DEFINED CONTRIBUTION PENSION PLANS AND THEIR INVESTMENT EDUCATION IN JAPAN

Tadashi Nakada

Nikko Financial Intelligence Inc., Tokyo, Japan

Abstract. Corporate pension systems were dramatically reformed around 2000 in Japan. One of which was the introduction of DC Plans, which reach 1.2 million participants and 1 trillion yen assets at the moment. Current situations of Japanese DC Plans are reported in this paper, including DC plan regulations, administration systems, statistics on DC Plans, results of interviews. Some issues to be solved are also discussed and the roles and responsibilities of actuaries in the DC Plans are suggested.

Key-words: defined contribution plan, investment education, baby boomers, personal actuary

1 Introduction

Corporate pension systems were dramatically reformed around 2000 in Japan. One of which was the introduction of DC Plans. Though a DC plan itself was not a new idea in the worldwide perspective, it was a very new to Japanese pension systems where only DB plans had been permitted for around four decades.

DC plan system have 1.4 thousand plans and 1.2 million participants at the moment, but it is far below populalized than expected at the introduction of DC Plan System. Some people, particularly people outside of Japan, sometimes say that the DC Plans are unsuccessful in Japan.

But it is too early to decide whether DC Plans are successful or not. It only passed three years and a half after the introduction of DC system, and number of plans and participants have been steadily increasing. It is certain that DC Plans will be one of important sources of peoples' retirement incomes though it will not become the biggest pillar for retirement income as expected at the system introduction. Therefore the important thing is not to decide whether DC Plans are successful or not, but to generate ideas how to make DC Plans more useful for peoples' retirement incomes.

2 Corporate Pensions Reform around 2000 in Japan

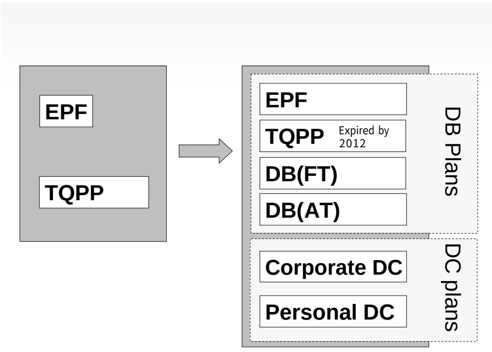
The Japanese corporate pension plans, which initiated in 1960s, had fallen into the corporate pension crisis in 1990s due to (a) historically low investment performance and increment of unfunded pension plans, (b) corporations' tendencies to reduce pension plan burden and abolish corporate pension plans for cost-cutting because of long-term stagnant economy, (c) employment policy change at corporations from Japanese style management(lifetime or long-term employment, seniority-based pay system) to American style (short-term employment, performance-based pay system), and (d) introduction of new accounting standards for retirement benefits, which disclosed the underfunded situation of corporate retirement benefit plans.

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 plans.

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.

Defined Benefit Corporate Pension Plans. The act provides (1) funding requirements, (2) fiduciary responsibility, and (3) reporting and disclosure signed by Certified Pension Actuaries.

Figure 1. Corporate pension systems reform



NOTE:

EPF: Employees' Pension Fund

TQPP: Tax Qualified Pension Plan

DB(FT): Defined Benefit Corporate Pension Plan (Fund Type)

DB(AT): Defined Benefit Corporate Pension Plan (Agreement Type)

Corporate DC: Corporate Defined Contribution Plan

Personal DC: Personal Defined Contribution Plan

3 Defined Contribution Plans

3.1 DC Plan Act 2001

a. DC Plans and Entrustment

Two types of DC plans were introduced in DC Plan Act 2001. The one is the Corporate DC Plan, which the employers made the agreements with employees and provide DC plans to their employees. The other one is the Personal DC plan, which the National Pension Fund Federation provides.

The employers can entrust their administrative jobs to administration institutions registered to the Minister of Health, Labor and Welfare, including recording or investment concerning jobs. They also must entrust their employees' assets management to financial institutions.

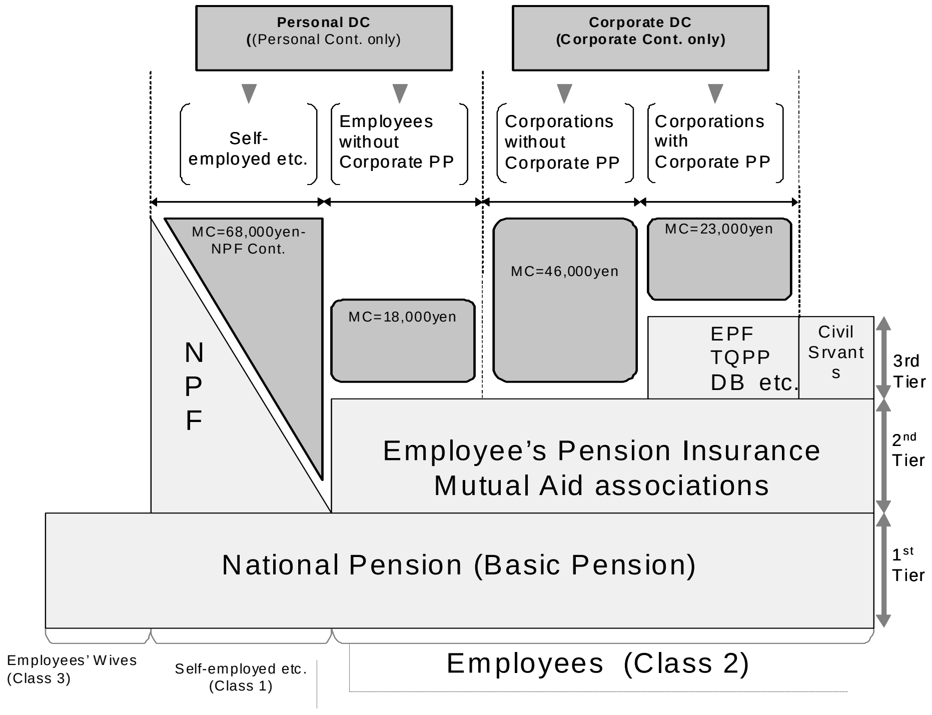
b. Eligibility and Contribution Limits

Eligible participants are (a) company employees where corporate DC plan is provided, and (b) self-employed and company employees where corporate DC is not provided. Government officers and spouses of company employees are not eligible.

The Corporations (to corporate DC plans) and individuals(to personal DC plans) have to pay their contributions within Maximum Contribution Limits. Maximum Contribution Limits are shown on the Figure 2.

The contributions payable are fixed amount, salary-related or those combination.

Figure 2. Eligibility and Maximum Contribution Limits



c. Pension Right Security

The employers are requested to obey laws and ordinances concerned and pension agreements, and to act faithfully for their participants. The investment to their own corporations are limited to some cases, required to fully disclose the information to participants, and their recommendations are prohibited.

The financial institutions managing employees' assets are also required to obey laws and ordinances concerned and asset management contracts, and to act faithfully for DC plan participants.

d. Investment

The DC Plan sponsors have to provide investment vehicles following regulations, which include;

(a) Three or more investment vehicles must be provided, which includes at least one principal guaranteed investment good,

(b) At least one chance has to be provided to change the selected vehicles every three months, and

(c) The DC plan participants have to be fully provided the information on the investment vehicles.

e. Portability of Pension Asset

Asset balance is recorded for each participants, and is transferred to the new DC plan when he/she moves to new corporation with DC plan. Asset is transferred to the National Pension Fund Federation when the participant moves to the corporation without DC plan.

f. Benefits

Benefits are old age benefit, disability benefit and death benefit (lump-sum). Old age benefit or disability benefit can be received as an annuity (5-20 years certain or lifetime (if provided as an insurance good) or a lump-sum. Old age benefit can be received if participants reach age 60 and have 10 or more contributory years. Withdrawal lump-sum can be received when withdrawer has a short contribution year(3 years) or small asset(less than 500,000yen).

g. Taxation

Taxes are deductible from incomes for participants' contributions, and treated losses for corporations' contributions.

Special corporation taxes are levied on pension assets (The taxation is suspended until 2008).

Tax deductions for social security pensions are applies to old age benefits for DC plans paid in annuities, and retirement allowance taxes are applied paid in lump-sums.

h. Investment Education

Ordinance requires to write contents and methods of investment education to participants in the DC Plan Agreements. Those educations should not contain investment advices which indicate individual investment goods.

Ministry of Health, Labor and Welfare issued Investment Education Guideline and indicated the information to provide to DC Plan participants in the investment education, which include the following items.

(a) What is a DC Plan?
- Outline of Japanese Pension Systems and DC Plans

- Outline of DC Plans
- Eligibility, Maximum contribution limit
- Investment vehicles providable, Presentation of investment goods, Opportunity for changing investment goods
- Benefits, Benefit eligibility, Pensionable age, Receiving
- Assets transfer
- Taxation
- Roles of employers, administration institutions, asset management institutions
- Rules of employers, administration institutions, asset management institutions

(b) Financial Vehicles and Their Characteristics (for Each Financial Vehicles)

- Characteristics
- Kinds
- Expected returns
- Risks
- Factors affecting prices

(c) Basic Knowledge of Asset Management

- Notes for asset management
- Kinds and Contents of Risks (Interest rate risk, Exchange risk, Credit risk, Volatility risk, Inflation risk)
- Risk and Return
- Long-term Investment
- Diversified Investment

3.2 DC Plan Administration

As for the Corporate DC Plan, the employers made the agreements with employees and provide DC plans to their employees.

The employers usually entrust their administrative jobs to administration institutions (records keeping institutions and investment concerning institutions). They also entrust their employees' assets management to financial institutions.

Records keeping institutions are managing participants' records as names, addresses, assets amounts and notify participants' investment orders to assets management institutions.

Investment concerning institutions are selecting investment goods, presenting them to participants and providing information concerning investments.

Assets management institutions are managing participants' assets.

As for the Personal DC Plan, the National Pension Fund Federation is providing their DC Plans. It entrust their administrative jobs to administrative institutions, and participants' assets management to financial institutions.

Figure 3-1. Corporate DC Plan Administration

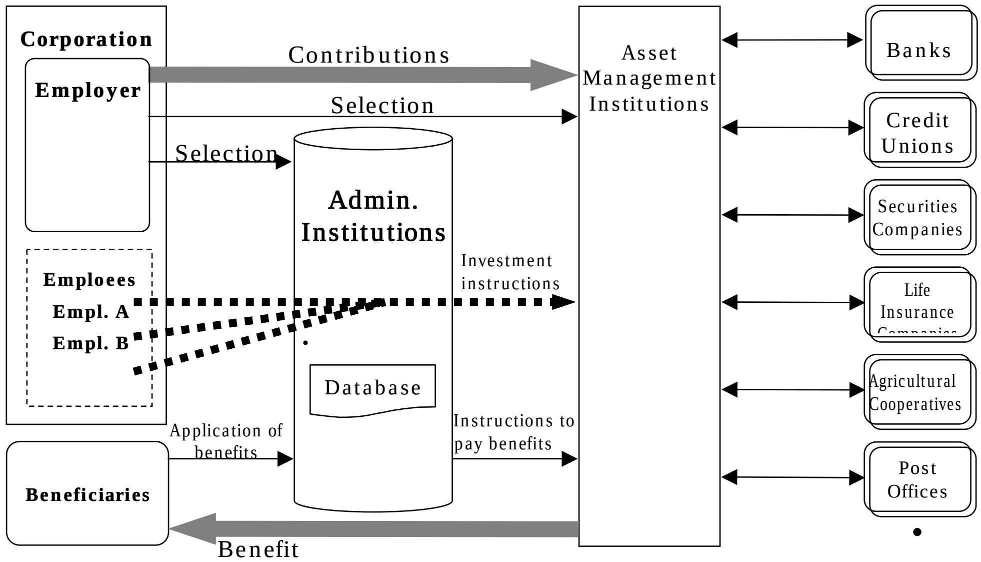
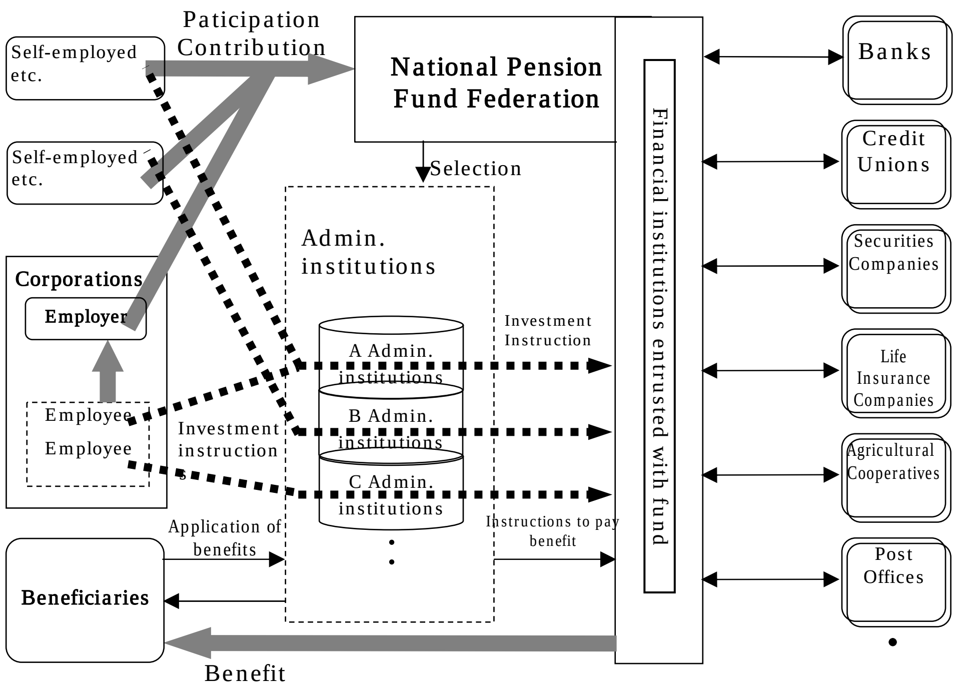


Figure 3-2. Private DC Plan Administration



4 Current Situation of Defined Contribution Plans

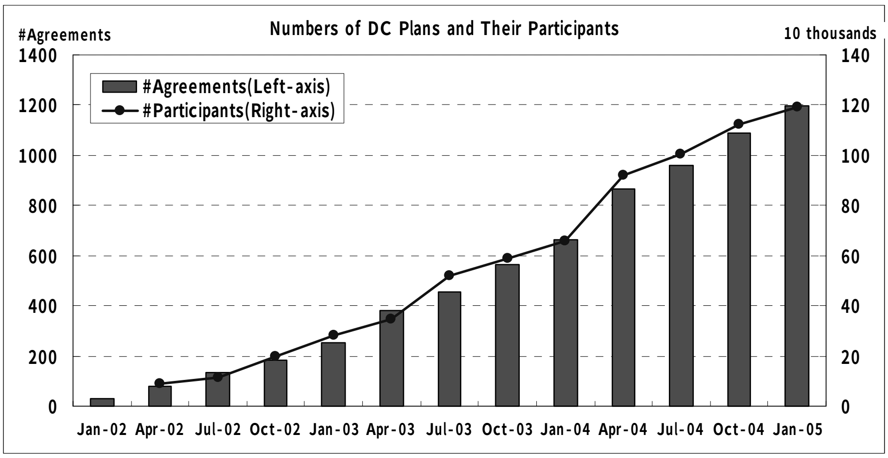
4.1 Plans, Participants, and Assets

DC Plans, which introduced in October 2001, have not steeply but steadily been popularized. Figure 4 shows the trend of both numbers of DC plans and their participants. They gradually have increased and reached 1,422 plans (in April 2005) and 1.26 million participants(in March 2005) respectively.

Total amounts of contributions and assets were respectively 60 billion and 520 billion yen, and per capita amounts are 12 thousand yen per month and 750 thousand yen in 2003 fiscal year(April 2003-March 2004)[1]. The amount of assets is estimated about over 1 trillion yen at this moment.[2]

The number of DC plan participants will be 4 million by the end of 2007 according to Nikko Financial Intelligence projection[3]. Whether 1.4 million at the moment and 4 million two years hence is large or not is rather controversial. Some might say more than one million is large enough, but others might say 4 million is only 7% of the 55 million people eligible.

Figure 4. Number of DC Plans and Their Participants



From statistics submitted to the DC Plan Committee at the Ministry of Health, Labor and Welfare, we can see the current status of DC plans in detail. Tables 1-3 are extracted from those statistics.

We can see the following from those tables.

(a) DC plans have been mostly introduced to medium or small corporations (see Table 1),
(b) More than half, particularly two third of corporations with less than 300 employees, are corporations with only DC plans (see Table 2), and
(c) 70% of DC plans are transfers from other pension plans (see Table 3).

Table 1. Number of Corporations with DC Plans

Number of Employees	Number of Corporations(%)
0-99	2,714 (57%)
100-299	755 (20%)
300-999	487 (13%)
1000-	375 (10%)

Note: As of Feb. 28, 2005
Source: Ministry of Health, Labor and Welfare

Table 2. Other Corporate Pension Plans Provided in Addition to DC Plans

	Corp. with Less Than 300 Employees	Corp. with More Than 300 Employees	Total
EPF	160	132	292
DB	10	106	116
TQPP	27	62	89
Mutual Aid Association for Private School Teachers	0	1	1
EPF/DB	0	11	11
EPF/TQPP	11	25	36
DB/TQPP	1	2	3
None	418	294	712
Total	627	633	1,260

Note: As of March 31, 2005
Source: Ministry of Health, Labor and Welfare

Table 3. Transfers of Assets from Other Retirement Plans

	Corp. with Less Than 300 Employees	Corp. with More Than 300 Employees	Total
EPF	0	23	23
DB	0	3	3
TQPP	276	217	493
Retirement Severance(RS)	50	120	170
EPF/TQPP	0	5	5
EPF/RS	0	6	6
TQPP/RS	80	94	174
EPF/TQPP/RS	0	6	6
DB/TQPP/RS	0	1	1
None	221	158	379
Total	627	633	1,260

Note: As of March 31, 2005
Source: Ministry of Health, Labor and Welfare

4.2 Investments

The statistics shows that the investment vehicles ranging 3-45 are provided and thirteen on average (Table 4) . Table 5 shows what kind of investment vehicles are provided and how much on the average. Of thirteen vehicles provided on average, 9 vehicles are valuable securities and around 2 are deposit or life/non-life insurance.

Table 4 Investment Vehicles Provided (Number)

	Corp. with Less Than 300 Employees	Corp. with More Than 300 Employees	Total
Average	12	15	13
Maximum	42	45	45
Minimum	3	3	3

Table 5 Investment Vehicles Provided (Average)

	Corp. with Less Than 300 Employees	Corp. with More Than 300 Employees	Total
Deposit	1.4	2.1	1.8
Money trust	0.5	0.6	0.6
Valuable securities*	8.3	10.1	9.2
Life/non-life insurance	1.4	2.0	1.7

* Including security investing mutual funds other than money trust

NPO Institute for DC Plan Investment Education Institute of Japan conducted the survey on the communications and investments to the DC plan 7,227 participants of five corporations introduced DC plans and got 60.6% response rate in mid-June to late July 2004.

The survey results show,

(a) Principal guaranteed goods were inclined to be selected in every age groups (Figure 5),

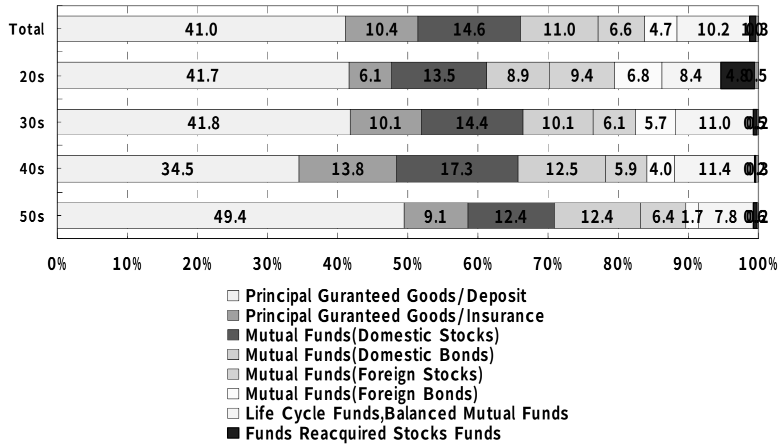
(b) Following two different groups could be found,
Mutual Fund Group (MFG): more than 50% were invested to mutual funds, and Principal Guaranteed Group(PGG): more than 50% were invested to principal guaranteed goods,

(c) MFG include innovative people with high adaptability to environmental changes. PGG include unaffiliated people with indifference or lack of understanding (particularly females) and convinced conservatives (particularly males of 50s), and

(c) MFG and PGG are different on the comprehension of mutual funds, or motivations to select financial goods.

	MFG	PGG
To know well or almost know mutual funds	24.4%	13.4%
To guarantee principals	25.8%	49.0%
To expect high returns	32.2%	10.7%

Figure 5 Asset Allocations of DC Plan Participants



Source: NPO Institute for DC Plan Investment Institute of Japan (2004)

4.3 DC Plan Related Services Providers

A lot of financial institutions and consulting firms are providing DC plan related services to employers or employees. Some are providing bundle services and some are providing services in boutique forms. Those service providers are

Records keeping institutions	:	5 institutions, and
Investment concerning institutions	:	676 institutions.

4.4 Cost

DC Plan Introductory cost is vary, ranging from 43,500 yen to 403 yen and 7,772 yen on the average per capita. Administration cost is also vary, ranging 6,000 yen to 100 yen and 1,062 yen on the average.

Those costs are highly dependent on the corporations scales.
Who are bearing costs is shown in Table 7. All costs are paid by corporations for investment education and investment concerning administration costs. Most of cost for investment fee and benefit payment are paid by employees.

Table 6 DC Plan Managing Cost (Yen, Per Capita)

	Average	**Maximum**	**Minimum**	**Median**
Plan Introductory Cost	7,772	43,500	403	5,952
Administration Cost (Monthly)	1,062	6,000	100	600

Source: Labor Policy Journal (2005)

Table 7 Cost Sharing (%)

	Employers	Employees
Investment Education	100.0	
Investment Concerning Ad.	100.0	
Record Keeping Ad.	98.6	1.4
Investment Fee	31.9	69.6
Benefit Payment	22.9	77.1

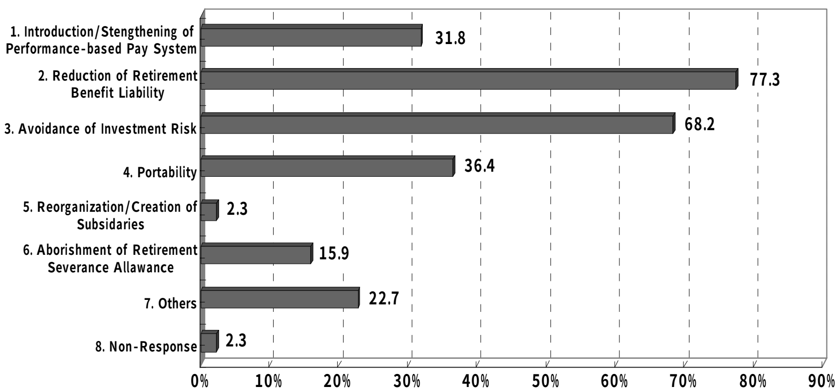
Source: Labor Policy Journal (2005)

4.5 Reasons Why Introduced DC Plans or Not

The Senior Plan Development Organization conducted the survey on the Progress and Future Direction of Retirement Benefit/Corporate Pension Plan Reforms during Nov. 25th – Dec. 26th , 2003 for 3,609 corporations and got responses from 317 corporations (Response rate is 8.8%).

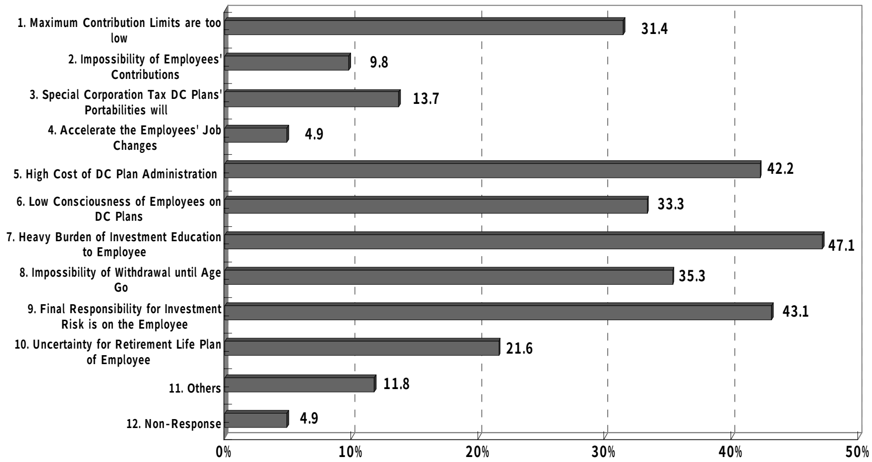
The major reasons for corporations to introduce DC Plans were "Reduction of retirement benefit liability" (77.3%), and "Avoidance of investment risks" (68.2%). On the other side, the major reasons why corporations did not introduce DC plans were "Heavy burden of investment education to employees" (47.1%), "Final responsibility for investment risk is on the employee" (43.1%), and "High cost of plan administration" (42.2%)

Figure 6. Reasons Why Corporations Introduced DC Plans



Source: Senior Plan Development Organization (2004)

Figure 7. Reasons Why Corporations Have Not Introduced DC Plans



Source: Senior Plan Development Organization (2004)

5 Current Situation of Investment Education for DC Plans

DC Plan participants usually have not experienced actual investment at the DC plan introduction. Therefore Main purpose for the initial education is to get the knowledge to be able to understand what the investment is, to allocate their assets by themselves, and to analyse the investment performance.

DC participants have experiences of actual investment after the plan started. Therefore continuous education is expected to give the more advanced and practical knowledge for investment by using actual performance data when necessary.

Several times of a few hours seminars in small groups are usually provided to DC Plan participants as initial investment educations, and educations using internet are provided as continuous educations in addition to seminar form educations.

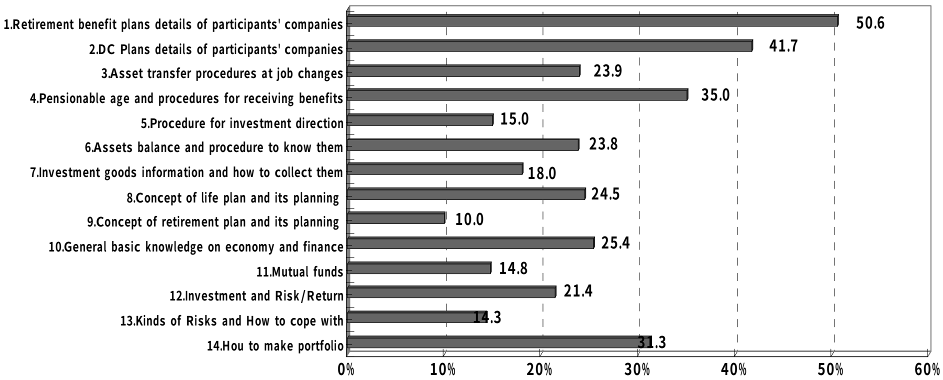
NPO Institute for DC Plan Investment Education Institute of Japan pointed the following features in their report presented at the 12th DC Plan Committee.

a. The most required information was basic one as " Retirement benefit plans details of participants' companies ",
b. Mutual Fund Group(MFG),which is investing more than 50% to mutual funds, requires information on practical investment,
c. Each age groups require different tools to get investment information,
d. Employees hope seminars in their working time, particularly half of 20s group do them,

e. About 80% participants want to participate in continuous education, and
f. High age groups of 40s and 50s require specific topics.

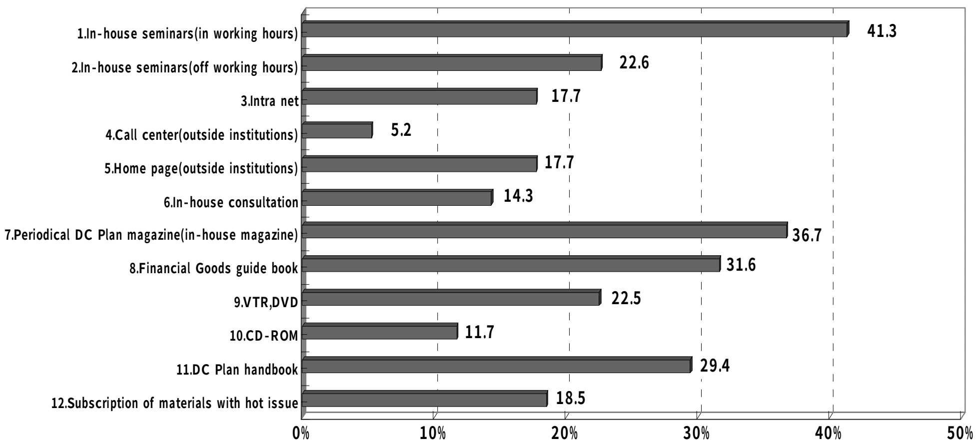
NPO Institute give the following suggestions to continuous education.
a. Motivation by age group will be necessary,
b. Practical education programme will be beneficial,
c. " Practice makes perfect " approach is important, and
d. To overcome " Risk to forget what people studied ".

Figure 8. Information Contents which DC Plan Participants would like to have



Source: NPO Institute for DC Plan Investment Institute of Japan (2004)

Figure 9. Tools at which DC Plan Participants would like to have information



Source: NPO Institute for DC Plan Investment Institute of Japan(2004)

6 Issues to Be Discussed for Popularization of DC Plans

The following points had been widely discussed to make DC Plans more useful in Japan.

a. Withdrawal is not allowed until age 60,

b. DC plan is self-help and self-responsible plan, so that sufficient invest education is necessary,

c. Special corporate tax should be abolished,

d. Maximum contribution limits should be increased, and

e. Smoothly transfer from other plans should become possible.

These issues have gradually been improved little by little, for examples,

a. Withdrawals become possible when the amount is less or equal to 500,000yen after Oct. 2005,

b. More continuous educations have become popular,

c. Special corporate tax is suspended until 2008, and

d. Maximum contribution limits have been increased since Oct. 2004, and

e. Transfer limit from other plans was abolished.

However, there still are issues to be discussed, which include

a. Maximum contribution limits are still low, particularly very low as compared with US 4-01(k) plans,

b. Withdrawals are not allowed for more than 500,000yen,

c. Matching contributions from employees are not allowed for corporate DC plans,

d. Investment educations were not enough at all.

Those issues mentioned above are almost related to asset accumulation process, but a big issue must not be missed on the decumulation (pay-out) process. That is whether the retired people will be able to have enough money to spend happy retirement lives. To solve the problem is particularly important because Japanese baby boomers born in 1947-49 (now aged 56-58) are now going to retire.

The problems are generated from two aspects. One of them is that employees prefer lump-sums to annuities and the other is that there are no good financial goods to transform accumulated assets to monthly cash flows. One solution is to buy pensions at market, but prices are not reasonable and markets are small.

We cannot deny the possibility for baby boomers to become “asset rich, and cash poor“. We have to look at lifetime annuity again and develop good vehicles to transform asset to monthly cash flow.

Bragg (2000) proposed an idea of “personal actuary“ to correspond to individuals’ new needs in the 21st century. He defined a personal actuary as " a personal actuary gives actuarial advise to or about individuals rather than corporations or big pension plans. He showed two examples of personal actuarial services in his article. The one was personal evaluation, in which the personal actuary provides reasonable estimate of client's health expectancy on the basis of his health history and age, sex and smoking status. The other one was personal risk management, in which the personal actuary determines the client's need for security plans of all kinds such as retirement income, property and life insurance, then use various product rating systems to evaluate and explain the security plans that are commercially available.

Some actuaries say that there is no actuarial work to do in the DC field. But DC plans will become a new practice area for actuarial profession if we think about the " personal actuary ".

7 Conclusion

The Japanese DC Plan System was introduced as one of corporate pensions reforms in 2001. It reached 1.2 million of participants, and 1 trillion yen of assets.

Some people say that Japanese DC pans have not succeeded because it has not been so popularlized as expected at the introduction. However its judgement is too early because the corporate pension reform is still on the process.

What the important is to generate ideas how to make DC Plans more useful for peoples' retirement incomes. From this point of view, to solve the issue at the decumulatuion process is very important in addition to issues pointed so far on the accumulation process. Current system is not fully equipped on the conversion from asset to monthly cash flow, and financial goods are not enough either in Japan.

Japanese baby boomers are now getting to retire, so that this issue should be solved as soon as possible. Actuaries can contribute to solve the problem to become more interested in personal finance.

References

[1] Bragg, John M.(2000),Getting Personal: A New Kind of Actuary for the Coming Millennium, American Academy of Actuaries: Contingencies Magazine March/April 2000 (http://www.contingencies.org/marapr00/)

[2] Labor Policy Journal vol.3651(in Japanese)

[3] Ministry of Health,Labor and welfare,Chapter 9
Overview of the Corporate Pension in Textbook for the Study Programme for the Asian Social Insurance Administers
(http://www.mhlw.go.jp/english/org/policy/dl/p36-37d7.pdf)

[4] Nakada, T (2004), Recent Corporate Pensions Reform and its Consequences in Japan , Presented to the PBSS Program Part of the IACA, PBSS & IAAust Colloquium

[5] NPO Institute for DC Plan Investment Institute of Japan(2004), Report on the communications and investments to the DC plan, Presented at the 12th DC Plan Committee, Ministry of Health, Labor and Welfare(in Japanese)

[6] Research Institute for Policies on Aging(2002),Corporate Pension System –DC/DB Plan– in Japan

[7] The Japanese Society of Certified Pension Actuaries (2004), Corporate Pension Plans in Japan

[8] Tsubono, T (2005), New Corporate Pension Plans 2nd ed, Nihon Keizai Shinbunsha, Tokyo (in Japanese)

TADASHI NAKADA: Vice Chairman of The Advisory Council, Nikko Financial Intelligence Inc.
Tokyo, Japan

---

[1] Latest statistics available are ;

Amount of contributions(yen/annual) (agreement) As of 30 Nov. 2004

	Corp. with Less Than 300 Employees	**Corp. with More Than 300 Employees**	**Total**
Average*	160,090	165,270	162,630
Average of max*	236,660	273,810	254,930
Average of min*	83,510	56,810	70,380
Max	552,000	552,000	552,000
Min	2,000	1,200	1,200

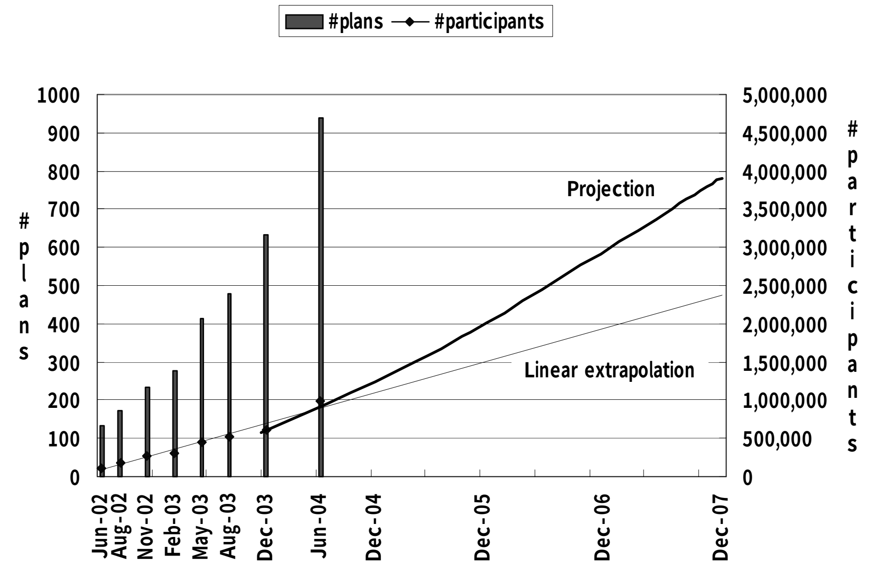
*: Non-weighted
Source: Ministry oh Health, Labor and Welfare

[2] Amount of assets(Entrusted to trust banks only) 100 million yen

	Mar.2002	**Sep.2002**	**Mar.2003**	**Sep.2003**	**Mar.2004**	**Sep.2004**
Total	176	551	1464	3575	5246	8755
Deposit	55(33%)	231(46%)	638(48%)	1819(54%)	2814(54%)	4445(51%)
Insurance	15(9%)	36(7%)	164(12%)	535(16%)	854(17%)	1518(18%)
Trust	4(2%)	8(2 %)	13 (1%)	20(1%)	31(1%)	126(2%)
VS*	93(56%)	222(45%)	505(38%)	995(30%)	1479(29%)	2575(30%)
Others	10	54	144	206	69	92

*Valuable Securities
Source: Pension Information, submitted to DC Plan Meeting, MHLW

[3] Projection for Number of Participants in Corporate DC Plans



source: Nikko Financial Intelligence