies. Items to be discussed at the meeting are notified to directors beforehand, and we also explain in detail if needed, so that directors are well aware of the contents to discuss them effectively.

In 2020, we plan to grant the authority related to ESG to the board, and the board plans to discuss in-depth key issues related to ESG.

\*Data Analysis, Retrieval and Transfer System, dart.fss.or.kr

 Key decided items: 2019 Business Report pp. 319-320

### 4. Committees under the Board of Directors

KT&G operates committees within the board of directors to enhance execution expertise and operational efficiency. We compose each committee considering expertise of each director to maximize efficiency. In April 2019, the Governance Committee was added to one of the committees for more systematic discussions and decision making in regard to governance. Thus, there are 4 standing committees (Governance Committee, Evolution Committee, Management Committee, and Audit Committee) and 2 non-standing committees (CEO Candidates Recommendation Committee and Independent Non-Executive Director Candidates Recommendation Committee). Governance Committee, Audit Committee, and CEO Candidates Recommendation Committee have their own operational regulations, and structures and functions of each committee are abided by the Article 34 of the articles of association and the Article 15 of the Board of Director Regulation. For efficient cross-check and transparent decision making of the board of directors and top management, Chairmans of all committees except for the Management Committee are assigned with outside directors, thereby operating independent committees under the board of directors.

#### Functions of Standing Committees

Category	Functions
Governance Committee	Make decisions on overall governance
Evolution Committee	Make decisions on managerial evolution/compensation of employees
Management Committee	Make decisions on general managerial activities and investment below a standardized amount*
Audit Committee	Audit accounting and work

\*Decision making on important matters related to key stakeholders such as workers and consumers, post-maintenance and risk management of the investment business, identification of and decision making on social contribution activities costing between KRW 500 million and KRW 1 billion that are not included in the budget approval.

#### Standing Committee Structure

Category	Name	Governance Committee	Evolution Committee	Management Committee	Audit Committee
Executive directors	Baek, Bok-In			●	
	Kim, Heung-Ryul	○		○	
Outside directors	Baek, Jong-Soo	○	●		○
	Youn, Hai-Su	●	○		
	Lee, Eun-Kyung	○			○
	Kim, Myung-Chul		○		○
	Koh, Yun-Sung		○		●

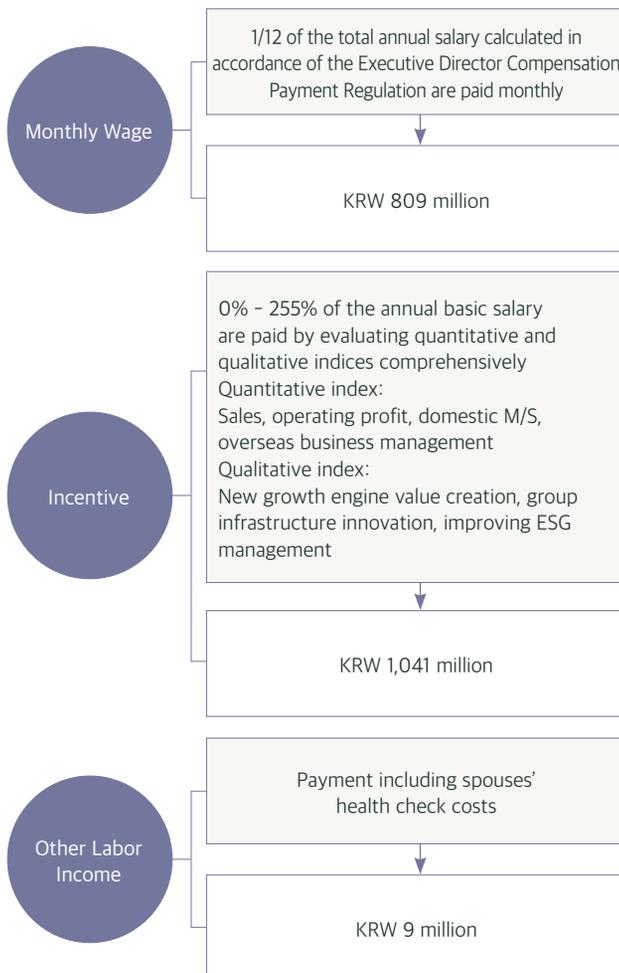
\* ●: Committee Chairman / ○: Committee Member

## 5. Evolution and Compensation

### Top Management Evolution and Compensation

KT&G established the Evolution Committee only composed of outside directors and enables compensations for the CEO and managing directors are executed fairly through the management evolution. The Evolution Committee decides on compensation and severance pay of executives, severance pay of general employees, and managerial goals set with CEO candidates. Moreover, the committee deliberates on compensation and severance pay of the CEO and executive directors, and it also has decision-making rights on managerial evolution and compensation of the CEO. In 2019, the Evolution Committee was held twice, and it made decisions on short- to long-term managerial goals and previous year's short- to long-term managerial evolution of the CEO. We currently include ESG-related index in our CEO evaluation index and plan to expand it to more detailed aspects.

Status of 2019 Executive Directors Compensation Regulation and Payment (sum of 2 executive directors)



\*KT&G retains the policy for clawbacks and malus of short-term and long-term incentives if any intended or significant mistakes of the executive management and errors in payment are found.

### Outside director Evolution and Compensation

According to the articles of association and the Board of Director Regulation, 'the board may conduct evolution of outside directors and self-assessment of the board activities.' Based on the regulation, the board of directors decides on the 'Board Activity Assessment Plan (draft)' at the end of every year and conducts assessment. In 2019, the assessment was performed in 4 categories. Compensation for directors are paid within the scope of maximum pay amount approved by the General Meeting of Shareholders considering the compensation standards of other companies and competitors in the industry, and specific amount and payment method are decided by the board. Moreover, we provide directors costs related to their activities to encourage their active engagement.

Status of 2019 Outside Director Evolution Items and Compensation Payment

Evolution Items	
Board Performance	Committee Activities
Board Operational Efficiency	Outside director Peer Evaluation

Evolution Results		
Category		Out of 5.0
Performance of the board	Review of active managerial decision making	4.83
	Review of key strategies and examination of accomplishment standard	4.50
	Active engagement in the HR plan	4.50
	Fulfilling a role as an advisor	4.33
	Function of supervising and checking the executive management	4.83
	Efforts for settling a sound governance structure	4.67
Efficiency in the board operation	Appropriateness of board meetings' frequency, size, and method	4.67
	Expertise and utilization of board members	4.33
	Factfulness of data offered to the board members	4.83
	Efficiency of the meeting and discussion cultures	4.67
	Suitability of training and support to the board members	4.67

\*The evolution of committee activities were conducted through narrative process, and peer evaluation of outside directors (out of 5.0) is not disclosed in case of impeding objectivity.



## 6. Board of Directors Independence

KT&G aims for an 'independent board of directors' for it to fulfill its role as overseeing the executive management. Through the Board Regulation, we require 'an outside director to be assigned as the Board Chairman to establish an objective and independent governance system that separates CEO and the Board Chairman. Moreover, each committee (excluding Management Committee) under the board has more than half of its members as outside directors (excluding Management Committee) to oversee and balance between an independent board and the top management. In particular, the Audit Committee and Evolution Committee are only composed of outside directors to realize practical overseeing of the top management.

Outside directors are recommended through the qualification process of the Independent Non-Executive Director Candidates Recommendation Committee among the candidates recommended by an independent external search firm, and they are finally nominated by the General Meeting of Shareholders. When recommending outside directors, we go through the double confirmation process of an external institution and self-verification for the independence standard such as employment status. Moreover, during the process of submitting items for the Ordinary General Meeting of Shareholders, we perform a final check by receiving the 'Outside Directors Qualification Letter' from the candidates directly. Thus, KT&G strives for nominating outside directors who are independent and neutral without any conflict of interest with the company.

## 7. Expertise of Board of Directors

KT&G's board of directors is composed of directors with expertise and various experiences to enable effective and considerate discussion and decision making. In addition, KT&G operates the Management Coordination Department under the Strategy & Planning Office which is an exclusive organization for the board. The Management Coordination Department conducts training related to outside directors' job execution and offers information relevant to the company and industry, thereby fortifying expertise of the board. In 2019, the department provided training about legal obligations and liabilities, as well as the current issues, to all directors. Henceforth, we plan to diversify specific field of expertise of the directors and strengthen supports of external experts' consultation in order to strengthen the expertise of the board.

### Specialized Field of Expertise by Director

Category	Name	Expertise
Executive directors	Baek, Bok-In	Business management, tobacco business
	Kim, Heung-Ryul	Business management, tobacco business
Outside directors	Baek, Jong-Soo	Law
	Youn, Hai-Su	Business management, corporate affairs
	Lee, Eun-Kyung	Global, finance affairs
	Kim, Myung-Chul	Global, finance
	Koh, Yun-Sung	Finance affairs, accounting

### Director Expertise Enhancement Activities

Date	Training Host	Participants	Key Training Contents
Jan. 30, 2019	KT&G	Youn, Hai-Su; Song, Op-Kyo; Lee, JuneQ; Lee, Eun-Kyung; Baek, Jong-Soo	Company's pending issues, etc. (Status related to heat-not-burn product, account settlement schedule, etc.)
May 22, 2019	KT&G	Song, Op-Kyo; Youn, Hai-Su; Lee, Eun-Kyung; Baek, Jong-Soo	Corrective actions related to governance
Jun. 13, 2019	KT&G	All directors	Legal obligations and responsibilities of directors
Sep. 18, 2019	KT&G	All directors	Company's pending issues, etc. (mid- to long-term business visions, group process innovation plans, etc.)

## 8. Audit Committee

KT&G runs the Audit Committee which is an independent auditing organization for business activities. The Audit Committee is held quarterly, and it monitors and assists KT&G to fulfill its responsibility and liability toward stakeholders by auditing lawfulness of directors and top management's job execution and reviewing accuracy of the financial report.

The committee is composed only of outside directors to maintain objectivity in its processes, independent from the board of directors and executive management. As of the end of May 2020, the Audit Committee is composed of 4 outside directors, and Koh, Yun-Sung is a chairman of committee, and Lee, Eun-Kyung, Baek, Jong-Soo, and Kim, Myung-Chul are audit members.

In addition, the Audit Committee is required to include one or more experts in accounting or finance to secure expertise, in accordance with the Charter of Governance and the Audit Committee Operational Regulation.

In 2019, the committee was held 7 times, and it made decisions in regard to the Internal Accounting Management System, internal monitoring means, Audit Report, and audit on items of the Ordinary General Meeting of Shareholders. An audit plan for the Internal Audit Department (Audit Group) had been submitted as a reporting item until 2019, and we are considering setting them as an official meeting agenda in the future. Through this effort, we will strengthen the committee's decision-making function.

## 9. Protecting Rights of Shareholders

KT&G operates the Shareholder Proposal System and the Cumulative Voting System to protect rights of all shareholders and prevent dismissal of minority shareholders' opinions in the decision-making process.

Shareholders who want to take shareholder proposal may submit a document recommendation for the purpose of the Ordinary General Meeting in paper or online 6 weeks before the Ordinary General Meeting of Shareholders. Shareholders who own 1/100 or more of the total issued shares are given rights for derivative claims in cumulative voting. Shareholders who want the cumulative voting may submit the claim in paper or online 6 weeks before a general meeting of shareholders is held for nominating 2 or more directors (In the case of the Ordinary General Meeting, it is based on the date of the Ordinary General Meeting in the previous year).

In addition to the shareholder proposal and cumulative voting, we guarantee rights of shareholders for demanding Q&As and explanations about items discussed at the General Meeting of Shareholders, in accordance with the Charter of Governance. KT&G strives to reflect opinions of shareholders by providing opportunities to speak after explaining thoroughly about the items, in order to enable fair and efficient deliberation of the meeting agenda. In the future, we plan to introduce the electronic voting system to offer more convenient environment for executing voting rights even for the shareholders who are not able to attend the meeting.

### Implementing the Shareholder Rights Protection System

In February 2018, the Industrial Bank of Korea (IBK) suggested to increase the number of outside directors through the Shareholder Proposal System, recommended 2 candidates for outside directors, and filed Cumulative Voting System through the Shareholder Proposal System. In response, KT&G submitted this proposal as a discussion item during the Ordinary General Meeting of Shareholders, but all of the agendas were rejected as a result of voting. In 2019, no items were submitted through the Shareholder Proposal System.