Public Sector Pension Plans in Japan
- Changes in Plan Design, Financing and Investment Policies -

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Abstract

Regarding public sector pension plans in Japan, there are private pension plans, provided by non-profit organizations and public pension plans, provided by government officials' pension funds and those of private school teachers.
Private pension plans provided by non-profit organizations were not previously regulated by the law, so various types of plans ware established for government officials and private school teachers, each of which adopted its own financing method, investment policy and risk management.
Recently the insurance law has become applicable for pensions of non-profit organizations, and the new non-profit organization law, the new tax law and the new accounting rules will be in effect by FY2008. Furthermore, the occupational additional pensions of the government officials and private school teachers will be reformed in 2010.
I hereby introduce the current status of some non-profit organizations' pension plans and the deliberation of new occupational additional pensions, and in comparison to corporate pension plans, I state the desirable nature of the design, financing and investment policies for these public sector pension plans in conjunction with regulations.

Keywords:

Public Sector Pension, Government Official, Financing, Investment Policy, Regulation

Introduction

In this paper, I introduce the fact that public sector pension plans in Japan are confronted with big changes and how these plans are trying to deal with them, and I state the desirable aspects for these plans and regulations. I would be delighted if this paper proved useful for other countries' studies of public sector pension plans.

1. Overview of the Japanese public sector pension plans

The Japanese public sector pension plans can be categorized into two types. One is the private pension plan, as provided by non-profit organizations, and the other is the public pension plan, which the pension funds for government officials or private school teachers provide. I explain the outline of these plans below.

(1) Non-profit organizations' pension plans

There are many kinds of non-profit organizations' mutual aid pension plans. I explain the representative plans as below. These plans adopt various financing methods and investment policies.

a. Plans for government officials

There are many benefit societies for government officials in Japan. These benefit societies are corporate juridical entities or foundations etc. because it is not permissible to establish the corporate pension fund for government officials under the pension law. They generally provide various kinds of pension plans as well as medical plans. These plans are based on voluntary participation and cover not only government officials but also their families.

b. Plans for private school teachers

In every prefecture, there are corporate juridical entities or foundations, which provide pension plans for private school and kindergarten teachers. Many of them were established in the 1960s as part of the retirement allowance system and they include available subsidies. The first plan was established before the Tax Qualified Pension Plans (TQPP) scheme was introduced in 1962 as the first corporate pension plan.

c. Plans for welfare institution personnel

Welfare institution personnel are covered by Employees' Pension Insurance (EPI) and a

corporate pension can be established for them. However, as welfare institutions are usually non-profit organizations, the conference of welfare institutions provides a mutual aid pension plan instead of a corporate pension plan. The benefit of certain such mutual aid pension plans is based on the occupational additional pension of government officials, because the government indicates that the benefit of such mutual aid pension plans for the welfare institution personnel should be based on the occupational additional pension of the local government officials.

There are certain kinds of pension plans provided by non-profit organizations that differ from the above types of plans (plans for single proprietorships etc.), but these are not related to the public. And some independent administrative institutions etc. provide corporate pension plans, the benefit of which is related to the occupational additional pension, but these are not mutual aid pension plans.

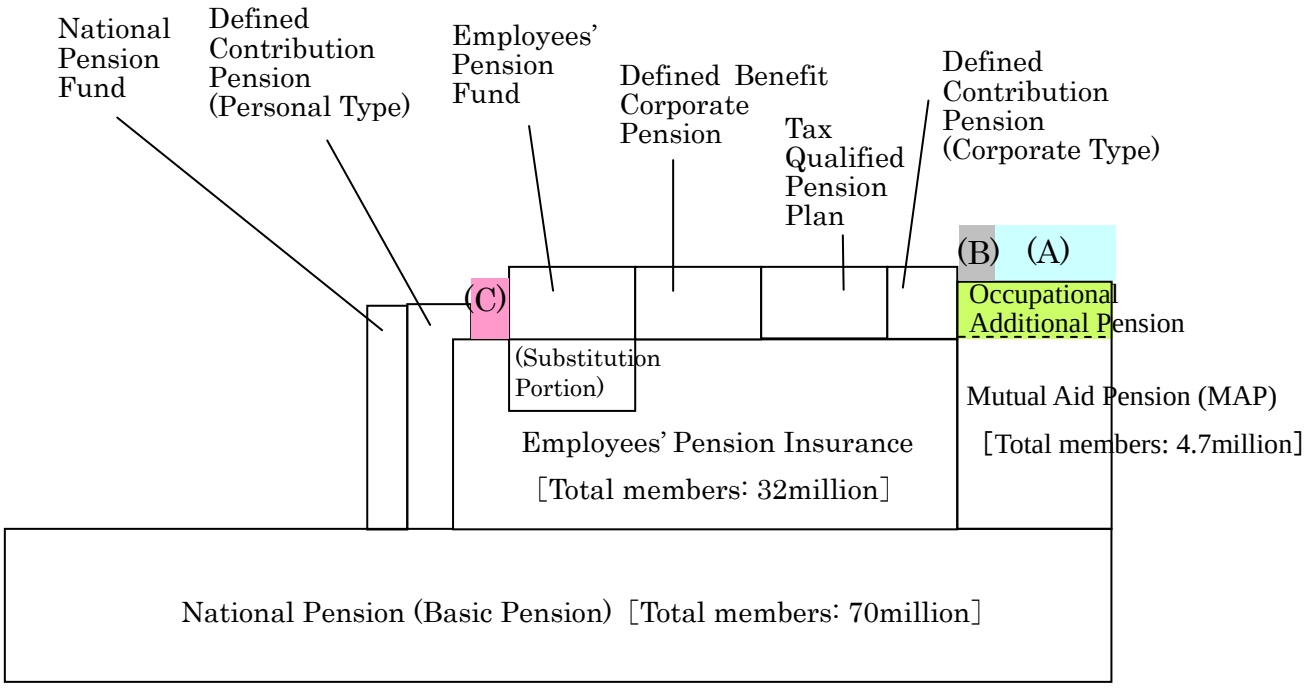
(2) Occupational additional pension

The government officials' pension fund and the private school teachers' pension fund provide the occupational additional pension, which is treated as a public pension. Originally, pensions for government officials started in the form of a superannuation before Employees' Pension Insurance (EPI) was established. Following pension reform in 1985, benefits in proportion to remuneration were made uniform between EPI and the Mutual Aid Pension (MAP) and the difference in benefit was arranged as the occupational additional pension (See Figure 1).

The financing method for the occupational additional pension is the same as the public pension, a partial funding method. This method has the characteristics of both the funding and the pay-as-you-go methods.

The policy portfolios of MAP are shown in Table 1. They adopt the lower risk portfolios compared to corporate pension plans (See Table 2).

Figure 1 System of Japanese pension plans



(A) Non-profit organizations' mutual aid pension plans for government officials
(B) Non-profit organizations' mutual aid pension plans for private school teachers
(C) Non-profit organizations' mutual aid pension plans for welfare institution personnel

Note: Some combinations of corporate pension plans are permissible.
Source: Author's tabulations from the Ministry of Health, Labor and Welfare's materials

Table 1 Policy Portfolios of Public Pension Plans

	Expected Return	Domestic Bond etc.*	Domestic Equity	Foreign Equity	Foreign Bond	Cash
Employees' Pension Insurance	3.37%	67%	11%	9%	8%	5%
Mutual Aid Pension for National Government Officials	2.5%	87%	5%	5%	0%	3%
Mutual Aid Pension for Local Government Officials**	3.21%	64%	14%	11%	10%	1%
Mutual Aid Pension for Private School Teachers	2.8%	65%	10%	10%	10%	5%

Note * : Including loans, real estate
Note **: Pension fund association for local government officials
Source: Author's tabulations from each public pension's disclosure

Table 2 Average Portfolio of Corporate Pension Plans

	Domestic Bond etc.*	Domestic Equity	Foreign Equity	Foreign Bond	Hedge Fund	Cash
Employees' Pension Fund and Defined Benefit Corporate Pension	31.56%	30.81%	18.32%	11.67%	4.18%	3.47%

Note * : Including general account of insurance company, loans, real estate and convertible bond etc.
Source: Author's tabulations from the investigation of the investment results in FY2005 by Pension Fund Association

2. Environment Changes

(1) New insurance law

On 1st April 2006, the new insurance law was enforced and the definition of the insurance business was changed. Although mutual aid for specific individuals had not previously been treated as part of the insurance business, under the new law, regardless of whether specific or otherwise, mutual aid is basically considered equivalent to the insurance business. However, limited cases prescribed by the insurance law (corporate pension plans, company's or group companies' mutual aid like captive etc.) are exempt.
Recently consumers have sustained increasing financial losses due to dishonest forms of mutual aid, which has become a social problem. In addition, many mutual aids do not include full insurance premium funds. The Financial Service Agency (FSA) plans to regulate them under the insurance law.

Consequently, the insurance law was revised and certain non-profit organizations providing mutual aid pension plans will have to become insurance companies in two years. An alternative method is to dissolve and establish a new defined benefit corporate pension (DB) plan but this is very complicated. Transitional treatments apply for corporate juridical entities and foundations, because of the reform of the corporation in the public interest. However, some of them will also have to become insurance companies as well, by FY2013 at the latest. Certain rules including explanations of the important items on offer and reporting the premium and liability valuation methods to the FSA etc. have been already applied in the case of mutual aids.

(2) Changes in the corporation in the public interest

Corporations in the public interest, such as corporate juridical entities and foundations, are confronted with the following major changes:

a. Accounting standards revision

For reasons of accountability and transparency etc., the new accounting standards are basically applicable from the fiscal year beginning from 1st April 2006. The new standards mean changes in the following aspects:

- The system of financial reporting is changed.
- Securities are evaluated in terms of market value.
- Retirement benefit obligation for the corporate personnel in the public interest

is measured by PBO.

There is no specified rule concerning mutual aid pension plans for groups or people other than the personnel of the corporation in the public interest, but some accountants say that actuarial liability valuation should be used to measure the liability.

b. Reform of the corporation in the public interest

The new law concerning corporate juridical entities and foundations was approved in the Diet in May 2006 as a revision, following almost a century-long lapse. One of the main purposes of the new law is to prevent government officials from parachuting and excluding the discretional administration of competent authorities. However, the details of treatments of the new law remain undecided and it is now being deliberated with the reform of the government official system. In any case, the current corporate juridical entities and foundations will have to transit to new corporate juridical entities and foundations by FY2013.

c. Tax law revision

With the new law of the corporate juridical entities and foundations, the tax law will be revised in 2007-2008. Tax treatments are related to the public interest. From the tax commission's perspective, to be treated as tax exempt, mutual aid pension plans of the corporate juridical entities or foundations must be acknowledged as public benefit plans. If the plan is not public benefit, it will be probably changed or dissolved due to the imposition of tax. Concerning other non-profit organizations, such as medical corporations and welfare institutions etc., the tax treatment might be revised.

(3) Mutual Aid Pension (MAP) reform

Due to fewer children and increased aging, the benefits and premiums of the public pensions for employees, including government officials, are expected to be on a uniform basis. And it is anticipated that the occupational additional pension for government officials will be abolished and the new system established.

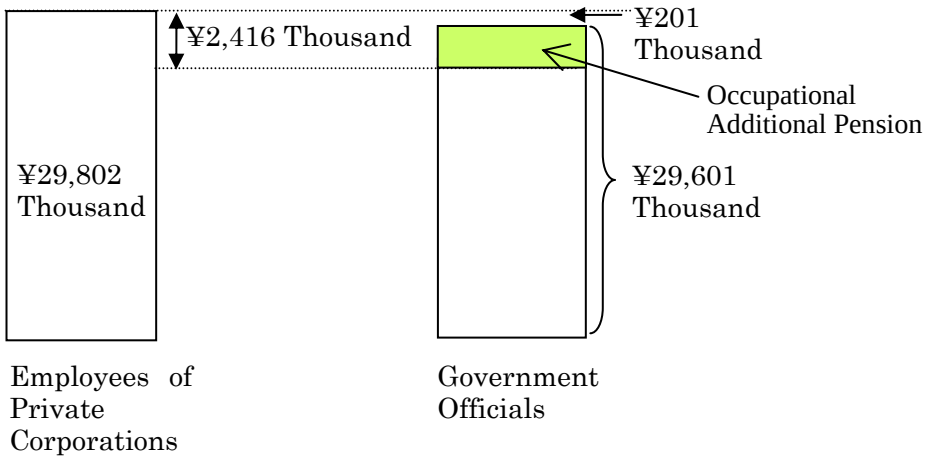
In November 2006, the National Personnel Authority (NPA) published the result of the investigation of the retirement benefit (See Figure 2). Although it differs from the result of the investigation conducted by some private organizations, the NPA did not re-investigate.

In February 2007, the draft of the new pension benefit was made out, based on the

NPA's investigation into retirement benefits, including participants' contributions. The draft is that the new benefit of the occupational additional pension will be about 60% of the current benefit. Of course, this is simply a draft and the kind of plans (cash balance (CB) plan, defined contribution (DC) plan, etc.) to be introduced remain undecided.

It might take additional time for the new system to be decided because it is related to the new government official system, government finances, public sector accounting standards and the next election.

Figure 2 Comparison of retirement benefit (excluding participants' contributions)



Source: The result of the investigation of the retirement benefit by the NPA

It is anticipated that the occupational additional pension for private school teachers will be abolished and the new system deliberated upon.

Private schools have been allowed to establish a DC plan since 2001 and a DB plan since 2002. However, there have been mutual aid pension plans provided by non-profit organizations, and since private schools are tax exempt corporations, the number of corporate pension plans is scarce. It seems the new system will be decided based on these mutual aid pension plans and corporate pension plans.

3. Examples of mutual aid pension plans

I cite a few examples to consider the public sector pension plans, as follows:

(1) Examples of voluntary participation pension plans

Some non-profit organizations provide voluntary participation pension plans for government officials and welfare institution personnel etc.. I introduce the examples below.

a. Hybrid pension type

The benefit of some plans is decided by the participant's contribution and dividend related to the actual investment return. Securities were previously evaluated based on the book value, as was the investment return. However, the accounting standards meant it became necessary to manage the market value. These types of plans are hybrid pension plans. One reason why they were established is that DB and DC plans are unavailable for government officials.

Considering the new insurance law and accounting standards, one corporation in the public interest, which provides this type of plan, will introduce the funding of reserves for contingencies and market price movement which the solvency margin standard is based on. It will also decrease the ratio of equities from about 40% to 10-20%. This corporation in the public interest is trying to manage the plan in compliance with the insurance law, but the rules of insurance law are actually too severe for perfect compliance. After transitional treatments of the insurance law, the plan may have to be dissolved.

b. Prescribed benefit type

The benefit amount of some plans is prescribed in the form of rules in advance. Certain plans in this category adopt various employees' contribution. Since no regulation is applied, flexible planning is possible.

Various funding methods are used, some of which have insufficient funds to cover the actuarial liability. In addition, some of them adopt the high risk portfolios. Under the new insurance law, the new accounting standards and the new tax law, they will have to be changed or dissolved in future.

(2) Examples of mutual aid pension plans for private school teachers

Some corporate juridical entities and foundations provide pension plans for private school teachers. Based on the new accounting standards, it is requested that securities should be evaluated based on market value and the actuarial liability reserve should be funded. But some of them have insufficient funds.

Under the new law applicable to corporate juridical entities and foundations, the new tax law and the new insurance law, these plans may have to be changed considering the new occupational additional pension, corporate pension and subsidy.

4. Consideration of the future of the public sector pension plans in Japan

(1) Comparison

For consideration of the public sector pension plans, I compare them to corporate pension plans (See Tables 3, 4).

Concerning the non-profit organizations, in general, various types of plans are available but it is insufficient to preserve the vested benefits. In fact, although some kinds of hybrid pension plans are continuing, other plans have been dissolved without being fully funded.

Concerning the occupational additional pensions, the partial funding method is used and the investment target is based on the real return. Their policy portfolios incorporate lower risk than typical corporate pension portfolios (See Tables 1, 2).

(2) Consideration

It seems to be excessive and improper to regulate mutual aid pension plans provided by non-profit organizations under the insurance law.

I think that the new private pension law should be established for government officials who are unable to participate in corporate pension plans. Of course, adjustment is necessary, based on the occupational additional pension for government officials. Where the pension law is applied, the insurance law must not be. The pension plan should be regulated as a pension plan under the pension law, rather than an insurance company. It also clarifies the fact that pension assets will be funded in advance and vested benefits

preserved. Investment policy will be made based on the advance funding method.

Although the new occupational additional pensions remain undecided, they are expected to use the advance funding method and be associated with change in the policy portfolios. A link must be arranged between the mutual aid pension plans, which non-profit organizations provide and the occupational additional pension at least.

Concerning private school teachers, it is necessary to arrange a link between the mutual aid pension plans which non-profit organizations provide, the occupational additional pension and the corporate pension plans. Concerning welfare institution personnel, it is also necessary to arrange a link between the mutual aid pension plans which non-profit organizations provide and the corporate pension plans.

We can learn from the history of the mutual aid pension plans provided by non-profit organizations. In these plans, hybrid pension plans that differ from corporate pension plans continue to utilize different financing methods and different investment policy. I think that such types of hybrid pension plans should be introduced to corporate pension plans so that private pensions can develop and become significant.

Table 3 Comparison of non-profit organization plans to corporate pension plans

Comparison of planning

	Non-profit organization plans	*Corporate pension plans*
Hybrid plan	Any type of hybrid plans is available.	Only CB and DB similar to CB are available.
Coverage	Voluntary participation is available.	Basically compulsory participation

Comparison of financing

	Non-profit organization plans	*Corporate pension plans*
Financing Method	Not regulated	Advance funding method
Contribution	Employees' contribution is not regulated.	Employees' contribution is regulated.

Comparison of investment policy, governance and fiduciary responsibility

	Non-profit organization plans	*Corporate pension plans*
Investment Policy	It is possible to share investment risk by using the hybrid plan.	Policy portfolio to perform the required rate of return
Governance	Regulated by the general statute and the guideline etc.	Administration by the representative meeting, the directors' board and the investment committee etc.
Fiduciary responsibility	Regulated by the general statute	Regulated by both the pension law and the general statute

Source: Author's tabulations

Table 4 Comparison of occupational additional pension to corporate pension plans

Comparison of planning

	Occupational additional pension	*Corporate pension plans*
Hybrid plan	No type of hybrid plans is available.	Only CB and DB similar to CB are available
Coverage	Compulsory participation	Basically compulsory participation

Comparison of financing

	Occupational additional pension	*Corporate pension plans*
Financing Method	Partial funding method	Advance funding method
Contribution	Employees' contribution is prescribed.	Employees' contribution is regulated.

Comparison of investment policy, governance and fiduciary responsibility

	Occupational additional pension	*Corporate pension plans*
Investment Policy	Policy portfolio to perform the required rate of return based on real return	Policy portfolio to perform the required rate of return
Governance	Administration by the representative meeting, the directors' board and the investment committee etc.	Administration by the representative meeting, the directors' board and the investment committee etc.
Fiduciary responsibility	Regulated by both the pension law and the general statute	Regulated by both the pension law and the general statute

Source: Author's tabulations

5. Concluding remarks

Based on the new insurance law and the changes in the corporation in public interest, only part of the current mutual aid pension plans provided by non-profit organizations is expected to be preserved under new plans regulated by the law. It will take a few years at least to construct the new pension plans or dissolve the current plans.

I would hope that the new private pension law would be established for government officials unable to participate in corporate pension plans and that pension plans would be arranged concerning private school teachers and welfare institution personnel.

Finally, I really hope that this paper may be useful for other countries' studies on public sector pension plans.