

1. Introduction

I don't believe we need as strict funding rules in Japan as the PPA* in the U.S. However, I think there are some important lessons for us in Japan to be learned from the PPA.

- In the U.S., between 2000 and 2002, investments reached their all time low. This period was called the “Perfect Storm”. It brought serious funding shortfalls in DB plans**.
 - At the same time, Japan faced a very similar situation .
- In the U.S., the PPA was enacted in order to make the finances of DB plans and the PBGC*** sound.
 - In Japan, some DB plans had serious funding shortfalls because of bad investment performance in the same period. However, it hasn't become a political problem like in the U.S. because, in Japan, there is no pension benefit guarantee system like the PBGC



2. History of DB plans

U.S.

Generally speaking, legal funding rules are mainly to protect employees. However, in the U.S., the funding rules of ERISA* exist primarily to protect the PBGC rather than employees.

1974 : “ERISA” enforced.



Minimum Funding Standard

1987 : “Pension Protection Act of 1987”

1994 : “Retirement Protection Act of 1994”

2000 ~ 2002 : Perfect Storm



PBGC crisis arises.

2004 : “Pension Funding Equity Act of 2004”

2006 : “Pension Protection Act of 2006”

*Employee Retirement Income Security Act of 1974

2. History of DB plans

Japan

1962 : “Tax Qualified Pension Plans”

1966 : “Employees’ Pension Funds”

1997 : “Going-Concern*” and “Non-Going-Concern**” introduced.

(only to “Employee’s Pension Funds”)

2001 : “DC Law***”

2002 : “DB Law****”

2007 : “DC & DB Law” amended

2012 : “Tax Qualified Pension Plan” abolished

Employers, who have “Tax Qualified Pension Plans”, are thinking about shifting to the other pension plans, or even abolishing them.

*a funding rule under continuing a DB plan **a funding rule under terminating a DB plan

***Defined Contribution Pension Law

****Defined Benefit Corporate Pension Law



3. Pension Benefit Guarantee System

Japan

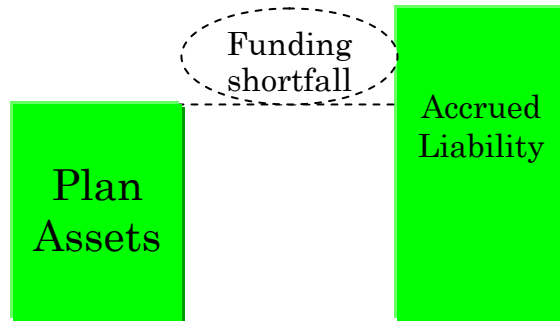
- The “DB Law” doesn’t provide a pension benefit guarantee system like the PBGC.
- In Japan, we are trying to reconsider whether to introduce a pension benefit guarantee system or not.

➤ When do we need a pension benefit guarantee system? We need it in case of extreme circumstances, such as company bankruptcy.

➤ It is important to increase plan assets in preparation for the issue of “Non-Going-Concern”.

➤ It is also important to have preferential rights of contributions.

4. Legal Funding Rules - Before PPA - U.S.

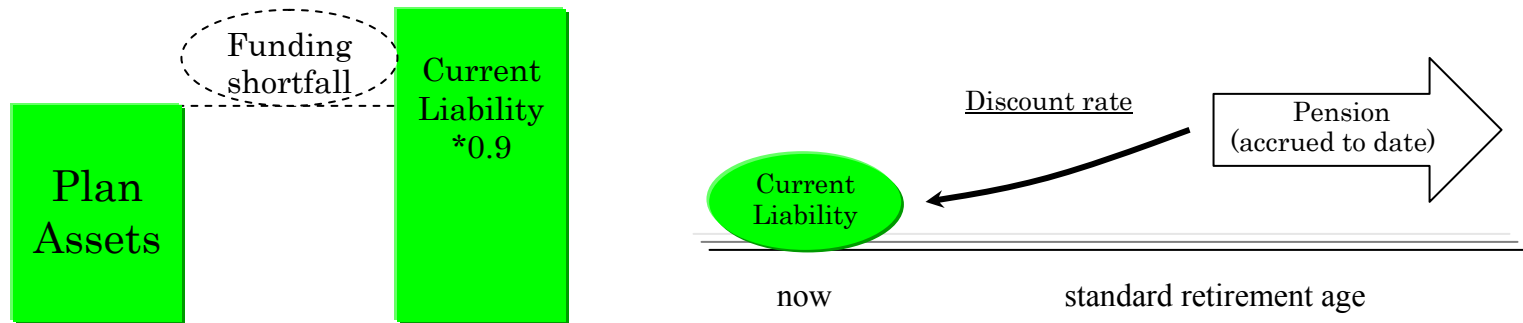


- The amortization period of funding shortfalls is from 5 to 30 years for “Single-Employer Defined Benefit Plans”.

- DB plans are required to maintain a special account called “Funding Standard Account”. “Credit Balance” results, for instance, if contributions in excess of the minimum required contributions are made.

Since the “Perfect Storm”, investment performance has improved. However, there were some employers who reduced required contributions by applying the “Credit Balance”. Therefore, overall, the funding level of DB plans has not improved since the “Perfect Storm”.

4. Legal Funding Rules - Before PPA - U.S.

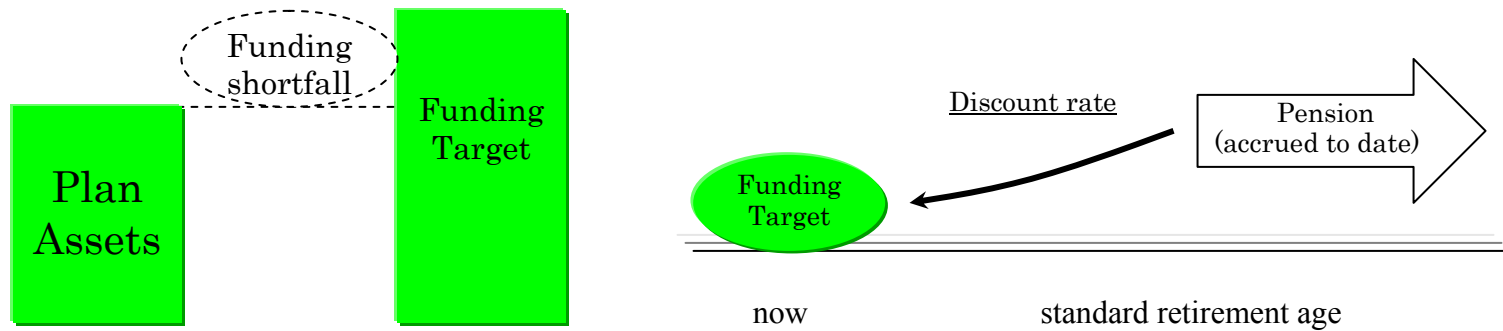


- Both “Current Liability” and plan assets can be smoothed.

“Smoothing” enables employers to contribute steadily without having to compensate for short term fluctuations in market value. However, in actual fact, employers delay contributing more when investment performance is bad. In the case of the “Perfect Storm”, employers put off addressing their funding shortfall.

5. Legal Funding Rules - PPA -

U.S.



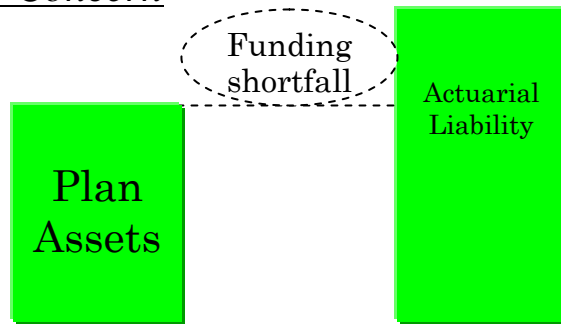
- If plan assets are less than 100 percent of “Funding Target”, employers have to contribute more in order to make up their funding shortfall over 7 years.

The PPA reduces the amortization period dramatically. That leads to greater contribution to DB plans. As a result, I think employers are starting to think about freezing DB plans or even abolishing them or shifting to a DC plan.

6. Legal Funding Rules – DB Law -

Japan

Going-Concern



- The assumed interest rate of “Actuarial Liability” is decided by employers based on the expected investment return rate.

- If the funding shortfall is more than the “Tolerant funding shortfall”, employers have to contribute more in order to cover their funding shortfall
- The amortization period of funding shortfalls varies from 3 to 20 years. Once employers decide the amortization period, the employers cannot extend that period anymore, only reduce it.

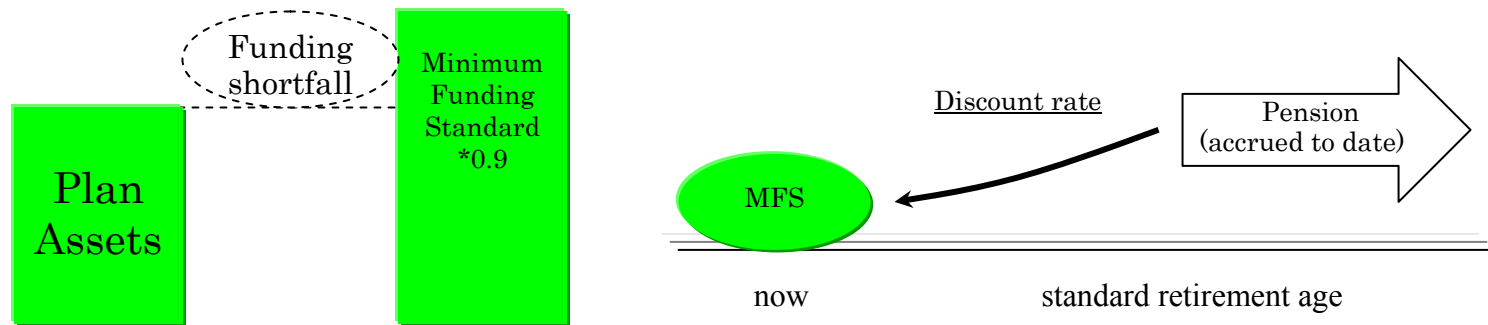
Employers hesitate to contribute big charges through short period amortization because they can't lower the big charges by extending the amortization period in case of excess contribution burden.



6. Legal Funding Rules – DB Law -

Japan

Non-Going-Concern



- According to “Non-Going-Concern”, plan assets are compared to the 90 percent of “Minimum Funding Standard”.
- If plan assets are less than the 90 percent of “Minimum Funding Standard”, employers have to contribute more in order to cover their funding shortfall.



6. Legal Funding Rules – DB Law - Japan

- The assumed interest rate of “Minimum Funding Standard” is decided by the Minister of Health, Labor and Welfare. It’s the average return rate of 30-year Treasury securities for the five-year period.
- This assumed interest rate must be within a permissible range that is between 80 percent and 120 percent.
- Employers can contribute all of their funding shortfall at one time, if they so wish.

According to “Going-Concern”, employers cannot contribute within 3 years. However, according to “Non-Going-Concern”, they can. I believe this is because “Non-Going-Concern” is more important than “Going-Concern”.

7. Conclusion

- Employers should conduct their financial management with greater awareness of “Non-Going-Concern”.
- The situation must be addressed as soon as possible when plan assets are less than “Minimum Funding Standard”.
- We should introduce a rule that funding shortfalls are paid off from 1, not 3, to 20 years.
- The contribution of funding shortfalls should have preferential rights, when plan assets are less than “Minimum Funding Standard”.