THE STRUGGLE OF JAPANESE CORPORATE PENSION WITH LOW INTEREST ENVIRONMENT

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9:30—10:00

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Low interest...

- Japan = An Advanced low interest rate country

10 year Government Bond Yield

- The United States
- Germany
- Japan
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)

Participants Category
- Spouses of private salaried / public workers
- Self-employed workers, etc
- Private salaried workers
- Public officers
Introduction
What is an EPF?

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

Non-EPF Participants

Tier 3
Supplemental Pension Plan

Employee’s Pension Insurance (EPI)

Tier 2

Tier 1

National Basic Pension

EPF Participants

Supplemental Portion of EPF

Substitution Portion of EPF (Fixed portion)

Remeasurement / cost-of-living portion of EPI

Paid by the EPF

Paid by the government

05 June 2015
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
  - Previous: Termination benefit as of valuation date
  - Current: Projected Unit Calculation method
Legislative changes
Defined Contribution (DC) and Defined 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

Obsstacles – 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

Efficient frontier with Stable and Growth portfolio

Growth portfolio

Efficient frontier just between bond and global equity portfolio

Stable Asset (100% bond)

Efficient portfolio construction through effective diversification

Diversified Asset Allocation

Emerging market Equity 5%

Opportunist ic Assets* 5%

Foreign Equity 10%

Domestic Equity 10%

Principal Guaranteed Insurance Product 10%

Foreign Bond (currency risk hedged) 25%

Domestic Bond 35%
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

15 Years Cumulative investment return

10 year Government Bond Yield (Japanese Yen Hedged)
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

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

Previous

Actuarial present value of future benefit

Actuarial liability

Normal cost

Current

Actuarial liability FYE N-1

+ Contribution in FY N

- Distribution in FY N

+ Actual investment return of GPIF in FY N

= Actuarial liability FYE N
Appendix – Trends in Asset Allocation

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