

National Pension Fund Management in Korea

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Presentation Outline

- ▣ Overview
 - National pension plan
 - Asset allocation and Performance
 - Pension fund management and Governance

- ▣ Challenges and Directions

- ▣ Conclusion



1. National Pension Plan

- ? **Founded in 1988 as defined benefits with partially funded**
- ? **Coverage : all workers and self-employed persons excluding government employees, private school teachers, military personnel**
- ? **Contributions : 4.5% by employee, 4.5% by employer**

5 \longrightarrow 9% in 2005 by the self-employed
 \uparrow
 (increasing 1% per year)

- ? **Benefit formula : $1.8(A+B)(1+0.05n)$, indexed to inflation**
- ? **Single largest pension program**



1. National Pension Plan (continue)

▣ Public Pension Funds in Korea

As of Dec. 2002, 2003

(1U\$ = 1,200 Won)

	Contributor	2002		2003(F)	
	(in million)	tril. Won	U\$ bil.	tril. Won	U\$ bil.
National Pension	12,4	92,8	77,3	110,2	91,8
Korea Teachers Pension	0,2	5,4	4,5	6,2	5,2
Government Employees Pension	0,9	4,8	4,0	4,0	3,3
Military Pension Fund		3,7	3,1	3,9	3,3

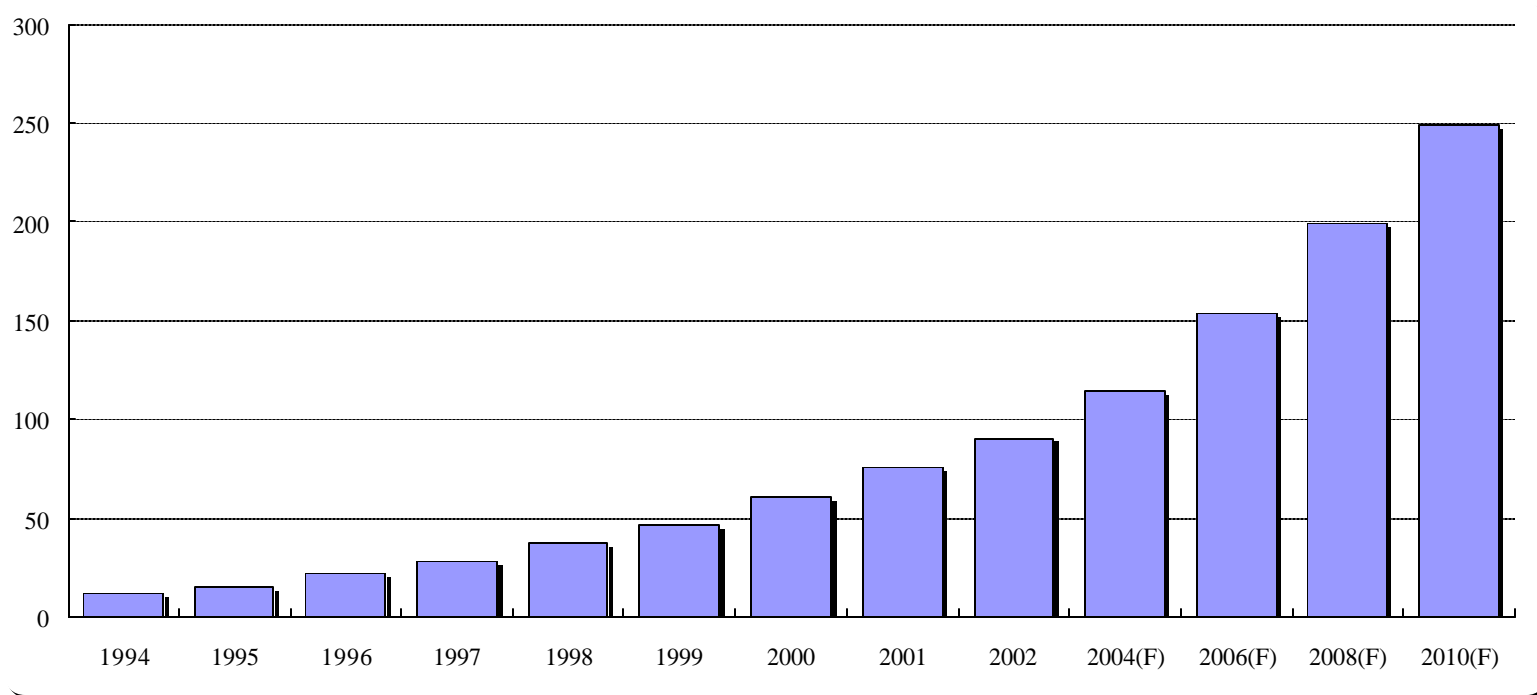
(Source : Ministry of Planning & Budget, National Pension Corporation)



1. National Pension Plan (continue)

▣ National Pension - Growth in the Fund size

(Unit : Trillion Won)



- Total Fund as at Dec. 31, 2002 amounted to 93 trillion won (U\$77 bil.)



1. National Pension Plan (continue)

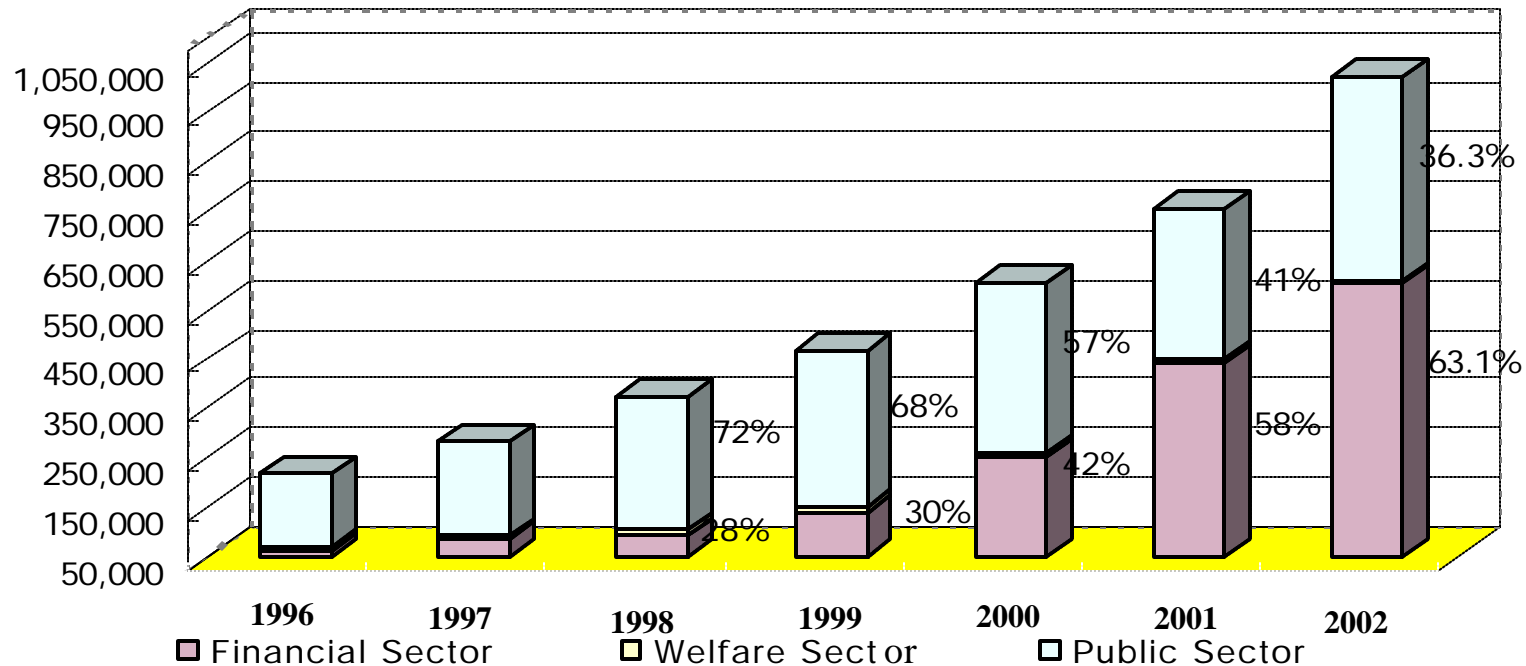
▣ Plan Changes

- ⊙ Decrease income replacement rate from 70% to 60% based on 40 years participation**
- ⊙ Increase pensionable age by one year every 5 years from 2013 and finally become 65 years old in 2033**
- ⊙ Contributions(revenue) will exceed benefits(expenditure) for 35 years**
- ⊙ Mandate five-year actuarial reviews to keep long-term financial stability**



2. Asset allocation and Performance

▣ Trends in investment composition by sector

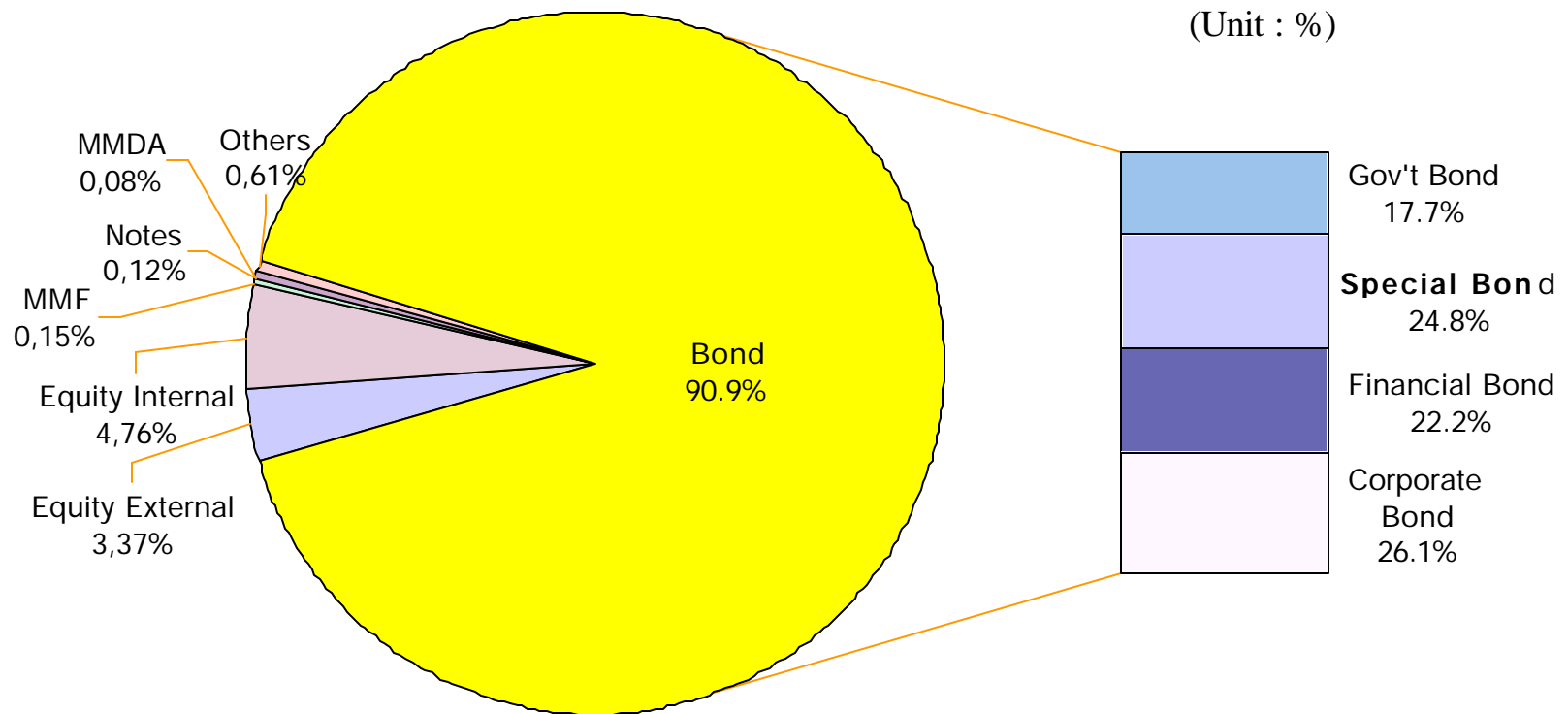


- No obligation of deposit to public sector has been reducing share of economically targeted/social investments since 1999



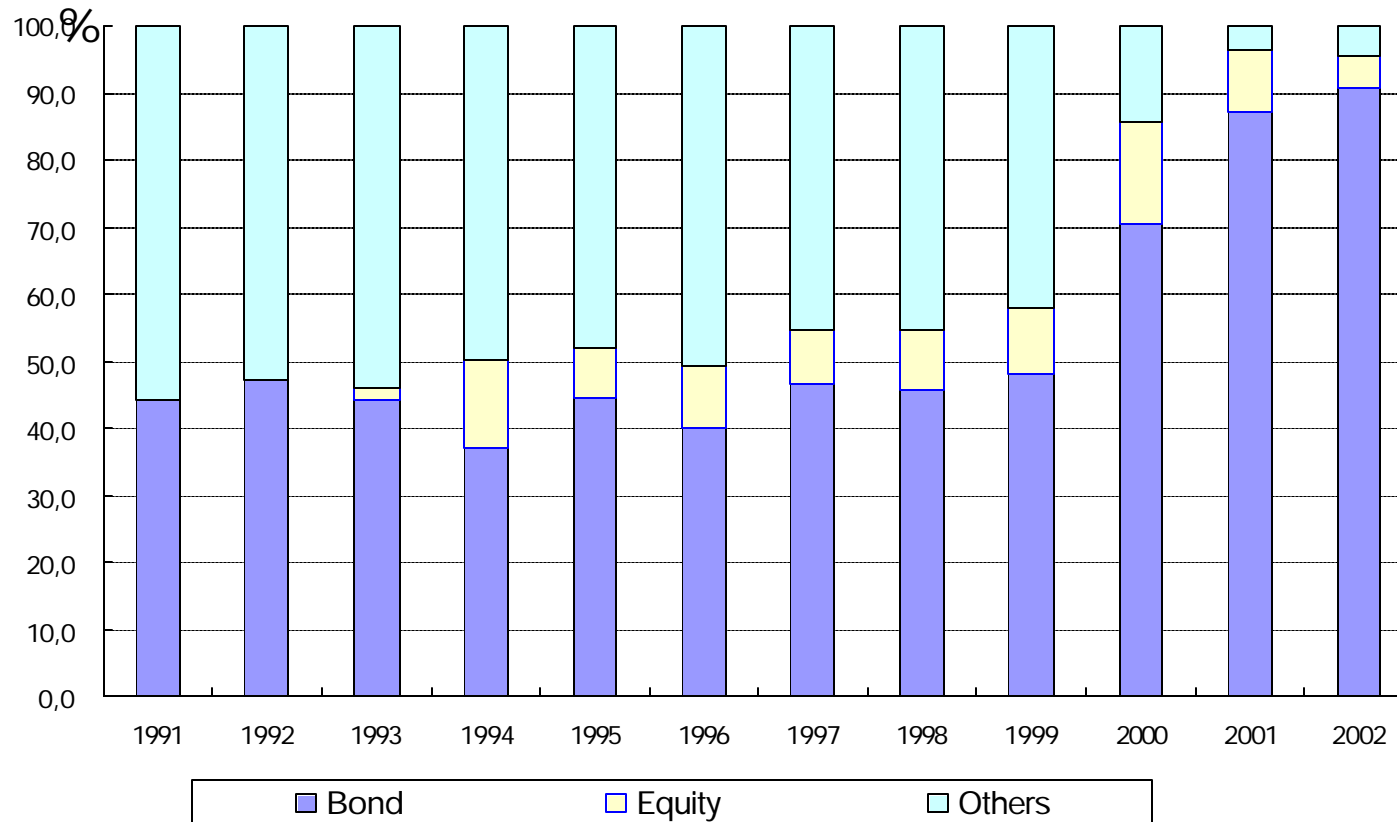
2. Asset allocation and Performance (continue)

▣ Asset allocation by asset class (2002. 12)



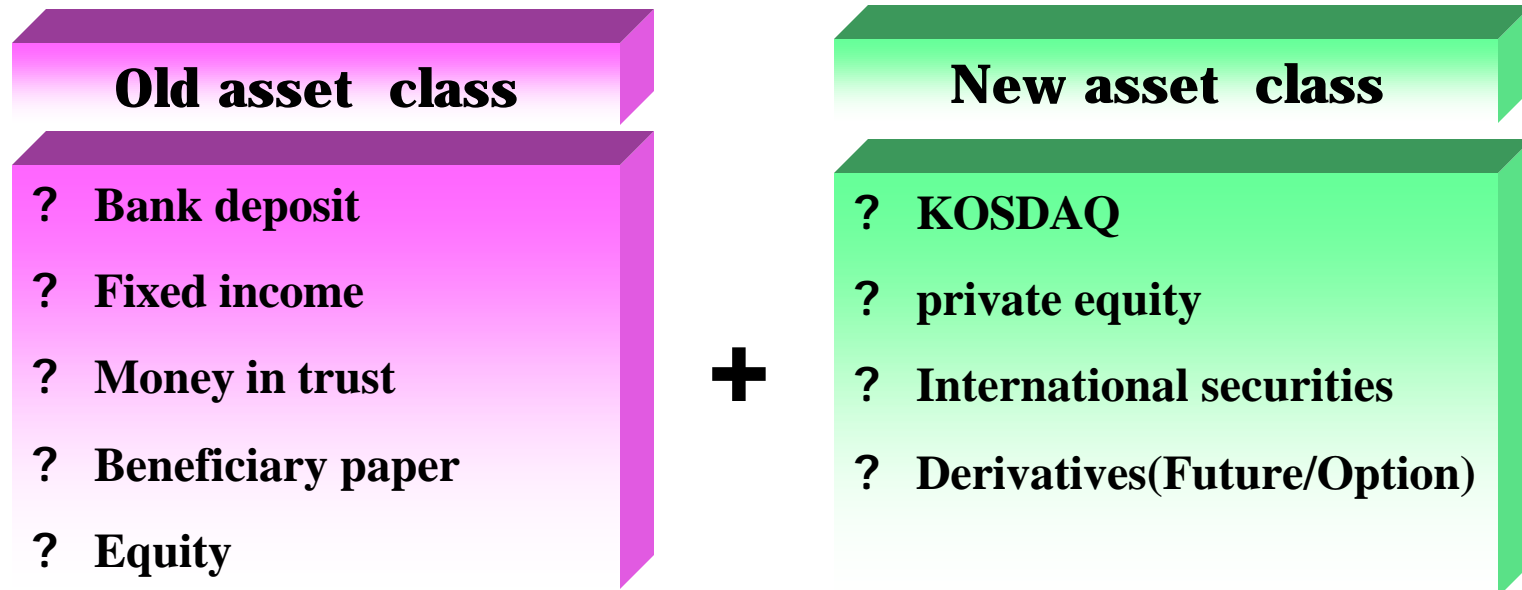
2. Asset allocation and Performance (continue)

■ Historical asset allocation by asset class



2. Asset allocation and Performance (continue)

▣ Diversification of assets



- Changes in NPC law related to diversification(July 2001)



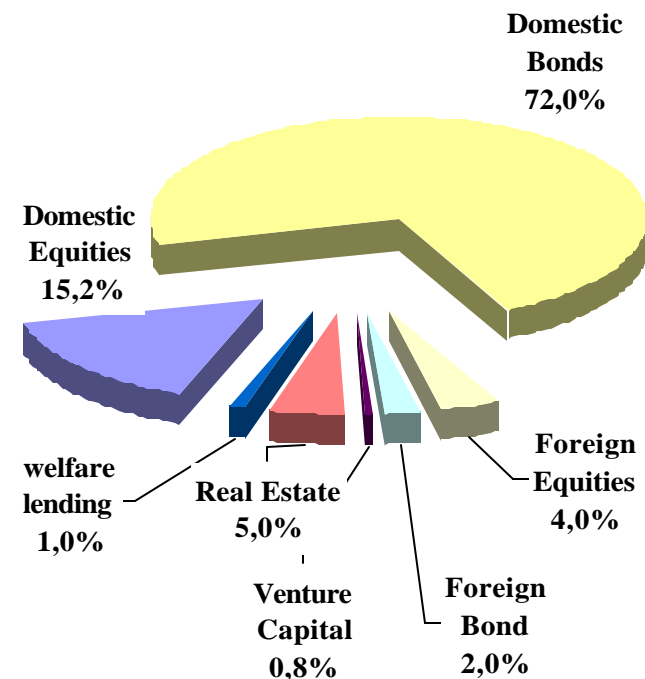
2. Asset allocation and Performance (continue)

▣ Long-term asset allocation

as of Dec. 31, 2012

asset class		
Equities	Domest by In-house	8,0%
	by External	7,2%
	Overseas	4,0%
	sub-total	19,2%
Bonds	Domestic	72,0%
	Overseas	2,0%
	sub-total	74,0%
Private Equities & Other	Venture Capitals	0,8%
	Real Estates	5,0%
Alternatives	sub-total	5,8%
Welfare lending		1,0%
Financial assets total		100,0%

(Source : National Pension Corporation)



2. Asset allocation and Performance (continue)

▣ Restriction of assets

• Financial bonds	BIS ratio of banking institution: 8% Credit rate of issuing company: A grade
• Corporation bonds with warrant	Credit rate of warrant authority: A grade Credit rate of issuing company: BBB grade
• Corporate bonds without warrant or ABS	Credit rate of issuing company: A grade
• Equities	Limit: 10% of issuing equity Limit: maximum 10% of NPC holding equities



2. Asset allocation and Performance (continue)

■ Historical rate of return by sector

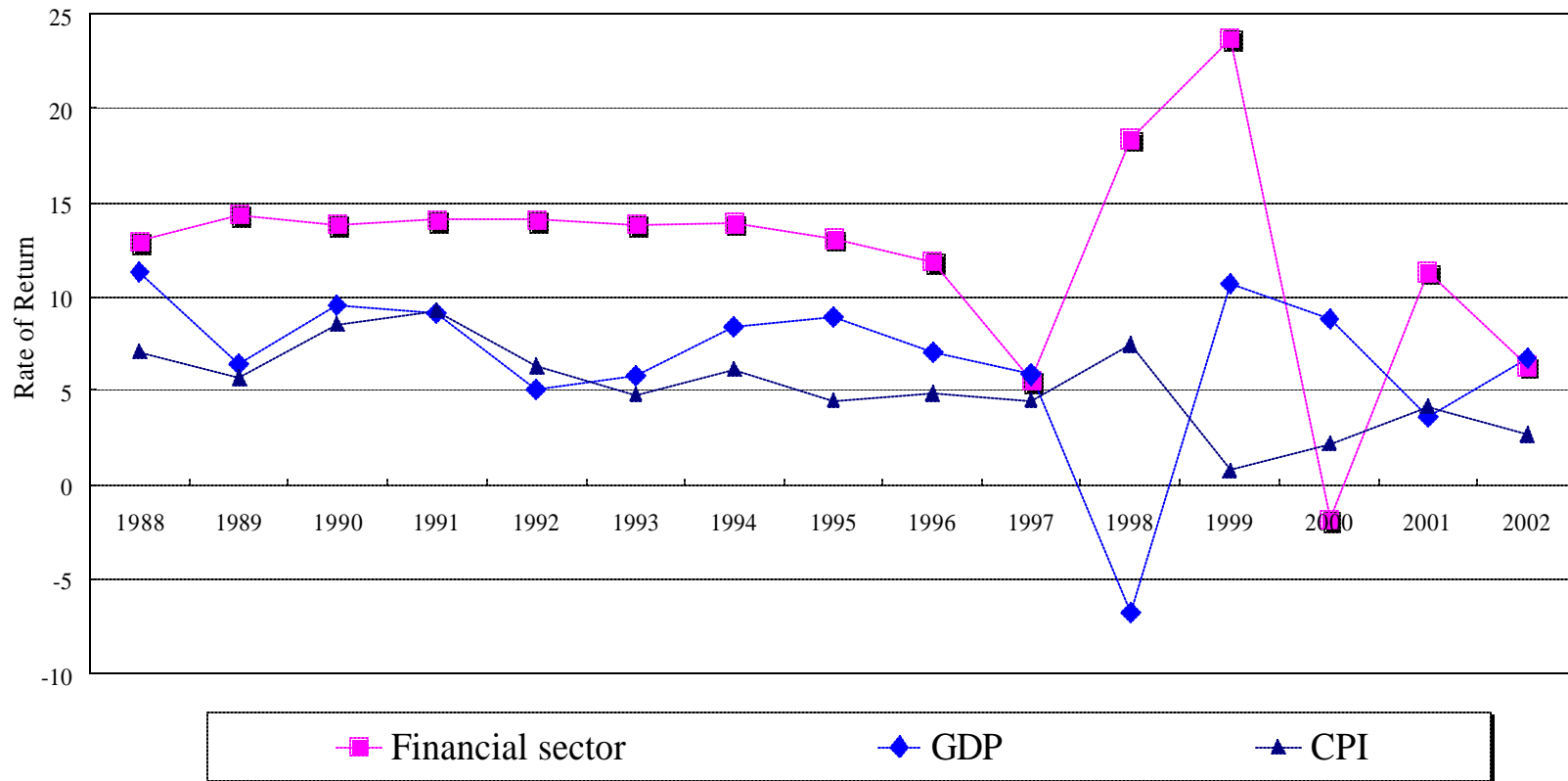
Year	Rate of Return				Economic Indicator	
	Total	Public	Welfare	Financial	GDP	CPI
1991	12.76	11.00	11.00	14.04	9.1	9.3
1992	12.68	11.00	11.00	14.07	5.1	6.3
1993	11.99	9.67	11.00	13.87	5.8	4.8
1994	12.10	10.25	10.94	13.91	8.4	6.2
1995	12.11	11.64	10.68	13.11	8.9	4.5
1996	10.75	10.30	9.69	11.86	7.1	4.9
1997	8.84	10.32	8.67	5.56	5.9	4.5
1998	14.41	13.02	8.93	18.37	? 6.7	7.5
1999	12.80	8.45	8.01	24.49	10.7	0.8
2000	4.69	8.57	8.05	? 1.83	8.8	2.2
2001	8.74	6.62	5.96	11.37	3.7	4.2
2002	6.35	6.47	4.53	6.30	6.8	2.7
Average Return	11.33	10.25	9.49	12.80	6.45	5.26



2. Asset allocation and Performance (continue)

■ Historical rate of return relative to GDP growth and CPI

(Unit : %)



2. Asset allocation and Performance (continue)

▣ Rate of return on Investments by Asset Class

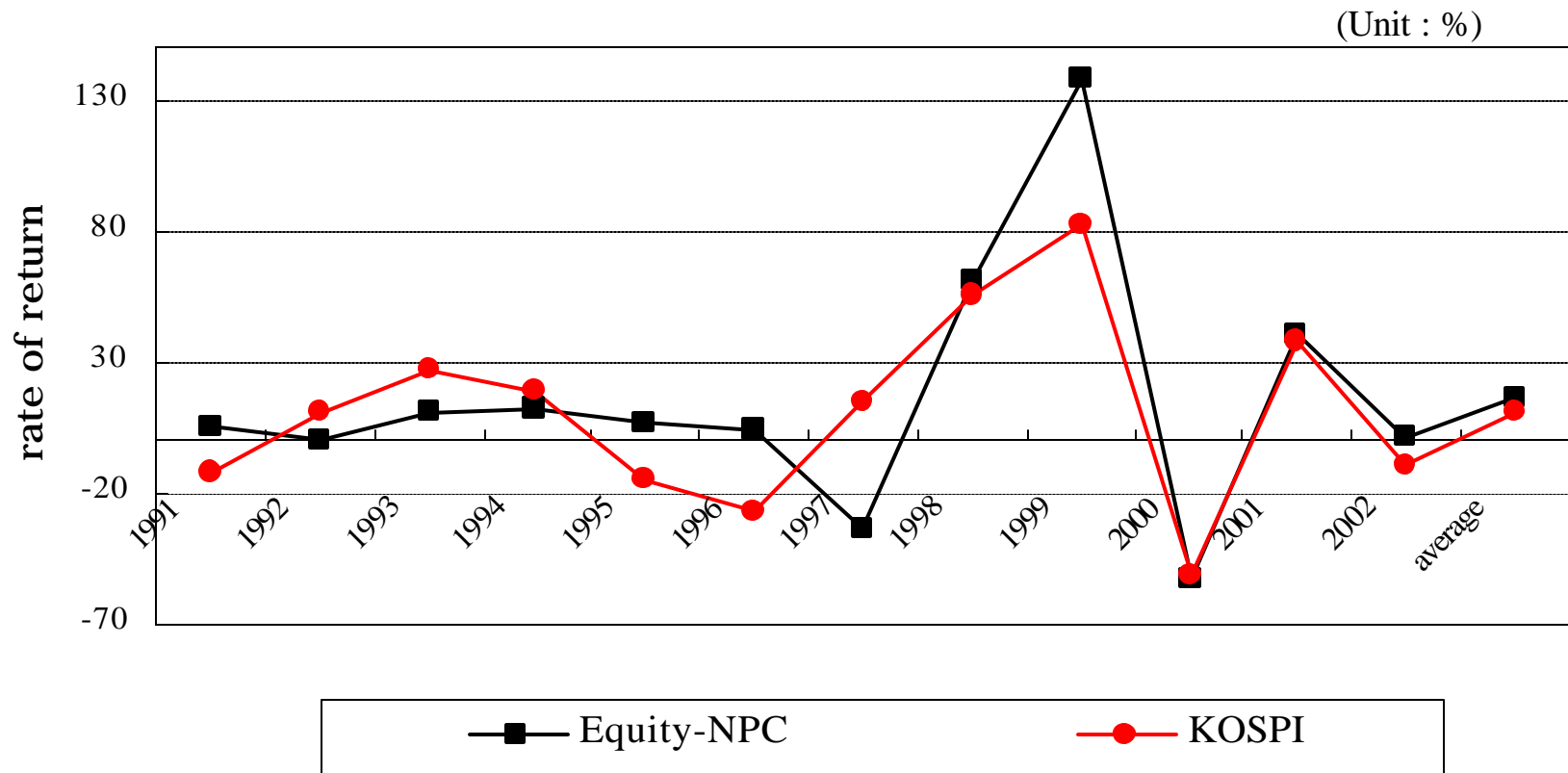
		1995	1996	1997	1998	1999	2000	2001	2002	*CAGR
Fixed	<i>Bonds</i>	13,8%	13,8%	13,4%	15,0%	12,5%	11,0%	8,7%	7,4%	11,9%
Income	<i>Bank Trusts</i>	14,0%	13,1%	12,9%	15,4%	17,1%	10,3%	11,6%	-15,2%	9,4%
	<i>Deposits</i>	11,0%	11,8%	12,9%	15,2%	16,0%	9,2%	5,1%		10,0%
	<i>Cash</i>	13,7%	12,1%	12,3%	13,0%	5,9%	6,2%	4,8%	4,0%	8,9%
	<i>3yr. Treasuries</i>		12,2%	15,0%	7,0%	9,0%	6,7%	5,9%	5,1%	8,6%
	<i>3 yr. Corporates</i>		12,6%	29,0%	8,0%	10,0%	8,1%	7,0%	5,7%	11,3%
Equities	<i>by In-house Man</i>	4,4%	3,6%	-33,6%	60,8%	137,3%	-52,1%	36,8%	-0,5%	7,5%
	<i>by External Manager</i>						41,9%	63,0%	-7,2%	29,0%
	<i>Unit Trusts</i>	11,4%	5,6%	5,6%	10,9%	14,2%	-45,7%	30,4%	6,8%	2,2%
	<i>Venture capital</i>							1,4%	3,5%	2,4%
	<i>KOSPI</i>	882,94	651,22	376,31	562,46	1028,1	504,62	693,70	627,55	

* Compounded Annual Growth Rate



2. Asset allocation and Performance (continue)

Historical rate of return(Equity) compared to KOSPI



Summary of background

- ? National pension plan is partially funded with DB
- ? Yearly inflows will exceed yearly outflows for next 35 years
- ? Excess funds are invested in capital markets
- ? Large exposure to fixed income assets
- ? Share of public sector investment has been declining since 1999
- ? Starting to invest 1.700 trillion won of funds outside Korea in 2003
- ? Average return of financial investment is 12.4% since 1988



3. NP fund management and Governance

▣ Objectives of fund management

- ⊙ Managing the funds in the best interest of contributors and beneficiaries
- ⊙ Investing the funds to achieve a maximum rate of return, without undue risk loss
- ⊙ Making loans for public/social purposes, if needed



3. NP fund management and Governance

- ▣ Governing body of fund management
 - ⊙ Investment policies are decided by NP Fund Management Committee (Board)
 - chairperson of the Committee is Minister of Health & Welfare
 - 21 members consisting of representatives from Government(6 persons), Employers(3), Employees(3), Self-employed(6), and Professionals(3)
 - ⊙ NPFMC is more independent and democratic
 - ⊙ Investment decisions are made for the best interest of all participants



3. NP fund management and Governance

- ▣ Governed body of fund management
 - ⊙ NPC investment management(NPCIM) was established as a separate investment operation unit in November 1999, with “arms-length” to the ordinary NPC functions
 - create independent corporation to manage reserve assets
 - ⊙ Focus on contribution to value added in the operational management given investment mandate and restrictions
 - responsible for “value added” against the benchmark
 - ⊙ Private fund managers hired by NPC
 - 8 teams and 65 persons (43 in-house fund managers)
 - compensating fund managers according to their performance



3. NP fund management and Governance

▣ Division of responsibilities

NPFMC(Governing body)

- ? Investment Policy Statement
- ? Strategic asset allocation
- ? Benchmark
- ? Risk limits
- ? Reports to Congress

NPCIM(Governed body)

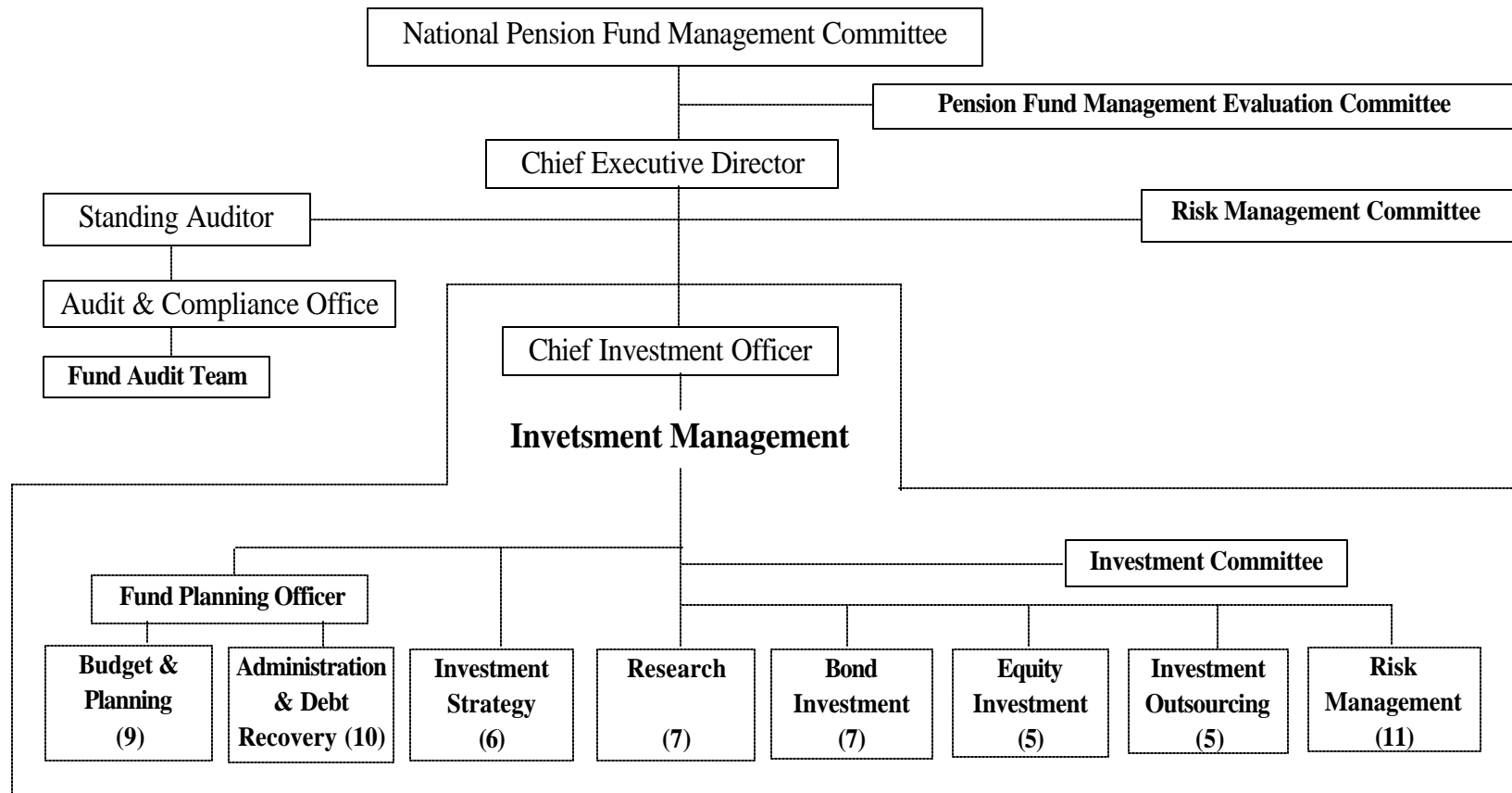
- ? Achieve as high return as possible given investment mandate and restrictions
- ? Tactical asset allocation
- ? Implementing policies, procedures and plans
- ? Risk control
- ? Reports to MOHW, NPFMC



3. NP fund management and Governance

■ Organisation & Investment Decisions

* Number of staff : as of Apr 15, 2003



3. NP fund management and Governance

- ▣ Checks and balances within NPC
 - ⊙ Performance of NPCIM is evaluated by both National Pension Research Center in NPC and outside evaluation institution
 - investment decisions are evaluated in relation to the benchmark portfolio
 - ⊙ Compliance checked by Audit department in NPC
 - compliance with guidelines
 - ⊙ Risk management committee was established under the president of NPC in 2001
 - extensive in-house functions for risk measurement and risk management



3. NP fund management and Governance

▣ Transparent reporting/disclosure

- ⊙ Annual report

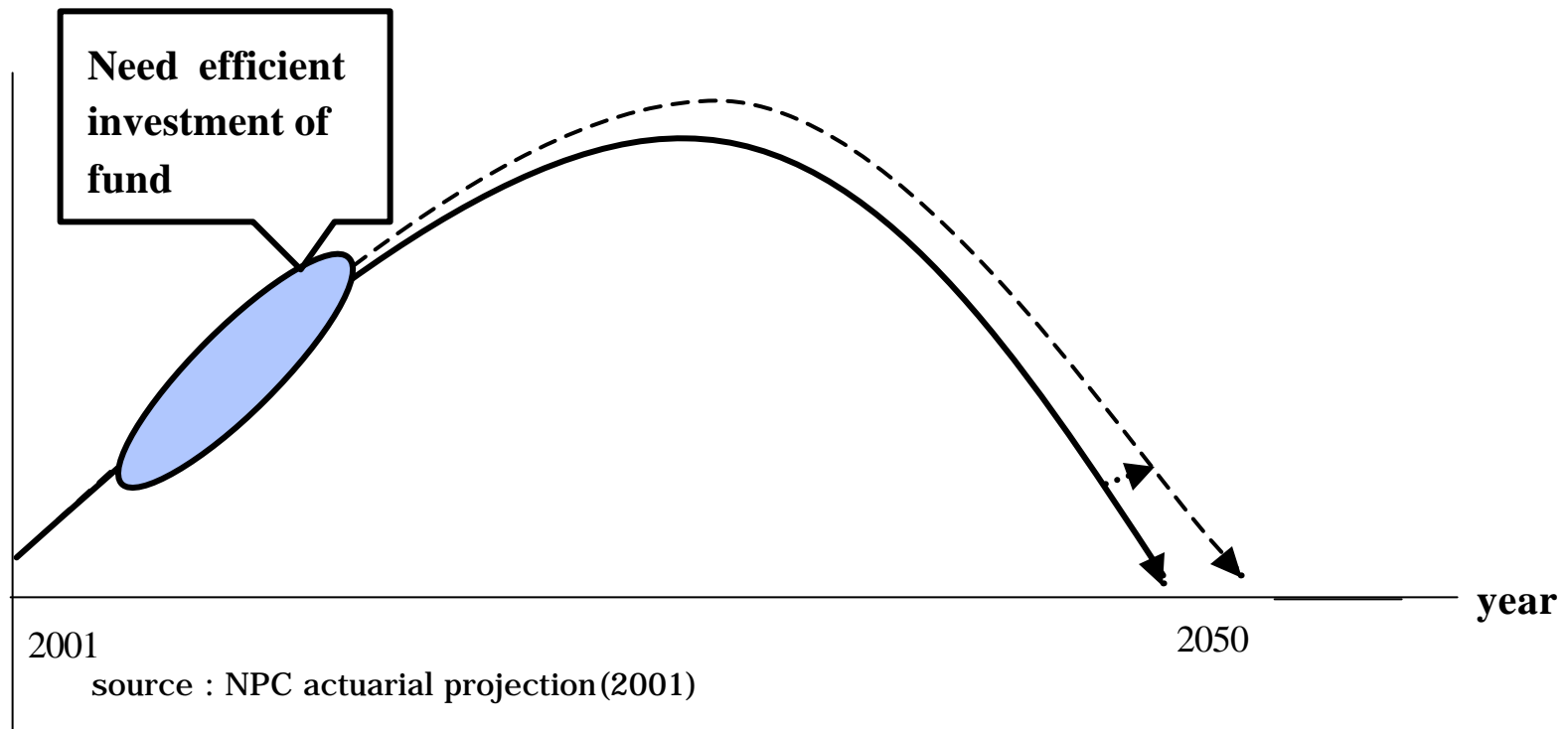
- ⊙ Disclosure of information through Newspaper, Internet etc.

- ⊙ Inspection by independent auditing firm



4. Challenges and Directions

▣ Long-term Financial Projection



4. Challenges and Directions

- ▣ A key challenge is how to make National pension plan sustainable over the long run
- ⊙ Pension is a long-term financial contract
- ⊙ Objective: to deliver affordable, reliable retirement benefits
- ⊙ Key: A long-term financial promise
 - Nature of promise : payment of secure
 - How long?



4. Challenges and Directions

- ▣ Another key challenge is to seek a long-term target rate of return
 - ⊙ How to set the long-term rate of return, eg. growth rate of GDP
 - ⊙ ALM approach to asset allocation is yet effective
 - Why little consideration to change in liabilities?



4. Challenges and Directions

- ▣ Third key challenge for fund management is how to sustain at least current level of returns in the new economic environment
- ⊙ Increase in exposure to risky assets(equities), venture, overseas investment, real estate, etc.
- ⊙ Reinforcement of advanced risk management
- ⊙ Passive vs Active
 - passive (index) management in core portfolio
 - active management in selected portfolio
- ⊙ Development of long-term securities(10-year, 20-year bonds)



4. Challenges and Directions

- ▣ Last key challenge is how to set good governance principles and practices by which funded reserves can safely maximize returns relative to a modest risk tolerance
- ⊙ Professional competence
- ⊙ Independence to make investment decisions
- ⊙ Clear-cut responsibilities and rights
- ⊙ Commitment to transparency



4. Challenges and Directions

- ▣ Significant amount of outsourcing to diversify of operational risk
 - ⊙ Utilization of outside professional managers in private sector
 - ⊙ Substantial share of outsourcing in asset allocation
 - ⊙ No distortion of national capital markets

- ▣ Reinforcement of corporate governance
 - ⊙ Protecting value of holding assets

 - ⊙ Focus on shareholder's role
 - exchange of information
 - exercise of voting rights



5. Conclusions

- ⊙ **Safeguards in capital markets**
- ⊙ **Good Governance**
- ⊙ **High focus on Transparency**

will be helping to keep the pension promise



Thank you for your attention

