



# A Study on Public Pension Proxy Voting Principles and Guidelines

JongWook Won



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Voting Principles and Guidelines

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on Future Society

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Chapter

01

# Background and Purposes





## Chapter 1

# Background and Purposes

## 1. Background

As the size of the National Pension Fund's investments in the Korean stock market is increasing, there are lively discussions about its proxy voting rights and a lot of talk about strengthening the exercise of the rights. In many cases, however, only the word "strengthening," is emphasized without much of detailed discussion about what the strengthening means. This might cause uncertainty and doubt. It's not that the NPF has not exercised its voting rights so far. If it has been exercising its rights, then what does it mean to say that the exercise of its rights should be strengthened further? And are all these discussions pointing to the right direction for the Fund to take it in the future? These questions need more in-depth study. A mounting controversy over the exercise of proxy voting rights without an official position from the Ministry of Health and Welfare or the National Pension Service (Investment Organization of the National Pension Fund) on ways of improvement may only fuel more doubt and uncertainty.

This study looks into what it means to strengthen the expertise of the National Pension Fund, which is a public pension fund, in terms of proxy voting. The NPF is a signatory of the UN PRI (Principles for Responsible Investment) and may receive

consulting services from firms specializing in proxy voting pursuant to an amendment to its proxy voting principles this year. In connection with these developments, this study analyzes the direction for the NPF to take to reinforce its expertise in exercising voting rights.

## 2. Purposes

The purposes of this study are to look into the international standards or guidelines that the National Pension Fund, as a public fund, should take into consideration when exercising its voting rights and to propose standards and guidelines for the Fund to adopt to improve its proxy voting plans. The exercise of voting rights by the National Pension Fund may be different from private pension funds or other institutional investors as it is a public pension fund. Therefore, how the principle of publicness - one of the NPF's investment principles - should be linked to the exercise of voting rights is another area that needs to be discussed and studied in depth.

With most of the public pensions and large institutional investors around the world as its signatories, the UN PRI has reached agreement on responsible investment and has been putting it into practice. It is true that the NPF has been focusing on boosting returns so far and consequently taking a conservative position on the exercise of voting rights, which is a responsibility entailed by its investments. However, as it is now a signatory of the UN PRI, the NPF also needs to incorporate the values pursued by the UN PRI into its proxy voting practices. This study examines

how the public pension fund should incorporate PRI-defined action items in the exercise of voting rights by looking into the proxy voting guidelines of major overseas public funds and analyzing their voting records.

As more and more companies are added to its investment portfolio, it is expected to become all the more difficult for the National Pension Service (NPS) to exercise its voting rights on its own. Therefore, it laid down grounds for getting consulting services from overseas firms specializing in proxy voting. The next step is to determine how it will accommodate the guidelines provided by the overseas consulting firms. After analyzing the voting guidelines and the governance evaluation criteria of RiskMetrics, a major service firm in the field of proxy voting, this study proposes what the NPF can accommodate in its practices.





Chapter

02

**Analysis of Domestic Stock  
Market Shares - National  
Pension and Major Overseas  
Public Funds**







## Chapter 2

# Analysis of Domestic Stock Market Shares - National Pension and Major Overseas Public Funds

### 1. NPF' s Korean stock market share (KIHASA estimates)

The total market capitalization of 927 KOSPI-listed companies as of the end of December 2010 is estimated at about KRW 1,141 trillion. The market capitalization of the domestic shares held by the National Pension Fund amounts to KRW 55 trillion, accounting for 4.8% of the total market cap.

〈Table 2-1〉 Investment amounts and percentages by sector

(Based on market prices, in KRW 100 million, %, % points)

Category	End of 2010 (A)		End of 2009 (B)		Difference (A - B)	
	Amount	%	Amount	%	Amount	%
Financial	3,235,975	99.9	2,772,519	99.9	463,456	0.0
Stock(Korean)	549,755	17.0	363,103	13.1	186,652	3.9
Stock(Overseas)	199,185	6.2	131,948	4.8	67,237	1.4
Bonds(Korean)	2,165,173	66.9	2,048,853	73.8	116,320	-6.9
Bonds(Overseas)	132,882	4.1	105,434	3.8	27,448	0.3
Alternatives	188,981	5.8	125,222	4.5	63,759	1.3
Welfare	1,282	0.04	1,540	0.1	-258	0.0
Others	2,650	0.1	2,365	0.1	285	0.0
Total fund assets	3,239,908	100	2,776,424	100	463,484	0.0

The funds entrusted to the NPF will grow exponentially in the future. If the NPF is to keep its current share of the total KOSPI market capitalization (4.8%), assuming that the ratio of its Korean stock holdings is kept at the current level as of the end of 2010 (17%), the KOSPI market cap should grow dramatically.

<Table 2-2> NPF's Korean stock holdings vs. KOSPI market caps (forecasts)

(In KRW 100 million)

Year	National Pension Fund increases	Korean stock holdings (kept at 17%) A	KOSPI market capitalization B	Ratio A/B
2010	3,235,972	549,755	11,410,000	4.8%
2015	5,750,980	977,666	20,368,041*	4.8*
2020	9,239,850	1,570,774	32,724,458*	4.8*
2025	13,044,470	2,217,559	46,199,145*	4.8*

Note: The KOSPI market caps and ratios in and after 2015 indicate KOSPI market capitalizations required to maintain the National Pension's current share as of the end of 2010 (4.8%).

The KOSPI market capitalization in 2015 (estimated at KRW 2,036 trillion) represents a growth of 78% compared with the end of 2010. In 2020, it should reach KRW 3,272 trillion (estimate), which means a growth of 60.7% against 2015. As the Korean capital market matures, it is hard to expect the KOSPI market cap to grow 2.8 times for next 10 years. Therefore, the ratio of NPF's Korean shareholding to the KOSPI market cap is expected to reach the 7 to 8% range, far bigger than the current 4.8%.

〈Table 2-3〉 KOSPI market cap growths (past 10 years)

(In KRW 100 million, %)

Year	Number of Companies	Market Cap	Year-on-Year Growth (%)
2010	777	11,418,855	28.6
2009	770	8,879,352	53.9
2008	765	5,769,277	-39.3
2007	746	9,519,179	35.1
2006	731	7,045,875	7.55
2005	702	6,550,746	58.7
2004	683	4,125,881	16.1
2003	684	3,553,626	37.3
2002	683	2,586,808	1.1
2001	689	2,558,501	36.0
2000	704	1,880,415	

If we look at the relationship between market capitalization and growth domestic product, the ratio of the market cap to the GDP has continued to grow over the past 10 years to reach 97% of the GDP as of 2010. This indicates that we can estimate a future market capitalization based on its ratio to GDP. Assuming that the ratio of market capitalization will be maintained at the 2010 level of 97% or at least at the average (80%) of the past three years, we have developed long-term market cap forecasts.

〈Table 2-4〉 Ratio of market capitalization to GDP

(In KRW billions)

Year	GDP (A)	Market Cap (B)	Ratio B/A
2000	603,236	188,041	0.31
2001	651,415	255,850	0.39
2002	720,539	258,681	0.36
2003	767,114	355,363	0.46
2004	826,893	412,588	0.50
2005	865,241	655,075	0.76
2006	908,744	704,588	0.78
2007	975,013	951,918	0.98
2008	1026,452	576,928	0.56
2009	1065,037	887,935	0.83
2010	1172,803	1141,885	0.97

Based on the data that the NPF used to estimate its finances in 2008, Korea's GDP is expected to grow to KRW 1,590 trillion in 2015, 2,179 trillion in 2020 and 3,483 trillion in 2030. The National Assembly Budget Office (NABO) estimated it a little lower than that, while the 2009 estimation of Korea Institute of Public Finance (KIPF) shows quite a big difference.

〈Table 2-5〉 Long-term Korean GDP estimates

(In KRW trillions)

Year	NPF's financial estimation in 2008 (based on KIHASA research)	KIPF	NABO
2015	1,590.90	1,569.20	1,597.90
2020	2,179.70	2,086.20	2,130.30
2025	2,755.60	2,651.50	2,740.40
2030	3,483.50	3,306.10	3,426.60
2035	4,177.50	3,944.90	4,227.30
2040	5,009.70	4,546.60	5,101.70
2045	5,864.20	5,175.50	5,859.40
2050	6,864.50	5,739.30	6,522.30

As a result of the estimations, market capitalization is calculated to reach a minimum of KRW 2,121 trillion (Estimate 2) and a maximum of 2,672 trillion (Estimate 1) in 2025. Earlier in this document, it was estimated that the stock market would have to grow to KRW 4,619 trillion in 2025 if the NPF's share of the Korean stock market would be kept at 4.8%. This is 2.17 times bigger than the market cap according to Estimate 2. To put it another way, the actual share in 2025 may become as big as 10.45% (if the percentage of stock investments is held at 17%).

〈Table 2-6〉 Estimates of market capitalization as compared with GDP

(In KRW trillions)

	Based on GDP used for NPF's financial estimation in 2008 (Estimate 1)		Based on GDP estimated by KPIF (Estimate 2)		Based on GDP estimated by NABO <sup>1)</sup> (Estimate 3)	
	0.97	0.8	0.97	0.8	0.97	0.8
	2015	1543.173	1272.72	1522.124	1255.36	1549.963
2020	2114.309	1743.76	2023.614	1668.96	2066.391	1704.24
2025	2672.932	2204.48	2571.955	2121.2	2658.188	2192.32
2030	3378.995	2786.8	3206.917	2644.88	3323.802	2741.28
2035	4052.175	3342	3826.553	3155.92	4100.481	3381.84
2040	4859.409	4007.76	4410.202	3637.28	4948.649	4081.36
2045	5688.274	4691.36	5020.235	4140.4	5683.618	4687.52
2050	6658.565	5491.6	5567.121	4591.44	6326.631	5217.84

Source: 1) National Assembly Budget Office's internal data

## **2. Major overseas public pensions' current state of investments and shares of domestic stock markets**

The largest public pension fund in the world is the Social Security Trust Fund of the United States. In terms of total assets relative to the national economy, the fund is equivalent to 17.9% of GDP. It does not invest in stocks but fully in government bonds alone, so it is excluded from our analysis of funds' shares of domestic stock markets.

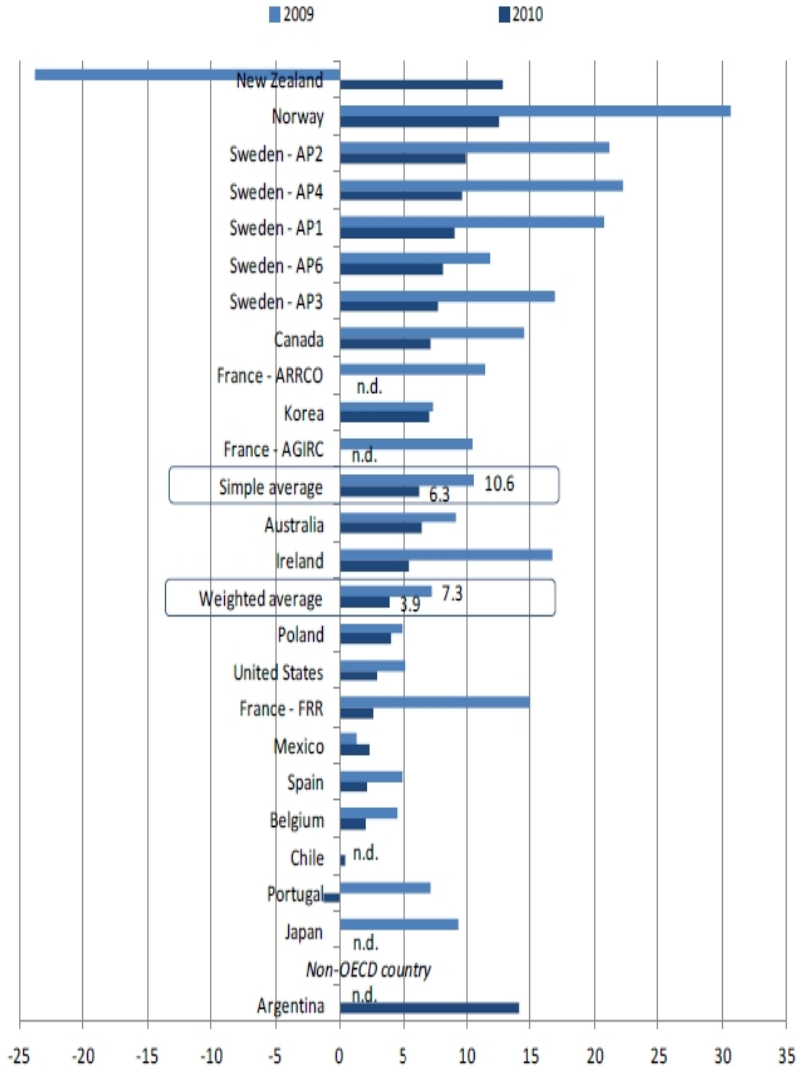
The second largest public pension fund is Japan's Government Pension Investment Fund worth USD 1,312.8 billion, with a high asset-to-GDP ratio at 25.9%. Korea's National Pension is the third largest in the world: As of the end of 2010, it is worth USD 280.4 billion and, in terms of importance relative to GDP, it has the highest ratio in the world at 27.6%. The Canadian Pension Plan worth USD 136 billion is the fourth largest after the Korean fund, and its asset-to-GDP ratio is 8.6%.

〈Table 2-7〉 Sizes of major overseas public pension funds (end of 2010)

Country	Name of the fund	Founded in	Assets	
			USD billions	% of GDP
U.S.	Social Security Trust Fund	1940	2609	17.9
Japan	Government Pension Investment Fund	2006	1312.8	25.9
Korea	National Pension Fund	1988	280.4	27.6
Canada	Canadian Pension Plan	1997	136.0	8.6
Sweden	National Pension Funds (AP1–AP4 and AP6)	2000	124.7	27.2
Spain	Social Security Reserve Fund	1997	85.3	6.1
France	AGIRC-ARRCO	n.d.	71.7	2.7
	Pension Reserve Fund	1999	49.0	1.9
Australia	Future Fund	2006	65.8	5.5
Norway	Government Pension Fund	2006	23.1	5.6

Source: "Pension Markets in Focus," July 2011 - Issue 8, OECD

[Figure 2-1] Returns of major overseas public pension funds

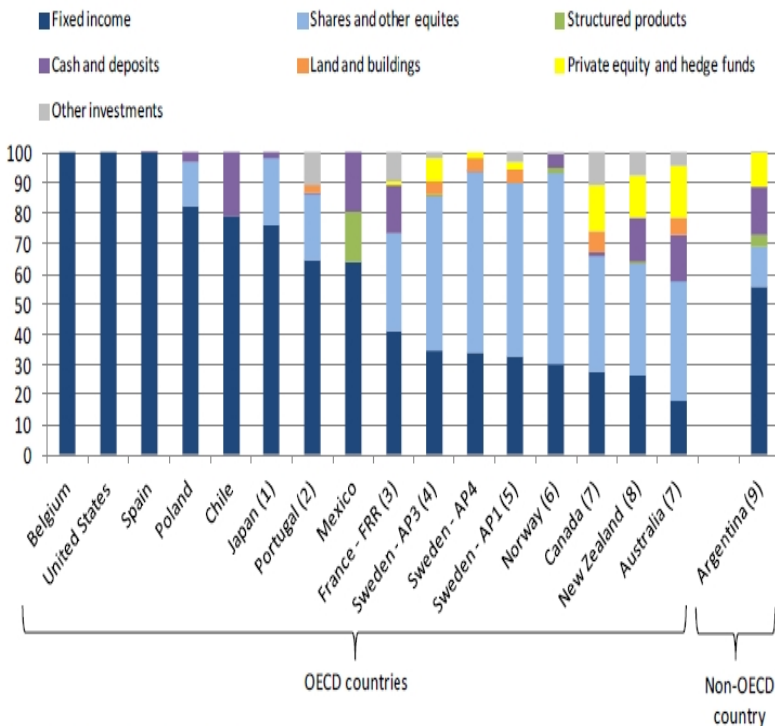


Source: OECD Global Pension Statistics



Returns of major overseas public pensions in 2010 were lower than 2009. New Zealand, Norway and Sweden gained the highest returns in 2010 in that order. The simple average of the returns achieved by the public pension funds of the OECD member countries in 2010 is 6.3%, a big drop from 10.6% in the previous year. The weighted average taking asset sizes into account is 3.9%, also a big fall from 7.3% in 2009.

[Figure 2-2] Asset allocations of major overseas public pensions



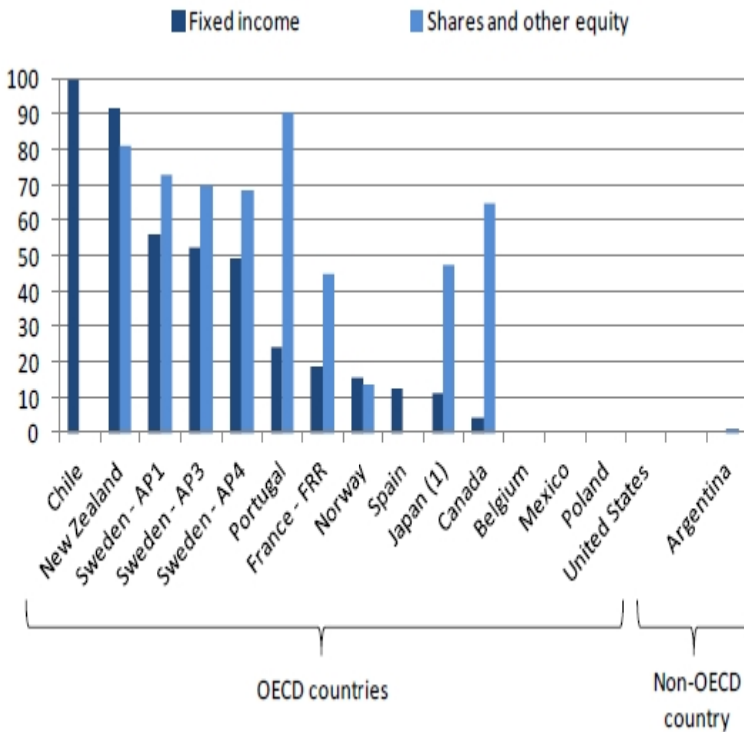
Source: OECD Global Pension Statistics

<Table 2-8> Asset allocations of major overseas public pensions (end of 2010)

(In %)

Country	Domestic Stock	Overseas Stock	Others
U.S.	-	-	US Fund invests 100% in domestic bonds.
Canada	14.1	39.4	46.5
Japan	11.0	9.0	80
Korea	17.0	6.2	76.8

[Figure 2-3] Asset allocations of major overseas public pensions for overseas investments



Source: OECD Global Pension Statistics

〈Table 2-9〉 Sizes of major overseas public pension funds (end of 2010)

Stock Exchange (by Country)	Market cap (in USD millions)		Market cap growth 2010/2009 (in USD)	Fund assets to market cap (end of 2010)
	2010	2009		
U.S. NYSE Euronext	13,394,081.8	11,837,793.3	13.1%	19.48%
Canada TSX Group	2,170,432.7	1,676,814.2	29.4%	6.27%
Korea Korea Exchange	1,091,911.5	834,596.9	30.8%	25.68
Japan Tokyo SE Group	3,827,774.2	3,306,082.0	15.8%	34.28

Source: "Annual Statistics—Equity Markets," World Federation of Exchanges, 2011

Calculations using the data available as of the end of 2010 show that the Japan's public pension fund (GPIF) has a 3.77% share in its domestic stock market, while Canada's share is 0.88% and Korea's is 4.36%. Canada has a bigger market capitalization than Korea, but Canada's public pension fund (CPPIB) has a far higher percentage of overseas stocks (39.4%) than domestic stocks (14.1%).

〈Table 2-10〉 Dollar amounts and market shares of major public pensions' domestic stock investments (end of 2010)

(In USD billions)

Country	Public pension fund	Assets	Domestic stocks %	Domestic stocks — amount (A)	Market cap (B)	Market share
Japan	GPIF	1,312.8	11.0%	144.41	3,827	3.77%
Korea	National Pension Fund	280.4	17.0%	47.67	1,091	4.36%
Canada	Canadian Pension Plan	136.0	14.1%	19.18	2,170	0.88%






Chapter

03

**Analysis of Proxy Voting  
Records by National Pension  
and Major Overseas Public  
Pensions**





## Chapter 3

# Analysis of Proxy Voting Records by National Pension and Major Overseas Public Pensions

## 1. National Pension's proxy voting records

The National Pension Fund attended a total of 528 general meetings of shareholders throughout 2010 and voted on 2,153 proposals. Of the 2,153 items tabled at the general meetings that it attended, the NPF voted in favor of 1,979 (91.9%) and against 174 (8.1%), with no abstention (0%).

〈Table 3-1〉 National Pension Fund's voting records

Year	Companies invested in	Meetings where NPF voted	Agenda items voted on <sup>2)</sup>	Voted		
				For (%)	Against (%)	Neutral (%)
Dec. 2010 - Nov. 2011	424 <sup>1)</sup>		1970		154 7.8%	
2010 cumulative (Jan - Dec)	563	528	2,153	1,979 91.9%	174 8.1%	0 0.05
2009	581	494	2,003	1,865 93.1%	132 6.6%	6 0.3%
2008	505	514	2,010	1,899 94.5%	109 5.4%	2 0.1%
2007	584	453	1,926	1,830 95.0%	96 5.0%	0 0.0%
2006	535	487	1,878	1,796 95.6%	70 3.7%	12 0.6%
2005	383	317	1,395	1,334 95.6%	38 2.7%	23 1.7%

Note: 1) It is the number of companies in Korea that the research team calculated based on the performance data available on the NPS homepage.

2) Voting rights are exercised on the companies one percent or more of whose equity is owned by the NPS. As for the companies of which the NPS owns less than 1%, it votes only on critical agenda items.

Source: National Pension Fund Evaluation Committee's meeting materials (February 2011)

Of a total of 174 proposals that the NPF voted against in 2010, 96 were about the election of directors or auditors, accounting for 55.17% of all the opposed proposals. It is reported that the Fund voted against amendments to the articles of incorporation (41 proposals, 3.56%), compensations for directors or auditors (24, 13.79%) and others (13, 7.47%). An analysis of the reasons for voting against director and auditor appointments shows that 45 proposals were due to lack of independence as the candidates had served the company concerned for nine years or more; 20 were because the candidates had served as full-time directors/employees for an affiliated company within five years of nomination; 19 were because they failed to meet the required board meeting attendance rate; and the rest 12 were for other reasons.

Based on the data disclosed on the NPS homepage, we looked into the companies for which the pension fund actually voted during almost one year from December 2010 to November 2011. As it turned out, it voted for a total of 424 domestic companies. Of a total of 1,970 items on the agendas, it voted against 154, which accounts for 7.8%. The proposals that the Fund opposed during this period break down into 85 director/auditor elections (accounting for 55%); 28 amendments to the Corporate Charter (18%) and 18 director/auditor compensations (11.6%).



〈Table 3-2〉 Breakdown of "no" votes between Dec. 2010 and Nov. 2011 (1 year)

Description of proposals voted against	Number of proposals voted against
Amendment to the Articles of Incorporation	28
Election of director/external directors	52
Approval of financial statements	17
Election of audit committee members/auditors	33
Limit on director/auditor remunerations	18
Regulations on retirement benefits for directors	1
Stock option grant	2
Others	3
Total	154

Source: Data disclosed on the NPS homepage

## 2. Voting tendencies of major overseas funds

### A. CalPERS (United States)

The California Public Employees' Retirement System (CalPERS) attended and voted in a total of 10,677 shareholders' meetings throughout the year of 2010. The total number of the items voted on were 95,508. Among them, 911 were brought in by stockholders, and the percentages of the approved items are shown in the following table (Table 3-3).

〈Table 3-3〉 Proxy voting records of US CalPERS in 2010

Period	Stockholders' meetings attended	Proposals voted on	Shareholder proposals	Shareholder proposals approved
January - March 2010	1,272	8,728	111	51%
April - June 2010	6,872	69,057	729	58%
July - September 2010	1,203	9,983	38	73%
October - December 2010	1,330	7,740	33	45%

Source: CalPERS Board Meeting Archive

Let us look into the details of the yes and no votes cast by the CalPERS from October 2010 to December 2010, focusing on key agenda items.

① Votes against director compensations

Overall, the fund appears to be against excessive rewards for directors and in favor of strengthening conditions for stock options in particular.

〈Table 3-4〉 Cases of votes against director compensation proposals

Company	Date	Reasons
Verint Systems Inc.	Oct. 5	A vesting period of at least 3 years is required to be eligible for a stock option.
Array Biopharm Inc.	Nov. 4	The reward package includes a reload stock option (additional stock options granted upon exercise) and an evergreen provision (additional rewards (stock options) in excess of normal compensations).
Radiant Pharmaceutical Corp.	Dec. 3	An evergreen provision is included.
WHX Corp.	Dec. 9	The proposal allows stock option prices to be revaluated.

## ② Votes in favor of shareholder proposals

CalPERS emphasizes strict compliance with the rules for directors' rewards and remunerations and independence of the BOD chairman from management and external interest groups. It also supports fair employment policies.

〈Table 3-5〉 Cases of votes in favor of shareholder proposals

Company	Date	Agenda	Reasons
News Corp.	Oct. 22	Advisory vote on director rewards	CalPERS considers advisory votes on director compensations as representing the interests of shareholders and the company.
Harris Corp.	Oct. 22	Neutrality of the BOD Chairperson	A board chairman can maintain a more objective position on the management of the company if he/she can maintain independence from management and interest groups
Regis Corp.	Oct. 28	Agenda related to the MacBride Principle	CalPERS strongly supports fair employment policies and labor standards.

## ③ Cases of votes against shareholder proposals

CalPERS is opposed to proposals trying to restrict management decisions from motives that may be too innocent.

〈Table 3-6〉 Cases of votes against shareholder proposals

Company	Date	Agenda	Reasons
Coach Inc.	Nov. 3	Stop using furs in production	CalPERS considers it desirable to leave this entirely to the management's decision.
Devry Inc.	Nov. 10	Prevent veterinary surgeries for educational (not medical) purposes	CalPERS thinks that this could weaken the company's long-term competitiveness.

## B. CPPIB (Canada)

### ① Votes against management proposals

Throughout the year of 2010, the CPP Investment Board (CPPIB) voted on a total of 3,245 proposals (Canada: 530, United States: 674, outside of North America: 2,041), and it voted against 11% of them. In 2009, the CPPIB opposed 15% (29,238) of the management proposals, but this was due to the change in the way that director election proposals were calculated. Starting in 2010, elections of individual directors are calculated as separate items, increasing the number of agenda items.

〈Table 3-7〉 Percentages of votes against management proposals

Agenda	Number and % of opposed items	Reasons
Introduction or revision of stock grant plan	473/1,214 (39%)	They go against the proxy voting principles; cost too much; dilute the value of the common stock; include a director who is not really a director; or give the board of directors too much authority to change the agenda.
Introduction or revision of shareholder rights	48/105 (46%)	The board is not fully prepared to respond to a take-over proposal that can improve shareholder value.
Additional issuance of authorized shares	31/64 (48%)	Issuance of common stock that does not increase shareholder value.
Election of a director with low attendance	Abstained on or against 131 items	Election of a director who has attended less than 75% of board meetings without justifiable reasons.

Source: "2011 Annual Report," CPPIB homepage

### C. Lessons from CalPERS and CPPIB voting principles

The basic direction for CalPERS and CPPIB to exercise their voting rights is that they do not try to manage the companies they invest in. They emphasize the division of roles among three parties – Shareholders, Board of Directors and Management – as well as their respective responsibilities. They also make it clear that they participate actively in responsible investment as proposed by the UN PRI.

Overall, their proxy voting principles are almost the same as those of the National Pension Fund, but they strongly recommend environmental, social and corporate governance

(ESG) disclosures, as is emphasized by the UN PRI. This points to the direction in which the NPF should move in the future to enhance its proxy voting expertise. Specifically, the principles clearly state that they should vote in favor of proposals that require ESG disclosures (demand that corporations submit sustainability reports and disclose specific statistics on environmental factors such as carbon emissions).


Therefore, what large Korean corporations should take interest in is ESG issues. Major pension funds and public pension funds in foreign countries have defined proxy voting guidelines with the advice of consulting firms such as RiskMetrics Group and have exercised their voting rights accordingly. Proxy voting consulting firms reference a variety of indicators and guidelines for ESG compliance: GRI Reporting Guidelines developed by Global Reporting Initiative and Governance Risk Indicators of Risk Metrics (or ISS) are most commonly used.



Chapter

04

# **Analysis of NPF Shareholdings and Proxy Voting Results**







## Chapter 4

# Analysis of NPF Shareholdings and Proxy Voting Results

### 1. Analysis of National Pension's Influence through critical probability (Korean Finance Association, 2009)

The Korean Finance Association (2009) analyzed the influence of the equities owned by the National Pension Fund by analyzing the critical probability of winning a proxy contest in the course of proxy voting in domestic companies. This analysis is based on the premise that, to be able to exercise tangible influence on management decisions including management control, the NPF should hold more than a certain percentage of equities and at the same time the ownership of the largest shareholder should be relatively lower. However, if the largest shareholder of a corporation owns more than 50% of the equities, the NPF has no influence on key decisions, especially those related to management control, regardless of how many shares it may have. For this reason, such corporations are excluded from the analysis.

For each of the corporations whose largest shareholders have less than 50% of the shares, this report calculated the following critical probability as a measure to quantify the possibility of the National Pension Fund to exercise influence.

$$\text{Critical probability} = (0.5 - \text{NPF's percentage shareholding}) / (1 - \text{NPF's percentage shareholding} - \text{Largest Shareholder's percentage shareholding})$$

That is, the critical probability measures how much support the NPF should earn from other shareholders than itself and the largest shareholder to win a proxy battle with the largest shareholder. To take an example, let us assume that the NPF has 5% of a company's shares, while the largest shareholder has 45%. In this case, the probability is calculated to be 90%:  $(0.5 - 0.05) / (1 - 0.05 - 0.45) = 90\%$ . It means that the NPF should get support from 90% or more of the shareholders other than itself and the largest shareholder. If the pension fund's shareholding exceeds that of the largest shareholder, the critical probability falls under 50%, and the higher the largest shareholder's percentage is, the bigger the critical probability becomes.

Based on this analysis, the report concluded that the NPF has a relatively higher possibility of exerting influence through proxy voting on companies with a critical probability of less than 60%. The number of companies that meet this criteria was calculated to be 42.

## **2. Proxy voting in accordance with stock holdings (KIHASA analysis)**

According to the KFA's analysis (2009), an increase in NPF's shareholding contributes to lowering the critical probability, which increases the possibility of intervening in management decisions

through proxy voting. The analysis concludes that the NPF has only a limited scope of influence on corporations. Now this study looks into the relationship between shareholding and proxy voting by analyzing the data of stock holdings of 5% or more and proxy voting records disclosed on the NPS homepage.

Let us first look at the current state of the corporations for which the NPF has disclosed a shareholding of 5% or more for the past four years (March 2008 through March 2011). Based on the NPS disclosures as of March 2010, the number of companies with 5% or more owned by the NPF is 149, which is the highest of the four years surveyed:

〈Table 4-1〉 Number of corporations with 5% or more owned by NPF (2008–2011)

As of	Number of corporations
End of March 2011	149
End of March 2010	93
End of March 2009	143
End of March 2008	100

Source: Data disclosed on the NPS homepage

NPF-invested companies can be classified as follows according to the 5%-plus shareholding criteria: Those disclosed for the past four consecutive years (counting back from March 2011) as companies of which the NPF has ownership interests in excess of 5%; those disclosed for the past three years as such; those disclosed for the past two years; and those disclosed for the first time. As of 2011, the NPF has a history of crossing the 5% shareholding level with 32 companies for four consecutive

years, while it has the same history with 37 for three years.

〈Table 4-2〉 Companies on or above the 5% threshold (March 2008–March 2011) – 1

No	4 times (including 2011)	3 times (including 2011)
1	Kunsul Chemical Industrial	Kiswire
2	Green Cross	Kia Motors
3	Daum Communications	Nexen Tire
4	Dong-A Pharmaceutical	Daeduck Electronics
5	Lotte Samkang	Koran Air
6	Samsung C&T Corp.	MODETOUR Network
7	Sebang	Samsung Engineering
8	Seah Steel	Samsung Electro-Mechanics
9	Shinsegae I&C	Samsung SDI
10	Shinsegae Food	Samyang Corporation
11	SBS	Samyung ENC
12	Ace Digatech	CJ CGV
13	LG Chem	SK Broadband
14	Orion Corp.	Woori Financial
15	UNID	Winix
16	Yuhan Corp.	KCC
17	Cheil Industries Inc.	KT
18	Korea Airport Service	KTB Investment & Securities
19	Korea Investment Holdings	Kolon Industries
20	Halla Engineering & Construction	Kiwoom Securities
21	Hanmi Pharmaceutical	POSCO
22	Hansol Chemical (Hansol Chemience)	Poongsan Corp.
23	Hanil Cement	Hana Financial Group
24	Hyundai Motors	Hankuk Paper Manufacturing
25	Hyundai Marine & Fire Insurance	Hanssem
26	Hotel Shilla	Handsome
27	CJ Cheiljedang	Hanjin Shipping
28	LG International	Hanwha

〈Table 4-2〉 Companies on or above the 5% threshold – 1 (continued)

No	4 times (including 2011)	3 times (including 2011)
29	LG Fashion	Husteel
30	LSIS	HU-CHEMS
31	S&T Daewoo	CJ
32	S&TC	KB Financial Group Inc.
33		LG Electronics
34		LIG Insurance
35		LS
36		S&T Dynamics
37		SK Chemicals

Source: Data of equity holdings disclosed on the NPS homepage

It is found that 44 companies crossed the 5% threshold for the first time in March 2011.

〈Table 4-3〉 Companies on or above the 5% threshold (March 2008—March 2011) – 2

2 times (including 2011)				1 time (2011)			
1	Kyeryong Construction Industrial	31	SK Networks	1	Kora Zinc	31	Hanshin Engineering & Construction
2	National Plastic NPC	32	SK Innovation	2	Kukdo Chemical	32	Hanjin Heavy Industries & Construction HHIC
3	Neowiz Games	33	SKC	3	NEPES	33	Hyundai Green Food
4	Dongkuk Steel Mill	34	Honam Petrochemical	4	Nexen Corp.	34	Hyundai Corporation
5	Dongyang Mechatronics	35	GS	5	Dasan Networks	35	Hyundai Motors(2PB)
6	Samsung Electronics			6	Daewoo International	36	Hwashin
7	Samsung Fine Chemicals			7	Korea Petrochemical Ind.	37	Whanin Pharm
8	Samsung Securities			8	Dongil Industries	38	Fila Korea
9	Samsung Fire &			9	Samkwang Glass	39	BS Financial

2 times (including 2011)				1 time (2011)			
	Marine Insurance						Group
10	Seah Besteel			10	Samyang Genex	40	KHVatec
11	Sejong Industrial			11	Samwha Capacitor	41	OCI
12	Shinhan Financial Group			12	Global Battery	42	SIMP AC
13	LG Display			13	Sonwon Industrial	43	S-Oil
14	LG Life Sciences			14	SBS Contents Hub	44	STX Engine
15	LG Hausys			15	NCsoft		
16	Cheil Worldwide			16	LMS		
17	Chong Kun Dang Pharmaceutical			17	OCI Materials		
18	KP Chemical			18	Woori Investment & Securities		
19	COSMAX			19	EO Technics		
20	Taeyoung Engineering & Construction			20	INTOPS		

〈Table 4-3〉 Companies on or above the 5% threshold – 2 (continued)

2 times (including 2011)				1 time (2011)			
21	Hana Tour			21	Iljin Electronics		
22	Hynix Semiconductor			22	Jinsung T.E.C.		
23	Korea Gas Corporation			23	CAPRO		
24	Halla Climate Control			24	KCC Engineering & Construction		
25	Hanwha Chemical			25	K.C.Tech		
26	Hyundai E&C			26	Techno Semichem		
27	Hyundai Mobis			27	PATRON		
28	Hyundai Steel			28	Korea Refractories		
29	KPX Fine Chemical			29	Hansae Fashion Worldwide		
30	S&T Holdings			30	Hansol Technics		

Source: Data of equity holdings disclosed on the NPS homepage

The number of the corporations in which the NPF had ownership interests of 5% or more between 2008 and 2011 turns out to be 148 in total. Of these, the NPF has maintained a shareholding of 5% or more in 32 companies for four consecutive years and voted against 6 proposals during the past year. On the contrary, it voted against 17 items in the case of the corporations (44) crossing the 5% threshold for the single year of 2011, which is relatively higher.

〈Table 4-4〉 Companies on or above the 5% threshold (2008–2011)

Duration	Number of companies (5%+ shareholding)	Proposals voted against (December 2010–November 2011)
4 consecutive years	32	6
3 years	37	6
2 years	35	6
1 year (2011)	44	17
Total	148	35

We looked separately into the details of proxy votes (December 2010 through November 2011) for the companies of which the NPF had a history of owning 5% or more for the past four years. The number of companies crossing the 5% threshold is 148 in total, and the agenda items voted against is 35.

〈Table 4-5〉 Breakdown of dissenting votes (December 2010—November 2011)

Items voted against	Number of items voted against (All invested companies) (A)	Companies with 5%+ shareholding history during past 4 years (B)	Companies without the history (C=A-B)
Amendment to Articles of Incorporation	28 (18.1%)	6 (17.1%)	
Election of directors/ outside directors	52 (33.7%)	16 (45.7%)	
Approval of financial statements	17 (11.0%)	1 (2.8%)	
Electron of auditors/audit committee members	33 (21.4%)	9 (25.7%)	
Limit on director/auditor remunerations	18 (11.6%)	3 (8.5%)	
Regulations on director retirement benefits	1 (0.65%)		
Stock option grant	2 (1.30%)		
Others	3 (1.95%)		
Total	154 (424 companies)	35 (148)	119 (276)
Opposed proposals per company	0.36	0.23	0.43

The National Pension Fund voted on the proposals of 424 Korean companies for the past year (December 2010—November 2011), and the average number of proposals opposed per company is 0.36. With 148 companies, the fund has a history of holding shares exceeding 5% in at least one of the past four years, and the number of items opposed per company is 0.23. When it comes to the companies in which the 5% threshold has never been crossed, the number of items opposed is 0.43 per company. If we actually take only the companies voted against, the NPF voted against one item or more in a total of 115 companies for the past year. Of the 115 companies, it had a 5% shareholding



for the past four years in 26 companies. If we separate the companies according to the 5% shareholding criteria, the probability of facing opposition in proxy voting is 17.56% for companies with the 5% ownership history, while it is 32.2% for companies without such history, which is double that of the former. In short, companies with the history of 5% shareholding are less likely to get opposing votes from the NPF.

<Table 4-6> Shareholdings and dissenting votes (1 year, 2011) – 1

	Companies voted against (All) (A)	Companies with 5%+ history during past 4 years; voted against (B)	Companies without the history; voted against (C=A-B)
Number of companies (Number of companies voted on)	115 (424)	26 (148)	89 (276)
Probability of getting dissenting votes	$115/424=$ 27.1%	$26/148=$ 17.56%	$89/276=$ 32.2%
Number of items opposed (companies voted against)	154 (115)	35 (26)	119 (89)
Number of items voted against per company voted against	$154/115$ =1.33	$35/26$ =1.34	$119/89$ =1.33

The table shows that there is no difference in the number of per-company items voted against between companies with and without the history of stock holdings of 5% or above. We divided the companies with the 5 percent-plus shareholding history in any of the four years into those with the history for four consecutive years and those with the history for three years or

less. If we classify them into Group 1, Group 2 and Group 3 for comparison, we can see that the probability of getting "no" votes is 15.62% for Group 1, far lower than Group 2 (18.1%) and Group 3 (32.2%).

<Table 4-7> Shareholdings and dissenting proxy votes (1 year, 2011) – 2

	Companies with 5%+ history for 4 consecutive years; voted against (Group 1)	Companies with 5%+ history for 3 years or less; voted against (Group 2)	Companies without the history; voted against (Group 3)
Number of companies (Number of companies voted on)	5 (32)	21 (116)	89 (276)
Probability of getting dissenting votes	5/32= 15.62%	21/116= 18.1%	89/276= 32.2%
Number of items opposed (companies voted against)	6 (5)	29 (21)	119 (89)
Number of items voted against per company voted against	6/5= 1.2	29/21= 1.38	119/89 =1.33

What this table indicates is that the NPF is far less likely to oppose a proposal of a company 5% or more of whose shares it has held for four consecutive years, compared with the other groups, especially companies in which it has a shareholding of less than 5%. It means that the more shares of a company the pension fund has, the less likely it will oppose a proposal in proxy voting. As a result of the data analysis, there is no concern that a simple increase of the NPF's shareholding in a company will also increase the possibility of its intervention in management.

Of course, there is a difference between the probability of

opposing a proposal and the probability of opposing one and actually having it defeated. Since there is no data available about the agenda items actually voted against by the NPF and ultimately defeated, there is a limit in further in-depth analysis. The research team's primary achievement is that we can confirm that the probability of the NPF to vote against a proposal is not proportional to its percentage of shareholding.






Chapter

05

# **Difference Between Global Proxy Voting Guidelines and NPF Guidelines**





## Chapter 5

# Difference Between Global Proxy Voting Guidelines and NPF Guidelines

## 1. RiskMetrics's "International Proxy Voting Guidelines"

One of the proxy voting guidelines accepted as international standards is RiskMetrics Group's "International Proxy Voting Guidelines." These guidelines have country-specific proxy voting principles. We compared RiskMetrics's guidelines applicable to Korea with the NPF guidelines to see how they were different.

### A. RiskMetrics's proxy voting guidelines for Korea

RiskMetrics defined basic principals for proxy voting in Korea and takes them into consideration when voting on behalf of overseas investors in Korea.

#### 1) Approval of financial statements (including cash and stock dividends)

RiskMetrics will generally recommend vote FOR approval of financial statements (and declaration of cash or stock dividends), unless:

- The dividend payout ratio has been consistently less than

30% without adequate justification;

- The payout is excessive given the company's financial position;
- There are concerns about the account methods or audit procedures used; or
- The company is not responsive to shareholder questions about specific items that should be publicly disclosed.

## 2) Election of directors/auditors or audit committee members

### ① Election of directors

RiskMetrics will generally recommend vote AGAINST the election of directors if:

- Adequate disclosure has not been provided in a timely manner according to appropriate procedures;
- There have been questionable transactions with conflicts of interest;
- There are clear concerns over questionable finances or financial restatements;
- There is any record of abuses against minority shareholder interests;
- The board fails to meet minimum corporate governance standards;
- A director has had significant involvement with a failed company;
- A director appears not to have acted in the best interests of all shareholders in the past;



- A director has breached fiduciary duties or engaged in willful misconduct or gross negligence in his/her capacity as a director;
- A director has been indicted or there are pending investigations against him/her; or
- A director has attended less than 75 percent of board meetings without a justifiable reason.

In addition to the rules above, RiskMetrics will recommend vote AGAINST shareholder-nominated candidates who lack board endorsement, unless they demonstrate a clear ability to contribute positively to board activities.

## ② Election of audit committee members

Under Korean law, large companies are required to establish an audit committee comprised of a minimum of three members, two-thirds of whom should be outside directors. RiskMetrics will consider this legal requirement when deciding to recommend in favor or against an election.

RiskMetrics will generally recommend vote AGAINST the election (re-election) of audit committee members if:

- There are serious concerns about the statutory reports presented or audit procedures used;
- There is concern about the qualifications of a candidate for the accounting audit committee;
- A candidate has had significant involvement with a failed

company;

- A candidate has in the past appeared not to have acted in the best interests of all shareholders;
- A candidate has breached fiduciary duties or engaged in willful misconduct or gross negligence in his/her capacity as an audit committee member (irrespective of whether such wrongdoing brings damages to the company or not);
- A candidate has been indicted and there are pending investigations against him/her;
- A candidate has attended less than 75% of committee meetings without a justifiable reason.
- An inside director seeks to become an audit committee member (for large companies only); or
- A candidate has engaged in some significant transactions with the company in the last three years and he/she cannot reasonably be seen to have the necessary objectivity and independence.

In addition to the rules above, RiskMetrics will recommend vote AGAINST shareholder-nominated candidates who lack board endorsement, unless they demonstrate a clear ability to contribute positively to board activities.

### ③ Election of auditors

RiskMetrics will generally recommend vote AGAINST the election of auditors if:

- There are serious concerns about the statutory reports presented or audit procedures used;
- There is concern about the qualifications of a candidate;
- A candidate has previously served the company in an executive capacity or can otherwise be considered affiliated with the company;
- A candidate has breached fiduciary duties or engaged in willful misconduct or gross negligence (irrespective of whether such wrongdoing brings damages to the company or not);
- A candidate has been indicted and there are pending investigations against him/her; or
- A candidate has engaged in some significant transactions with the company in the last three years and he/she cannot reasonably be seen to have the necessary objectivity and independence.

### ④ Remuneration cap on directors and auditors

#### ④-1 Remuneration cap on directors

RiskMetrics will recommend vote FOR approval of remuneration cap on directors, unless:

- The proposed limit on directors' remuneration is excessive related to peer companies' remuneration caps; and/or
- The company is asking for a significant fee cap increase where the company reported sound financial performance but its dividend payout ratio has been 30% or lower for the past couple of years without any reasonable justification; and/or
- The company has generated a net loss in the most recent two financial years.

④-2 Remuneration cap on auditors

RiskMetrics will recommend vote FOR approval of remuneration cap on auditors, unless:

- The proposed limit on auditors' remuneration is excessive related to peer companies' remuneration caps.

⑤ Amendments to the Articles of Incorporation

⑤-1 Related to the issuance of new shares, convertible securities or bonds with warrant

Proposals for amending the articles of incorporation are frequently tabled in Korea. Articles about issuing new shares, convertible bonds, etc. are separately identified under the guidelines, and when such articles are sought to be amended, RiskMetrics will recommend vote FOR the amendments, only if:

- The potential dilution ratio to existing shareholders does not exceed 20%; or
- The proposed issuance limit of new shares is set at no higher than 20% of issued shares.

#### ⑤-2 Preferred stock/non-voting common shares

RiskMetrics will generally recommend vote FOR the issuance of preferred stock up to 50 percent of the issued capital unless the terms of the preferred stock would adversely affect the rights of existing shareholders.

#### ⑤-3 Reduction in capital and increase in capital

RiskMetrics will generally recommend FOR proposals to reduce a company's capital that accompany return of funds to shareholders and is part of a capital-management strategy and an alternative to a buyback or a special dividend. Such a resolution normally does not involve any material change relative to shareholder value. In the case of reduction in capital not accompanied by cash consideration, RiskMetrics will generally recommend vote FOR proposals if a company takes this action because its net assets are in danger of falling below the aggregate of its liabilities or its stated capital. RiskMetrics usually supports such proposals as they are considered to be routine accounting measures.

RiskMetrics will recommend vote FOR, unless the increase in the authorized capital results in less than 30 percent of the

proposed authorized capital on issue, as long as the proposed increase is pursued within the limit of 100 percent of the current authorized capital.

⑥ Stock option grants

Under Korean law, companies are allowed to grant stock options up to 10 percent of the total number of issued shares. RiskMetrics will recommend vote AGAINST a proposed option grant if the maximum dilution level under the plan exceeds 5 percent of issued capital for a mature company or if it exceeds 10 percent for a growth company.

⑦ Removal of directors or auditors

RiskMetrics will consider the following when deciding whether to recommend in favor or against the removal of a director or an auditor:

- Management performance relative to the performance of other companies in the same industry;
- Strategies of a new candidate as compared with those of the current directors/auditors;
- A candidate's independence;
- A candidate's experiences and expertise;
- Current state of the company's corporate governance;
- Crowding-out effect on management; and

- Approaches to communicating with and responding to shareholders.

## ⑧ Independence of outside directors

Under Korean law, there are nine items proposed as the conditions of an outside director's independence. All of them are consistent with the basic direction of RiskMetrics, except for one. RiskMetrics takes a different position on the fifth condition (for an outside director's independence). The Korean law states that a candidate, although he/she has previously served the company in an executive or employee capacity, may be elected as an outside director after two years of leaving the company. But RiskMetrics defines the minimum grace period to be five years.

## 2. Differences from NPF proxy voting guidelines

The major differences between RiskMetrics's proxy voting guidelines for Korea and National Pension Fund's proxy voting principles can be summarized as follows:

- ① Recommend vote AGAINST proposals to elect inside directors into the audit committee if the company is a listed corporation with assets of KRW 2 trillion or more (effective in 2007).
- ② Recommend vote AGAINST proposals to amend the Articles of Incorporation to issue new shares, convertible bonds or bonds with warrant if the maximum dilution level under the plan exceeds 20% of issued capital (effective in 2008).

- ③ Recommend vote AGAINST proposals to reelect outside directors for all listed companies if an outside director has attended less than 75% of board meetings (effective in 2009). This rule requiring a 75% attendance rate for outside directors applied only to listed companies with assets of KRW 2 trillion or more.
- ④ Recommend vote AGAINST proposals to elect a director who cannot reasonably be seen to have the necessary independence if the company is a listed company with assets of KRW 2 trillion or more and its ratio of external directors to inside directors does not represent the majority (>50%) unless a nominee is a member of the founding family. (Effective in 2010)

Aside from formal differences between the guidelines as summarized above, there are also considerable differences in the process of interpretation. Country-specific internal policies are formulated focusing on individual markets. If an issue arises that is not covered in these country-specific policies, the default position of RiskMetrics is to rely on the first of the attached documentations. As the first appendix is comprehensive and has a good summary of the basic principles for corporate governance and the expectations of institutional investors around the world, an analysis process is carried out across all the markets to apply the basic principles of corporate governance and country-specific internal policies at the same time. To take an example, let us assume that the Korean National Assembly approves a bill for amending the Commerce Act to introduce a poison pill plan,



suddenly before the proxy season of 2010, the country-specific internal policies will inevitably have to be updated ultimately. For the upcoming proxy season, however, judgement on proposals related to poison pill is made based on the comprehensive internal policies and basic principles of corporate governance in the first appendix.






Chapter

06

**Plan to Strengthen NPF's  
Expertise for Desirable Exercise  
of Proxy Voting Rights**





## Chapter 6

# Plan to Strengthen NPF's Expertise for Desirable Exercise of Proxy Voting Rights

Many academic papers are being published, stating that, if shareholders exercise voting rights in the direction of boosting the value of the company from a long-term perspective instead of just holding shares, it will ultimately help improve the value of the company. Also, the role of public pension funds as responsible investors is being emphasized throughout the world. The United Nations in particular helped create the "Principles for Responsible Investment." The process of defining the principles was coordinated by the UN Environment Programme Finance Initiative and the UN Global Compact, and now 784 large institutional investors around the world are signatories to the UN PRI. The UN demands through this agreement that large investors and public pension funds around the world take a more aggressive position on ESG issues.

In 2010, the UN PRI conducted a survey with its member institutions. In the survey, a large number of the members responded that they were incorporating recommendations by the UN PRI, particularly on ESG issues, into their investment decisions across the board. According to the 2010 Report on Progress, 95% of the asset owners and 87% of the investment managers adopt investment policies dealing with ESG issues. The percentages of the members (asset owners) responding as follows

have continued to increase: They actively reflect UN PRI recommendations and ESG requirements into their investment policies across the board; they manage them as separate internal policies; and they not only reflect them into investment policies but also manage them as separate internal policies. What this implies is that many overseas institutional investors have been strengthening their role as responsible investors through prior communications with the companies in their portfolios and the exercise of proxy voting rights. The National Pension Fund joined the UN PRI in 2009. Considering that the existing members are acting as responsible investors, the NPF is expected to shift its policies from the conservative position that it has been showing so far into the direction of exercising proxy voting rights more aggressively. Therefore, listed companies, especially large blue-chip companies who are typical targets for the NPF to invest in, should start taking more interest in ESG requirements and preparing for them as they are now being raised as global issues.

The UN PRI requires its members to comply with the following six principles voluntarily. The status and progress of the members in implementing the principles is described below.

(1) We will voluntarily incorporate ESG issues into investment analysis and decision-making processes.

→ In 2009, 64% of the members implemented this principle, but the percentage increased to 69% in 2010.

(2) We will induce the entities in which we invest to make improvement on ESG through proxy voting.

→ The percentage of the members incorporating ESG issues in proxy voting guidelines increased from 88% to 90%.

(3) We will ask for annual reports on ESG issues by the entities in which we invest.

→ The percentage of the members seeking appropriate disclosure on ESG issues increased from 21% in 2009 to 46% in 2010.

(4) We will promote acceptance and implementation of the UN PRI Principles within the investment industry.

→ The percentage of the members adding ESG issues to external investment agreements increased from 63% in 2009 to 66% in 2010.

(5) We will work together to enhance our effectiveness in implementing the UN PRI Principles.

→ The percentage of the members working together for this purpose increased from 75% in 2009 to 90% in 2010.

(6) We will each report on our activities and progress towards implementing the UN PRI Principles.

→ 94% of the members disclosed reports on reflecting ESG issues into investment activities in 2010.

It is desirable, therefore, that the strengthening of the National Pension's proxy voting expertise should develop towards reflecting ESG issues stressed by the UN PRI. The current controversy

in Korea corresponds to the "G" part of ESG. The message that the National Pension should convey to the companies in which they invest is that it recommends that they measure and manage their risk levels by adopting indicators like the Governance Risk Indicators of RiskMetrics, as mentioned earlier, or developing their own indicators internally. On the other hand, "E" in ESG can be linked to sustainability reports mentioned earlier. It is necessary for the National Pension to recommend the companies they invest in to prepare and disclose sustainability reports.

In this context, efforts to strengthen the pension fund's proxy voting expertise need to be made in two steps. The first is to provide and recommend more objective and transparent principles about its areas of interest. It should announce that it recommends NPF-invested companies to prepare and disclose the two reports cited as examples above. The second step is to recommend that they should maintain the indicators in the reports at or above a certain level. With regard to sustainability reports, this means that the NPF should recommend availability of accurate information and disclosure of such information. As for governance risk indicators, it means that the NPF should recommend all areas to be kept at the "low concern" level.

For large Korean corporations to apply these principles, it is necessary for the NPF proxy voting principles to provide clear guidelines on the specifics. For example, when it comes to independence being undermined in the election of a director, it is necessary to specify in what cases independence will be deemed undermined by providing specific numbers and amounts, as is the case with the CalPERS of the United States and the



CPPIB of Canada. We consider it a considerably risky idea to strengthen proxy voting rights unconditionally. It is more desirable to be specific about what should be turned into indexes or indicators and managed accordingly. This will also secure transparency and objectivity in the exercise of proxy voting rights. Therefore, the National Pension Fund needs to state clearly what is required to strengthen its proxy voting expertise, especially the disclosure requirements it recommends corporations to meet.



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