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The Japanese Society of Certified Pension Actuaries

INTERNATIONAL ACTUARIAL ASSOCIATION
ASSOCIATION ACTUARIELLE INTERNATIONALE

THE STRUGGLE OF JAPANESE CORPORATE PENSION WITH LOW INTEREST ENVIRONMENT

9 JUNE 2015
9:30－10:00

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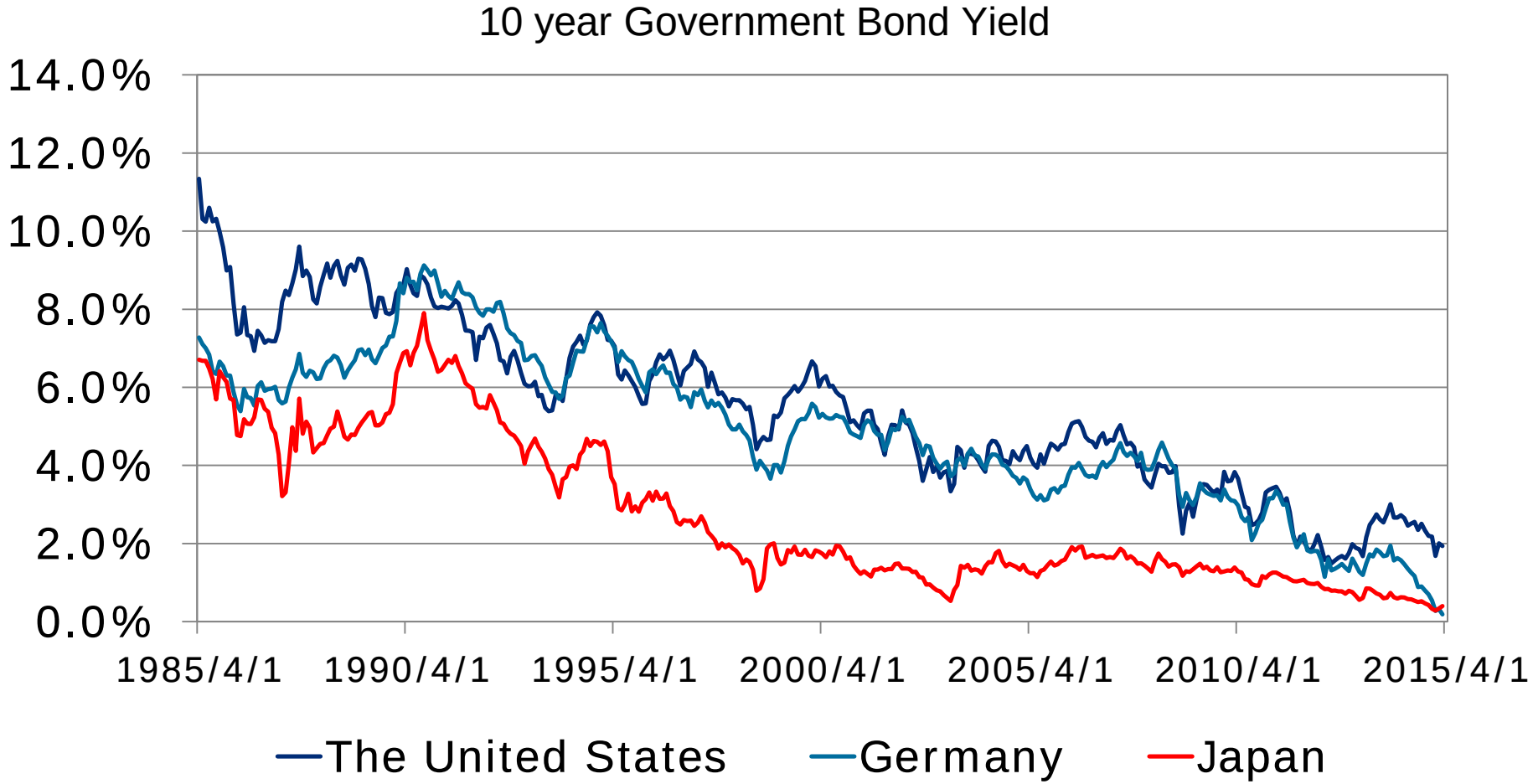
Low interest…

- Japan = An Advanced low interest rate country



Opening

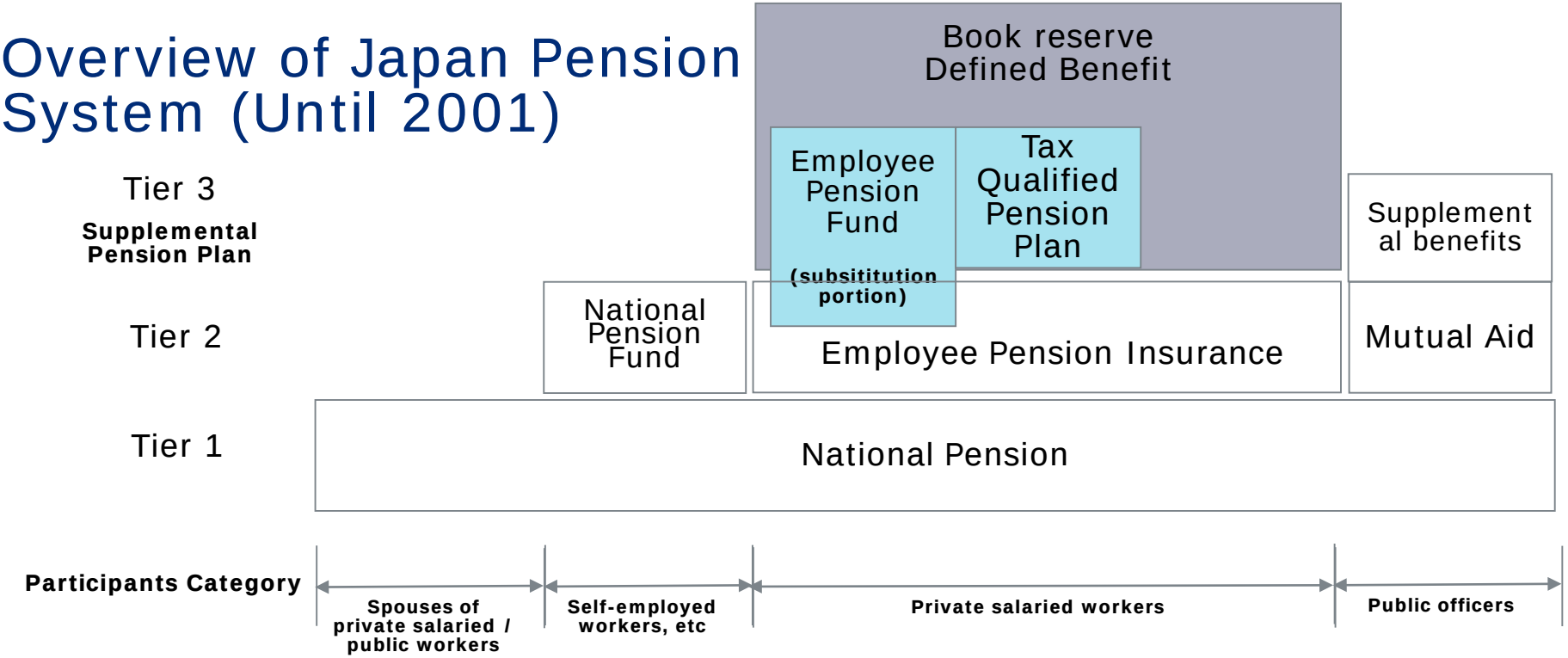
- Presenter – Takashi Kato, The Japanese Society of Certified Pension Actuaries
- Contents – How Japanese corporate pension plans struggled
- Today's goal – Find essences of action against low interest
- Next step – Seek any opportunities to implement the essence (if applicable)
- Duration – Until 9:55
- Question policy – QA session after completion of presentation

Introduction

Background of retirement benefit in Japan

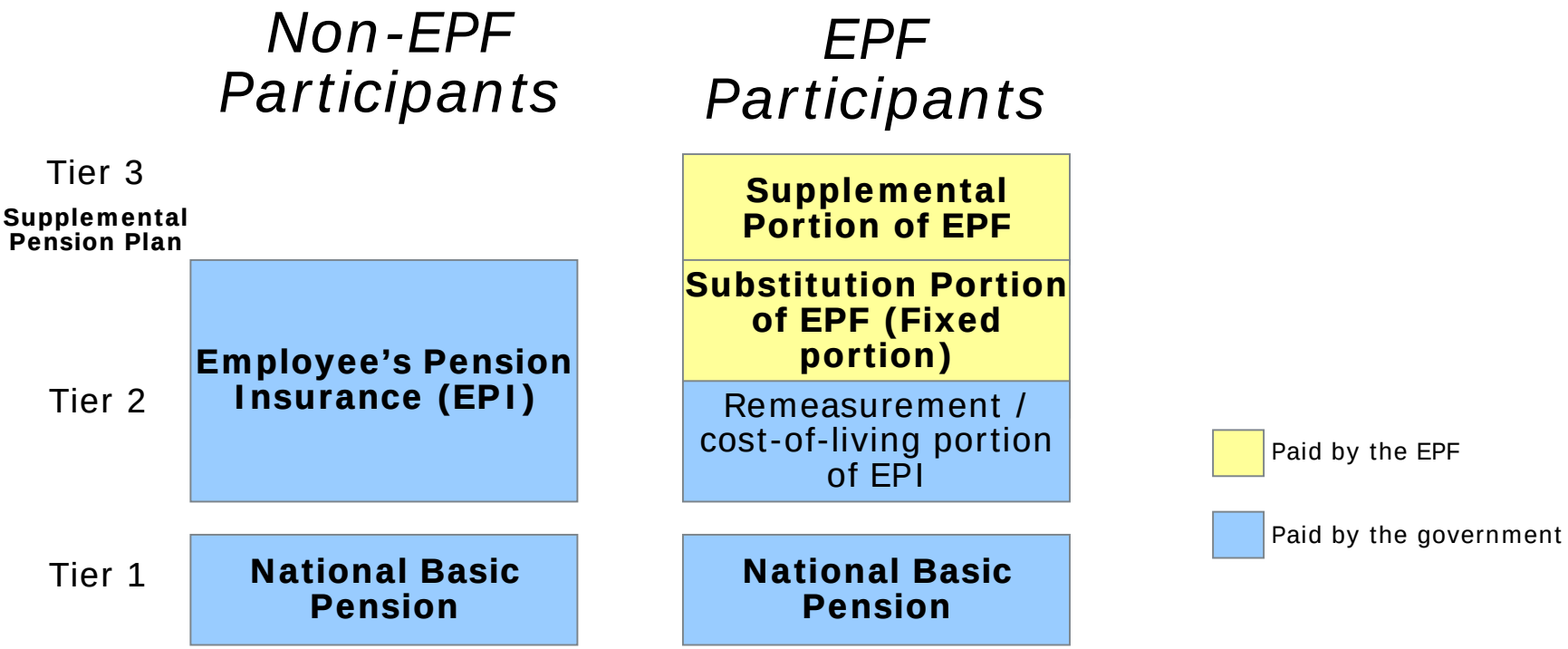
- 1962 – Tax Qualified Pension Plan (TQPP)
  - Which gives advanced tax benefits without any funding requirement
- 1966 – Employee Pension Fund (EPF)
  - Which covers a certain portion of state benefits with the plan unique benefits

Overview of Japan Pension System (Until 2001)



Introduction
What is an EPF?

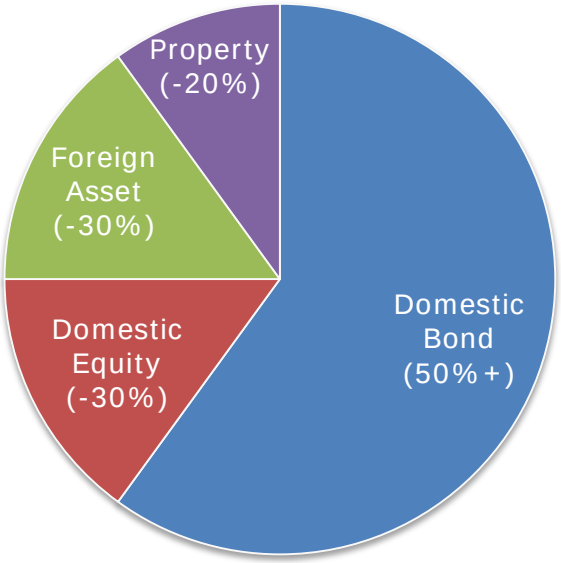
- 2 types of Employee's Pension Funds (EPF):
  - Stand alone (including group companies plan)
  - Multi-employer



Introduction
Regulation of Japanese corporate pension plan

Regulation (Until 1995)

- No benefit reduction had been allowed
- A 5.5% discount rate is used for pension liability evaluation
- Limited investment strategy
  - ✓ 50%+ to guaranteed or stable assets (i.e. domestic bond)
  - ✓ Up to 30% can be in domestic equity
  - ✓ Up to 30% can be in foreign assets
  - ✓ Up to 20% can be in properties

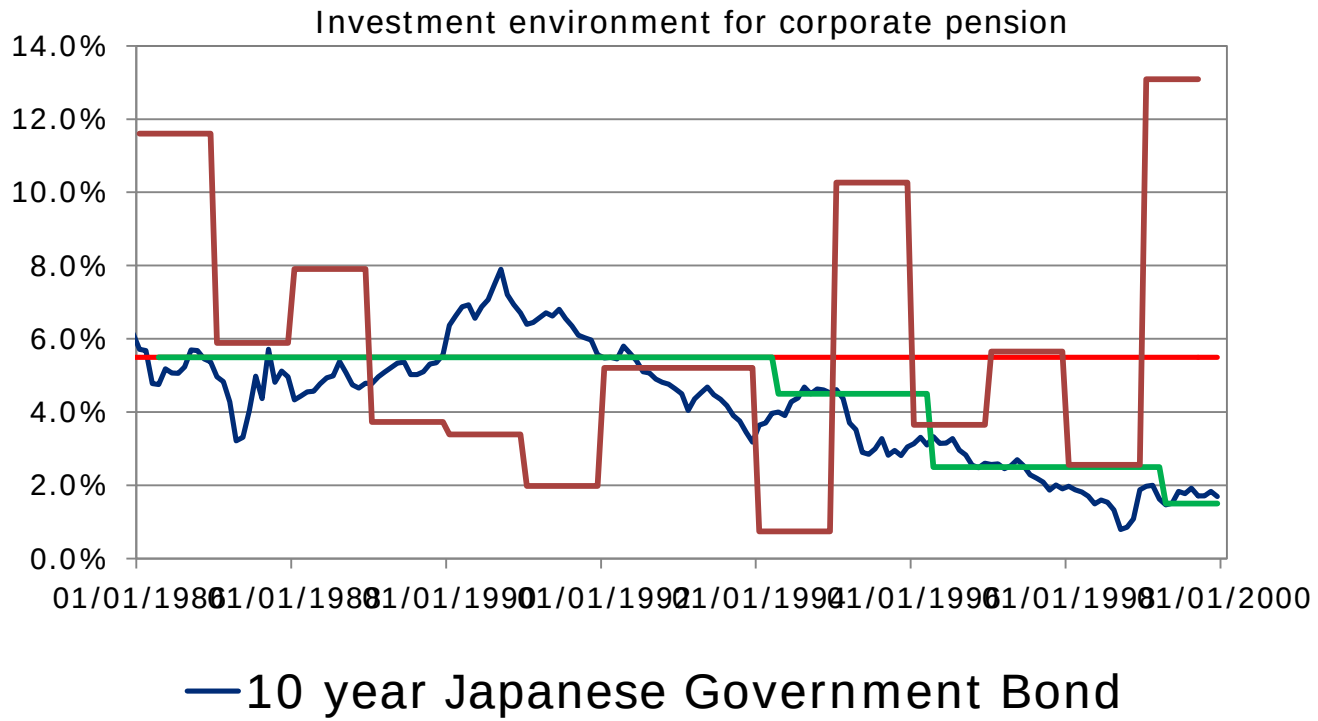


Investment environment
Changes began around 30 years ago

Actual investment environment (-1986)

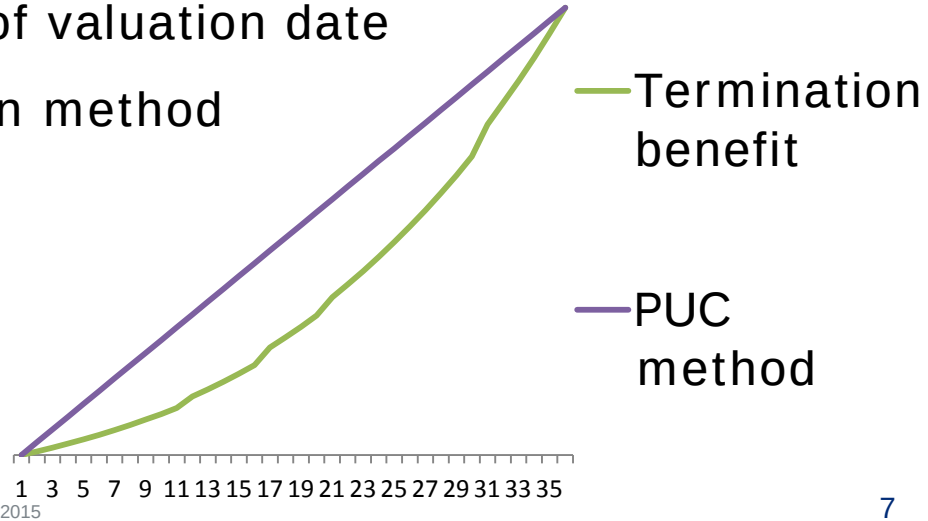
- Guaranteed product – above 5.5% including dividends (Until early 90's)
- Average of investment return – 8.0%-10.0% (During 1972-1986)

Environmental changes…



Legislative changes
Significant changes with flexibility are introduced

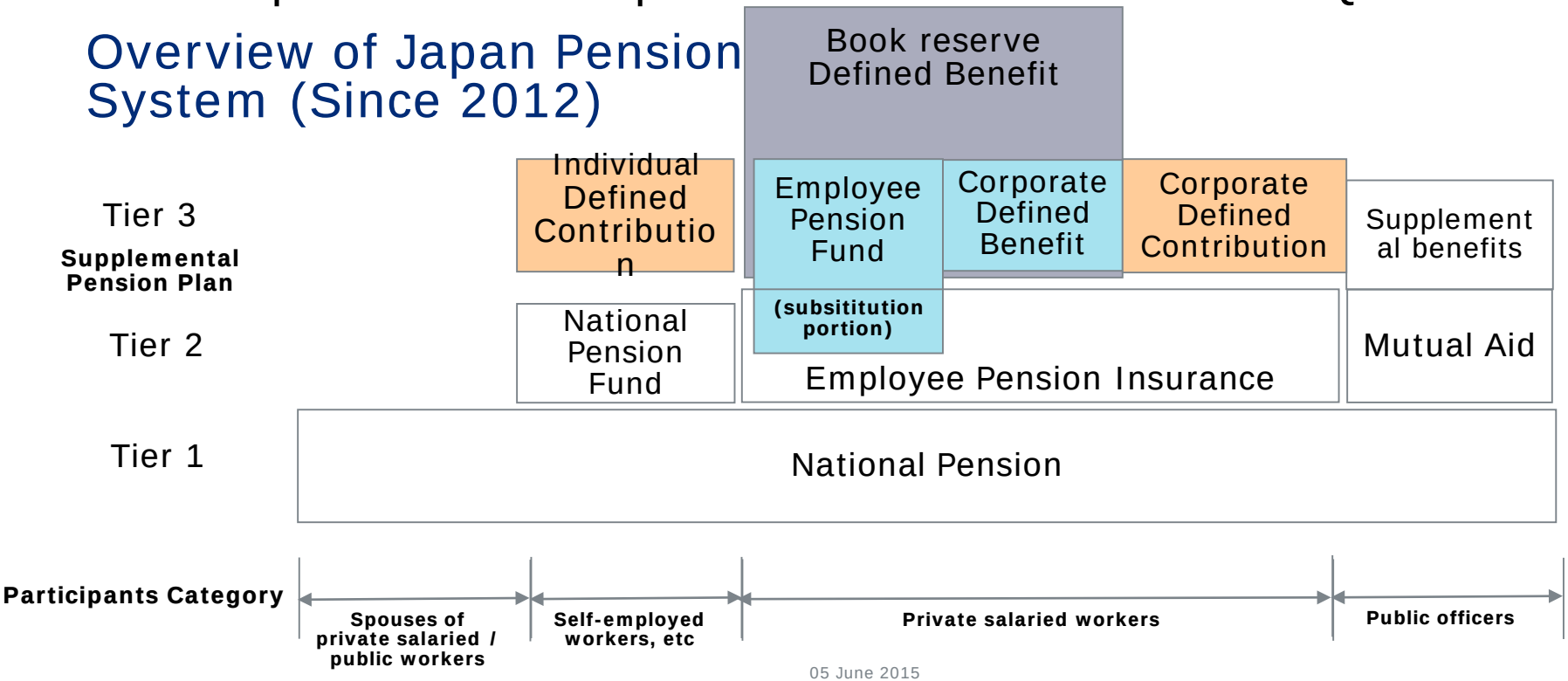
- Investment option can be selected by plan sponsors (1996)
- Target investment return can be set by plan sponsors (1997)
- Benefit reduction is allowed with employees consent (1997)
- Changes in funding valuation for state benefits part (1999)
  - Had likely decreased liability against both funding and accounting liability
- Changes in accounting standard (2000)
  - Previous: Termination benefit as of valuation date
  - Current: Projected Unit Calculation method



Legislative changes
Defined Contribution (DC) and Define Benefit (DB)

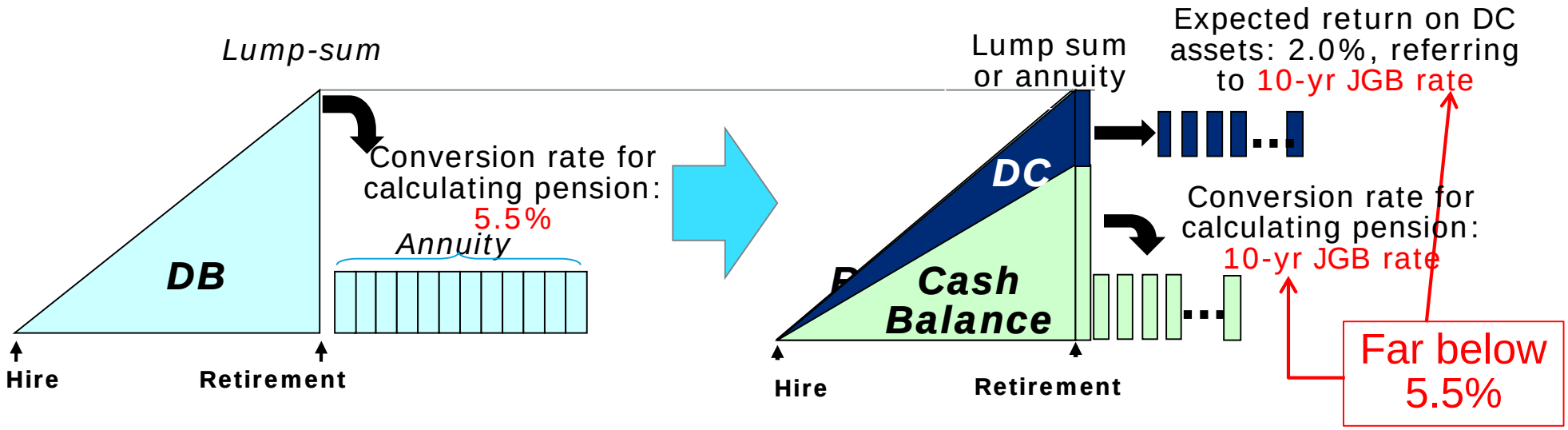
- Abolishment of TQPP (2002 with 10yr transition)
- Right to return state benefit portion from EPF to government (2002)
- DC Corporate Pension plan became available (2001)
- DB Corporate Pension plan became a successor of TQPP and EPF

Overview of Japan Pension System (Since 2012)



Action by corporate pension plan
Case study – Plan change and benefit reduction

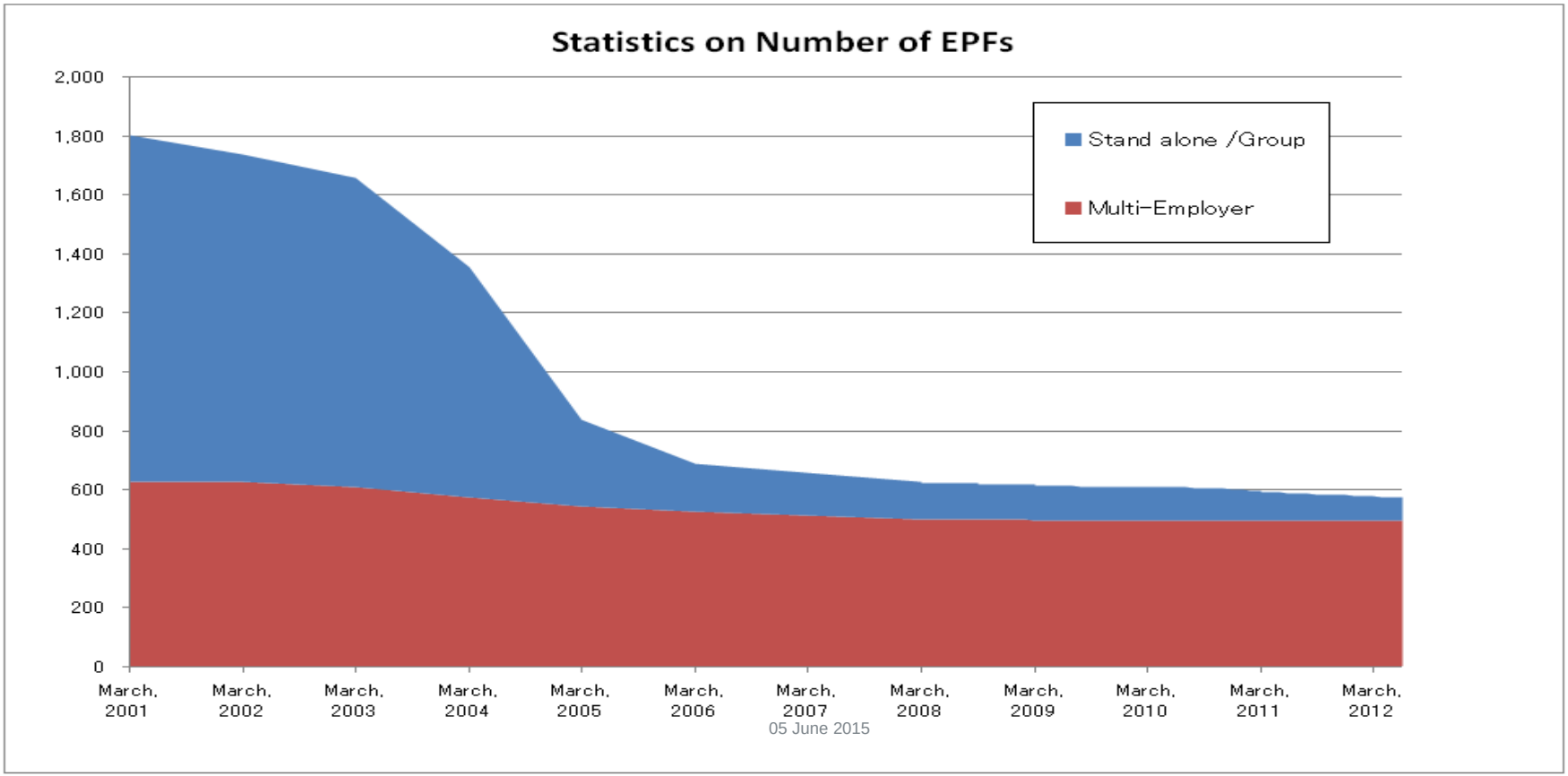
- Similar size of lump sum arrangement
- Offer DC plan – to share investment risk with employees
- Pension value reduction – to meet the economic environment



- Obstacles – Employees tend to be resistant but 2/3 of employees' buy-in required!

Action by corporate pension plan (EPF)
Case study – DB risk transfer (Single employer)

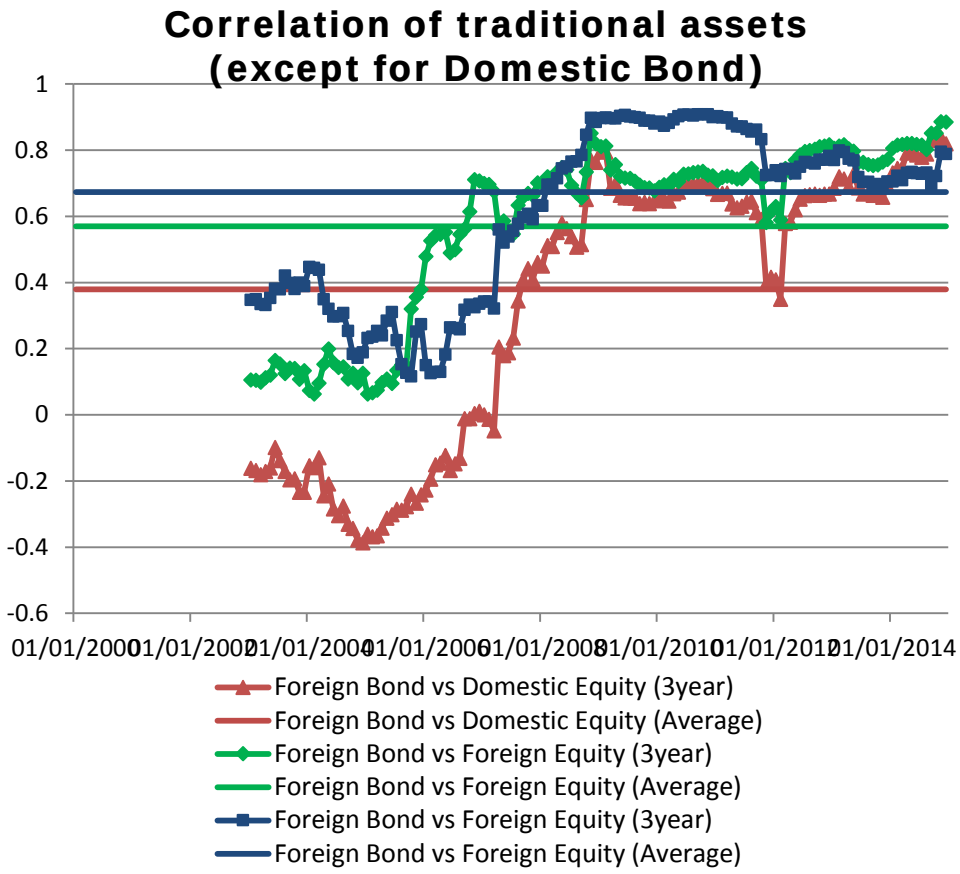
- State benefit part only but very strong trend for single employer plan in early 2000's
  - DB de-risking
  - A special profits, in case buy-out value is less than accounting liability



Action by corporate pension plan

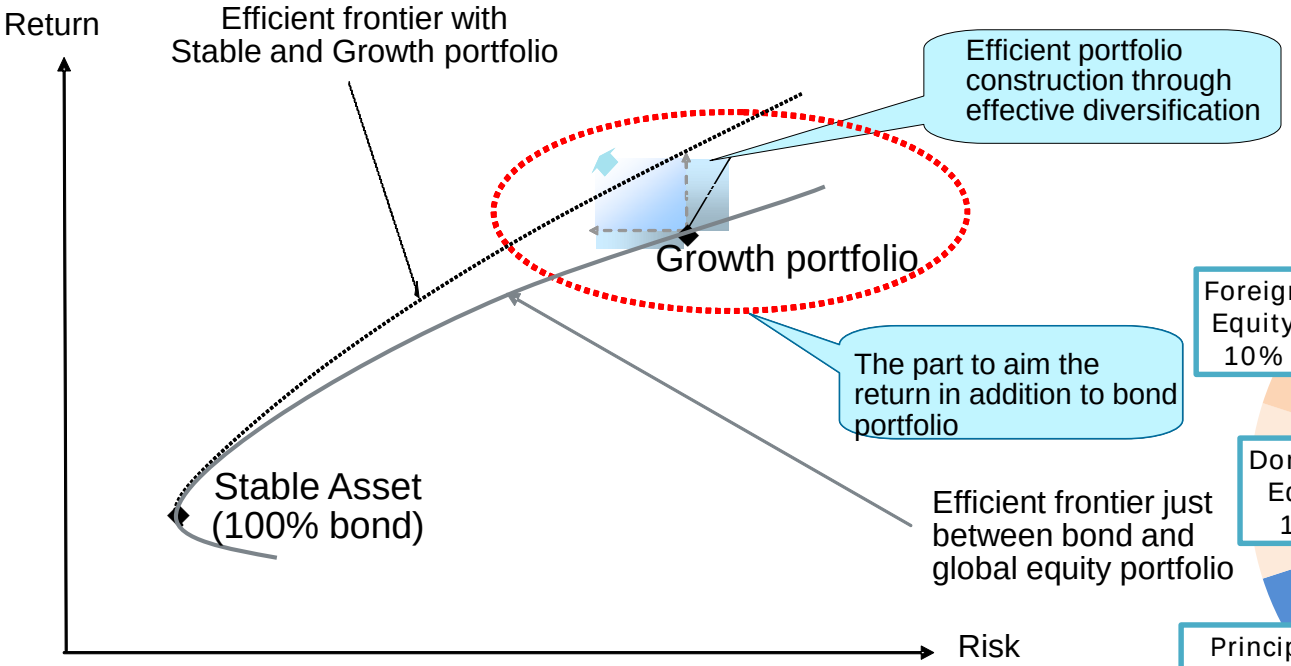
Case study – Investment approach, past experience and learning

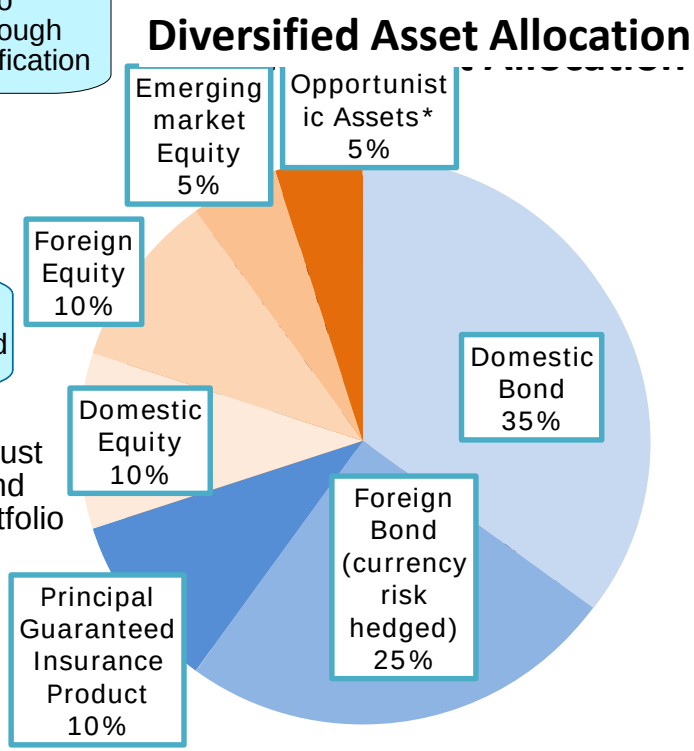
- Diversification may not work after crisis



Action by corporate pension plan
Case study – Investment approach

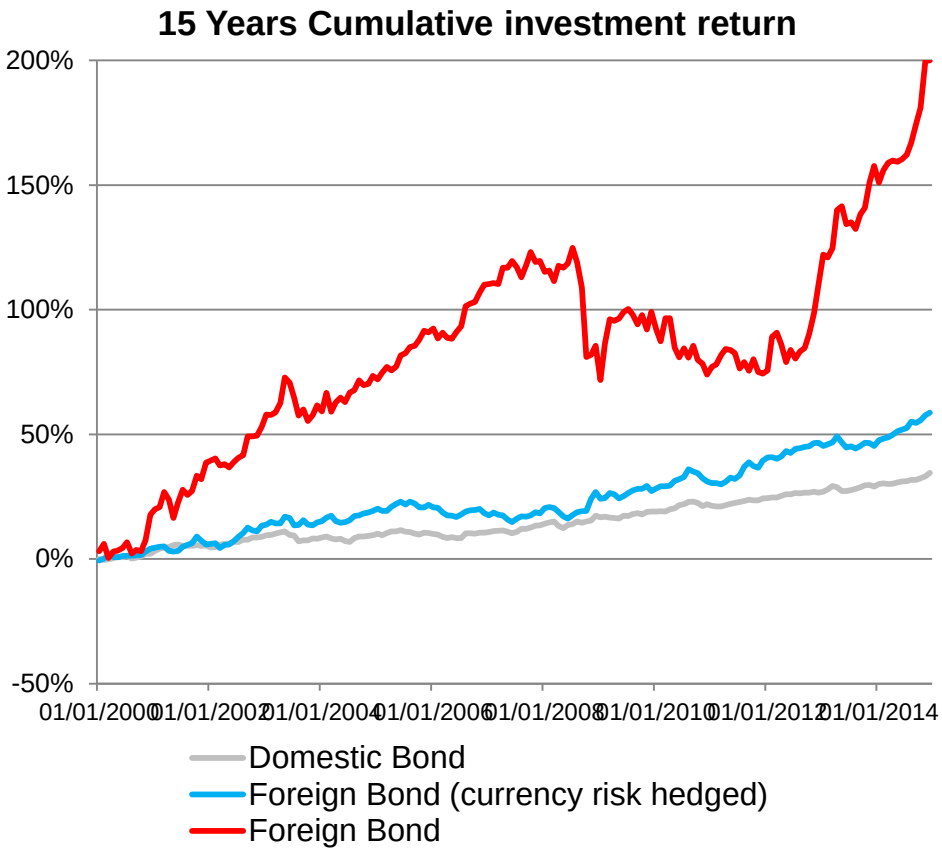
- Limited expectation to diversification affect
- Try to find other value-add source as much as possible

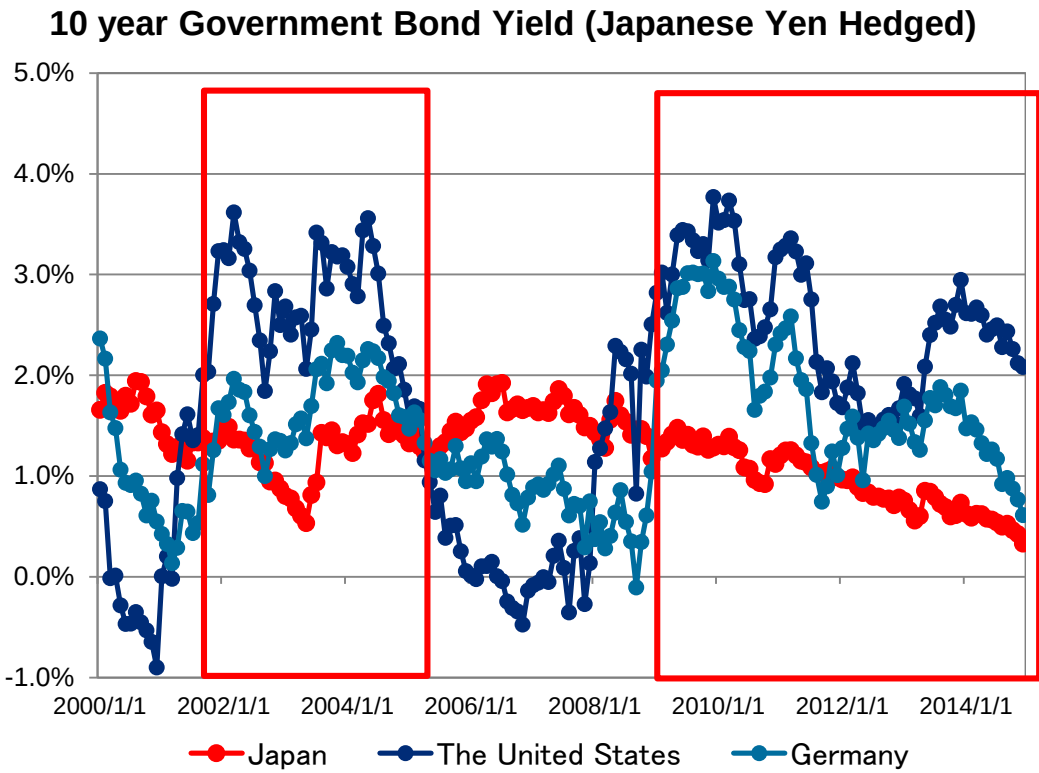




Action by corporate pension plan
Case study – Finding other investment opportunity

- Yield hunting over the world – currency hedged foreign bond
- Risk level can be similar to domestic bond
- But more interest rate in somewhere at a certain period





Review

- Legislation can be changed appropriately depending on environment
- De-risking activities can be still sought
  - Investment performance linked Cash balance plan
  - Collective DC plan, invested by plan sponsors
- Diversification of risk/return
- More communication, more governance structure
  - For better decision making and better results

End

Tusen Tukk!

Thank you for listening!

For more questions/comments:

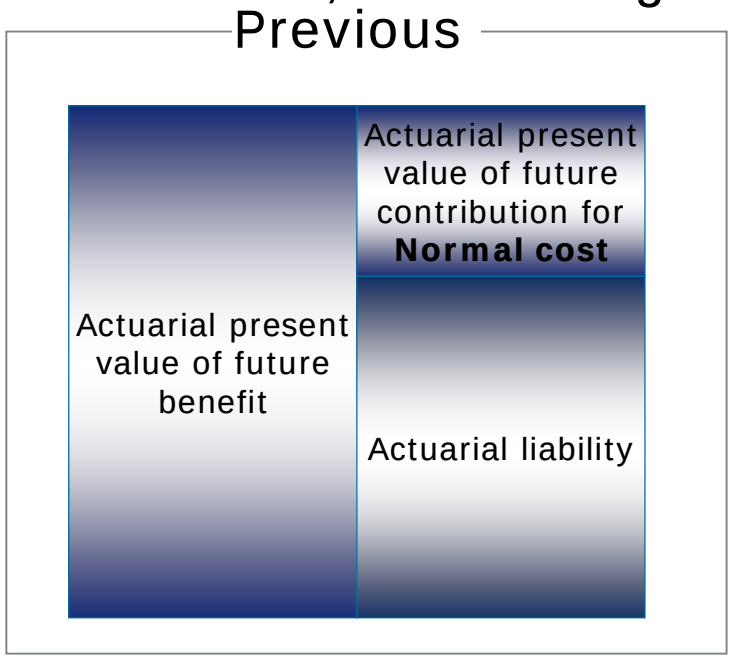
Feel free to rise your hand!

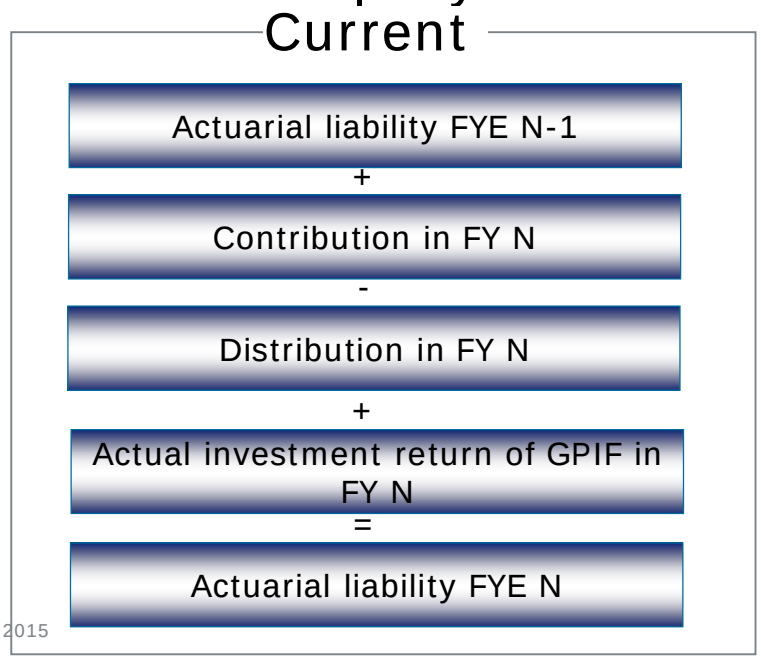
Appendix – References

- Bloomberg: for historical investment data gathering
- Databank: for historical investment data gathering
- Pension Fund Association (2014): *Basic material about Corporate Pension 2014* (in Japanese)

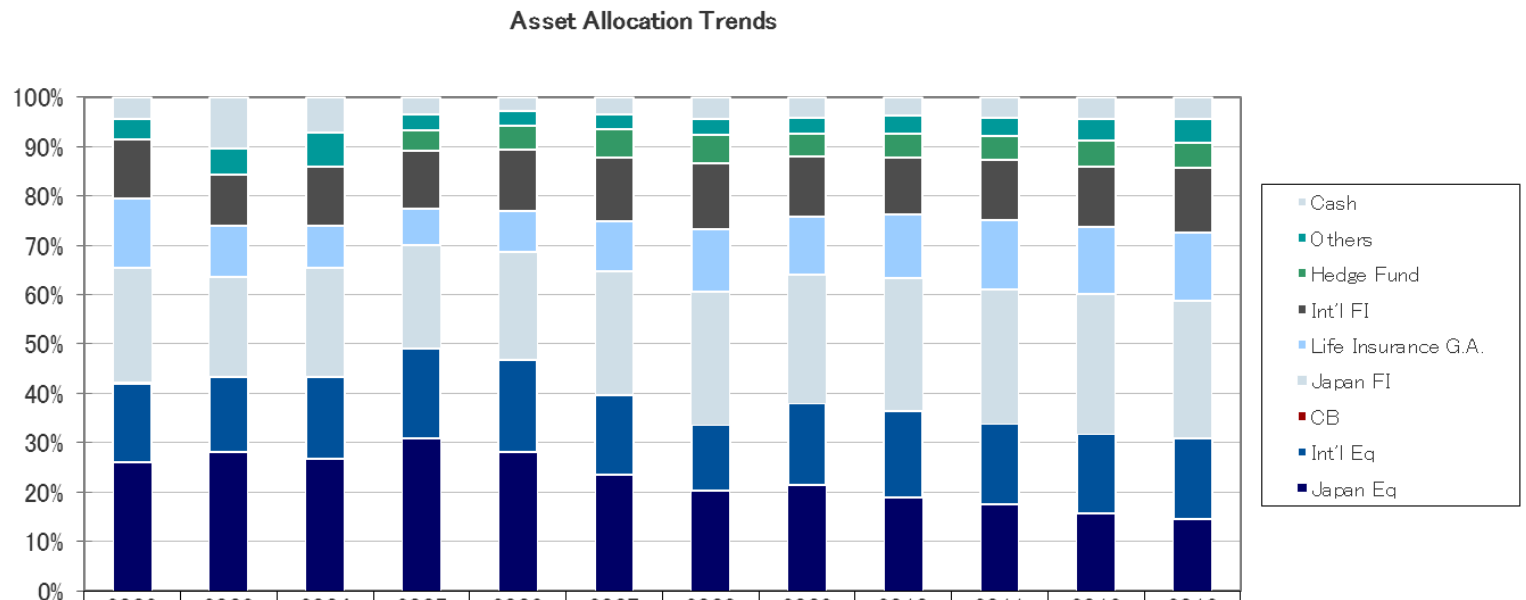
Legislative changes
Funding liability evaluation

- Previous: Actuarial valuation
  - considering future benefit payment and contribution
- Current: Loan from Government Pension Investment Fund
  - Highly "geared" structure:
    - If actual return > GPIF return, then the funding deficit reduces
    - Otherwise, the funding deficit increases rapidly





Appendix – Trends in Asset Allocation



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Cash	4%	10%	7%	3%	3%	4%	4%	4%	4%	4%	5%	5%
Others	4%	5%	7%	3%	3%	3%	3%	3%	4%	4%	4%	5%
Hedge Fund				4%	5%	6%	6%	5%	5%	5%	5%	5%
Int'l FI	12%	10%	12%	12%	13%	13%	13%	12%	11%	12%	12%	13%
Life Insurance G.A.	14%	11%	9%	7%	8%	10%	13%	12%	13%	14%	14%	14%
Japan FI	23%	20%	22%	21%	22%	25%	27%	26%	27%	27%	29%	28%
CB	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Int'l Eq	16%	15%	17%	18%	19%	16%	13%	17%	18%	16%	16%	17%
Japan Eq	26%	28%	27%	31%	28%	24%	20%	21%	19%	17%	16%	15%

G.A. =life insurance company's product with floor (e.g.1.25%), Others represent hedge fund and property/private equities until 2004, while it represents property/private equities (Hedge fund has been "independent" of "Others" since 2005)

Source: Pension Fund Association, Mercer

Appendix – AIJ Scandal

- In February 2012 the Japan Financial Services Agency suspended AIJ Investment Advisors after it couldn't account for a majority of the pension funds it claimed to have managed
  - Many of AIJ's biggest clients belonged to multi-employer EPFs
- The AIJ scandal shed light on the structural issues around governance of EPFs
  - Lack of diversification in investment allocation
  - Lack of accountability and clarity around responsibilities
  - Decision making process
  - Government's responsibilities over the "contracted-out" benefits in lieu of the state pension
- The government changed EPF relevant law as of 1 April 2014;
  - No new EPF
  - 5-year easement window of winding-up for severely under-funded EPF
  - The Minister can give a dissolution order to slightly under-funded EPF
- **Therefore majority of existing EPF would take risk transfer action as well**