OPINION

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Key Considerations in Designing a Fund-Based Retirement Pension System

The debate over introducing a fund-based retirement pension system is closely tied to calls for a qualitative transformation following the rapid expansion of retirement pension assets. Although retirement pension reserves have grown quickly, the current contract-based governance structure and the individual-choice-centered operation of defined contribution (DC) plans have not been sufficient to achieve the system's objectives of improving long-term returns and securing retirement income. In particular, a structure in which participants must search for, choose, and switch products tends to turn inattention and choice avoidance into an excessive concentration in principal- and interest-guaranteed products.

A fund-based system should therefore be understood as an additional governance option intended to mitigate these limitations. The key is not to replace the contract-based system with a single solution, but to design and operate different types of funds – public funds, nonprofit association funds, and open funds operated by financial institutions – according to their respective policy objectives. Public funds should focus on closing coverage gaps and protecting benefit entitlements; nonprofit association funds on economies of scale based on solidarity; and financial-institution open funds on raising long-term returns through competition in asset management.

Accordingly, the conditions for success do not lie in imposing identical regulations and governance structures on all fund types. Common standards should be established for acting in participants' best interests, fiduciary responsibility, conflict-of-interest controls, and transparent performance disclosure, while differentiated designs should be adopted according to the purpose of each fund type. In particular, to address the structural weaknesses of DC plans, the institutional design should center on a genuine opt-out default structure that reduces participants' product-

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selection burden, the independence of professional investment organizations, performance and fee competition among funds, and corrective and exit disciplines for persistently underperforming funds.

Introduction

A multi-pillar pension scheme is generally divided into public and private pensions. Korea's retirement pension system, which occupies the second pillar, is unusual in that it is a quasi-public social welfare institution combining both private and public characteristics. The fully funded method, in which a portion of wages is accumulated during employment and used as retirement income after leaving the workforce, is a typical feature of private pensions. At the same time, because the state legally mandates participation and benefit payment for the retirement income of all working people, the system also has a strong public-pension character. The success or failure of the retirement pension system is therefore directly linked not merely to financial-market performance but to the sustainability of the multi-pillar pension system. If the National Pension Service performs the role of the first-pillar public pension, retirement pensions should function as a second-pillar pension that contributes a meaningful share of old-age income from assets accumulated during working life.

Over the roughly two decades since its introduction, Korea's retirement pension system has grown rapidly in terms of asset size, yet it continues to reveal limitations in qualitative investment performance and, ultimately, in strengthening retirement-income security. A pension system should be understood not simply as a vehicle for accumulating old-age assets through financial savings, but as an institutional mechanism for generating a stream of income paid month by month in retirement. As Korea approaches a mandatory unification of severance pay into the retirement pension system, reform of DC plans is particularly urgent. In DC plans and individual retirement pensions (IRPs), outcomes depend heavily on individual choices, but it is unrealistic to expect individuals to repeatedly make successful decisions over long horizons regarding asset allocation, product selection, rebalancing, and risk management. The heavier the burden of choice, the more likely choice avoidance becomes, and the experience of the past twenty years shows that this has resulted in a concentration of retirement assets in cashlike or principal- and interest-guaranteed products.

The recent discussion of fund-based retirement pensions begins from this diagnosis. A fund-based system does not treat retirement assets merely as an aggregation of individual contracts and product choices. Instead, it provides an institutional framework in which a trustee corporation and a professional investment organization assume responsibility for long-term management. It preserves the individual's ability to choose at the level of plan participation while reducing the neglect of asset management caused by choice avoidance at the product-selection level. In this sense, a fund-based retirement pension system can be understood as an institutional extension of a default structure. After more than a decade of difficult debate over whether the system should be introduced at all, Korea has now reached the stage of detailed institutional design. Few areas illustrate the saying that “the devil is in the details” more clearly than pension-system design. The success of the fund-based system will depend on whether different fund types are introduced for clearly defined purposes, and whether governance, investment arrangements, supervisory disciplines, and performance evaluation are precisely designed to fit those purposes.

Background to the Introduction of a Fund-Based System

According to the Ministry of Employment and Labor and the Financial Supervisory Service's 2025 retirement pension statistics[1], total retirement pension assets reached KRW 501.4 trillion, comprising KRW 228.9 trillion in defined benefit (DB) plans, KRW 141.6 trillion in DC plans, and KRW 130.9 trillion in IRPs. Principal- and interest-guaranteed products still accounted for a high 75.4% of total assets. By plan type, however, the share remained as high as 91.9% in DB plans, while falling to 67.0% in DC plans and 55.7% in IRPs, indicating that performance-based products are expanding rapidly where individuals bear investment responsibility.

Differences in short-term returns across market conditions stem from these differences in investment structure. In 2025, annual returns were 3.53% for DB plans, 8.47% for DC plans, and 9.44% for IRPs. Long-term annualized returns for DC plans and IRPs have also exceeded those of DB plans, but this simultaneously implies wider dispersion in outcomes depending on each participant's decision-making capability and risk tolerance. The long-term performance

1) Ministry of Employment and Labor and Financial Supervisory Service, 2026, 2025 Korea Retirement Pension Investment White Paper.

of performance-based products has also turned upward since 2022, with the five-year average return rising to about 5.37%. The view that a higher share of performance-based products can improve long-term returns is spreading, but employees' confidence in investment outcomes cannot yet be regarded as fully established. Ultimately, the core objective of pension provision - retirement-income security - is difficult to achieve if pension assets are left entirely to nonprofessional individual choice.

The core problem is that while individuals bear investment responsibility for DC assets, the institutional mechanisms that systematically support rational investment behavior remain inadequate. In other words, the low returns historically observed in Korea's retirement pension system are a problem of the system rather than of individuals. Managing retirement assets does not end with a one-time financial-product choice; it requires repeated investment judgments throughout a worker's career or even over the life cycle. Unless the difficulty of these choices is institutionally reduced, it is hard to sustain the fundamentals of pension investing - long-term diversified investment - and outcomes inevitably become highly dependent on market conditions or recommendations made through sales channels.

The discussion of introducing a fund-based retirement pension system is not new. A fund-based model was proposed in the 2014 policy package for revitalizing retirement pensions.[2)] Subsequent legislative notice, inter-ministerial consultation, and Cabinet approval were completed, but the bill was discarded when the National Assembly's term expired. More recently, discussions by the advisory group for introducing the fund-based system and a tripartite labor-management-government task force led to a joint declaration in February 2026, after which the Ministry of Employment and Labor began follow-up work on legislation and implementation design. This indicates that the policy debate has advanced from whether the fund-based system should be introduced to how each type should be designed in detail. Given that the reform is proceeding on the basis of a hard-won tripartite consensus, it is reasonable to expect that a legislative amendment introducing fund-based retirement pensions could become a reality within this year.

The tripartite joint declaration clearly states that the fund-based system will be introduced as one of multiple governance models, not as a complete replacement for the contract-based model. Contract-based governance is likely to continue accounting for a large share of the

2) Financial Services Commission, 2014, Measures to Revitalize Private Pensions.

market for a considerable period and to coexist with fund-based governance. The introduction of fund-based pensions should therefore be accompanied by reforms to the investment structure of contract-based plans, improvements to the pre-designated investment option system, broader discretionary outsourcing of DB assets, and improvements in the evaluation and comparative disclosure of retirement pension providers.

Default Arrangements and Governance Design

The experience of advanced pension countries shows that a default structure is the most effective institutional device for reducing the burden of individual choice. A default is not one option among several choices made by an individual; it is the pre-existing state before the act of choice itself. A genuine default arrangement is therefore fundamentally an opt-out, not an opt-in, structure. The expression “choice-based default option,” often used to describe Korea's pre-designated investment option system, is thus self-contradictory. An opt-in structure in which investment begins only after the participant makes a prior selection cannot structurally achieve the policy objective of reducing investment distortions caused by choice avoidance. In a system where assets remain unmanaged unless a participant chooses, long-term diversified investment cannot become the default. Future reform should move from a structure in which non-choosers are left unattended to one in which assets are professionally managed even without an active choice, while participants retain the right to change or opt out at any time.

A fund-based retirement pension system is intended to create an institutional environment in which this default concept can be extended across the entire process of participation, investment management, and benefit payment. Under a fund-based system, participants can move away from repeated lower-level decisions to search for and switch individual products, and instead concentrate on a one-time higher-level choice such as the governance structure or trustee institution. In a private pension system, participant choice - which cannot be disregarded - can be protected not through opt-in access to a proliferation of products but through a freely exercisable opt-out structure. For this structure to work properly, the trustee institution must be subject to strict fiduciary responsibility. The trustee institution should be responsible for asset allocation, manager selection, monitoring, and rebalancing, while an independent custodian should separately hold assets and make benefit payments. Only when authority and responsibility are separated yet organically connected in this way can fund-based governance function as an institutional device that addresses the structural weaknesses of DC plans.

A credible fund governance structure should distinguish decision-making, investment management, custody and execution, and supervision and verification, while linking them into a single accountability framework through fiduciary responsibility. The board of the trustee corporation should set the target return, risk limits, and investment guidelines. A professional investment organization or outsourced manager should conduct asset allocation, manager selection, and rebalancing. An independent custodian should separately safeguard assets and make benefit payments, while supervisors and audit and actuarial functions should verify soundness, conflicts of interest, and performance. Fiduciary responsibility must not remain a declaratory principle. It should operate as a concrete discipline that prevents a fund from being used for policy objectives or institutional interests rather than the best interests of participants. Conflict-of-interest controls, internal controls, performance disclosure, corrective measures and exit for underperforming funds, and participants' rights to transfer among funds are all mechanisms that make fiduciary responsibility effective.

Conditions for the Success of Fund-Based Retirement Pensions

It is important from a policy perspective that the current initiative to introduce a fund-based system under the leadership of the Ministry of Employment and Labor originated in long-standing deliberation and agreement among labor, management, and government. Aligning the interests of diverse stakeholders is both exceptionally difficult and exceptionally important in pension reform. Through compromise and accommodation, the tripartite joint declaration established the basic direction of reform. The three types of retirement pension funds proposed by the tripartite parties reflect these different interests. However, such broad direction alone does not guarantee successful implementation. For fund-based retirement pensions to take root successfully, the institutional structure and operating framework of each type must be designed so that its specific policy objective can actually be achieved.

Table. Characteristics and Roles by Type of Retirement Pension Fund

Type	Primary objective	Key design issues	Success criteria
Public	Close coverage gaps for small and micro enterprises and protect minimum benefit entitlements	Target support; fiscal-support criteria; balance public purpose and investment performance	Participation rate; continuity of contributions; protection of benefit rights; costs and returns
Nonprofit association	Achieve economies of scale through a common base such as industry, occupation, or region	Separate representation from professional investment independence; rules for joining, withdrawal, and transfers	Sustainability and scalability of the pooled fund; substantive basis of solidarity
Financial-institution open	Raise long-term returns through financial expertise and competition among funds	Use existing infrastructure; proportionate conflict-of-interest rules; performance and fee disclosure	Risk-adjusted long-term returns; cost efficiency; participant transfer rights

Source: Author, based on the Tripartite Joint Declaration (February 6, 2026).

The objective of a public fund should not be to increase the size of the fund itself. Policy should not seek to expand the range of workplaces eligible for a public fund as broadly as possible. The purpose of a public fund is to close the coverage gap for workers in small and micro enterprises that are not adequately served by the private market and to provide a universal investment vehicle for workers who are mandatorily shifted from the severance-pay system to the retirement pension system. The success of a public fund should therefore be judged not by its asset size, but by reductions in coverage gaps and the secure protection of benefit entitlements. Government fiscal support for the public fund should likewise be linked to these performance criteria. At the same time, structurally weak investment performance should not be tolerated merely in the name of public purpose. The investment challenge facing a public fund is more difficult than it may appear.

A nonprofit association fund aims to secure economies of scale and a professional investment base through the federation of workplaces sharing a common foundation such as industry, occupation, or region. The crucial point is to separate representation based on solidarity from professional investment management. Participation by labor and management is necessary to reflect members' interests, but industrial-relations agendas must not impair investment efficiency. The board should be responsible for strategy and oversight, while the professional investment organization independently conducts asset allocation and implementation. Beyond improving investment efficiency during the accumulation phase, a nonprofit association fund should also consider the possibility of evolving into a system that collectively manages risks during the benefit-payment phase - in other words, an evolution toward the European model of Collective DC (CDC) based on solidarity within a homogeneous group. To support such evolution, the rules governing entry, withdrawal, transfers between funds, asset transfers, and allocation of investment performance must be specified in advance. If arbitrary combinations are permitted solely in the name of solidarity, accountability may become unclear and economies of scale may prove unsustainable.

An open fund operated by a financial institution has a comparative advantage in actively improving investment returns by utilizing the institution's existing infrastructure and investment expertise. Appropriate use of asset-management capabilities, risk management, information technology, distribution networks, and group-level personnel and systems can reduce duplication and improve cost efficiency. At the same time, because these are for-profit funds, strict control is needed over possible biases toward affiliated products and other conflicts of interest. The appropriate direction of regulation should not be a blanket prohibition, but a framework under which the institution must demonstrate that such use serves participants' interests and bear clear ex post responsibility.

Ex ante restrictions intended to prevent improper conduct should not make it structurally impossible for financial institutions to participate actively in pursuit of the very objective for which for-profit funds are introduced: higher investment returns.

Because the three fund types have different success criteria, supervision and evaluation should also differ. For public funds, key indicators should be participation rates and reductions in coverage gaps; for nonprofit association funds, the sustainability of the pooled fund and participant representation; and for financial-institution open funds, risk-adjusted long-term returns and cost efficiency. Applying identical evaluation criteria would dilute the advantages of each model and encourage formal compliance unrelated to the underlying policy objective.

Conclusion

Korea's retirement pension system has now reached a turning point at which it must move beyond quantitative expansion and strengthen its substantive function of securing retirement income. A fund-based retirement pension system is an important institutional option for making that transition. The fund-based form itself, however, does not guarantee success. Only when the purpose of each fund type is clearly defined and the target group, operating entity, governance structure, investment rules, and performance evaluation are differentiated accordingly can fund-based governance remedy the institutional limitations of the existing contract-based system.

To mitigate the structural weaknesses of DC retirement pensions, the system must shift from one in which assets are left unattended unless participants make a choice to one in which assets are professionally managed even when participants do not actively choose. A genuinely functioning default arrangement, long-term diversified investment, professional investment organizations, transparent disclosure, and participant transfer rights should therefore become the core pillars of institutional design. Participant choice must be protected, but that right should not be transformed into the burden of navigating complex product selections.

Ultimately, the success of a fund-based retirement pension system depends on balancing universality, efficiency, and accountability. Public funds should concentrate on closing coverage gaps; nonprofit association funds on building sustainable pooled funds; and financial-institution open funds on improving long-term returns through investment competition. When purpose-specific differentiated design is combined with a common fiduciary standard - rather than identical regulation and identical governance for all - fund-based governance can function as core infrastructure for the “Retirement Pension 2.0” era.