Comparative Analysis of Social Context, Institutional and Accounting Regulations of Pensions in Australia and Korea: Risks to be Managed and Synergies to be Optimised

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Aims of research

• To compare the social context and institutional rules in place in Australia and Korea and link this to the accounting for pensions in both jurisdictions

• Risks to be managed include investment, bankruptcy and longevity risks
Motivation

• Policy-makers worldwide, such as the OECD and the World Bank are increasingly vocal on pension policy reforms at the national level

• OECD (2006) isolated inadequate funding (investment risk), bankruptcy and moral hazard risk as three key elements that need addressing
Motivation

• Ageing populations and increasing longevity heighten the urgency of pension reform as governments unable to fund retirement and increasing health costs

• Pension reform and sustainability of pension systems is major policy issue in Korea and Australia
Background

• Prior to 1992, Australia and South Korea did not have a private national employment-related retirement income plan (the second “pillar”) (Bateman, Kingston and Piggott, 2001)
Australia

• In 1992, introduced SGC legislation
• SGC popularised DCP (immediate vesting but investment risk assumed by member)
• use combination of minimum funding requirement (DBP), restriction of equity ownership in employer/sponsor, setting of investment policy and fund disclosure principles
Korea

- Traditional DCP/DBP for retirement purposes not introduced until December 2005
- Instead, retirement allowance plans (RAP) introduced by Labor Standards Act 1961 provided for lump sum payment upon termination of employee
- RAP resemble redundancy payments and rarely used for retirement
Korea

• Employee Retirement Security Act (ERSA) 2004 encourages substitution of RAP by DBP and DCP

• Labour system in Korea is highly unionised and inflexible

• Korean population is ageing at a fast rate
Korea’s economy

• Member of OECD in 1996
• Now Asia’s fourth largest economy
• Concerns that Korea is losing its competitive edge to China
• Korean economy dependent upon manufacturing and exports of just a few products (phones, semiconductors, cars, flat screens)
Korea’s financial system

- In 1980s government had direct control of financial institutions eg appointed CEOs
- Risk analysis by banks was minimal due to government acting as guarantor
- Government was permitted discretion with respect to exercise of prudential regulation
- Government, business and banks were closely connected
- As competition increased from developing economies and technological gap narrowed, need for more open economy in 1990s
Korea’s financial system

- 1997 crisis many financial institutions collapsed due to poor profitability, growing non-performing loans, falling prices for exports, poor balance of trade and pressure to depreciate Korean won
- 1998 economy-wide restructuring focused on introducing global standards and strengthening market principle
- Financial Supervisory Commission created to revamp prudential regulation
Korea’s financial system

• Measures to introduce corporate transparency by mandating (combined) financial statements for large firms and introducing GAAP
• More flexibility introduced into labour market by making terminations easier
• Also, safety net was strengthened (National Minimum Living Standard Security Act)
Korea’s financial system

• Announcement to cut government regulations by half
• Opened doors to foreign investment in 1997
• Now nearly 50% of stock market capital owned by foreigners
• Still, impediments to growth include inconsistent regulatory policy (eg chaebols), lack of English and anti-foreign sentiment (or economic nationalism)
Korea’s financial system

- Need to fully endorse market principles
- Government anxious to boost Seoul’s image as financial capital
- So restructuring entire financial system in 2007 to encourage competition in financial markets
Korea’s financial system

- Korea Exchange (KRX) has long listing procedures and complex disclosure rules that act as disincentive for foreign companies to list
- KRX had first foreign IPO listing in 2007 (Chinese textile group)
- To encourage knowledge creation Korea needs to change top-down management style
Korea’s pension reforms

- Need for pension reforms is critical as Korea’s population ages
- Greater flexibility of workforce including better utilisation of female labour
- Need flexibility over choice of pension structure and design of benefits
- Encouraging employee contributions (voluntary) by permitting these to be paid from pre-tax wages
- Also some “matching” of employee contributions by employer
Korea’s pension reforms

• Pension benefits can be either lump sum or annuity
• Generous tax benefits for annuity payment
• Cultural resistance to annuity-type payment
• Annuity market not well developed and currently expensive conversions terms
• Insurance industry needs to develop to offer annuity products at competitive prices
Plan: figure 1

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<th>Australia</th>
<th>Synergies</th>
<th>Korea</th>
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<td><strong>Social context of superannuation</strong></td>
<td>➢ Provide connections for dialogue between Australia and Korea</td>
<td><strong>Social context of pensions</strong></td>
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<tr>
<td>• Early plans for “white collar” membership</td>
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<td>• Wide coverage of workers</td>
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<td>• Early plans: defined benefit</td>
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<td>• Mostly defined benefit (66.4% total plan assets)</td>
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<td>• To encourage employee loyalty</td>
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<td>• Called redundancy plans</td>
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<td><strong>Institutional regulations</strong></td>
<td>➢ Increased understanding of institutional pension regulations between Australia and Korea</td>
<td><strong>Institutional regulations</strong></td>
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<td>• SIS Act (1993): fosters DCP</td>
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<td>• Pension regulations introduced 1 December 2005</td>
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<td>• Post-SIS Act: superannuation coverage increased to 92%</td>
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<td>• Permits both DBP and DCP</td>
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<td>• Funding system supported by good plan governance and disclosures</td>
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<td>• To protect members and employers</td>
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### Accounting regulations

- Convergence to IFRS 1 January 2005: introduced accrual accounting for pensions
- Adopts IAS 19: net pension position (fair values) on sponsor’s balance sheet
- Discourages growth of DBP

### Accounting regulations

- Accounting for pensions varies from IFRS
- Does not follow IAS 19
- Transition to IFRS for pension accounting planned for 2009-2010
- Need to establish high quality pension accounting standards

### Impacts allocation of economic and social resources

- OECD member
- Market-based economy
- Ageing population
- Economic relevance of assets invested in superannuation September 2006: $A945.6b

### Impacts allocation of economic and social resources

- OECD member 1996
- Moves to market-based economy
- Ageing population
- Economic relevance of assets invested in superannuation February 2007: KRW 756.8b

- Korea as knowledge base to assist Korean transition to IFRS for pension accounting
- Inform Korean actuarial profession of adverse impact of IFRS before-the-fact

- Australia as knowledge base to assist Korean transition to IFRS for pension accounting
- Korea as source of extensive manpower to ease Australia’s skills shortage: informed workforce with improved living standards
- Korea to maintain the balance between DBP and DCP
Going forward

• Develop framework that includes good fund governance principles to analyse Australian and Korean pension systems
• Collect company pension disclosures in Australia and Korea
• Link social context and institutional regulations to accounting for pensions in both jurisdictions
• Develop disclosure/accounting frameworks for both Australia and Korea that includes good corporate governance principles
Going forward

• Received funding from Australia-Korea Foundation to support this research (July 2007)