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# **Aiming to Increase Sovereign Wealth: Current and Future Global Investments by Korea Investment Corporation**

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## **I. Introduction**

The world remembers well that it was the sovereign wealth funds, particularly those for emerging markets, that subscribed to the stock offerings of financial institutions in Europe and the US in 2008, just when the global financial crisis was deepening. Although not widely reported on by the media, one of the government-affiliated funds that has been consistently investing globally while making information disclosures has been the Korea Investment Corporation (KIC), an institution designed pursuant to legislation passed by Korea's parliament.

Since the beginning of the global financial crisis, Korea has been known for its corporations' business expansion into emerging markets and for its public-private cooperation in infrastructure exports, but as evidenced by KIC, Korea has also been leveraging its own financial assets in an effort to globalize its financial and capital markets and develop talent in the financial sector. In this paper, we provide an overview of KIC, including the events leading up to its establishment, its institutional design, and its investment performance, as then give our thoughts on what may lie ahead.

## **II. What is KIC?**

### **1. The events leading up to KIC's establishment**

The Korea Investment Corporation (KIC) was established on 1 July 2005 pursuant to the KIC Act, which was passed into law on 24 March that year. KIC started out with total capital of \$20 billion, including \$17 billion of foreign reserves managed by the Bank of Korea (Korea's central bank) and \$3 billion from the Foreign Currency Stabilization Fund managed by what was then the Ministry of Finance and Economy (MOFE) and is now the Ministry of Strategy and Finance (MOSF).

There are two main reasons why the KIC was established. The first is because of strong political leadership. In December 2003, Korea's president at the time, Roh Moo-hyun, announced his Northeast Asia Financial Hub Concept, which was aimed at

leveraging the unique characteristics of Korea's financial and capital markets and developing Korea into a financial hub for East Asia. The establishment of KIC was aimed at the global development of Korea's investment industry.

The second reason was to lower the cost of managing Korea's macroeconomy. When Korea intervenes in currency markets, it raises won-denominated funds with Foreign Exchange Equilibrium Fund Bonds issued by MOSF and then sells that won for dollars in order to keep the won from appreciating excessively. On the asset side, Korea's foreign-exchange reserves are invested in dollar-denominated US Treasuries and thus exposed to the risk of dollar depreciation, making it necessary to take into account both assets and liabilities. The surplus liquidity within Korea created by the MOSF's won selling and dollar buying was mopped up through the Bank of Korea's issuance of Monetary Stabilization Bonds in order to prevent inflation, but this made it necessary to consider the stress being put on monetary policy. Consequently, a domestic consensus was gradually reached that using a portion of foreign exchange reserves to establish an investment management company to pursue investment returns overseas was a practical policy to pursue.

Within this context, KIC was expected, as a global investment management company dedicated to maintaining and expanding sovereign wealth, to (1) pursue high investment returns through overseas investments, (2) contribute to the development of Korea's financial and capital markets and make Korea a financial center, and (3) serve the role of developing individuals with financial expertise.

In addition, prior to the establishment of KIC, parliament had passed the KIC Act, and this was followed on 30 June 2005 by passage of the Enforcement Decree of KIC Act and publication of the full text of the KIC Articles of Incorporation. It is of note here that the core legislation, the enforcement decree, and the articles of incorporation were all published in English, a decision that probably helped the KIC to operate as a global investment management company.

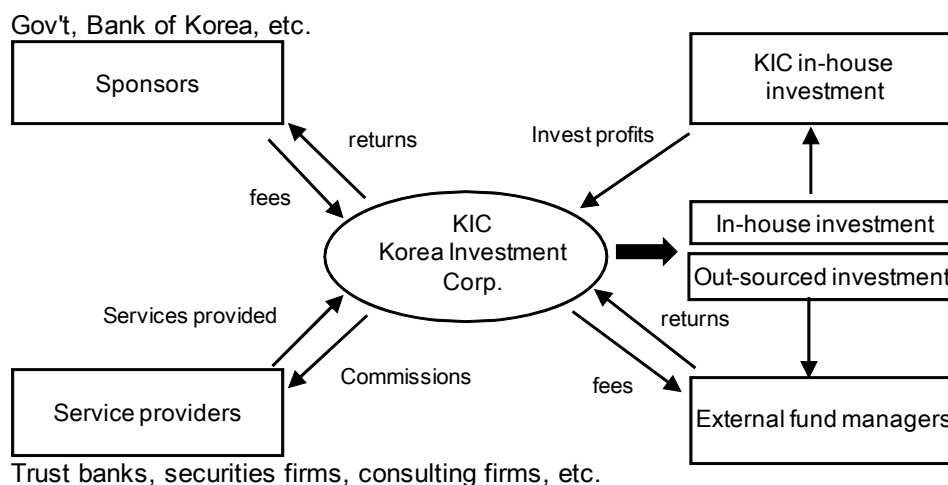
## **2. KIC's investment guidelines**

As shown in Figure 1, KIC's investments comprise both the investments it makes on its own and the investments that it re-entrusts to others (Article 31, Paragraph 2 of the KIC Act). At the same time, KIC is required to invest its assets in foreign-currency-denominated overseas assets (Article 31, Paragraph 3). As already noted, this is to minimize the stress placed on Korea's macroeconomic policies and as a way to prevent domestic inflation, as clearly stated in the law.

KIC invests in (1) securities, (2) foreign exchange, (3) financial derivatives, (4) deposits, (5) real estate, and (6) other areas as prescribed by Presidential Decree (Article 31, Paragraph 1). In addition, KIC's investments in bonds and stocks are indexed (passive) investments.

As shown in Figure 1, KIC's global investments have created business for trust banks, securities firms, consultants, and other outside service providers. Its re-entrustment of investments has also led to a trust business with outside investment

**Figure 1: Parties involved in managing KIC's assets**



Source: Nomura Institute of Capital Markets Research, based on data from KIC

institutions. As noted, KIC is expected to play an important role in helping to develop these investment-related businesses.

### III. KIC's institutional design

#### 1. KIC's management and decision-making process

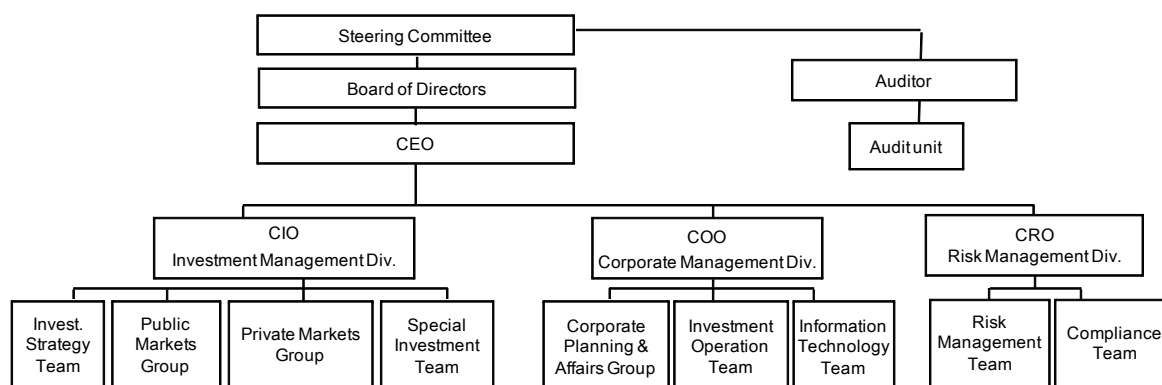
A Steering Committee was set up to establish KIC's management guidelines and review its performance (Articles 9 through 14 of the KIC Act, see Figure 2). The committee must be made up of no more than 12 members serving two-year terms, including a chairman. The Steering Committee can include up to six private-sector members who are nominated by the KIC's internal Civil Member Candidate Nomination Committee.

The KIC has up to five directors (including a president/CEO) and one auditor (KIC Act Article 15), all serving three-year terms (KIC Act Article 21, Paragraph 1). The president/CEO is nominated by the President Nominating Committee, vetted by the Steering Committee, proposed by the Minister of Strategy and Finance, and appointed by the President of Korea (KIC Act Article 17, Paragraph 1).

Directors other than the president are appointed by the president after being vetted by the Steering Committee (KIC Act Article 17, Paragraph 2). The auditor is vetted by the Steering Committee and appointed by the Minister of Strategy and Finance (KIC Act Article 17, Paragraph 3).

The president also serves as the CEO, below which there is a CIO in charge of investment management, COO in charge of corporate management, and CRO in charge of risk management.

**Figure 2: KIC's organizational chart (end-April 2010)**



Source: Nomura Institute of Capital Markets Research, based on data from KIC

**Figure 3: KIC's Steering Committee**

Sector	Name	Position
Private	Ke Sop YUN (Chairman)	Professor, Seoul National University
	Kyung Soon SONG	Representative Director, Korea Expert Consulting Group
	Thae S. KHWARG	CEO, SEI Asset Korea
	Deok Ryong YOON	Korea Institute for International Economic Policy
	Chang-Ki PAIK	CEO, Tongyang Investment Trust Management Co.
	Ky-Tack HONG	Professor, Chung-ang University
Government	Young-wook CHIN	CEO, KIC
	YOON Jeung-Hyun	Minister of Strategy and Finance
	Choongsoo KIM	Governor of the Bank of Korea

Source: Nomura Institute of Capital Markets Research, based on data from KIC

## 2. Members of the Steering Committee

The members of KIC's Steering Committee, six private-sector professionals and three government officials, are listed both in its annual report and on its web site (Figure 3). The private-sector members include those with backgrounds in academia, government-affiliated think tanks, consulting companies, and private-sector financial institutions. The three government officials are the KIC's CEO, the Minister of Strategy and Finance, and the Governor of the Bank of Korea.

The Chairman of the Steering Committee is chosen from among the private-sector members by a Steering Committee resolution. The current Chairman, appointed in September 2010, is Dr. Ke Sop Yun<sup>1</sup>, a professor at Seoul National University and previously a member of the Presidential Committee of Financial Reform.

<sup>1</sup> Ke Sop Yun has also served as President of the Korea Money and Finance Association, Commissioner of the Securities Exchange Commission, President of the Korea Securities Association, President of the Korea Tax Association, and President of the Korea Securities and Economy Institute.

**Figure 4: KIC's senior management**

Name	Young-wook CHIN	Huynh Wook KANG	Scott E. KALB
Title	President & CEO	Auditor	Chief Investment Officer
Work history	Vice Chairman; President & CEO of Hanwha Non-Life Insurance Co. CEO of Hanwha Securities IMF Economist Ministry of Finance	2010 KIC Auditor 1978-2010 Ministry of Strategy and Finance 1994-1997 Asia Development Bank	Balyasny Asset Management, Portfolio Manager Black Arrow Capital Management, Principal and CEO, Portfolio Manager Tudor Investment Corp. Vice President and Senior Equity Portfolio Manager Citigroup (Smith Barney International Asset Management), Managing Director Drexel Burnham Lambert James Capel & Co. Economic Planning Board, Korea
Education	M.B.A., University of Texas at Austin B.A., Seoul National University	M.A, Yale University M.A, Seoul National University B.A., Sungkyunkwan University	M.A., Harvard University B.A., Oberlin College

Name	Je Yeong PARK	Yong Shin LEE
Title	Chief Operating Officer	Chief Risk Officer Compliance Officer
Work history	Korea Exchange Bank Regional Headquarter Head Chief Secretary to President & CEO Head of Corporate Communication/IR Director, Miami Branch	The Bank of Korea Director General of Reserve Management Department Director General of Reserve Investment Office Director General of Reserve Management Support Office Head of Reserve Management Planning Team Head of Portfolio Management Team Senior Economist, Foreign Exchange Market Team Economist, London Representative Office
Education	B.A., Yonsei University	B.A., Yonsei University

Source: Nomura Institute of Capital Markets Research, based on data from KIC

### 3. Management lineup and work experience

KIC's annual report and web site list the names, work experience, and education of its senior management, namely its President & CEO, CIO, COO, CRO, and Auditor (Figure 4).

The current President & CEO, Young-wook Chin, is formerly a high-ranking official in the Ministry of Strategy and Finance, but has worked in international finance as an IMF economist, and also gained experience as an officer in a securities brokerage firm and a property & casualty insurance company after he left his post in the MOSF. COO Je Yeong Park came from the Korea Exchange Bank, CRO Yong Shin Lee came from the Bank of Korea's Reserve Management Office, and Auditor Huynh Wook Kang came from the MOSF, but also worked at the Asia Development Bank. Particularly worth noting is that the CIO, Scott E. Kalb, is a foreigner with experience in private-sector asset management companies<sup>2</sup>. This could be taken as evidence of KIC's strong commitment to developing its global investments.

<sup>2</sup> On 16 December 2008, the KIC posted a notice on its web site that it was looking for a CIO from outside the organization for a three-year term.

**Figure 5: KIC's Investment Management Division (end-April 2010)**

Division	Composition	Staff size
Investment Management Div.	2 groups, 2 teams	37
Corporate Management Div.	1 group, 2 teams	28
Risk Management Div.	2 teams	9
Audit Unit	1 unit	2
Total	3 divisions 4 groups 6 teams	76

Source: Nomura Institute of Capital Markets Research, based on data from KIC

#### **4. Investment organization**

The Investment Management Division is directly responsible for KIC's investments. It was previously made up of five teams, one each for investment strategy, stock investments, bond investments, alternative investments, and out-sourced investments, but was reorganized in May 2009 into four teams/groups: the Investment Strategy Team, Public Markets Group, Private Markets Group, and Special Investment Team.

The Investment Strategy Team designs and proposes KIC's investment policies, the Public Markets Group handles investments in stocks, bonds, and outsourced investments, and the Private Markets Group handles alternative investments. The Special Investment Team is new, and appears to be a specialized investment team created to manage KIC's strategic investment in Merrill Lynch, as described later in this paper.

Total staff in the Investment Management Division, including front, middle, and back office, was 76 as of end-April 2010, 37 of whom were in the front office (Figure 5).

## **IV. KIC's past investment performance**

### **1. KIC's investment milestones**

KIC has incrementally expanded its global investment activity (Figure 6). It began global bond investments (outsourced) in November 2006, global stock investments (outsourced) in April 2007, global bond investments (in-house) in August 2007, strategic investment in February 2008 (beginning with its initial \$2 billion investment in US-based Merrill Lynch), global stock investment (in-house) in March 2008, and alternative investments in August 2009.

Generally, it outsourced investments before doing it in-house, invested in bonds before it invested in stocks, and invested in public markets before adding strategic and alternative investments. KIC started with initial capital of \$20 billion (\$17 billion

**Figure 6: KIC's investment milestones**

Year	Month	Event
2005	March	Korea Investment Corporation Act passed into law
	July	KIC established
2006	June	Signs investment management agreement (for \$17 billion) with Bank of Korea
	October	Signs investment management agreement (for \$3 billion) with Ministry of Finance and Economy (now the Ministry of Strategy and Finance MOSF))
	November	Begins (outsourced) investment in global bonds
2007	April	Begins (outsourced) investment in global stocks
	August	Begins (in-house) investment in global bonds
2008	January	Signs investment management agreement (for \$2 billion) with MOSF
	February	Begins strategic investments
	March	Begins (in-house) investment in global stocks
	October	Signs investment management agreement (for \$2.77 billion) with MOSF
2009	July	Signs investment management agreement (for \$3 billion) with MOSF
	August	Begins making alternative investments
	December	Signs investment management agreement (for \$2 billion) with MOSF

Source: Nomura Institute of Capital Markets Research, based on data from KIC

from the Bank of Korea and \$3 billion from the MOSF), and received another \$9.77 billion of additional capital from the MOSF pursuant to an investment management agreement signed with that Ministry.

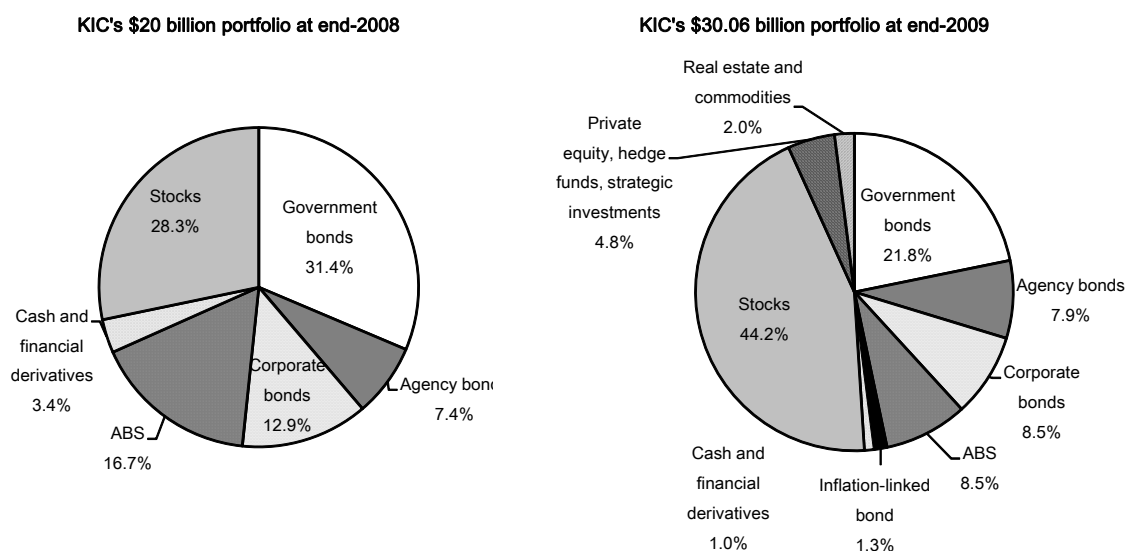
## **2. Portfolio allocations**

### **1) Overall portfolio**

At end-2008, the \$20 billion portfolio was allocated 68.4% in bonds (31.4% government bonds, 7.4% agency bonds, 12.9% corporate bonds, and 16.7% asset-backed securities), 28.3% to stocks, and 3.4% in cash and financial derivatives, but the 2009 annual report reported allocations across two portfolios, traditional (stocks, bonds (including cash and financial derivatives), and CPI linkers) and alternative (private equity, hedge funds, strategic investments, real estate, and commodities). This is shown in Figure 7.

As of end-2009, the total \$30.06 billion portfolio was allocated 93.2% (\$28.02 billion) in the traditional portfolio and 6.8% (\$2.04 billion) in the alternative portfolio. It also reported allocations by asset class: 49% bonds (21.8% government bonds, 7.9% agency bonds, 8.5% corporate bonds, 8.5% ABS, 1.3% CPI linkers, and 1% cash and financial derivatives), 44.2% stocks, and 6.8% alternative investments (4.8% private equity, hedge fund, and strategic investments, and 2% real estate and commodities).

**Figure 7: KIC's portfolio allocations**



Note: Portfolio allocations at end-2008 exclude cash investments in US Treasuries and the strategic investment in Merrill Lynch.

Source: Nomura Institute of Capital Markets Research, based on data from KIC

Although a strict comparison with the portfolio allocations at end-2008 is difficult because the figures are broken down differently, it is clear that KIC substantially increased its allocation into stocks while also gaining exposure to alternative investments.

## 2) Allocations within the traditional portfolio

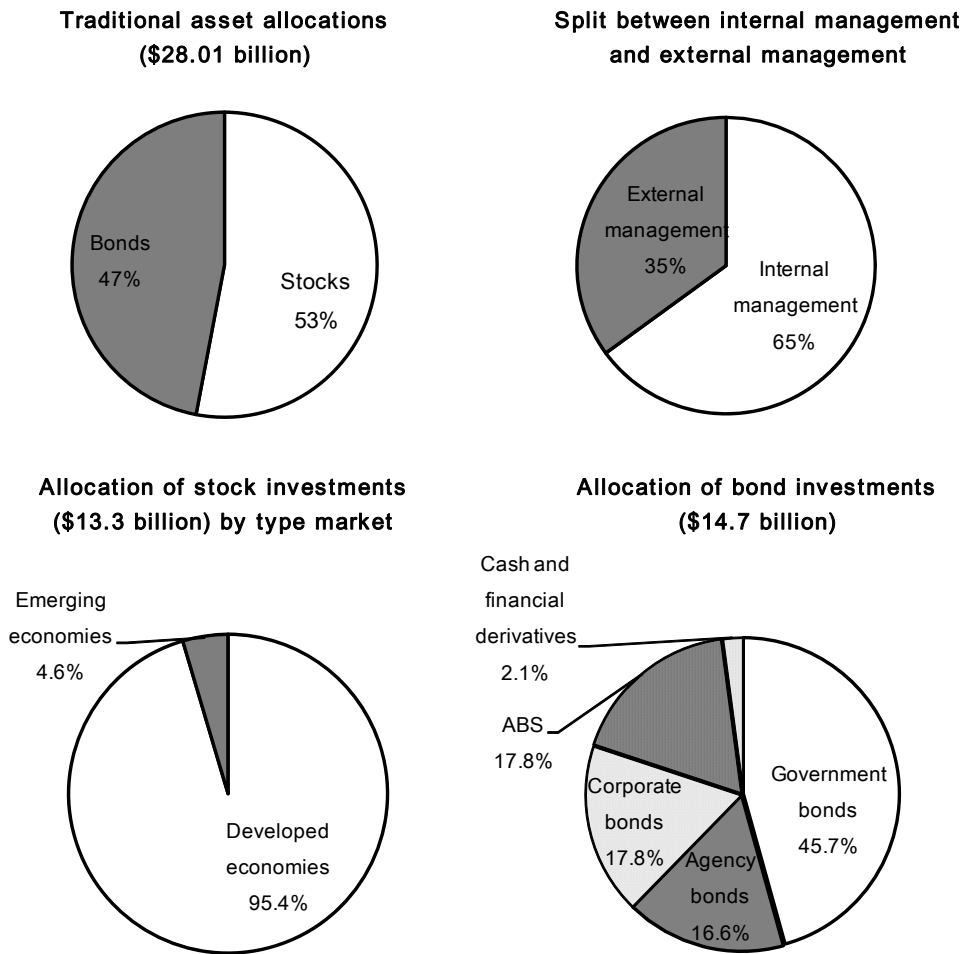
As shown in Figure 8, the \$28.01 billion traditional portfolio at end-2009 was 47% (\$13.3 billion) stocks and 53% (\$14.7 billion) bonds. By investment method, 65% (\$18.2 billion) of the traditional portfolio was invested in-house, and 35% (\$9.8 billion) was invested indirectly (outsourced).

Of its stock investments, 95.4% (\$12.7 billion) were in advanced economy stocks and 4.6% (\$600 million) in emerging markets stocks. Of its bond investments, 45.7% (\$6.7 billion) were in government bonds, 16.6% (\$2.4 billion) in agency bonds, 17.8% (\$2.6 billion) in corporate bonds, 17.8% (\$2.6 billion) in ABS, and 2.1% (\$300 million) in cash and financial derivatives.

Overall, most stock investments were made in advanced economies and roughly 60% of bond investments were in sovereigns or government-affiliated issuers, while the share of investments it is making on its own (versus outsourcing) appears to have increased substantially.



**Figure 8: Allocations in KIC's traditional portfolio (end-2009)**



Source: Nomura Institute of Capital Markets Research, based on data from KIC

### 3. Thinking on currencies and countries/regions

The bond and stock investments in KIC's traditional portfolio are chosen based on currency and the country/region of investment, based on the investment management agreement with MOSF (Figure 9).

As of end-2009, KIC had bond investments in 21 different currencies and 56 different countries, regions, or multilateral financial institutions. Changes relative to end-2008 were removal of the Slovakian koruna from the currency mix and Slovakia from the country/region mix, and the addition of the Brazilian real and Brazil.

KIC had stock investments as of end-2009 in 27 currencies and 38 countries/regions. The only change relative to end-2008 was the addition of the Brazilian real and Brazil.

**Figure 9: Allocations in KIC's traditional portfolio by currency  
and by country/region (end-2009)**

**KIC invests in bonds denominated in 21 different currencies**

US Dollar	Canadian Dollar	Euro
Pound Sterling	Danish Krone	Norwegian Krone
Swedish Krona	Japanese Yen	Australian Dollar
New Zealand Dollar	Singapore Dollar	Hong Kong Dollar
Czech Koruna	Hungarian Forint	Mexican Peso
Polish Zloty	Chilean Peso	Brazilian Real
Taiwan Dollar	Malaysian Ringgit	South African Rand

**KIC invests in stocks denominated in 27 different currencies**

US Dollar	Canadian Dollar	Euro
Pound Sterling	Danish Krone	Norwegian Krone
Swedish Krona	Swiss Franc	Japanese Yen
Australian Dollar	New Zealand Dollar	Czech Koruna
Singapore Dollar	Hong Kong Dollar	Polish Zloty
Hungarian Forint	Mexican Peso	Russian Ruble
Chilean Peso	Israeli Shekel	Chinese Yuan
South African Rand	Malaysian Ringgit	Taiwan Dollar
Indian Rupee	Brazilian Real	Thai Baht

**KIC invests in bonds issued by/in 56 different countries, regions, or multilateral financial institutions**

Australia	UK	Canada	Denmark
Japan	New Zealand	Norway	Singapore
Sweden	Switzerland	US	Qatar
Euro zone: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxemborg, the Netherlands, Portugal, Spain			
Saudia Arabia	United Arab Emirates	Slovenia	Bermuda
Hong Kong	Taiwan	Bahrain	Cyprus
Estonia	Iceland	Lithuania	Slovakia
Trinidad & Tobago	Chile	China	Czech Republic
Hungary	Israel	Malaysia	Poland
Croatia	Kazakhstan	Latvia	Rumania
Bulgaria	Tunisia	India	Mexico
Russia	South Africa	Thailand	Brazil
Supranational institutions			

**KIC invests in stocks issued in 38 different countries or regions**

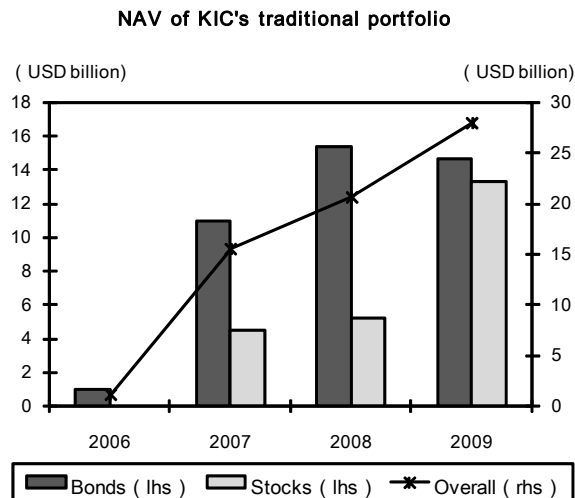
Australia	UK	Norway	Denmark
Japan	New Zealand	US	Singapore
Sweden	Switzerland	Canada	Taiwan
Euro zone: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxemborg, the Netherlands, Portugal, Spain			
Thailand	Chile	China	Hong Kong
Hungary	Israel	Malaysia	Czech Republic
India	Mexico	Russia	Poland
South Africa	Brazil		

Source: Nomura Institute of Capital Markets Research, based on data from KIC

**Figure 10: Investment performance of KIC's traditional portfolio**

Asset	Return (%)	Benchmark (%)	Excess return (ppt)	Length of period (months)
Bonds	3.81	5.16	-1.36	12
Stocks	-41.43	-41.32	-0.11	12
Overall	-13.71	-13.05	-0.66	12

Asset	Return (%)	Benchmark (%)	Excess return (ppt)	Length of period (months)
Bonds	8.56	6.85	1.71	12
Stocks	31.96	32.2	-0.23	12
Overall	18.67	17.24	1.42	12



Source: Nomura Institute of Capital Markets Research, based on data from KIC

#### 4. KIC's investment performance

The performance of KIC's traditional portfolio in 2009 improved substantially over that in 2008 (Figure 10). Overall return in 2008 was -13.71%, including +3.81% for bonds and -41.43% for stocks, while in 2009 overall return was +18.67%, including 8.56% for bonds and +31.96% for stocks. In addition, excess return<sup>3</sup> was -0.66% overall, -1.36% for bonds, and -0.11% for stocks in 2008, but +1.42% overall, +1.71% for bonds, and -0.23% for stocks in 2009; hence KIC overall outperformed the market in 2009.

Although it had a negative excess return on its stock investments in 2009, we think its decision to raise stock allocations during the global stock market recovery contributed to its achieving an overall positive excess return.

### V. Future outlook for KIC

#### 1. Keys are strengthening alternative investments and the talent pool

As already noted, KIC has incrementally expanded the scope of its investments since its establishment in July 2005, and was able to achieve excess returns in 2009. For it to achieve its objective of increasing sovereign wealth, it is important that KIC pursue even better investment performance. We think the keys in this regard are

<sup>3</sup> Excess return refers to the difference between the fund's rate of return and the benchmark rate of return, with a positive figure indicating outperformance, i.e., better investment results than the benchmark.

strengthening the talent pool and the alternative investments that it began in earnest in 2009.

We note that investments in resources and energy were added to its alternative investment mix in 2010. On 21 June 2010, Chesapeake Energy, the third-largest natural gas company in the US, announced that KIC, the China Investment Corporation (CIC), Singapore's Temasek Holdings, and two private equity firms (HOPU Investment Management and Canada's Li Ka Shing Foundation) had together agreed to purchase \$900 million of its preferred stock. KIC will purchase \$200 million of that total. In an interview with Bloomberg on 26 August 2010, KIC CIO Scott Kalb revealed that (1) KIC's investment profits, which had risen 18% in 2009, have been flat in 2010, and that the market environment has made it difficult to increase profits on its portfolio investments in stocks and bonds; (2) consequently, KIC plans to double its allocation to direct investments in corporations, private equity, hedge funds, and real estate, from roughly 10% of its overall portfolio to 20%; and (3) KIC has already put together an investment team specialized in corporate stock acquisitions, and in addition to Chesapeake Energy plans one or two more deals before the end of 2010. This purchase of Chesapeake Energy's preferred shares is interesting in that it is a joint investment with other sovereign wealth funds.

Potential ways for it to strengthen its talent pool include strengthening both new graduate and mid-career hires. On the new hire side, it will have two internships in 2010, just as it did in 2009. Specifically, over the two-month period from 21 June until 20 August 2010, it will have internships in the Public Market Group, the Private Markets Group, and the Investment Strategy Team. Then over a six-month period from 1 July until 30 December, the Public Markets Group, Private Markets Group, and Compliance Team will have internships. On the mid-career hire side, six job descriptions in four divisions were posted in March 2010 and another six jobs in four divisions were posted in July 2010. Depending on the position, the minimum relevant job experience requirement ranged from one year to seven years, and KIC is trying to play a role in providing a talent pool to Korea's investment industry.

## **2. Involvement in Japan**

KIC's involvement in Japan includes investing in Japanese stocks and the Japanese yen. KIC limits its shareholdings to no more than 1% of an issuer's outstanding shares, and its policy is to exercise voting rights in good faith and based on the principle of improving long-term shareholder value. When voting rights are exercised, they are checked by the compliance officer, and the CIO must report the votes cast to the Board of Directors and the Steering Committee. Japanese corporations should probably gear their IR activity with KIC based on an understanding of KIC's guidelines regarding the exercise of voting rights.

In addition, KIC also invests in yen-denominated bonds and bonds issued in Japan. KIC's bond investments include government bonds, agency bonds, corporate bonds, and ABS, and we expect Japanese bond issuers will also need to conduct debt IR geared toward KIC.

The process that KIC has gone through as described in this paper should be of reference for emerging market government in managing their economies when dealing with the problem of having to invest the foreign exchange reserves they have amassed. At the same time, moves by KIC, which has the development of Korea's investment industry as one of its objectives, will probably continue to attract attention from capital market participants both domestically and internationally.