Recent Corporate Pensions Reform and its Consequences in Japan

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Abstract

Corporate pension systems were dramatically reformed in recent years in Japan. The defined contribution plans were introduced in 2001, and new defined benefit pension plans in 2002. These resulted in corporations having a wider variety of options for their corporate pension plans.

After a few years passed since the reform, how have the corporate pension plans changed in Japan? A lot of corporations selected DC plans? More employees have been covered by the corporate pension plans? How much are contribution and benefit levels?

This paper reports recent corporate pension reform and its consequences. The 2004 social security pension reform in Japan, which passed the Diet in June, will be reported by Mr Sakamoto at this Colloquium. Therefore, two reports will give audiences the current situation of both public and private pension plans in Japan.

1. Introduction

The corporate pension reforms which took place around 2000 gave the wide variety of corporate pension plan options to employers and employees in Japan. These reforms included introduction of defined contribution plans in 2001 and new defined benefit pension plans in 2002. The cash balance plans were also introduced as a kind of DB plan.

This paper reports recent corporate pension reform and its consequences in Japan. That is, how the corporate pension plans have changed in Japan. A lot of corporations selected DC plans? More employees have been covered by the corporate pension plans? How much are contribution and benefit levels?

The 2004 social security pension reform in Japan, which passed the Diet in June, will be reported by Mr Sakamoto in another place in this PBSS meeting. Therefore, two reports will give audiences the current situation of both public and private pension plans in Japan.

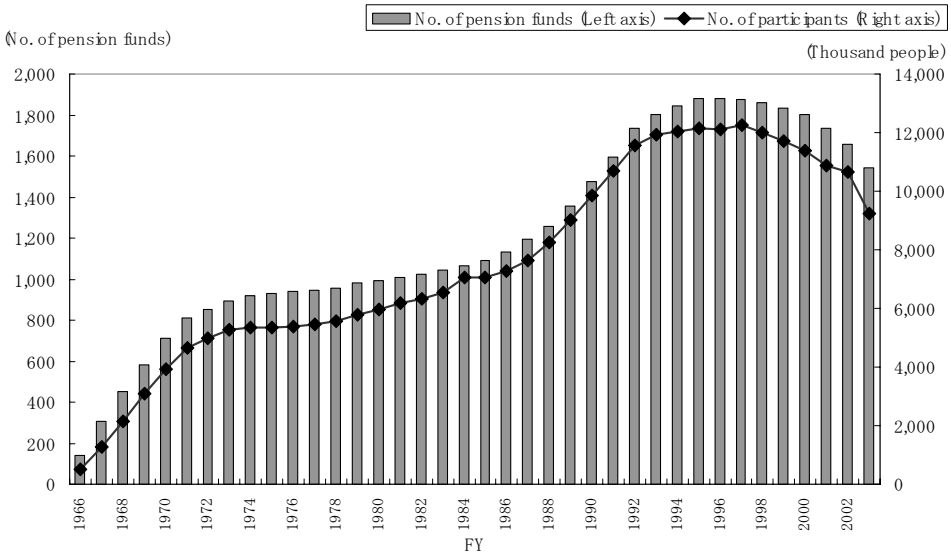
2. Outline of reforms of corporate pension systems around 2000

2.1 Brief History of corporate pension systems in Japan

Though K.Migitani " A History of Corporate Pensions " indicates Kanebo Spinning Mutual Association inaugurated in 1905 as the first modern corporate pension plan in Japan, the legislative corporate pension system began in Tax Qualified Pension Plans in 1962 and Employees' Pension Funds in 1966 after the Second World War.

After the initiative boom of corporate pension plans in late 1960s, the second boom came in late 1980s.

Fig.1 Numbers of Employees Pension Funds and their Participants



The Employees' Pension Fund System was greatly reformed in 1988 and the reform became the driving force of popularization of corporate pension plans in late 1980s. The reform included;

(1) Benefit level of social security and corporate pensions together should be aimed at 60% of pre-retirement income of average employee,
(2) Deregulation of establishment standards of corporate pension plans,
(3) The Certified Pension Actuary System was introduced,
(4) Benefits guarantee program was inaugurated by the Employees' Pension Fund Association, and
(5) Program of providing pension benefits to former participants in dissolved pension funds was also inaugurated by the Employees' Pension Fund Association.

Investment and management of Employees' Pension Funds had been gradually deregulated since late 1980s. Deregulation processes were as follows.

(1) Investment deregulation process

1986 Investment Advisors Act Enacted
1996 Statement of Investment Principles Obliged
1997 Assets Valuation by Market Value for EPFs Introduced
Abolishment of investment 5:3:3:2 regulation

(2) Management deregulation process

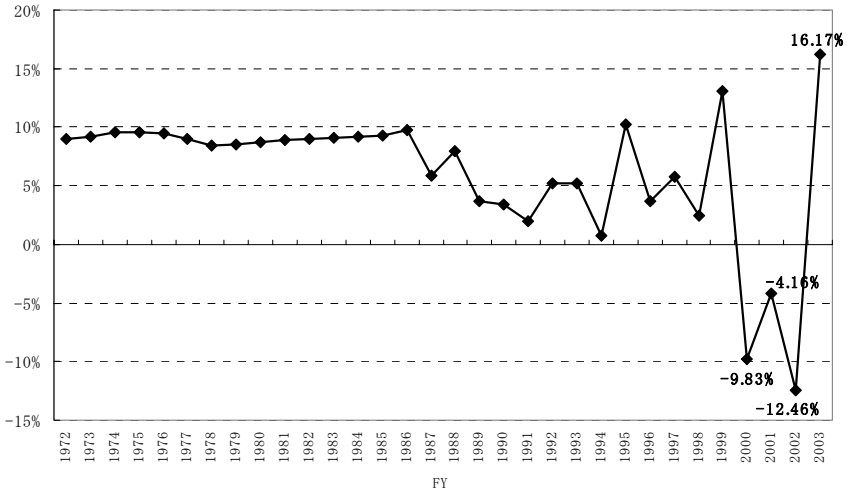
1986 Appointed Juridical Person Scheme for Pension Plan Administration Introduced
1988 Certified Pension Actuary System Inaugurated
1996 Pluralization of Rebates for EPFs
1997 Standards for Discontinuation for EPFs Introduced
Abolishment of 5.5% regulation
Introduction of actuarial valuations of assets including smoothing method
Appointed Certified Pension Actuary System Introduced for EPFs

The Employees' Pension Funds had been popularized due to investment and management deregulation, and reached 1,878 Funds, 12million participants at their peak in 1996. The Tax Qualified Pension Plans had 92 thousand contracts, 11 million participants. More than half employees were covered by corporate pension plans.

2.2 Crisis of corporate pension systems around 2000

The Employees' Pension Funds had been developed on the basis of deregulations of investment and management , including market price valuations. These gave decisive damage to the EPFs' financing with the successive three year negative investment performance since 2000.

Fig.2 Investment Performances (EPFs)



Note: Figures are on the book value basis until 1966.

Under the stagnant economy and severe financial conditions in the 1990s, it was whispered there was a " Corporate Pension Plan Crisis ".

Several factors generating a corporate pension crisis could be pointed out.

(1)Historically low-interest policy by Japanese Government/Central Bank of Japan and sluggish stock market due to the long-term stagnant economy generated the low investment performance to pension plans(negative performance during 2000-02), and increased the underfunded pension plans

(2)Long-term stagnant economy also gave corporations the tendencies to reduce pension plan burden for improving corporate financial situation, and to restruct (lay-off) employees and hire part-time job workers, and abolish corporate pension plans for cost-cutting.

(3)The corporations have attached the importance of market mechanism since 1990s,which generated the change from Japanese style management(lifetime or long-term employment, seniority-based pay system, enterprise union) to American style (labor market employment(short-term employment), performance-based pay system). Employees also prefer current wage s than future benefit s or money backed saving system (DC) than contract for the future(DB)

(4)Introduction of accounting standards for retirement benefits in 2000 disclosed the

underfunded situation of corporate retirement benefit plans including pension plans in terms of accounts, which accelerated the " Corporate Pension Plan Crisis ".

2.3 Reforms of corporate pension systems as a response to the corporate pension crisis

A crisis was particularly serious in Employees' Pension Funds . EPFs usually used 5.5% as an interest rate for financial valuation because they had subtracted part which had been managed on the basis of 5.5% interest rate. But 5.5% was too high for pension investment to achieve in the severe investment environment, so that the gap between required performance and realized one had been expanded and unfunded volume had been accumulated. In addition to that, the new accounting standards applied to EPFs' subtracted parts in the same way as other retirement benefit systems, where the discount rates used were ordinarily 2-3%, revealed the huge volume of underfunded liabilities and gave the shock to employers.

To assist deteriorated financial situation of EPFs due to the causes mentioned above, the government took several measures including relaxation of deficiency level carried forward from 0.5% to 1.0% of 20 year payrolls, or relaxation of standards to require ad hoc revaluation which the unfunded EPFs are obliged to take.

As the corporate pension crisis was so severe that so-called partial remedy could not improve their symptoms.

Two corporate pension system bills passed the Diet in June 2001, and the Defined Contribution Pension Act (DCPA) was enacted in October 2001 and the Defined Benefit Corporation Pension Act(DBCPA) was enacted in April 2002. The cash balance plan was also introduced as a kind of DB plan.

The purpose of DCPA is to introduce defined contribution pension plans as a new option for retirement income security. One major purpose of DBCPA is to introduce the common framework to protect employees' benefit rights covered by defined-benefit type corporate pension plans; both EPFs and Defined Benefit Corporate Pension Plans. The act provides (1) funding requirements, (2) fiduciary responsibility, and (3) reporting and disclosure signed by Certified Pension Actuaries.

The following figure summarizes the change of corporate pension systems after the two corporate pension acts in Japan.

< Before June 2001>	< After June 2001>
・Employees Pension Fund (EPF)	・EPF ・Fund Type Corporate Pension Plan (FTCPP)* ・Agreement Type Corporate Pension Plan (ATCPP)*
・Tax Qualified Pension Plan (TQPP)	・TQPP (expired by 2012)
・Severance Payment Plan (SPP)	・SPP (tax exempt for the SPP account will be abolished

in 2003)
・Defined Contribution Pension Plan (DCPP)**

* FTCPPs and ATCPPs were introduced by Defined Benefit Corporate Pension Act.
** DCPPs were introduced by Defined Contribution Pension Act.

These reforms generated a new era in corporate pension systems of Japan that " Employers and employees can adopt their pension plans by themselves from a wide variety of options ".

Important points of reforms which affected the decisions of employers and employees would be;

(1) To be admitted the " Daiko-Henjo（1） ", and
(2) To be introduced new type pension plans such as defined contribution plans and cash balance plans.

It also affected the decisions of employers and employees that the underfunded status was revealed under newly introduced retirement benefit accounts, and that was thought to generate the increase in fund raising cost.

3. Responses of corporations to reforms of corporate pension systems

Corresponding to the socio-economic and legislative environmental change, corporations can choose their own way from the following options.

(1) To increase the contribution rate,
(2) To decrease the benefit level,
(3) To terminate the corporate pension plan, or
(4) To change to another plan.

Tables 1-4 show some results of "2002 survey of EPFs' financial verification" conducted by the EPFA. Table 1 indicates that the EPFs which needed to intentionally recover underfunded situation amounted more than 70% due to bad investment performance in 2002 accounting settlement. Table 2 shows how the EPFs corresponded to get their financial soundness. Almost half were to increase the contribution rate, or to decrease the benefit level. Around a quarter were to introduce CB plans, or to review asset management.

Table 1 Financial status of EPFs

Recovery plan for underfunded is necessary	71.4%
not necessary	28.6%

Source: 2002 survey of EPFs' financial verification, EPFA

Table 2 Correspondence for financial soundness(EPFs)

Measures	Yes(m.a.)
To increase the contribution rate	48.8%
To decrease the benefit level	48.7%
Of which: Future service(Members)	39.0%
Past service(Members)	25.0%
Including beneficiaries	9.7%
To introduce CB plans	26.2%
To decrease the interest rate	34.3%
To review asset management	28.0%
Of which: review of policy asset mix	19.7%
Review of managers	18.3%

Table 3 On the " Daiko-Henjo* "

No intension for " Daiko-Henjo "	36.6%
Intension for " Daiko-Henjo "	12.1%
Already " Daiko-Henjo " done	33.8%
Undecided	17.4%

* Only " Daiko-Henjo " for future service was admittable in 2002.

Table 4 Plan after " Daiko-Henjo "

Fund Type Corporate Pension Plan	68.6%
Agreement Type Corporate Pension Plan	19.4%
Defined Contribution Plan	9.9%
Dissolution	5.2%
Undecided	12.9%

Other statistical data are available from the Survey(3) conducted by the Senior Plan Development Organization during Nov. 25th – Dec. 26th , 2003. Though the response rate is low (317 corporations, 8.8%), the results are indicative.

(1) More than half the corporations have not reformed their pension plans, and they seem to consider not to decide their future pension plans in a few years.

(2) The largest reason of corporate pension plan reforms is the reduction of retirement benefit liability and cost, which shows how strong the impact of introduction of retirement benefit accounting standards in 2000 was. The result also shows the preferences of corporations towards new performance-based pay system from traditional seniority-based pay system.

(3) The benefit levels after the reform resulted almost the same as before.

(4) Transfers of pension plans due to the corporate pension system reforms are still on the process, and a lot of corporations are planning their pension plan reforms including introductions of DCs, DBs or CBs.

4. Consequences of recent corporate pension reforms

The consequences of recent corporate pension reforms could be summarized as the following table 5.

Table 5 Current Situation of Corporate Pension Plans in Japan

1. Employees' Pension Funds

（1） No. of Funds	＜Mar. 31st, 2001＞	＜Aug. 1st, 2004＞
Total	1,801 Funds	1,111（765） ＊Funds
Of which:Single&Allied	1,172	544（206）
Multi	629	567（559）
（2） NO. of Participants	11.4 million	7.3million
（3） "Daiko-Henjo" EPFs		
"Daiko-Henjo" for future service		798 Funds
Of which:existing Funds(EPFs）		346 Funds
for past service(DB plans)		429 Funds
dissolution		22 Funds
（4） Dissolved Funds		
No. of Dissolved Funds Total		347 Funds
Of which: Apr. –Aug.2004		20 Funds
Apr.03-Mar.04		92 Funds

2. Tax Qualified Pension Plans

	＜Mar.31st,2001＞	＜Mar.31st,2004＞
No. of Contracts	77,555 contracts	59,162 contracts
No. of Participants	9.66 million	7.77 million

3. Defined Benefit Corporate Pension Plans

	＜Aug. 1st,2004＞
Total	656(433)＊＊contracts
Of which: Fund Type	331(326)
Arrangement Type	325(107)

4. Defined Contribution Plans

	＜June 31st,2004＞
Corporate Type No.of Contracts	938 contracts
No. of Participants	935 thousands＊＊＊
Individual Type	32,294 Paticipants

5. Retirement Benefit Mutual Association for Small Companies(No. of contracts transferred from TQPPs)

	＜Apr.02-Mar.04＞
No. of Companies	3,413 companies
No. of Employees	910 thousands

Note: * The number of EPFs excepting those "Daiko-Henjo" for future service is mentioned in the parenthesis.

* * The number of transferred contracts is mentioned in the parenthesis.

* * * As of May 31st, 2004.

(1) Employees' Pension Funds (EPFs)

Table 5 shows that the number of EPFs is 1,111 on August 1st , 2004, and of which 777 Funds are those without " Daiko-Henjo ". Therefore the difference of two figures 346 （＝1,111-777 ） is the number of Funds with " Daiko-Henjo " for future service(2).

Of the " Daiko-Henjo " 798 Funds, 346 Funds are only " Daiko-Henjo " for future service, 429 Funds also for past service and 22 Funds dissolution.

Accumulated number of dissolved Funds is 347, and those dissolved during April-August, 2004 is 20 Funds.

(2) Defined Benefit Corporate Pension Plans

The number of DBCPPs is 656, of which 433 plans have been transferred from EPFs as of Aug. 1st,2004.

Statistical data on other transfers such as Defined Benefit Corporate Pension Plans from TQPPs or Defined Contribution Plans from EPFs, TQPPs have not been cleared at this moment. Statistics on new establishment of DBCPPs or DCPs have not been cleared either.

We might say the following points according to the statistics and daily work including consulting as consequences of recent corporate pension reforms in Japan.

(1) Employers revealed the tendencies towards adopting inexpensive pension plans rather than generous ones. These seem to be particularly the results of the introduction of retirement benefit accounts.

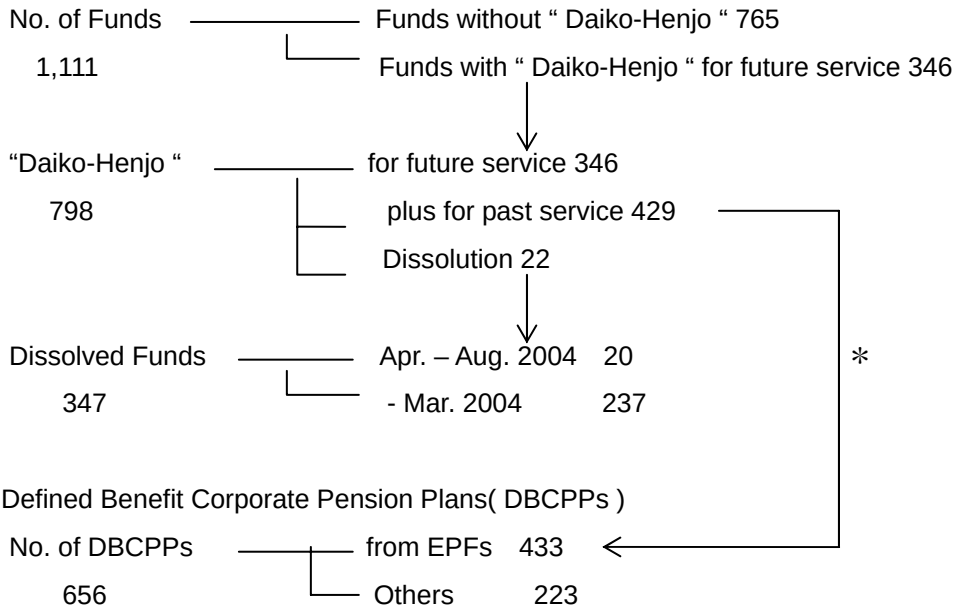
(2) Transfers from EPFs were particularly apparent in the large companies. EPFs in which half of participants were employees at large companies might be possible to become pension plan system composed of small companies in due course due to " Daiko-Henjo" and dissolutions.

The 2004 Pension Reform were made to the corporate pension systems, particularly EPF system, as well as social security pension systems. It includes financial neutralization between Employees' Pension Insurance and EPFs. In addition to this reform, the recent business recovery, the high investment performance in 2003 and the discussion on the transformation of retirement benefit accounting standards, relieved the avoidance from EPFs, so that it generates the possibility to stop or decrease the transfers from EPFs.

(3) Single Defined Contribution Plans have not been as popular as expected so far. Instead of them, combinations of DBs, DCs and Cash Balance plans have become popular at particularly large corporations.

Fig. 1 Transfers of Pension Plans

(1) EPFs



Note: ＊ The difference is due to the division or merger of EPFs.

5. Conclusion

The corporate pension system has been completely changed in Japan recently. Responses of corporations to those reforms are still on going.

As the social security pension system has also been reformed this year, which aimed to recover the benefit-contribution balance to maintain plan's sustainability. It included the decrease of income replacement ratio from 59% to 50% instead of the upper limit of 18.3% contribution rate for Employees' Pension Insurance. Therefore people become more expectant with private pensions including corporate pensions.

The ideas of living longer are getting to be popular so that the social security pensions afford the basic part of retirement lives and private pensions including corporate pensions use for better lives. Wide variety of options for corporate pension plans become available owing to corporate pension system reforms around 2000.

If we come back to the initial questions, we can find the following answers.

Q1. How the corporate pension plans have changed in Japan?

A lot of EPFs, particularly single or allied employer Funds (usually at large companies), made the decisions of " Daiko-Henjo ", and transferred or will transfer to DBPPs. Major component of EPFs might become multi-employer Funds, whose members are small companies.

Recent business recovery, high investment performance in 2003, pension system reform

in 2004 and discussion on transform of retirement benefit accounting standards might give another aspect. That might be to stop or decrease the transfers from EPFs.

Some, but not many, Tax Qualified Pension Plans were transferred to DBPs or Retirement Benefit Mutual Association for Small Companies. New pension plans ,small DBs or DCs, have not been generated much as the expectation to spread pension plans to small companies.

A lot of large corporations have combination of pension plans, DBs, Dcs or CBs. Therefore some pension plan transfers remain partial, for example from DB+DB to DB+DC.

Q2. Did a lot of corporations select DC plans?

Some corporations selected DC plans, but not many so far. Employers tend to prefer CB plans in Japan. Japanese original pension plans might be necessary.

Q3. Have more employees been covered by the corporate pension plans?

Some pension plans including EPFs or TQPPs are transferred to other plans as DBs, DCs or CBs. However, some plans have been abolished, but new plans have not been generated so much as canceling the abolishment.

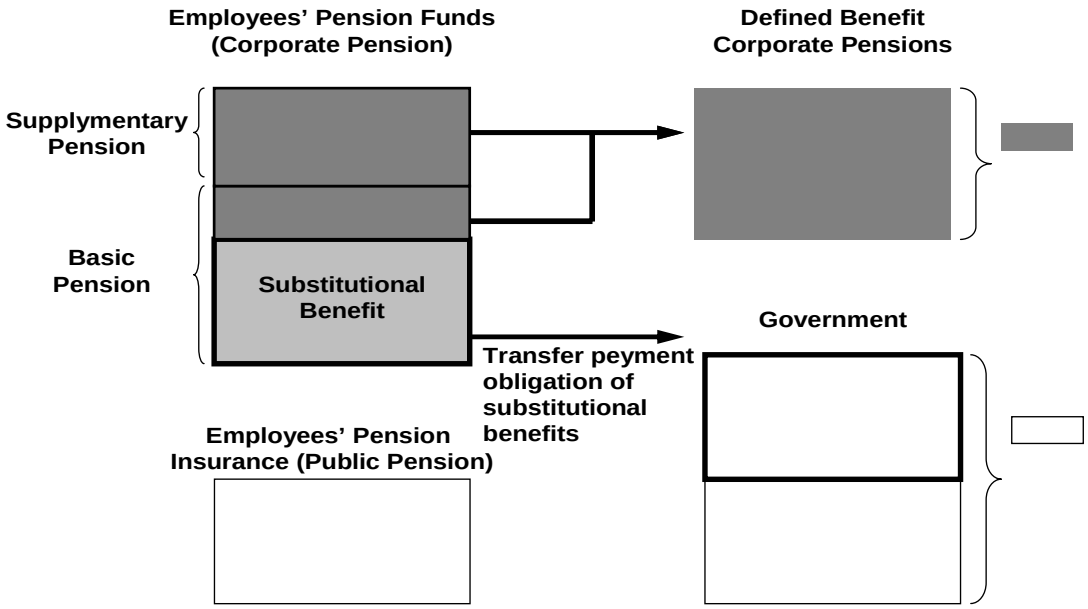
Q4. How much are contribution and benefit levels?

The benefit levels seem to have not been changed after the transfers of plans, so that contribution levels would not been changed either at least at this moment.

Business is getting better this year in Japan. It is a good time for employers and employees to discuss and select better corporate pension plans. A new era of corporate pension plans has come to Japan, that is “ employers and employees can adopt their pension plans by themselves from a wide variety of options. “

Notes

(1)‘*Daiko-Henjo*’, refunding the portion of Substitutional Benefit of Employee’s Pension Fund (EPF), means to stop Substitutional System and transfer Payment Obligation of Substitutional Benefits and accumulated assets associated with those benefits to the government. It came into force since June 15, 2001, by The Defined-Benefit Corporate Pension Law



Drawn by Institute of Pension Research, Nikko Financial Intelligence, Inc.

(2)"Daiko-Henjo" could be done for the future service first, and for the past service afterwards. The pension plan is still the EPF when it only does " Daiko-Henjo " for the future service, and it is regarded as separated from EPF system after " Daiko-Henjo " for past service too.

(3) Senior Plan Development Organization," Report on the Progress and Future Direction of Retirement Benefit・Corporate Pension Plan Reforms ", June 2004. The report is based on the results of survey conducted by the Senior Plan Development Organization during Nov. 25th – Dec. 26th , 2003 for 3,609 corporations. Detailed hearings were also done for 39 corporations.

Tables 1-４ show some results of the survey.

Table 1 Pension Plan Reforms after the Enactment of the New Corporate Pension Acts

Pension Plan Reforms	
No Reform	53.6%
Reforms	44.8%
Of which: Introduction of point system*	11.0%
Decrease of interest rate	15.8%
Decrease of benefit converting interest rate	12.6%
Introduction of defined contribution plan	8.8%
Introduction of defined benefit corporation pension plan	6.3%
"Daiko-Henjo"	8.6%
Dissolution of EPF	3.8%
Abolishment of TQPP	5.7%

Note: * means the introduction or strengthening of performance-based pay system.

Table 2 Corporations with Corporate Pension Plans without Reform

Corporate Pension Plans including TQPPs	74.1%
Corporate Pension Plans not including TQPPs	25.9%

Table 3 Major Reasons of Corporate Pension Plan Reform

Reasons of Corporate Pension Plan Reforms	
Introduction or strengthening of performance-based pay system	28.9%
Reduction of Retirement Benefit Liability	67.6%
Reduction of Retirement Benefit Cost	42.3%
Avoidance of Investment Risks	45.8%

Table 4 Future Plans for Corporate Pension Plan Reforms

Plans for Corporate Pension Plan Reforms	
Introduction of point system*	26.8%
Introduction of defined contribution plans	33.4%
Introduction of defined benefit corporation pension plans	26.5%
Introduction of cash balance plans	35.6%
Abolishment of TQPP	27.8%

Note: * means the introduction or strengthening of performance-based pay system.

References

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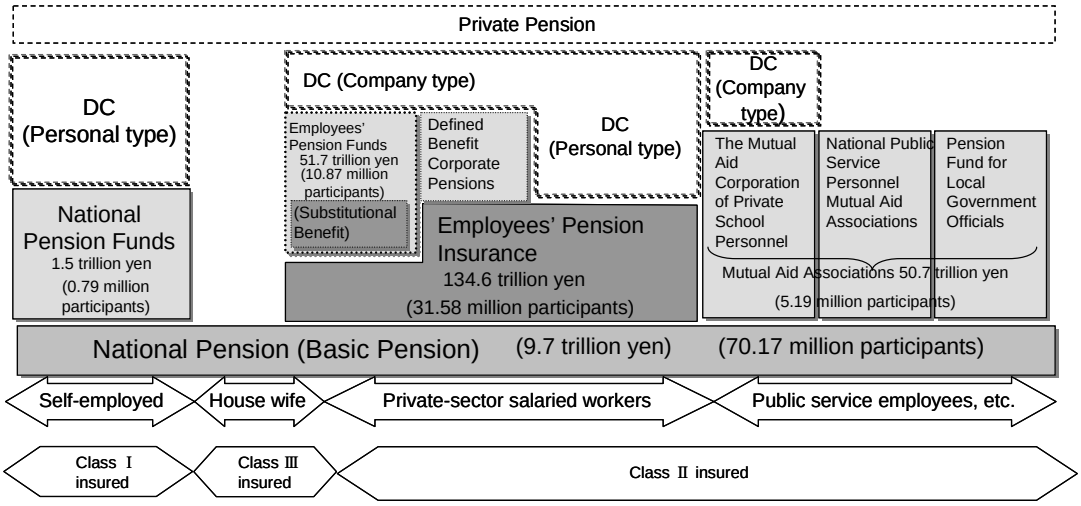
Senior Plan Development Organization," Report on the Progress and Future Direction of Retirement Benefit・Corporate Pension Plan Reforms ", June 2004(Japanese)

Appendix 1　Current Pension Systems in Japan



Notes:
1. The number of participants and reserves are as of the end of March, 2002.
2. Public Pension Schemes in Japan are composed of two state pension schemes (National Pension and Employees' Pension Insurance) and three Mutual Aid Pension Plans.
3.DC; Defined Contribution. Defined-Benefit Corporate Pensions took effect on April 1, 2002.Tax-Qualifies Pension Plans (22.7 trillion yen, 9.17 million participants) will change over to New Company Pension Plans etc. within 10 years.
4. Mutual Aid Association of Agriculture, Forestry and Fishery Corporation Personnel (2.0 trillion yen, 0.46 million participants) combined with Employees' Pension Insurance on April 1, 2002.
5. Breakdown of Mutual Aid Associations (As of the end of March, 2002)
National Public Service Personnel Mutual Aid Associations (8.7 trillion yen, 1.11 million participants)
Pension Fund for Local Government Officials (36.9 trillion yen, 3.21 million participants)
The Mutual Aid Corporation of Private School Personnel (3.1 trillion yen, 0.41 million participants)
Mutual Aid Association of Agriculture, Forestry and Fishery Corporation Personnel (2.0 trillion yen, 0.46 million participants)
Source: Ministry of Health, Labour and Welfare. Drawn by Institute of Pension Research, Nikko Financial Intelligence, Inc.

Appendix 2　Brief History of Corporate Pension Systems in Japan

(Beginning of Corporate Pension System)

1905 Kanebo Spinning Mutual Association (First Corporate Pension Plan in Japan)

(Inauguration of Pension System for Laborers)

1942 (ss)Enactment of Laborer Pension Law (It changed the name to Employees' Pension Insurance Law in 1944)

(Postwar Revival and Popularization of Corporate Own Pension Plans without Legislative Support)

1949 Matsuzakaya Department Store Pension Plan

1952 Jujo Paper Manufacturing Pension Plan, Mitsubishi Electronic Pension Plan

1954 (ss)Reform of Employees' Pension Insurance Law

(Achievement of Universal Pension Coverage)

1961 (ss)Enactment of National Pension Insurance Law (for farmers, fishermen, self-employed)

(Inauguration of Tax Qualified Pension System and Employees' Pension Funds)

1962 Tax Qualified Pension Plans inaugurated

1966 Employees' Pension Funds (EPFs) inaugurated

1973 (ss)Reform of Employees' Pension Insurance Law (cost of living adjustment , revaluation of previous wages)

(Popularization of Corporate Pension Plans)

1985 (ss)Introduction of Basic Pensions

1986 Investment Advisors Act Enacted

Appointed Juridical Person Scheme for Pension Plan Administration Introduced

1988 Certified Pension Actuary System Inaugurated

Employees' Pension Fund Association Inaugurated Benefits guarantee programs and Provision of pension benefits to former participants in dissolved pension funds

1991 National Pension Funds Inaugurated

1996 Pluralization of Rebates for EPFs

Statement of Investment Principles Obliged for EPFs

1997 Standards for Discontinuation and Assets Valuation by Market Value for EPFs Introduced

Appointed Certified Pension Actuary System Introduced for EPFs

(Structural Reform of Corporate Pension Systems)

2000 Accounting Standards for Retirement Benefits Introduced

2001 Enactment of Defined Contribution Pension Act

2002 Enactment of Defined Benefit Corporate Pension Act

Reform of EPFs' Management (Introduction of Cash Balance Plans etc.)

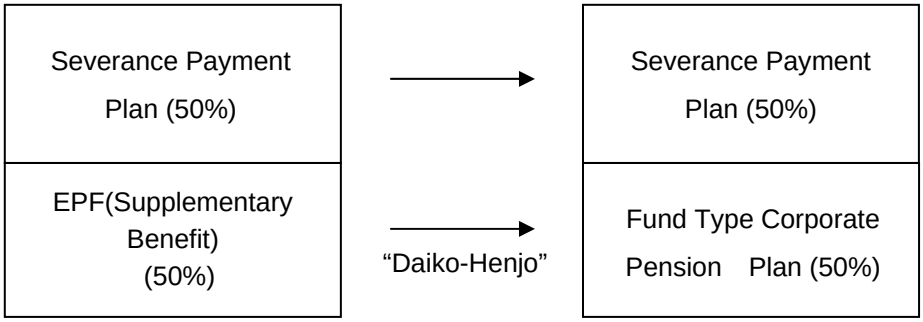
2003 Regulation of " Daiko-Henjo "

2004 (ss)Reform of Employees' Pension Insurance Law

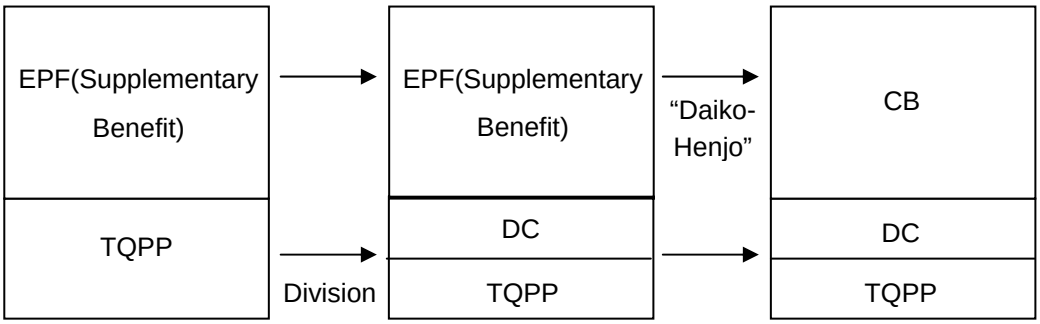
note: (ss) indicates the event in the social security pension field.

Appendix3 Some Pension Plan Transfer Examples(Extracted from Senior Plan Development Organization," Report on the Progress and Future Direction of Retirement Benefit・Corporate Pension Plan Reforms ", June 2004)

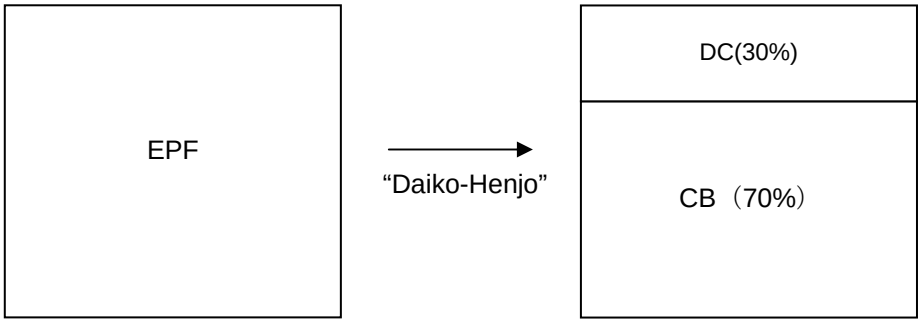
（1） A construction company: "Daiko-Henjo" and transfer to Fund Type Corporate Pension Plan.



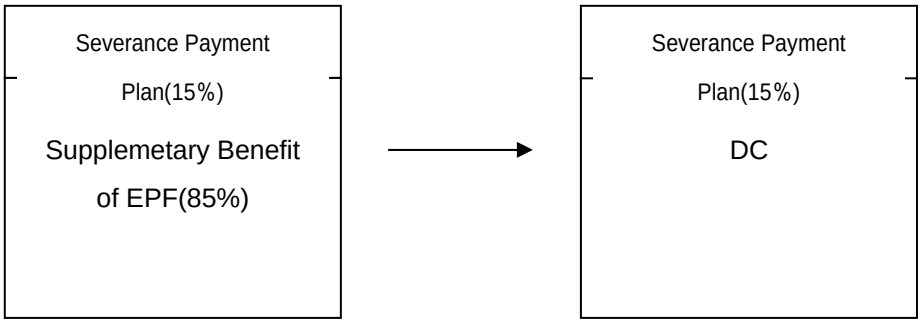
（2） B wholesale business company: "Daiko-Henjo" and introduction of CB Plan.



（3） C information and communication service company: "Daiko-Henjo" and transfer to CB and DC Plans.



（4） D food company:Dissolved EPF and transfer to DC Plan.



（5） E pharmaceutical company: “Daiko-Henjo” and transfers to CB Plan,and introduction of DC Plan.