# Korean Public Pension Fund's Investment in Overseas Energy Resources

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## I. Joint investments with Korean conglomerates planned

On 3 January, 2011, it was reported that Korea's National Pension Service (NPS), a public entity in charge of the country's public pension, plans to jointly establish a private equity fund for investing in overseas energy resources with some Korean business groups, possibly including Samsung Group, Hyundai Motor Group, SK Group (which includes SK, an oil refiner), Goldstar Group (which includes the oil refiner SK), and the telecom giant KT[1]. Although the exact amount of investment was not disclosed, it was estimated at several hundred billion won.

NPS's objective in investing in overseas energy resources is to raise long-term returns through diversification. These investments are also consistent with government policy, with South Korea's Lee Myung-bak administration having announced in December 2012 a goal of doubling the share of Korea's oil and gas imports produced at overseas facilities under South Korean ownership from 9% in 2009 to 18% in 2012[2].

## II. Alternative investments gaining a larger presence in the NPS asset portfolio

The NPS, the public pension scheme launched in 1988, covers employees and the self-employed in the private sector. The size of its reserve fund has grown each year, and was the world's fourth largest in 2009 (Figure 1). It had total assets as of end-November 2010 of 317 trillion won (approximately ¥23 trillion).

As shown in Figure 2, government bonds account for the lion's share of the NPS portfolio, which at first glance has an asset allocation similar to that of the Government Pension Investment Fund (GPIF), which manages Japan's public pension

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1 "Korea's National Pension Plans Private Equity Fund for Energy Investments," Bloomberg, 3 January 2011. On the very next day, the 4 January 2011 online edition of the Wall Street Journal ran a story entitled "South Korea Pension Service to Form Private-Equity Fund."

2 "President's men lead Korea's resources strategy," Korea Times, 28 December 2010.

reserve fund. In recent years, however, NPS has been investing more aggressively in overseas real estate, infrastructure, and other alternative investments, which had grown to account for 5.5% of the portfolio as of end-November 2010. In this respect, NPS differs greatly from GPIF, which invests in the four traditional asset classes of domestic and overseas stocks and bonds.

**Figure1: Overview of pensions in Japan**

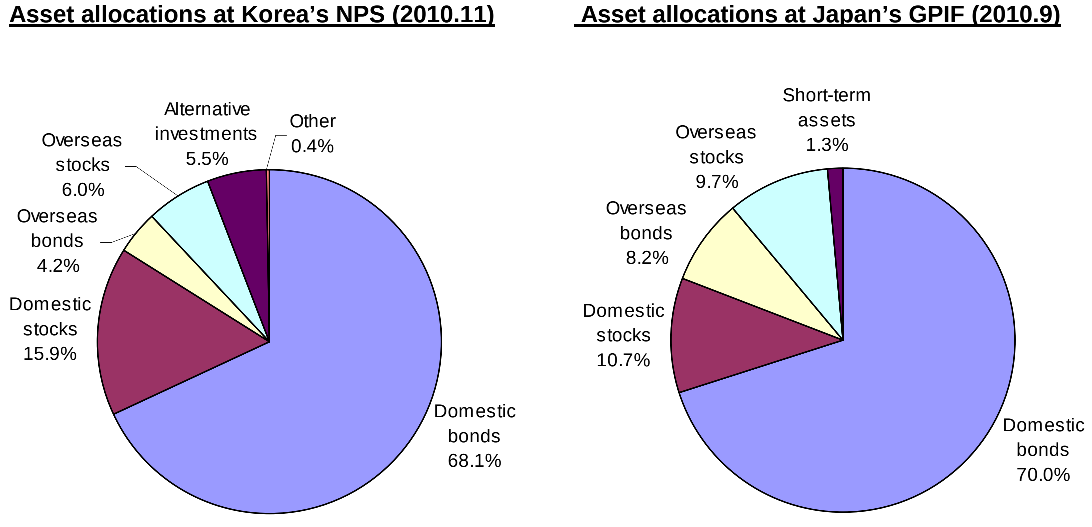
($ millions)

| 2009 | 2008 | Name of fund | Country | Type of fund | Assets |
|---|---|---|---|---|---|
| 1 | 1 | GPIF | Japan | Public pension | 1,315,071 |
| 2 | 2 | Government Pension Fund Global | Norway | Public pension | 475,859 |
| 3 | 3 | ABP | Netherlands | Gov't employees | 299,873 |
| 4 | 6 | NPS | Korea | Public pension | 234,946 |
| 5 | 5 | Federal Employees TSP(1) | US | Gov't employees | 234,404 |
| 6 | 4 | CalPERS | US | Gov't employees | 198,765 |
| 7 | 7 | Pension Fund Association for Local Government Officials(2) | Japan | Gov't employees | 164,510 |
| 8 | 9 | CalSTRS | US | Gov't employees | 130,461 |
| 9 | 10 | NYSLRS | US | Gov't employees | 125,692 |
| 10 | 17 | PFZW | Netherlands | Private sector | 123,390 |

Note: 1. As of end-September 2009.
2. Estimates.

Source: Pensions & Investments

**Figure2: Asset allocations of Korea's NPS and Japan's GPIF**




Source: Nomura Institute of Capital Markets Research, based on the National Pension Service's website and the Government Pension Investment Fund's report entitled "Investment results for the second quarter of fiscal 2010."

For example, in February 2010 NPS acquired a 12% stake in the UK's Gatwick Airport from its owner, Global Infrastructure Partners. Infrastructure investment is becoming increasingly popular among the world's leading pension funds. NPS has also invested in real estate located in Europe and Australia. In the energy sector, NPS jointly acquired with the buyout firm KKR a stake in Colonial Pipeline, operator of the largest petroleum pipeline linking refineries near the Gulf coast with markets on the East Coast of the US. (Figure 3)

NPS has proposed raising the allocations to domestic and foreign stocks and alternative investments spelled out in its medium-term asset allocation plan for 2008–2014. Specifically, it proposed raising allocations from 12.1% to 20% for domestic stocks, from 2.4% to 10% for foreign stocks, and from 3.7% to 10% for alternative investments.

**Figure3: NPS's investments in overseas real estate and infrastructure**

| | |
|---|---|
| Jul 2009 | Jointly acquired a large office building in the bay front area of Tokyo with the Carlyle Group for 35 billion yen. |
| Nov 2009 | Acquired London real estate from ING's real estate division for £183 million. Acquired a 50% interest in a property located near Buckingham Palace for £85 million. |
| Nov 2009 | Acquired HSBC's European headquarters building in London's Canary Wharf for £772.5 million. |
| Jan 2010 | Announced an agreement to acquire the Aurora Place office tower in Sydney for 750 billion won. |
| Feb 2010 | Announced the acquisition of roughly a 12% stake in London's Gatwick airport for £100 million. |
| Jun 2010 | Acquired Sony Center in Berlin from Morgan Stanley Real Estate Fund VI for 850 billion won. |
| Aug 2010 | Acquired a 51% stake in the O'Parinor shopping center in Paris for €217 million. |
| Oct 2010 | Jointly acquires with KKR a 23.44% stake in Colonial Pipeline from Chevron. |

Source: Nomura Institute of Capital Markets Research, based on various news reports

## III. The possibility of further diversifying public pension assets should be pursued

Some observers within Korea have noted in regards to its aggressive overseas investments that NPS has been behaving like a giant hedge fund, despite that fact that it manages the public pension assets that comprise the safety net for old age[3]. On the other hand, NPS chairman Jun Kwang-woo argues that NPS assets are already too large to be limited to Korea's capital markets, and that there is a need to pursue returns by taking manageable risks and investing overseas[4].

Ultimately, the question of how public pensions are invested comes down to what is acceptable to the citizenry, and each country will be different in this regard. One trait shared by both Japan and Korea is the great importance of effectively managing a

3 "National Pension suffers from identity crisis," Korea Times, 14 October, 2010.
4 "We are no longer small fry, says NPS chief," The Korea Herald, 5 November, 2010.

public pension fund of world-class size so as to improve the sustainability of the public pension system in a race against the rapid aging of their populations.

In Japan, as well, a government panel on how GPIF should manage the reserve fund met over a one-year period beginning in November 2009, and issued its final report in December 2010. That report went no farther than presenting two opposing viewpoints on the GPIF's asset allocations, one supporting more diversification and the other supporting a more cautious approach[5]. Although it appears that the report has reaffirmed how difficult it is to forge a consensus on allocation, we think the search for ways to diversify the investment of public pension assets needs to continue.

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5 *Nenkin Tsumitatekin Kanriunyou Dokuritsu Gyousei Houjin no Un'ei no Arikata ni Kansuru Kentoukai Houkoku* (Report from the Panel on Management of The Government Pension Investment Fund), 22 December 2010 (in Japanese). Also in December, the OECD published a paper entitled "Options to Improve the Governance and Investment of Japan's Government Pension Investment Fund." The paper was primarily focused on governance, but also commented on the diversification of asset allocation.