

Against the Odds: Korea's National Pension Service Success in a Slower-Growth Era*

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In the face of an aging population, slowing birthrates, and gradually dwindling investment opportunities in the local market, Korea's National Pension Service (NPS) has grown into the fourth largest public pension fund in the world with over KRW 400 trillion in assets under management as of February 2013 - up three-fold in less than ten years. Given the significance and implications of NPS' apparent success for practitioners and the broader investment community, this case study seeks to provide a comprehensive background to the development and recent investing strategies of NPS - specifically with regards to: (1) asset diversification; (2) globalization of investment; and (3) enhancement of risk management. In addition, this case study examines the role of governance and internal management in shaping and executing NPS strategies. Through a critical examination of the NPS case, some light may be shed on the applicability of the investment model for other institutions seeking to enhance their longer-term performance.

Key Words: National Pension Service, NPS, Korea, pension fund, investment

I. Introduction

One common feature of many industrial economies is the existence of a public pension or social security scheme that accounts for a significant portion of disposable income of the elderly. Historically, government involvement in the provision of such pensions has

been justified by reasons of efficiency (market failure), redistribution, insurance failure or paternalism (Aidt et al 2002). And while some countries introduced public pensions as early as the nineteenth century, large-scale social security systems began to emerge as an important feature in many countries only after World War II (Aidt et al 2002).

By these standards, Korea's National Pension

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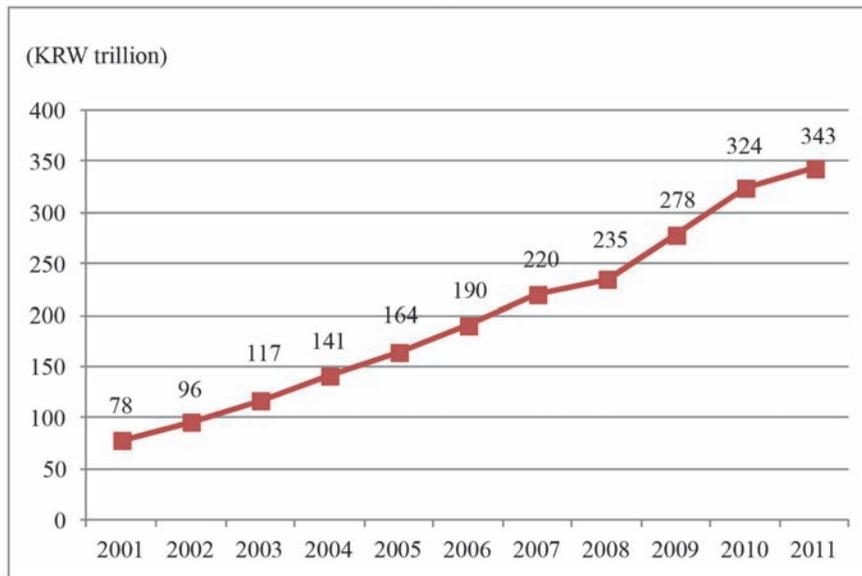
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Scheme is relatively new. But since its establishment in 1988, Korea's National Pension Service (NPS) has grown from just KRW 530 billion in fund reserves to around KRW 400 trillion as of February 2013 (Figure 1). This makes Korea's NPS the fourth largest public pension fund in the world in terms of asset size (Figure 2). Going forward, NPS management and industry experts expect the NPS to continue to grow and serve as a leading investing force in the local and, increasingly, global markets.

The rapid growth of Korea's NPS and its apparent success to date provide for a timely case study that has potential implications for practitioners and the investing community at-large. To better understand the salient features of NPS and its investment strat-

egies, this case study first provides a comprehensive overview of Korea's National Pension Scheme and the role of the NPS. Second, the case examines key strategies that have arguably contributed to the recent growth of the National Pension Fund, namely: (1) asset diversification; (2) globalization of investment; and (3) enhancement of risk management. Third, this case examines the role of governance and internal management in the shaping and implementation of NPS policies and strategies. Taken together, a critical examination of this case should reveal key factors that contributed to the recent growth of NPS and the potential applicability of NPS' investment model for institutions looking to enhance their investment performance.

<Figure 1> Annual Growth of the NPF



Note: 1) 2011 data denotes NPF size as of July 2011

(Figure 2) Global Pensions Fund Size Comparison, USD billion

Rank	Institution	Assets (US\$ bn)	Rank	Institution	Assets (US\$ bn)
1	GPIF (Japan)	1,432.1	11	California State Teachers	138.9
2	GPF (Norway)	550.9	12	NY State Common (US)	133.0
3	ABP (Netherlands)	318.8	13	PFZW (The Netherlands)	133.0
4	National Pension Service	289.4	14	National Social Security	129.8
5	Federal Retirement Thrift	264.0	15	GEPF (South Africa)	128.2
6	CalPERS (US)	214.4	16	Pension Fund Association	125.0
7	Local Government Officials	189.6	17	ATP (Denmark)	123.8
8	Canada Pension (Canada)	149.1	18	Florida State Board (US)	123.4
9	Employees Provident Fund	145.6	19	NY City Retirement (US)	115.2
10	Central Provident Fund	144.8	20	Ontario Teachers (Canada)	108.4

Note: assets refer to end-2010 data

II. Korea's National Pension Scheme

Korea's National Pension Scheme was established in 1988 with the goal of contributing to social stability and welfare promotion by providing pension benefits for those in need due to old age, disability, or death. According to the NPS, as of July 2012, the number of insured persons exceeded 20 million while the number of current beneficiaries surpassed three million. This is equal to around 40% and 7%, respectively, of South Korea's population of roughly 50 million.

2.1 Coverage and Contribution

Insured persons under the National Pension Scheme are Korean nationals and foreigners residing in Korea who are between the ages of 18 and 60 (Figure 3). Coverage type can

generally be divided into persons insured mandatorily (workplace-based) and voluntarily. Pension benefit payments and other operating expenses are mainly financed through contributions paid by insured persons and their employers as well as by investment income. According to the NPS, the contribution rate was 9% in July 2011. Under the scheme, contribution amounts are calculated by multiplying an insured person's monthly income by the contribution rate (in this case, by 9%). For workplace-based insured persons, the contribution amount is shared equally between the employer and the employee (the insured person) with each party paying 4.5%. Those insured voluntarily pay the full amount of their contributions.

2.2 Benefits

The National Pension Scheme outlines a

〈Figure 3〉 Annual Overview of Insured Persons

Date	Total	Workplace-Based		Individually Insured			Voluntarily Insured	Voluntarily & Continuously Insured
		Workplace	Insured Persons	Subtotal	Urban	Rural		
2012.06	20,089,867			8,537,356	1,936,882	6,600,474	200,379	78,519
2011	20,089,867	1,103,570	10,976,501	8,675,430	1,986,631	6,688,799	171,134	62,846
2010	19,228,875	1,031,358	10,414,780	8,674,492	1,951,867	6,722,625	90,222	49,381
2009	18,623,845	979,861	9,866,681	8,679,861	1,925,023	6,754,838	36,368	40,935
2008	18,335,409	921,597	9,493,444	8,781,483	1,940,510	6,840,973	27,614	32,868
2007	18,266,742	856,178	9,149,209	9,063,143	1,976,585	7,086,558	27,242	27,148
2006	17,739,939	773,862	8,604,823	9,086,368	1,972,784	7,113,584	26,991	21,757
2005	17,124,449	646,805	7,950,493	9,123,675	1,969,017	7,154,658	26,568	23,713
2004	17,070,217	573,727	7,580,649	9,412,566	2,009,142	7,403,424	21,752	55,250
2003	17,181,778	423,032	6,958,794	9,964,234	2,062,011	7,902,223	23,983	234,767
2002	16,498,932	287,092	6,288,014	10,004,789	2,007,196	7,997,593	26,899	179,230
2001	16,277,826	250,729	5,951,918	10,180,111	2,048,075	8,132,036	29,982	115,815
2000	16,209,581	211,983	5,676,138	10,419,173	2,037,722	8,381,451	34,148	80,122
1999	16,261,889	186,106	5,238,149	10,822,302	2,083,150	1,890,187	32,868	168,570
1996	7,829,353	164,205	5,677,631	2,085,568	2,085,568	-	50,514	15,640
1995	7,496,623	152,463	5,541,966	1,890,187	-	-	48,710	15,760
1992	5,021,159	120,374	4,977,441	-	-	-	32,238	11,480
1988	4,432,695	58,583	4,431,039	-	-	-	1,370	286

defined benefit plan which is designed to provide income protection for insured persons in the event of disability or death and also during old age. Benefits typically take three forms. First, old-age pension (divided pension) is designed to support an insured person's income when the insured becomes economically inactive due to old age. Second, disability pension provides for insured persons who have struggled with disabilities caused by disease or injury and guarantees insured persons with an appropriate income level. Third, survivors' pension is payable to surviving dependents following the death of pensioners or insured persons. As of July

2012, the number of beneficiaries reached 3.3 million. These include around 2.6 million old-age pensioners, 73,000 disability pensioners, and 465,000 survivor pensioners. In addition, the number of lump-sum receivers reached 8.8 million (Figure 4).

III. The Role of the National Pension Fund

In observance with Article 102 of the National Pension Act, the National Pension Fund (NPF) was established to serve as a reserve

(Figure 4) Annual Benefit Payment by Type, persons, KRW million

Classification		Total	Pension				Lump Sum			
			Subtotal	Old-Aged	Disabled	Survivors	Subtotal	Disabled	Refund	Death
Total	Beneficiaries	12,404,551	3,470,671	2,832,013	125,577	513,081	8,933,880	58,084	8,778,620	97,176
	Amount	71,997,729	56,924,440	46,397,595	2,678,658	7,848,187	15,073,289	456,795	14,400,799	215,695
2012-06	Beneficiaries	3,235,829	3,142,910	2,605,308	72,730	464,872	92,919	1,401	86,055	5,463
	Amount	5,529,871	5,183,001	4,446,423	155,857	580,722	346,869	16,496	314,858	15,515
2011	Beneficiaries	3,166,983	3,015,244	2,489,614	75,895	449,735	151,739	3,480	136,628	11,631
	Amount	9,819,296	9,273,039	7,905,180	305,547	1,062,312	546,257	41,919	475,051	29,287
2010	Beneficiaries	2,975,336	2,820,649	2,330,128	76,280	414,241	154,687	3,447	141,347	9,893
	Amount	8,635,467	8,107,420	6,861,876	296,305	949,239	528,047	37,299	465,123	25,625
2009	Beneficiaries	2,770,344	2,602,630	2,149,168	74,535	378,927	167,714	3,836	154,119	9,759
	Amount	7,471,934	6,946,490	5,814,825	287,016	844,649	525,444	40,940	460,476	24,028
2008	Beneficiaries	2,517,579	2,366,626	1,949,867	72,166	344,593	150,953	4,902	137,654	8,397
	Amount	6,180,804	5,764,986	4,765,528	268,100	731,358	415,818	47,921	348,026	19,871
2007	Beneficiaries	2,244,477	2,110,519	1,731,560	67,091	311,868	133,958	5,167	121,200	7,591
	Amount	5,182,611	4,748,988	3,857,709	245,878	645,401	433,623	48,325	368,374	16,924
2006	Beneficiaries	1,985,502	1,858,769	1,517,649	61,762	279,358	126,733	4,898	115,394	6,441
	Amount	4,360,239	3,899,369	3,103,161	225,607	570,601	460,870	44,239	400,674	15,957
2005	Beneficiaries	1,757,674	1,651,681	1,349,626	54,467	247,588	105,993	4,147	96,078	5,768
	Amount	3,584,901	3,210,044	2,531,536	193,931	484,577	374,857	35,713	324,885	14,259
2004	Beneficiaries	1,533,059	1,424,083	1,156,098	47,260	220,725	108,976	3,609	99,750	5,617
	Amount	2,914,015	2,568,966	1,987,451	163,629	417,886	345,049	29,297	303,194	12,558
2003	Beneficiaries	1,169,441	1,052,414	819,800	39,727	192,887	117,027	2,853	108,740	5,434
	Amount	2,328,449	2,017,911	1,533,339	131,921	352,651	310,538	21,978	278,232	10,328
2002	Beneficiaries	1,052,327	916,630	717,488	32,876	166,266	135,697	2,194	129,239	4,264
	Amount	1,915,255	1,652,529	1,254,730	103,849	293,950	262,726	16,419	238,685	7,622
2001	Beneficiaries	948,164	770,568	602,197	27,456	140,915	177,596	2,469	170,542	4,585
	Amount	1,569,257	1,301,142	973,630	83,583	243,929	268,115	18,286	243,445	6,384
2000	Beneficiaries	927,545	618,232	482,042	21,914	114,276	309,313	2,170	304,127	3,016
	Amount	1,607,035	924,518	651,368	70,098	203,052	682,517	15,799	662,420	4,298
1999	Beneficiaries	1,249,257	282,407	175,572	16,906	89,929	966,850	1,944	962,578	2,328
	Amount	3,871,969	477,350	299,592	45,740	132,018	3,394,619	11,887	3,378,752	3,980
88-89	Beneficiaries	6,240,248	206,523	115,008	15,273	76,242	6,033,725	11,567	6,015,169	6,989
	Amount	7,026,628	848,686	411,251	101,596	335,839	6,177,942	30,276	6,138,606	9,060

Note: 1) The total figures indicate the number of beneficiaries, including the aged, disabled, and surviving persons by year. They refer to the number of beneficiaries accumulated from 1988 to the applicable year, when former beneficiaries' pension rights are expired.

fund to secure financial resources necessary to implement the National Pension Scheme. As such, the NPF serves as the financial arm of the Scheme as well as a financial guarantor of post-retirement welfare. The National Pension Fund consists of contributions, returns from asset management, a reserve, as well as earnings retained by the NPS. With regards to the latter, the NPS is empowered to operate the Fund under powers delegated by the Ministry of Health and Welfare. The Fund is managed with the goal of maximizing profits and thus contributes to achieving long-term financial stability of the National Pension Scheme.

3.1 Brief History

In 1988, the NPF was established with KRW 530 billion in fund reserves. The Fund began

deposits to the Public Capital Management Fund in 1994 and launched a loan business for private childcare facilities the same year. The Fund also established senior citizens' welfare facilities in 1995 and provided for the livelihood of the unemployed during the Asian financial crisis in 1998. In November 1999, the NPS expanded the Fund Management Department and renamed it the Fund Management Center with the purpose of developing and practicing more systematic and efficient fund management. As such, the Center is charged with enhancing global talent in fund management, providing innovations in the investment process, and improving long-term profitability and stability (Figure 5).

In 2000, the NPS initiated external management of domestic equities to maintain expertise and stability in investment, and followed with investment in venture capital and

〈Figure 5〉 Chronology of Key Events

Date	Key Event
2000	Commenced outsourcing of domestic equities investment (January)
2002	Commenced investment in venture capital (March) and outsourcing of overseas equities (December)
2003	Launched the domestic fixed income lending program (March), commenced investment in a corporate restructuring fund (May), achieved KRW 100 trillion in fund reserves
2004	Commenced outsourcing of domestic fixed income investment
2005	Commenced outsourcing of overseas fixed income investment and lending business
2006	Launched the Overseas Investment Team
2007	Reorganized the Fund Management Center, achieved KRW 200 trillion in fund reserves
2009	Commenced in-house management for overseas equities investment
2010	Reorganized the Fund Management Center by appointing a compliance officer separate from the Center; achieved KRW 300 trillion in fund reserves
2011	Reorganized the Fund Management Center by expanding overseas investment units and reshuffling the Center according to asset class

outsourcing for overseas equity investment in 2002. After reaching just KRW 100 trillion in 2003, total fund reserves exceeded KRW 300 trillion in 2010. By July 2012, the NPF's total assets under management reached KRW 368 trillion. On the one hand, recent growth has been credited to efforts to increase long-term investment returns through portfolio diversification. But given that the scheme is relatively new, much of the Fund's recent growth can also be attributed to a growing number of subscribers on the one hand, while the number of beneficiaries is much smaller. In other words, the Fund's growth can be explained in part by higher fund inflows versus outflows. As noted in Figures 3 and 4, total subscribers as of June 2012 were over 20 million, while beneficiaries totaled just around 3.3 million.

3.2 Governance

Under Article 102 of the National Pension Act, the Minister of Health and Welfare is responsible for managing the Fund and implements the Fund in compliance with the decisions of the National Pension Fund Management Committee. The fifth clause of Article 102 of the National Pension Act requires efficiency in management, with the Minister of Health and Welfare entrusting implementation of the Fund solely to the NPS. The NPF Management Center was thus created to boost profitability and enhance professional capability, working as a special

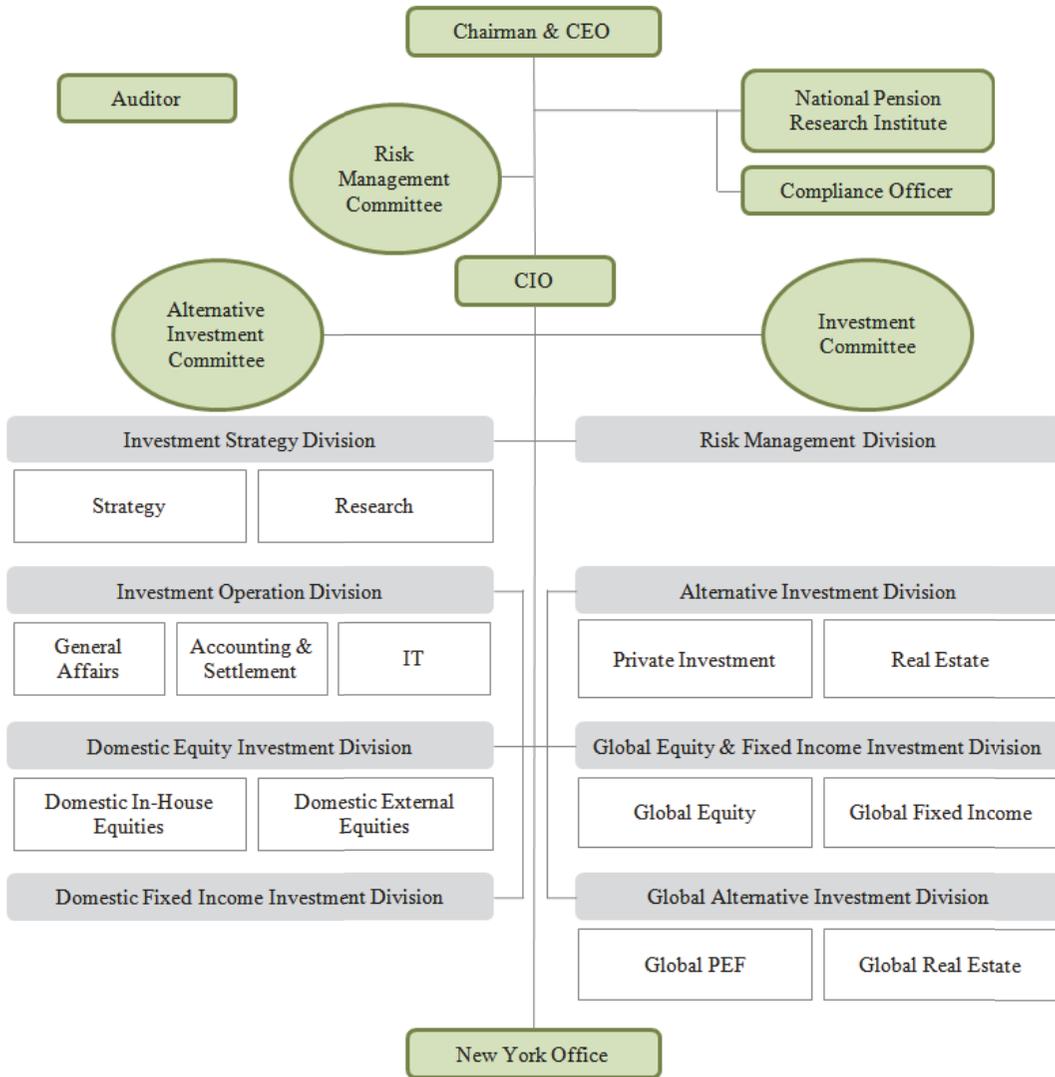
body specializing in fund management. In sum, the National Pension Fund Management Committee is the highest decision-making body and deals with major issues of fund management such as composition and implementation of the Fund Management Guidelines, formation of the Annual Fund Management Plans, and evaluation of fund performance. The NPS reports work related to fund management to the Minister of Health and Welfare (Figure 6).

3.3 Fund Management Committee

Given the size of the National Pension Fund and the significant role it plays in the health of the national economy, the NPS is subject to strict regulation and oversight. To help maintain a balance between profitability and stability through appropriate allocation of investment assets and risk management, the Ministry of Health and Welfare established the National Pension Fund Management Committee to deliberate and resolve major issues of fund management. The Management Committee, chaired by the Minister of Health and Welfare, serves as the Fund's highest decision-making body and consists of 20 members - 12 of whom are representatives of insured persons.

Operating under the NPF Management Committee are several bodies which assist the Committee in meetings its goals and maintaining efficiency. These include the NPF Evaluation Committee for National Pension

〈Figure 6〉 Fund Management Organization



Fund Operation, the Experts Council on Investment Policy, the Experts Council on the Exercise of Voting Rights, and the Experts Council on Performance Evaluation & Compensation (Figure 7).

3.4 Risk Management Committee

To enhance operational risk management practices, the NPS established the Risk Management Committee. The Risk Management Committee is chaired by the NPS and consists of the Chief Investment Officer (CIO)

<Figure 7> Committees under the NPF Management Committee

Committee	Role
NPF Fund Evaluation Committee	The Evaluation Committee deliberates on and evaluates specific issues and fund management performance, which it presents at the NPF Management Committee hearings, including: <ul style="list-style-type: none"> • Asset portfolios and accounting matters • Measurements of fund performance and improvement in fund management • Points of discussion that have been approved by its chairman, and other issues that the NPF Management Committee may request
Council of Experts on Investment Policy	The Council is an advisory body that reviews and deliberates on investment strategies to ensure that the Management Committee arrives at appropriate decisions for: <ul style="list-style-type: none"> • Mid- to long-term or annual fund management plans • Investment policy requiring objective evaluation based on in-depth knowledge • Development of new investment policies or the amendment of existing policies
Council of Experts on the Exercise of Voting Rights	To ensure integrity and rationality, every year the Council reviews and amends guidelines enacted based on social consensus regarding: <ul style="list-style-type: none"> • Overseeing and amending the guidelines on the exercise of voting rights • Resolving controversies presented by the Fund Management Center • Other matters brought to its attention by the chairman of the Management Committee
Council of Experts on Performance Evaluation & Compensation	The Council integrates the processes of performance evaluation and compensation through creation of more flexible compensation policies, including: <ul style="list-style-type: none"> • Advice on performance evaluation and policy proposals • Determination of compensation for fund managers, including the CIO of the Fund Management Center • Reviews on reports of performance evaluation from inside and outside the NPS

and between five and seven external experts appointed by the chairman. The Committee convenes at least four times a year and holds additional special meetings upon request of the chairman or at least one-third of the membership. Areas of deliberation include: (1) basic policies for risk management; (2) determination and management of permissible risk or loss limits; (3) implementation and operation of a risk management system; and (4) risk management for newly-introduced investment vehicles.

IV. NPS' Key Investment Strategies

Particularly in light of the difficulties in Europe due to pension system reform following the 2008 financial crisis, there have been concerns on the viability of Korea's National Pension Scheme. Former NPS chairman Jun Kwang-woo suggested that "European public pensions are managed using a benefit imposition system, whereby payments are deducted from wages every year, so they have

low savings. But in the case of Korea's National Pension, we have a 'young pension' where more income comes from insurance premiums than from wages and the fund grows. Through the two rounds of improvements we have already made, we have created financial stability policies that can maintain the fund until 2060" (Hankyoreh 2012).

Notwithstanding, the NPS has looked to enhance the value of current investments and also seeks sources of greater potential returns in the face of an aging population and slowing birthrates. Regarding investments at the domestic level, the NPS has taken steps to enhance its role in the market and has gradually shifted from a generally passive to a more active stance regarding its investments. As early as 2010, the NPS suggested that "remaining passive is not necessarily the right thing for the future value of our fund. We will look at how we can better carry out our fiduciary duty" (Bloomberg 2010). This coincides with earlier statements that "the ultimate goal is to have greater corporate value,

and that should be good for shareholder value" (Bloomberg 2010).

This stance has contributed to more active engagement in corporate governance issues through shareholding and exercising voting rights by the NPS for the many locally-listed stocks in its investment portfolio. The NPS exercises voting rights for its equity holdings with the goal of maximizing returns on investment and long-term shareholder value in compliance with the Guidelines for Exercise of Voting Rights enacted by the Management Committee. As of July 2011, the NPS cast 2,011 votes in the first half of 2011. This figure compares with 2,153 votes cast during the entire year in 2010. In addition, the NPS disagreed with the majority in 7.1% of votes cast in the first half of July 2011, compared with 3.7% of total votes in 2006 (Figure 10).

Given the Fund's sizable growth outlook, investment volume into equity markets is expected to grow further even if NPS maintains its current weight of equities in its investment portfolio. As such, due attention is be-

〈Figure 8〉 Exercise of Voting Rights

Year	No. of Companies Invested	No. of Shareholder's Meetings Held	No. of Voting	Details (Ratio, %)		
				Agreed	Disagreed	Neutral/ Abstained
2011 ¹⁾	545	478	2,011	92.9	7.1	0.0
2010	563	528	2,153	91.9	8.1	0.0
2009	581	494	2,003	93.1	6.6	0.3
2008	505	514	2,010	94.5	5.4	0.1
2007	584	453	1,926	95.0	5.0	0.0
2006	535	487	1,878	95.6	3.7	0.6

Note: 1) 2011 denotes voting data between January and July 2011.

ing paid to NPS' exercise of voting rights. The NPS is expected to maintain its independence in voting rights and to comply with detailed guidelines for the exercise of voting rights as a public pension fund management agency.

On top of greater involvement in its existing local investments, the NPS has actively

implemented strategies to address longer-term issues of Fund viability and continuity with regards to the composition of its investment portfolio. Specifically, the NPS has looked to the: (1) diversification of assets; (2) globalization of investment; and (3) enhancement of risk management.

〈Figure 9〉 NPF Investment Policies by Asset Class

Asset Class	Investment Policies
Domestic Fixed Income	For its fixed income investment, NPS seeks returns with long-term stability through a buy-and-hold strategy and allocates its investment portfolio by type, issuer, corporate structure, and maturity structure. NPS considers credit spread between the credit rating of bond issuers and risk-free fixed income when investing in the bond market. However, NPS also pursues high returns by adjusting the duration of fixed income within a permissible range.
Domestic Equities	NPS invests in domestic equities on a long-term basis and aims to achieve the highest possible returns within an acceptable level of risk. For in-house management of investments, NPS selects groups of stocks with high potential and develops portfolios around them. It also follows a passive management approach over the mid- to long-term. However, it ensures that its externally managed investments are handled more actively, thereby diversifying into a variety of investment vehicles and taking advantage of the expertise of external managers.
Overseas Investments	The main purpose of NPS overseas investment is to supplement domestic investment and expand into additional investment instruments, improving the efficiency of asset allocation. From a long-term perspective, NPS also expands the portion of overseas investment based on the selling prices of assets for payment of benefits at maturity of the pension. This practice will minimize the impact on the domestic financial market caused by disposition of invested NPS assets to pay benefits in the future.
Alternative Investments	NPS invests into alternative assets to create additional revenues by using their "high risk, high return" tendency compared to conventional invested asset classes such as stocks and bonds. NPS seeks new alternative investment opportunities in real estate, infrastructure, venture capital, CRCs, PEFs and resource development. Since alternative investment attempts to allocate assets within a certain period of time after a contract is concluded, NPS implements contract limits every year. To enhance efficiency and professionalism in alternative investments, NPS has an Alternative Investment Committee, a special unit for investment decision-making which operates apart from the Investment Committee.
Other Investments	NPS invests into short-term assets that are managed for less than 3 months. NPS selects products with high returns, safety and liquidity. Additionally, the main purpose of a security lending transaction is to secure additional profits without loss of safety.

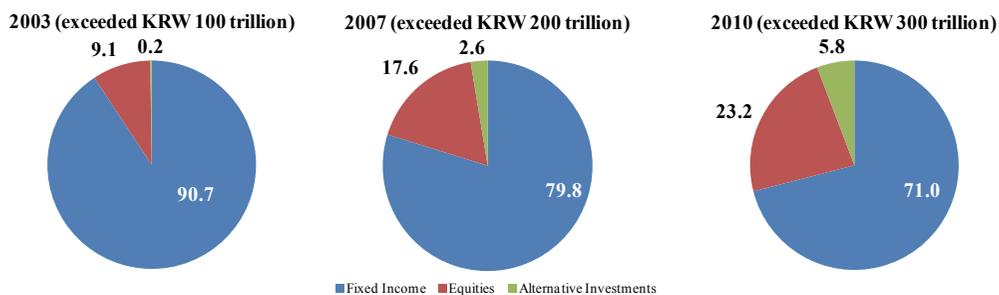
4.1 Asset Diversification

Increasingly, the NPS has sought investment opportunities from more diversified assets. The Fund has expanded the weight of equities and alternative assets in an investment portfolio traditionally dominated by domestic fixed income. The rationale behind asset diversification includes the ability to improve risk-reward ratio and secure long-term stability (e.g., Markowitz 1952). Figure 11

highlights NPS investment guidelines for each asset class.

Between 2003 and 2010, the portion of fixed income of total investments fell from around 90% in 2003 to slightly over 70% in 2010. During the same time, investments in equities grew from just under 10% to over 23%. The portion of alternative investments, or investments other than fixed income and equity, grew from 0.2% in 2003 to around 6% in 2010 (Figures 12, 13, and 14).

〈Figure 10〉 NPS Investment Portfolio (Market Value), %



Classification	2003 (exceeded KRW 100 trillion)	2007 (exceeded KRW 200 trillion)	2010 (exceeded KRW 300 trillion)
Fixed Income	90.7	79.8	71.0
Equities	9.1	17.6	23.2
Alternative Investments	0.2	2.6	5.8

〈Figure 11〉 Breakdown of Returns on Investment (Market Value), %

Classification	2010	3-year Average (2009 - 2011.07)	5-year Average (2007 - 2011.07)	Cumulative (1988.01 - 2011.07)
Total	10.37	8.04	6.37	6.92
Fixed Income	7.55	5.43	5.88	6.00
Equities	21.86	18.87	9.15	11.30
Alternative Investments	8.66	3.39	3.49	3.57

(Figure 12) Asset Allocation (Market Value), KRW billion, %, %pt

Classification	2008		2009		2010		YoY Change
	Amount	Weight	Amount	Weight	Amount	Weight	
Fund Reserve	235,432.5	100.0	277,642.4	100.0	323,990.8	100.0	
Welfare	184.2	0.1	154.0	0.1	128.2	0.0	-0.1
Financial	235,001.5	99.8	277,251.9	99.9	323,597.5	99.9	0.2
Fixed Income	191,124.0	81.2	215,085.3	77.5	229,166.0	70.7	-6.8
Domestic In-House	172,942.5	73.5	194,812.6	70.2	200,988.0	62.0	-8.2
Domestic External	8,962.0	3.8	9,756.3	3.5	14,889.6	4.6	1.1
Overseas In-House	6,035.1	2.6	5,966.9	2.1	6,853.4	2.1	0.0
Overseas External	3,184.4	1.4	4,549.5	1.6	6,435.0	2.0	0.4
Equities	34,263.5	14.6	49,720.0	17.9	74,973.2	23.1	5.2
Domestic In-House	14,305.9	6.1	18,323.6	6.6	29,430.6	9.1	2.5
Domestic External	14,290.1	6.1	18,004.8	6.5	25,627.4	7.9	1.4
Overseas In-House	-	-	198.1	0.1	2,452.5	0.8	0.7
Overseas External	5,667.5	2.4	13,193.5	4.8	17,462.8	5.4	0.6
Alternative Investments	8,804.4	3.7	12,524.1	4.5	18,900.8	5.8	1.3
Short-Term Investments	1,675.8	0.7	342.2	0.1	639.1	0.2	0.1
Others	246.8	0.1	236.5	0.1	265.0	0.1	0.0

Additionally, the NPS continued to expand the portion of its assets in socially responsible investments (SRI), aiming to contribute to both the advancement of financial markets as well as the development of society. The NPS became a signatory of the United Nation's Principles for Responsible Investment in June 2009 and has faced growing internal and external demands for expansion of responsible investments. As of end-2010, domestic external managers have managed SRI funds which have grown to KRW 1.7 trillion. In terms of academic literature, results on studies of SRI fund performance vary. While Hamilton et al (1993) find no notable superior performance from SRI funds compared to

conventional funds and Bauer et al (2005) conclude that there is little evidence to show outstanding differences in risk-adjusted returns between SRI funds and conventional funds, studies such as those by Gil-Bazo et al (2010) conclude that SRI funds outperform respective conventional funds.

According to the NPS, the funds have produced an "average excess return of over 6% against their benchmark, the KOSPI, since its inception in 2006. Going forward, the NPS will continue its gradual approach and return-oriented mindset in selecting managers and seeking stronger cooperative relationships with other international pension funds in terms of SRI investments. In addition, the NPS will

continue to strengthen transparency and fairness in investing and exercising shareholders' rights in order to eliminate any unnecessary debates on pension fund socialism due to the expansion of SRI investment" (Asia Asset Management).

4.2 Globalization of Investment

In addition to asset diversification, the NPS has gradually pursued investment opportunities outside the local market. NPS is by far the largest investor in Korea's domestic financial market, which limits NPS' investment opportunities at home. This has been referred to as NPS being "a whale in a pond" (The Economist 2011). By expanding its investments in overseas markets in order to overcome domestic limitations, the Fund has aimed to create ample liquidity while also maintaining the

value of asset disposals for sale during the maturity period of the Fund (30 years from now). Given the growing amount of investment in various asset classes as well as across the globe, the NPS has actively used external managers to help manage the Fund's resources (Figure 15).

It is understood that globally well-diversified portfolios could benefit from a significant reduction in risk (e.g., Levy and Sarnat 1970; Solnik 1974), while recent evidence shows a decrease in the diversification benefit due to increasing correlations among international equity markets (e.g., Driessen and Laeven 2007; Errunza et al 1999; Longin and Solnik 1995). Previous research has focused on the benefits of diversification to US investors, while the diversification benefits to foreign investors are typically ignored. But according to more recent findings by You (2010), there

(Figure 13) Overview of External Managers

Asset Class		External Manager(s)
Domestic	Equity	28 local registered companies
	Fixed Income	14 local registered companies
Overseas	Equity	Aberdeen, Acadian, Baillie Gifford, Batterymarch, Edinburgh, Fidelity, First Eagle, Fisher, Hexavest, Investec, J.P. Morgan, Lazard, Longview, MFS, Morgan Stanley, Newton, Nomura, Nordea, Robeco, Sarasin, Schroders, SSgA, Templeton, Wellington
	Fixed Income	BlackRock, Franklin Templeton, Goldman Sachs, Morgan Stanley, Pictet, Pimco, Rogge, Schroders, Standish Mellon, StoneHarbor, World Bank, Wellington
	Alternative Investments	Ares, Bain Capital, Babson Capital, Baring Asia, Credit Suisse, Blackstone, Carlyle, CVC, Goldman Sachs, Highbridge Principal Strategies, Oaktree, Pantheon, Silver Lake, TPG Alinda, AXA PE, Beacon, BlackRock, Carlyle, GIP, Heitman, Hines, INVESCO, J.P. Morgan, KKR, Morgan Stanley, Pramerica, Rockspring, RREEF, Silverpeak, Townsend

seems to be ample evidence that it is still beneficial to possess a global portfolio if one is diversifying from a market outside the US.

With regards to fixed income investment, the domestic portion of fixed income investments declined from around 76% of the Fund's total portfolio in 2008 to around 66% in 2010, while the overseas portion of fixed income investments stayed relatively similar at around 4.0% in 2008 to 4.1% in 2010. Within the overseas fixed income investments, the externally-managed portion increased from 1.4% in 2008 to 2.0% in 2010.

For equities, the domestic portion of equity investments increased from 12% of the Fund's total portfolio in 2008 to around 17% in 2010, reflecting the general growth in equity investments for the Fund as a whole. Investment in overseas equities showed a significant increase, up from 2.4% in 2008 to 6.2% in 2010, with the bulk of overseas equities investment managed externally.

To better cope with its global investments, the NPS established its New York office in June 2011, and plans to establish overseas offices in other financial hubs in 2012, including London and Hong Kong. The NPS has also actively sought investment opportunities in overseas markets. For example, in March 2012, China's State Administration of Foreign Exchange (SAFE) announced that it had granted USD 1.66 billion worth of qualified foreign institutional investor (QFII) quotas to ten financial institutions, with the Korea National Pension Fund obtaining a quota of

USD 100 million.

4.3 Enhancement of Risk Management

Given growing external uncertainty given shifts in strategy towards asset diversification and expansion of overseas investments, the NPS has enhanced its internal risk management system to weather abnormal market conditions, including financial crises. By recognizing, measuring, and controlling a variety of risks¹⁾ that accompany fund management, the NPS has taken steps to comply with and enhance guidelines on fund management. According to the NPS, the Fund is managed within risk tolerance levels permissible for annual fund management plans and excess fund management plans approved by the Management Committee. Systematic risks arising from strategic asset allocation to control Market VaR and Credit VaR and un-systematic risks arising when the fund attains excess earning rates are managed separately, and results of risk management are reported to the Management Committee.

V. Performance to Date

While the NPF was established in 1988 with just KRW 530 billion in reserves, total assets under management reached KRW 368 trillion in July 2012. Much of this growth has taken place within the past ten years, with

assets under management increasing more than three-fold at around KRW 100 trillion in 2003 to over KRW 300 trillion in 2010. While growth in subscriptions vis-à-vis fewer beneficiary payments helped contribute to the Fund's growth, enhanced returns from asset diversification has also made meaningful contributions.

With regards to asset diversification, the NPS expanded the scope of its investments by decreasing the weight of fixed income in its investment portfolio from 90% in 2003 to

71% in 2010 and increasing the portion of equities and alternative assets. Following returns of 10.39% in 2009, the NPS generated total fund returns of 10.37% in 2010 - marking the second consecutive year that NPS attained double-digit yields. By asset class, fixed income investments generated returns of 7.55%, while returns on equities generated returns of 21.86%. During the same period, investments in alternative generated returns of 8.66% (Figures 16 and 17).

〈Figure 14〉 Annual Asset Allocation, KRW million

Classification	2005	2006	2007	2008	2009	2010
Total	163,948,592	189,606,491	219,539,945	235,432,503	277,642,385	323,990,750
Public Sector	0	0	0	0	0	0
Welfare Sector	302,455	248,256	203,621	184,204	153,961	128,214
Financial Sector	163,350,871	189,059,665	219,009,916	235,001,477	277,251,888	323,597,490
Equities	20,394,906	21,986,279	38,470,449	33,973,704	49,505,099	74,893,935
Domestic In-House	10,318,102	10,130,054	15,240,818	14,011,099	18,304,103	29,347,450
Domestic External	9,395,371	10,592,427	17,848,426	14,294,265	18,006,242	25,628,016
Overseas Equities	681,433	1,263,798	5,381,205	5,668,341	13,194,754	19,918,469
Fixed Income	141,482,371	164,432,382	174,844,219	191,053,790	215,086,587	229,166,338
Domestic In-House	124,385,738	142,581,596	149,403,433	172,877,628	194,813,338	200,988,538
Domestic External	5,135,623	5,421,691	8,078,035	8,961,962	9,756,284	14,889,593
Overseas Fixed Income	11,961,010	16,429,095	17,362,751	9,214,199	10,516,965	13,288,206
Alternative Investments	779,834	2,167,831	5,406,136	8,802,476	12,522,187	18,898,084
Time Deposits	668,534	447,844	372,615	1,690,807	342,187	639,132
Short-Term Assets	25,226	25,329	-83,503	-519,300	-204,172	0
Others	295,266	298,570	326,410	246,822	236,536	265,047

(Figure 15) Annual Returns on Investment, %

Classification	2005	2006	2007	2008	2009	2010
Total	5.63	5.77	6.79	-0.18	10.39	10.37
Public Sector	4.16					
Welfare Sector	3.60	3.63	1.52	-0.77	0.53	0.29
Financial Sector	5.66	5.77	6.81	-0.19	10.41	10.39
Equities			33.66	-42.87	45.40	21.86
Domestic In-House			34.37	-37.46	58.65	26.04
Domestic External			39.42	-40.41	45.09	24.73
Overseas Equities			3.70	-58.69	26.50	13.04
Fixed Income	0.26	5.81	2.65	10.51	4.02	7.55
Domestic In-House			2.69	10.64	4.08	7.63
Domestic External			2.46	10.89	4.50	7.34
Overseas Fixed Income			2.43	9.14	2.58	6.52
Alternative Investments			6.08	2.73	-0.92	8.66
Short-Term Assets			4.75	5.87	-0.49	2.31

Note: 1) Returns include gains/loss on fixed income valuation. Since 2000, returns have covered all yields.

VI. The Role Management and Organizational Reform

Academic research has suggested that better corporate governance can also enhance investment returns. The link between pension fund governance and corporate governance has been recognized by many scholars, including Clapman et al (2007) and Clark et al (2007). Results suggest that superior per-

formance is linked to strong governance.

In facing some of its key challenges, the NPS has largely attributed success to both diversifying assets and investing globally. Industry watchers have also credited management for spearheading organizational reform, directing strategy, and improving the general reputation of the NPS. This can be seen in the NPS being chosen for three consecutive years (2009, 2010, and 2011) as the "Plan Sponsor of the Year²⁾" by Asia Asset

1) According to the 2011 National Pension Fund Management Report, the NPS defines market risk as: "the threat of losses on a trading position that may result from market fluctuations in stock prices, interest rates, or foreign exchange rates, and is measured precisely with the value at risk (VaR), statistical data. The NPS defines as credit risk those losses that may result from an issuer's or counterparty's refusal to honor a contractual credit obligation. The NPS defines liquidity risk as the possibility of incurring losses due to a temporary shortage in funds: such shortages may result from a maturity mismatch or an unexpected capital outlay. Liquidity risk soars when assets are sold below a normal price and funding rates rise. Legal risk is defined as losses when a counterparty is not legally able to enter into a contract or legal obligation. Operational risks are defined as exposure to losses arising from inappropriate or faulty work processes, internal workforce or systems, or certain external factors, which may adversely affect the NPS's reputation."

2) Plan Sponsor of the Year is an award given to an association with the best result and improvement in investment in pension funds and creating innovative models.

Management, as well as NPS' former chairman receiving the "CEO of the Year in Asia 2011" award by the same institution.

With regards to asset diversification and globalization of investment, management has placed priority on human resource training and utilized external managers to help with the NPS' local and global investments. The NPS also forged relationships with global financial celebrities and has invested in global landmarks and real estate (Figure 18).

In terms of organizational reform, the Risk Management Committee was shifted and placed directly under the CEO in an effort to enhance operational risk management practices. The New York office was also established for more effective management of overseas investments, with several other overseas offices slated to open in 2012.

Regarding the relationship between invest-

ment and politics, the NPS suggested that "...improving corporate value coincides with the interests not only of national pensions but also of firms... However, this is an issue that must be approached from an angle that maximizes proper function because of those that have expressed concern about the method of public control or interference in management" (Hankyoreh News 2012). In this sense, the NPS has taken great measures to maintain its independence from government in investments and crafting the NPS' reputation as the guarantor of post-retirement welfare within the National Pension Scheme.

VII. Key Challenges

Like many pension funds, the NPS has and

〈Figure 16〉 NPS Global Real Estate Holdings

Region	Asset	Date	Amount	Share	Asset Class
Japan	KDX Toyosu Grandsquare	Jun 2009	KRW 97 billion	49%	Office
US	Macerish Shopping Mall	Sep 2009	KRW 152 billion	36%	Retail
UK	40 Grosvenor Place	Nov 2009	KRW 173 billion	50%	Office
	88 Wood Street	Nov 2009	KRW 185 billion	100%	Office
	HSBC tower	Nov 2009	KRW 1.5 trillion	100%	Office
	Gatwick Airport	Feb 2010	KRW 180 billion	12%	Infra
Australia	Aurora Place	Mar 2010	KRW 750 billion	100%	Office
Germany	Sony Center	Jun 2010	KRW 340 billion	100%	Mixed-use
France	O Parinor	Oct 2010	KRW 350 billion	51%	96%
US	Colonial Pipeline	Oct 2010	KRW 1.2 trillion	23%	Infra
	Portfolio of small- and medium-size shopping centers	Jun 2011	KRW 289 billion	11%	Retail
	Hemsley Building	Jun 2011	n/a	49%	Office

continues to face the challenges of an aging population and slowing birthrate. Up until now, the number of subscribers has far outweighed the number of beneficiaries. This means that the Fund has been able to enjoy more inflows than outflows, and even in times of mediocre returns, fulfilling pension payments has been a non-issue. But an aging population signifies a growing number of beneficiaries and pension receivers. Furthermore, as life expectancy continues to increase, the average beneficiary will receive pension payments for a longer period of time. This is further exacerbated by the potentially damaging effects of slowing birthrates. This suggests fewer future subscribers as well as potential harmful accumulation of public debt (Bongaarts 2004). The growing burden of payments mixed with the potential depletion of resources flowing into the Fund has raised questions as to the Scheme's longer-term viability.

In addition, the Fund has faced dwindling investment opportunities in the domestic market given its already-extensive fixed income investments as well as equity shareholding. According to the NPS, the NPS alone constitutes around 14% of the local fixed income market and has a more than 5% share of 222 listed companies as of the end of 2012. Lack of expertise and human resources in global markets may have contributed to delays in broadening the Fund's investment scope, thus limiting the Fund to primarily local investment opportunities.

At the same time, drastic diversification in-

to higher-risk, higher-return asset classes may also pose additional challenges for the Fund. As a pension scheme designed to ensure future pension payments to beneficiaries and as a Fund mandated by the government, it is unclear to what extent investments in riskier asset classes can be made. Balancing this with observations that returns from primarily fixed income investments may be unable to meet pension payments presents a host of managerial and investment challenges.

Lastly, alongside issues of the Fund's viability is that of reputational risk. Although the actual investment decisions are carried out by investment professionals, the NPS is mandated by the government as guarantor of post-retirement welfare. According to the Scheme, the NPS chairman is appointed by the government. And given the extent of NPS shareholdings in publicly-listed firms, there have been concerns as to whether the Fund is solely acting upon the best interests of pension-holders or is potentially being used as a financial and/or political tool by the government. The possibility of conflicting interests may hinder future subscribers, particularly voluntary persons, from seeking coverage from the NPS.

VIII. Looking Ahead

With regards to the NPS' general strategy of asset diversification and globalization of

investment, industry watchers should expect this to continue. NPS maintained that it is “large but still young, and its share of international assets is much smaller than many other large pension funds. Their experience in broadening their investment base beyond their domestic market gives us good lessons” (Bloomberg 2010).

In line with this, the NPS’ Management Committee promulgated in June 2011 a mid-term asset allocation plan through 2016 based on an analysis of the global economy, risks and returns of each NPF asset, and its previous asset allocation plan of 2011-2015. According to the mid-term asset allocation plan for 2016, the NPS target rate of returns is 6.5%. To achieve this rate, its target portfolio must consist of more than 30% in equities, less than 60% in fixed income, and more than 10% in alternative assets. The weight of overseas investment is also expected to make up more than 20% of the total, with the NPS expecting the portion of investment in equities and alternative assets to exceed 35% by the end of 2012 and the portion of overseas investments to reach 15%. But while there has been a gradual reduction in the weight of domestic fixed income due to investment portfolio diversification, the NPS is likely to continue to avoid rapid reduction of fixed income investment due to the potential impact on financial markets.

Regarding the NPS in issues of corporate governance, management has maintained that “institutional investors can increase their in-

fluence if they exercise shareholder’s rights through meetings, as happens in other countries” (Hankyoreh News 2012). On the one hand, even if NPS does not actively exercise shareholder rights, the NPS’ growing role as a controlling shareholder in many local firms carries several implications. For example, the type of stance NPS takes given the possibility of further M&A attempts by foreign firms, as in the case of SK Corp. and Sovereign (Park 2004), will play an important role going forward. In addition, there is the possibility of increasing agency problems due to the divergence in management and control rights, especially for many financial firms (Cheon 2008). As such, we can expect the NPS to be watchful given the broad implications to financial profitability.

On the other hand, the NPS has acknowledged the need to address the tenuous line between professional investment intended to contribute to the building of a sound, social safety net and politics: “In foreign countries, institutional investors set their direction through shareholder meetings and vote together. In Korea, such voting is cumbersome as it can cause political controversy. The first thing that must be done is the forming of a social consensus” (Hankyoreh News 2012). In this regard, it is likely that the NPS will continue to serve as an important voice in corporate management for the foreseeable future through voting, to the extent that it increases corporate value and contributes to a broader consensus on value creation.

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저성장 시대에서의 국민연금의 성장사례

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요 약

고령화, 출산율 저하 및 저성장 경제로의 진입과 같은 여러 어려움을 직면하는 가운데 한국의 국민연금은 지난 10년간 3배 이상 성장하며, 2013년 2월, 현재 기금규모가 400조를 돌파하여 세계 4위의 연기금으로 성장하였다. 투자자는 물론 금융업계 전반에서의 국민연금의 중요성과 그 동안의 우수한 성과를 고려하여, 본 케이스 연구는 국민연금의 발전과 최근 투자 전략에 대한 포괄적인 배경을 제시하고자 하였다. 이 중에서 특히 (1) 자산 다변화, (2) 투자 분야의 세계화, 그리고 (3) 리스크 관리 개선 부분을 중점적으로 살펴보았다. 또한, 국민연금이 각종 전략을 수립하고 수행함에 있어 지배구조와 내부 경영진이 어떻게 개별적인 역할을 수행하는지 조사하였다. 본 케이스 연구의 수행 결과는, 장기 성과를 개선하고자 하는 기관 투자자들의 투자 모델 설정에 적용할 수 있을 것으로 기대된다.

주제어: 국민연금관리공단, 한국, 연금, 투자

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<Teaching Note>

Against the Odds: Korea's National Pension Service Success in a Slower-Growth Era

Synopsis

This case reviews the spectacular growth of Korea's National Pension Service (NPS) from its founding in 1988 to the present. The case is framed in the light of major obstacles faced by the NPS, including slower growth in the domestic market as well as demographic trends such as dwindling birthrates and an increasingly aging population. Against these odds, the NPS has grown into the fourth-largest pension scheme in the world by asset size and has received accolades such as The Asset's "Investor of the Year Award" (Pension Fund category) in 2013. The significance and implications of NPS' apparent success for practitioners and the broader investment community demands a comprehensive background to the development and recent investing strategies of NPS. As such, this case study examines investment strategies with regards to asset diversification, globalization of investment, and enhancement of risk management to shed light on the applicability of the investment model for other institutions seek-

ing to enhance longer-term performance.

Teaching Objectives and Issues

This case is suitable for MBA courses or advanced undergraduate courses in finance, portfolio management, as well as international business and strategy. Participants in executive programs may also find the implications of the case study helpful as company executives and middle- to upper-management would be best positioned to reflect any findings of the case study to their respective organizations.

In this respect, key teaching objectives of this case study are:

1. To familiarize students with the development of Korea's NPS and its role in local and global financial markets. Given the size of the fund and growing presence in financial markets in Asia and around the world, it is imperative for serious business students and programs to

be familiar with the pension scheme and articulate the scheme's key growth strategies and future challenges.

2. To expose students to key country-level, institutional-level, and individual-level features that characterize Korea's NPS and how these features have shaped the fund to date.
3. To highlight key investment strategies that have contributed to the NPS' phenomenal growth, specifically, asset diversification, globalization of investment, and enhancement of risk management.
4. To raise important questions regarding the future direction of the NPS and challenge students to think analytically and creatively.

Teaching Strategy

This case is best used for the purpose of class discussion and may provide the basis for presenting comparative case studies with prominent pensions funds from around the world. Comparative studies may touch on similarities and differences between pension funds that include, but are not limited to: (1) founding (date, circumstances behind founding); (2) annual fund size trends (asset size, number of contributors/beneficiaries,

growth); (3) annual fund performance (overall, by asset class); (4) key investment strategies; (5) response to internal/external issues (e.g., fund management, competition, demographics, etc.); and country-level, institutional-level, and individual-level characteristics of respective pension schemes. Such an analysis would provide greater color regarding investment strategies of pension schemes in general and pension schemes analyzed in the case studies in particular.

Suggested Student Assignments

1. What were the main challenges the NPS faced with regards to demographics and investment opportunities?
2. To face these challenges, what were the NPS' main strategies and how were these implemented?
3. Socially responsible investing, or SRI, refers to an investment strategy where investors consider both potential for financial returns and the social impact of investments. As mentioned in the case study, the NPS has increased investments in SRI particularly in recent years, and the trend is likely to continue going forward. In May 2013, a local company, Namyang Dairy Products, Co. (ticker: 003920.KS), came under fire for abusing

power over small retailers and forcing them to accept merchandise they did not need. As a result of the incident, there were calls for the NPS and investors in general to reduce shareholdings of the company. What are the potential pros and cons of the politicization of investment in general, and implications for NPS in particular?

4. What potential issues may the NPS face if it decides to exercise shareholder rights for the firms in its portfolio more actively?

Teaching Note

This case highlights the development, management, and recent investing strategies that contributed to the noteworthy success of Korea's National Pension Service (NPS).

1. Key demographic challenges faced by the NPS include an aging population and slowing birthrate as these two factors contribute to a growing burden of payments and potential depletion of resources flowing into the Fund.

With regards to an aging population, the speed of aging in Korea is incredibly rapid. The percentage of elderly persons aged 65 and above has risen from around

3.3% in 1955 to 10.7% in 2009, with the trend likely to continue. As such, the shape of Korea's population shifted to a pyramid type in the 1990s, suggesting more young people and fewer old people, to a diamond type in 2010, reflecting less youth and a larger proportion of middle-age individuals. Implications include the possibility of a shrinking labor force, and thus productivity, resulting in a decrease in the percentage of economically-active persons. In addition, recent data on Korea's total fertility rate (TFR) suggest that the average number of children born to women in their childbearing years is slightly over 1. This level is much lower than the TFR average for many emerging as well as developed economies, and will likely contribute to continued growth of an aging population going forward.

Regarding investment challenges, the Fund was initially limited to domestic fixed income and equity investment opportunities. As its fund reserves exceeded KRW300 trillion, the Fund's investment impact on Korean financial markets was considerable (especially when considering that the market value of all listed companies was around KRW1,000 trillion).

2. The NPS has aimed to both enhance the value of current investments and seek alternate sources of greater potential

returns. At the domestic level, the NPS has gradually shifted from a passive to a more active stance regarding its investments and has more actively engaged in corporate governance issues through shareholding and exercising voting rights. The domestic investment portfolio has also seen shifts from a heavy bias on fixed income to greater investment volume into equity markets.

The NPS has also implemented strategies to address longer-term issues of Fund viability and continuity with regards to the composition of its overall investment portfolio. The NPS has focused on the: (1) diversification of assets; (2) globalization of investment; and (3) enhancement of risk management.

- (2) Diversification of assets: The NPS has increasingly sought investment opportunities from more diversified assets, with the Fund expanding the weight of equities and alternative assets in an investment portfolio traditionally dominated by domestic fixed income. The rationale behind asset diversification includes the ability to improve returns and secure long-term stability. The NPS has also expanded the portion of its assets in socially responsible investments (SRI) with the aim of contributing to both the advancement of financial markets as well as the development of

society. This strategy is also consistent with the Fund's goal of enhancing the quality of its existing investments.

- (2) Globalization of investment: The NPS has gradually pursued investment opportunities outside the local market. Expansion into overseas investment has enabled the NPS to overcome domestic limitations, and the Fund has aimed to create ample liquidity while also maintaining the value of asset disposals for sale during the maturity period of the Fund (30 years from now). To manage the growing amount of investment in various asset classes as well as across the globe, the NPS has begun setting up overseas offices and has actively used external managers to help manage the Fund's resources.
- (3) Enhancement of risk management: Growing external uncertainty given shifts in strategy towards asset diversification and expansion of overseas investments prompted the NPS to enhance its internal risk management system to weather abnormal market conditions, including financial crises. The NPS has taken steps to comply with and enhance guidelines on fund management by recognizing, measuring, and controlling a variety of risks that accompany fund management. The Fund is managed within risk tolerance levels permissible for annual fund

management plans and excess fund management plans approved by the Management Committee. Systematic risks arising from strategic asset allocation to control Market VaR and Credit VaR and unsystematic risks arising when the fund attains excess earning rates are managed separately, and results of risk management are reported to the Management Committee. To enhance the operations and function of the Risk Management Committee, a recent realignment of organizational structure has the Risk Management Committee report directly to the CEO.

3. The recent Namyang Dairy scandal included ten sales agents of Namyang filing a complaint with the prosecutors' office in May 2013 over enforced sales orders, also referred to as "pushing out." According to these filings, agents claimed that Namyang Dairy also forced them to buy products close to their expiry date. Claimants felt that they had no choice but to buy the products because they believed that Namyang Dairy would not extend business contracts if they did not comply. In addition, agents accused Namyang Dairy's sales employees of demanding "pocket money" of around 100,000 Korean won (approximately \$91) to 200,000

Korean won per employee during the holiday seasons. News of these dealings led to widespread boycotts of Namyang Dairy products as well as calls for shareholders, such as the NPS, to reduce shareholdings of the company due to unethical behavior.³⁾⁴⁾⁵⁾

On the one hand, greater awareness of ethical misconduct by corporations is viewed as a positive change from the lack of transparency that characterized Korea's pre-financial crisis economic landscape. In addition, in terms of the perspective of the NPS, former Chairman Jun previously stated that "...improving corporate value coincides with the interests not only of national pensions but also of firms." One way that the NPS has begun to exercise greater influence and shareholders' rights is through shareholder meetings, as in the case of other countries.

Aside from the benefits of greater awareness, the Namyang Dairy Products case may also raise concerns on potential over-politicization of investment practices. In this sense, rather than acting as an independent investment scheme intended to maximize pensions for future beneficiaries, the NPS may be seen as a political tool that can be wielded at the whim

3) http://www.koreatimes.co.kr/www/news/nation/2013/05/116_135228.html

4) <http://m.koreaherald.com/view.php?ud=20130509000861>

5) http://english.khan.co.kr/khan_art_view.html?code=710100&artid=201305241658117

of the presidential administration or other interest groups. The question is whether proactive interference by outside parties helps to maximize the proper function of the NPS, given the need to maintain and even enhance the scheme's reputation as a credible investment institution.

To address the line between professional investment and politics, the answer may lie in the formation of a social consensus, where the NPS exercises its role as an investment institution in terms of maximizing potential returns while (and perhaps, by) encouraging corporate management to increase corporate value through a broader consensus on value creation that extends to ethical practices and conduct.

4. In one sense, the NPS has already begun to take a more active stance in exercising shareholders rights for firms in its portfolio. This can be seen in data found on Figure 10 of the case study. As of July 2011, the NPS cast 2,011 votes in the first half of 2011 compared with 2,153 votes cast during the entire year in 2010. In addition, the NPS disagreed with the majority in 7.1% of votes cast in the first half of July 2011, compared with 3.7% of total votes in 2006.

Going forward, the NPS is expected to maintain its independence in voting rights and to comply with detailed guidelines

for the exercise of voting rights as a public pension fund management agency. But this may also raise additional issues regarding a more active pension fund. Because the NPS owns more than 5% of shares in over 100 domestic companies as of late 2010, more active exercising of shareholders rights would have a considerable impact. Because the NPS is housed under the Ministry of Health and Welfare, there are concerns that greater activity might translate into excessive government interference of corporate affairs. As such, rather than being used a tool to promote better corporate governance (and possibly firm value and fund value by consequence), critics contend that abuse of such practices may detract the pension scheme from focusing on its primary responsibility of investment and securing future pension distributions.