



# Legislative Change in Korea: Structured Governance Now Required for Large-sized Defined Benefit Plans

March 2021

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*National Assembly has approved the amendment of Employee Retirement Benefit Security Act (ERSA) on March 24, 2021.*

*The changes include the requirement of Structured Governance for DB Plans with more than 300 members.*

## Overview

The amendment of Employee Retirement Benefit Security Act (ERSA) was proposed in August 2020. The original bill included:

- Requirement of governance for DB plan
- Penalty fine for plan sponsors who did not resolve shortfall of DB plan asset
- Introduction of pension trust for small-sized enterprises
- Abolishment of Severance Pay Plan by mandatory conversion to ERSA-qualified Plan.

Environment & Labor Committee (ELC) of Korean National Assembly provided conditional approval on the bill by postponing the decision on the abolishment of severance pay plan in February 2021. The bill was revised to exclude the “abolishment of severance pay plan” and received the final approval on March 24, 2021.

The effective date of changes is to be announced by Ministry of Employment & Labor in April 2021.

## DB Governance

Over 90% of the Korean DB plan asset are invested in principal-interest guaranteed (PIG) products<sup>1</sup>. Korean government believes the reason for this extreme risk-avoiding behaviour of DB plan is due to the lack of DB governance. By requiring DB plans to have a structured governance, Korean government is hoping that the DB plan asset is to be managed with proper investment strategy.

The requirement for the structured governance is for companies with DB plan that have more than 300 employees. It is not mandatory for smaller-sized plans.

As part of the structured governance, the plan sponsor must (1) establish an internal investment committee who will look over the investment of DB plan asset and take responsibilities over decisions involving the investment, and (2) draft the investment policy statement at least once a year which contains the asset allocation, target return on assets and evaluation of the investment performances.

There will be a time period between now and the actual effective date, providing employers with time for preparation.

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<sup>1</sup> Principal Interest Guaranteed (PIG) products are investment option providing guarantee on principal and fixed interest rate, like time deposit.

## DB Funding

All ERSA-qualified DB plans must meet the minimum funding requirement. The minimum funding requirement is currently 90% of the actuarial liability<sup>2</sup>, and is to be increased to 100% from 2022.

The plan administrator is required to provide funding adequacy statement within six months from the plan's financial year-end, acknowledging the plan sponsor whether the plan is adequately funded or not.

In case of shortfall, the result of the funding adequacy is also sent to the employee representative. The employer must prepare the Financial Stabilization Plan – the financial plan for how the plan sponsor will make up the shortfall – and submit to the plan administrator.

The new changes introduced are the penalty fines. If the plan administrator fails to deliver the funding adequacy statement within required timing to the plan sponsor, and employee representative in case of shortfall, the plan administrator is subject to the penalty fine up to KRW 10 million.

If the plan sponsor does not resolve the funding shortfall as previously announced in financial stabilization plan, the plan sponsor is subject to the penalty fine up to KRW 10 million.

This is just imposing penalty fine on the regulation that is already in place. However, the penalty fine along with scheduled increase in funding requirement is making more difficult for companies to maintain defined benefit plan. This may further boost the market trends toward defined contribution plan.

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<sup>2</sup> Actuarial liability for regulatory funding is calculated using same method as benefit obligation under IFRS or US GAAP. However, the actuarial assumptions are dictated by ERSA and are different from the accounting.

## Pension Trust for Small Companies

There will be a pension trust established for small-sized companies with less than 30 employees. This pension trust will be managed by Korea Workers' Compensation & Welfare Service (KCOMWEL).

This change is for Korean government to provide the subsidies to the small-sized companies more effectively. This pension trust will not be relevant for most of the multinational companies who will not be eligible for government subsidy for pension.

## Abolishment of Severance Pay Plan

The original bill contained the abolishment of severance pay plan. According to the proposed bill, the severance pay plan will no longer be allowed, and all companies must make a conversion to ERSA-qualified DB or DC plan.

The deadline for the plan conversion was as short as six months from enactment of change for companies with more than 100 employees. The deadline is to be longer for smaller companies.

At ELC meeting, all politicians agree that mandatory conversion of severance pay to DB or DC is must. However, they were concerned about the timing. In case the current pandemic situation continues for longer period, this mandatory conversion may become a large cash burden for companies who are already experiencing difficult times.

This meeting was held in the fourth week of February, which was also the week when the first vaccination shot for COVID-19 was made. The politicians were hopeful that we will be able to at least discover when Koreans can escape from the COVID-19 pandemic. The meeting had ended with a promise to discuss the timing of mandatory conversion in six months.

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