Overview of Korean Retirement Pension Plan

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April 2005
Major Contents

- Overview of current pension systems in Korea
- Current Severance Payment System
- Contents of Employee Retirement Benefit Security Act (ERBSA)
- Effects and prospects of the new system
**Introduction**

- According to the Employment Retirement Benefit Security Act*, Retirement Pension Plan is to be enforced after December, 2005

  * officially announced on January 27, 2005

- Presidential decree and its ordinance are under discussion
### Current Pension Systems in Korea

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**Diagram:**

Special Occupational Pensions are designed exclusively for government employees, private school teachers and military personnel.
National Pension (mandatory and life annuity)

- Established: 1988
- Coverage: All Citizens except government employees, private school teachers, and military personnel
- Contribution Rates: 9% of the standard monthly income (4.5% employer, 4.5% employee)
- Replacement Ratio: 60% (average income earners with 40 years contribution)

Occupational Pension (mixed form of NP and CP)

- Government Employees Pension (1960), Private School Teachers Pension (1975), Military Personnel Pension (1963)
2nd Pillar (Severance Payment System)

- **Severance Payment System (mandatory and lump sum)**
  - Established: 1953 (voluntary) → 1961 (mandatory)
  - Coverage: employees of the business with more than five
  - Funding: Book value Internal or External funding contributed
    entirely by employers (at least 8.3% of annual salary)
  - Benefits: \# of service yrs x average monthly salary of last three months
    - No portability and limit of benefit payment age

- **External Funding Schemes (Retirement Insurance, Retirement Trust)**
  - Established: 1999
  - Providers: Banks (trust account), Insurers (separate account),
    Asset Management Companies
Critiques of current Severance Payment

- Employees of business with less than five excluded
- Lack of Portability
- Weak security of retirement benefits in case of employer’s insolvency
- Lump sum payment rather than annuity
Major contents of Employee Retirement Benefit Security Act

- Introduction of retirement benefit system
- Plan design and operation
- Individual retirement accounts
- Rule of conducts and compliance
- Others
Introduction and change of retirement benefit system

- Choose at least one of Severance Payment, Defined benefit or defined contribution plan
  - based on the agreement between employer and employees
- Obtain the consent of employee representative to change the plan type
In order to begin the pension plan, sponsor is required to
- make retirement pension agreement based on the consent of employees, and
- report the agreement to the Minister of Labor
Defined Benefit Plan

Retirement benefits are based on employee’s final salary level and service period

- Investment results change employer’s contribution to pension plan
- Agreement must include the contents for the financial soundness of the plan
- Lump sum amounts equivalent to or more than 30-day salary per service year upon the retirement date
At the end of fiscal year, sponsor is required to reserve following amount, whichever is larger

- Amount calculated based on the estimated present value of expected benefit payments and contribution incomes, or
- Expected expenses to pay the benefits for all the participants during service period
To be qualified for the annuity payment, the participants aged 55 or above should:
- have participated in the plan for ten years or more,
- accept annuity payment with five years or longer

Lump sums are paid to:
- participants not entitled to receive annuity or
- those who want to receive
- Service providers are required to notice the status of reserves and investment results at least once a year
- Under DC plan, sponsor’s contribution is predetermined and retirement benefit depends on the investment results.

- Sponsor’s contribution must be at least 1/12 of the total annual salary of participants in cash.

- Employee’s additional contribution is allowed.
Investment of reserves

- Participants have the right to choose the investment vehicles of reserves

- Sponsor must provide the followings to participants;
  - more than three types of investment vehicles with different structures of risk and return semi-annually
  - necessary information such as the possibility of profits and losses for the participants to choose the investment of reserves
Operation management services

- allowed to insurers, banks, securities companies and asset management companies
- include the followings;
  - providing investment vehicles and information for each alternative
  - arranging plan design and actuarial service
  - keeping records of reserves and investment results
  - transferring the investment orders to the asset management providers
• Asset management services
  • based on the insurance or trust contracts
  • allowed to the insurers and trust companies
  • include the followings;
    - account opening and managing
    - receipt of contribution
    - custody and management of reserves
    - payment of benefits
    - execution of investment orders
Pension Service Providers

- Required to register with adequate qualifications
- Scope of service providers
  - insurers, banks, securities companies and asset management companies
  - others
- Prudent man rule applied to the service providers
- Requirements of investment alternatives
  - understandable and easy to acquire information
  - easy to be changed
  - transparent evaluation methods and procedures of investment results
  - at least one principal and interest guarantee product for DC plan and IRA
  - diversification for sound investment
Individual Retirement Accounts

- Coverage
  - the retirees who receive lump-sum payments
  - the employees of business with less than ten

- basic operations are the same as those of Defined contribution plan
Obligations of sponsors

- Education to participants regarding the operation of pension plan at least once a year
  - allowed to consign this obligation to service provider

- The followings are prohibited;
  - conflicts of interest
  - any other breaches of obligations
Obligations of service providers

- Compliance with Act, regulations, orders of authorities and contracts
- No denial of contracts without acceptable reasons
- Not unfairly compelling to make contracts with specific service providers
 Illegal actions of service providers

- Promise to pay back entire/partial losses
- Offer special benefits to sponsor or participants
- Use participants’ private information beyond the pension operation
- Propose specific investment vehicles for the purposes of boosting its own or a third party’s interests
Responsibilities of service providers

- Education service to the participants at least once a year regarding the plan operations and status

- A report on the pension business and performance to sponsors, the Minister of Labor and FSC within three months following a fiscal year
• Ask report on the plan operation
• Carry out field exam
• Order to terminate the unfair plan, and
• Take corrective measures if sponsors do not follow the orders or regulations

Minister’s supervision on sponsors
Supervision on service providers

- Minister can ask the reports on plan business and its performance

- FSC regulates the business of service providers and can ask corrective measures against the violation of responsibilities

- FSS can examine the business and operation of service providers
Consignment of Minister’s power

- Minister’s powers such as registration of service providers, regulation of investment and supervision on their business and operation, can be consigned to FSC.
Prospects of new pension system

New Pension System

- Stronger Security (Vesting Rights etc.)
- Balanced Social Security (public and private pensions)
- New Opportunity (the variety of investment vehicles)
- The Growth of Financial Industry

Ultimate improvement of participants’ Welfare & Economic Growth