"New Movements in the Japanese Corporate Pension System"

Tooru Shimada, Satoshi Sugita,Tadanori Chiba, Jumpei Saino

Japan

Summary

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This report will introduce the contents of these laws and examine the future direction of the corporate pension plans in Japan.

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Introduction

In 2001, two laws concerning corporate pension plans, i.e., the defined benefit corporate pension plan law and the defined contribution corporate pension plan law, were introduced in Japan. The former, the law concerning defined benefit corporate pension plan, aims to establish a unified treatment system for the purpose of protecting beneficiary rights of the defined benefit corporate pension plan. The latter, the law concerning defined contribution corporate pension plan, indicates a treatment system for defined contribution corporate pension plan, which has not been regulated by laws in Japan. Both of the laws contain provisions that could fundamentally reform the existing corporate pension plans, and therefore could have serious impact on the meaning of Japanese corporate pension plans in the future.

This report will introduce the contents of these laws and examine the future direction of the corporate pension plans in Japan.

Chapter I Changes of the Environment Surrounding Corporate Pension Plan

At present, there are two representative corporate pension plans that Japanese companies are implementing, i.e., a defined benefit-type employees' pension fund plan and tax-qualified pension plan. Under these plans, companies can be given a tax break (contributions are treated as losses), and in the case of employees' pension fund plan, the company pays a part of benefit of public pension plan on behalf of the government, in addition to the benefit designed by the company on it's own terms.

Many Japanese companies are providing one of the above-mentioned corporate pension plans. Recently, the environment surrounding corporate pension plan is changing, e.g., prolonged slump in corporate earnings, deterioration in the investment environment, corporate restructuring such as merger and spin-off of business and the introduction of an accounting standard for retirement allowance based on the international accounting standard. These have caused an increase in running costs for corporate pension plans, and have become major factors in suppressed corporate earnings.

(1) Deteriorated Investment Environment

Under the corporate pension plan, the pension plan fund will manage the contributions paid by the company periodically, pays by investing in markets, and increase pension assets in order to pay pension to retirees. The contribution rate, which is a basis for contributions, is calculated based on the various preconditions (rate of mortality, retirement rate, salary increase rate, investment yields on pension assets (discount rate), etc.) lest payments of pensions should stop in the future. In Japan, many companies have set the discount rate for calculation of contribution rate at 5.5% per annum since corporate pension plans were introduced.

Table 1 indicates the investment yields on pension assets of the employees' pension fund over the past six years, and changes of the investment yields on pension assets of the tax-qualified pension plan are almost the same as the former. The performance in fiscal 1999 substantially exceeded that of fiscal 1998 because prices of domestic shares, which accounted for about 40% of the total portfolio assets, soared although foreign bonds weakened due to appreciation in the yen. In fiscal 2000, however, investment yields exceeded minus 10% due to the sluggish stock market, and are expected to post the worst yields since the corporate pension plan started in Japan. As a result, shortage in funds will take place due to the deviation between expected and actual investment yields, and many companies may substantially raise the contribution rate in and after fiscal 2001 one after another.

(Table 1) Changes in investment returns of employee's pension plan

Fiscal year	1994	1995	1996	1997	1998	1999
Investment returns	0.74	10.27	3.65	5.65	2.56	13.04

- Results of a survey by the Employee's Pension Fund Association
- Surveyed on 1,830 funds
- Fiscal year means from April 1 to March 31 next year.

(2) The Introduction of a New Accounting Standard for Retirement Benefit

From fiscal 2000 on, accounting standard for retirement benefit, based on the International Accounting standards, was introduced. Under the old accounting standards, shortage of funds for the corporate pension plan was not necessary to be entered in financial statements as liabilities, but it must be entered under the new accounting standards. As mentioned above, many companies are setting the discount rate at 5.5% for calculating the contribution rate of the corporate pension. Nonetheless, the discount rate to be used for calculating liabilities based on the new accounting standards must be set on the basis of gross yields on safe long-term bonds such as government bonds. Presently, many companies are setting the discount rate at 2.5% to 3.0%. Under the corporate pension plan, companies had set funding schedule for pension assets based on the liabilities calculated employing a discount rate of 5.5% per annum. In the corporate accounting, however, fund shortage must be calculated on the basis of liabilities calculated by a discount rate of 5.5% per annum or lower. Following the above change in accounting standards, therefore, companies are obliged to enter enormous fund shortage in their financial statements as liabilities.

Chapter II Impact Caused by the Introduction of the Defined Benefit Corporate Pension Plan Law

1. Purpose of the Introduction of the Defined Benefit Corporate Pension Plan Law

Companies have become concerned about an increase in costs necessary for the adoption of the corporate pension plan. They are taking measures, including personnel cuts, cut in benefits payable by the corporate pension plan and abolition of the corporate pension plan to secure the life of employee after retirement, thus it might decline in the future.

(Table 2) Number of dissolved employee's pension plans

Fiscal year	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Number of plans dissolved	0	0	0	1	1	7	14	18	16	29
Number of new plans established	120	143	69	45	38	15	5	4	0	1
Total	1593	1735	1804	1842	1878	1883	1874	1858	1835	1801

(Table 3) Number of employee's pension plans that implemented a cut in benefits

Fiscal year	1997	1998	1999	2000
Number of plans dissolved	7	16	52	177

(Note) Reduction in benefits of employee's pension plan was approved from fiscal 1997.

Under this background, the defined benefit corporate pension plan law was mapped out under the philosophy of 'based on a unified framework, to enhance necessary systems for a defined benefit corporate pension plan from a viewpoint of protecting participants' rights while respecting independence of labor and management.'

The six purposes for the establishment of the law concerning a defined benefit corporate pension plan are as follows:

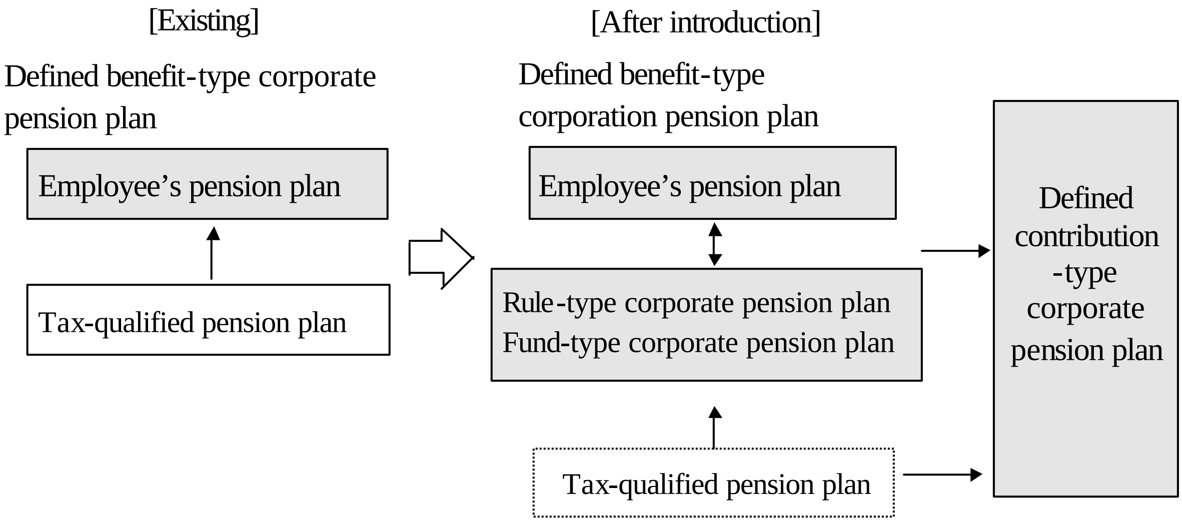
(1) Promoting the protection of participants' rights.
(2) Consolidating systems into a unified one while respecting independence of labor and management.
(3) Introducing a new type corporate pension plan.
(4) Establishing common rules of the corporate pension plan.
(5) Establishing rules on switching between different corporate pension plans.
(6) Establishing rules on funding standards, fiduciary responsibility, information disclosure, etc. for protecting participants' rights.

2. Corporate Pension Plan after the Introduction of the Defined Benefit Corporate Pension Plan Law

(1) Corporate Pension Plan after the Introduction of the Defined Benefit Corporate Pension Plan Law

Presently, Japanese representative corporate pension plans include an employees' pension fund plan and tax-qualified retirement pension plan. Under the law concerning defined benefit corporate pension plan, rule-type corporate pension plan and fund-type corporate pension plan will be newly introduced, and the tax-qualified retirement pension plan is to be abolished after an interim measure period of 10 years. Therefore, defined benefit-type corporate pension plans eventually include three types, employees' pension fund plan, rule-type corporate pension plan and fund-type corporate pension plan.

(Chart 1) Corporate pension plan after the introduction of the defined benefit plan law and the defined contribution corporate pension law



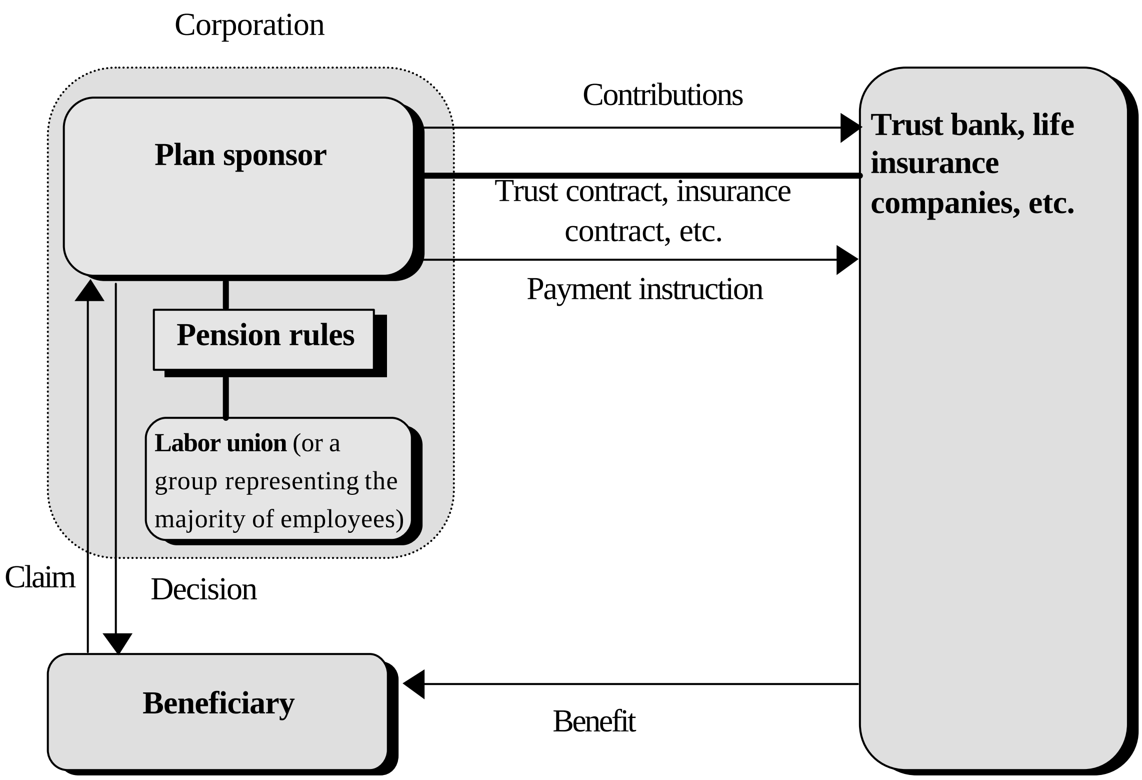
(Note) (→) means that the type of corporate pension plan can be changed.
Tax qualified pension plan will be discontinued after a 10-year transient period.

The law concerning defined benefit corporate pension plan provides that switching between employees' pension fund plan, rule-type corporate pension plan and fund-type corporate pension plan is possible. Changing to a defined contribution corporate pension plan, which is to be newly handled, will also be possible.

(2) Rule-Type Corporate Pension Plan

Under the rule-type corporate pension plan, the company concludes agreement with asset management companies such as trust banks, life-insurance companies and investment advisory companies. It is a corporate pension plan, where pension assets are legally separated from the company, managed, invested, and pension benefits are paid out according to pension rules to be mutually agreed by both labor and management. The scheme is similar to that of the current tax-qualified retirement pension plan.

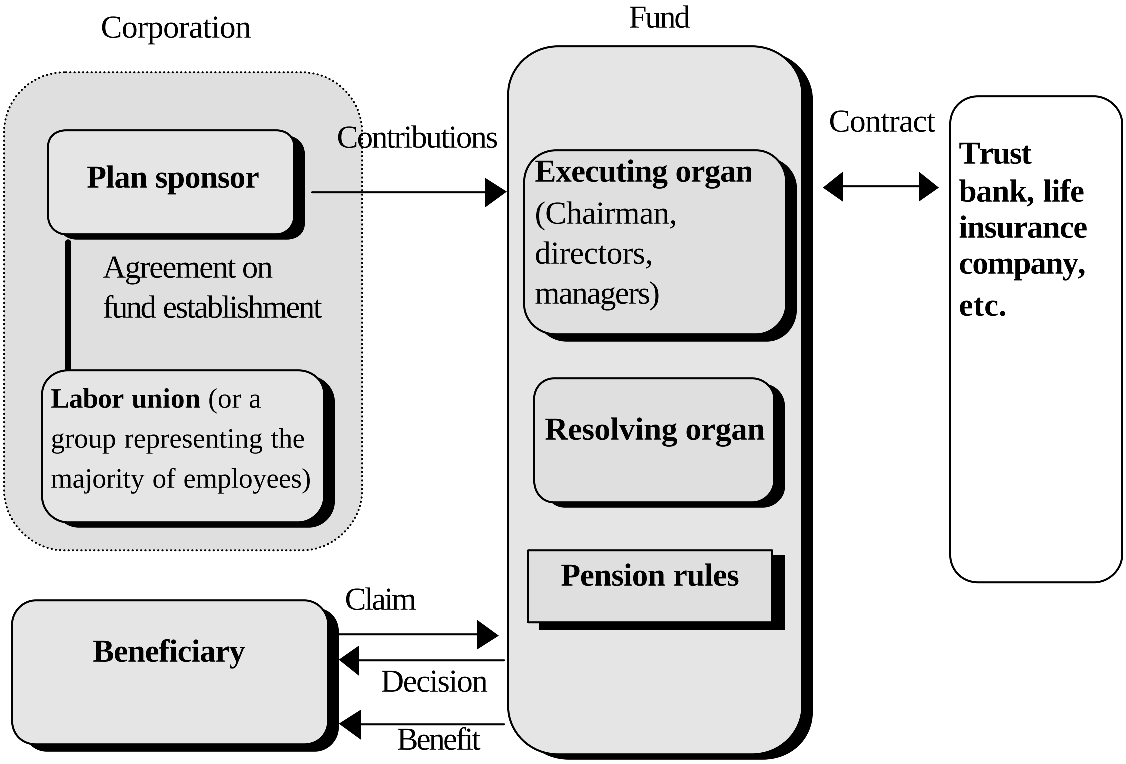
(Chart 2) Scheme of rule-type corporate pension plan



(3) Fund-Type Corporate Pension Plan

A fund-type corporate pension plan is a corporate pension plan, whereby a fund with a different corporate status from the company is set up and will conclude a contract with asset management companies, and pension assets will be managed under the name of the fund and the fund will pay out pension benefits. The scheme is similar to that of the existing employees' pension fund plan. But the difference is that it does not pay a part of the public pension plan on behalf of the state. It can be said that pension assets' independence from the company is strongly maintained as compared with the case of the rule-type because the fund, having a different corporate status from the company, is set up. Therefore, the fund is permitted to manage its' pension assets.

(Chart 3) Scheme of fund-type corporate pension plan



3. Enhancement of the Protection of Participants' Rights

One of the purposes of the establishment of the defined benefit corporate pension plan law is to promote the protection of participants' rights. As the concrete contents for it, the law concerning defined benefit corporate pension provides three points, including funding obligation, clarification of fiduciary responsibility and information disclosure. These are familiar for those companies that are adopting an employees' pension fund plan, but new for those companies that are providing a tax-qualified retirement pension plan. The defined benefit corporate pension plan law mainly purposes to promote a shift from the tax-qualified pension plan in which treatment of the protection of participants' rights is insufficient, to a new-type corporate pension plan, which promotes the protection of participants' rights, by introducing various measures such as actuarial valuation.

(1) Funding Obligation

Companies must review the contribution rate necessary for running a corporate pension plan at least every five years in accordance with the real situation changes. Apart from this, they need to examine reviewing the contribution rate after studying if the amount of pension assets are exceeding both the actuarial reserve and the amount of minimum funding standard.

Actuarial reserve is calculated by deducting the current value of contribution revenue from the current value of expenses necessary for future benefits. The minimum amount for funding standard means the current value of expenses necessary for the benefits for the corresponding participating period until the end of the business year.

The comparison between pension assets and actuarial reserve is called actuarial valuation of continuance standard. It is the standard for examining how to set the level of contribution in order to maintain the corporate pension plan on the premise that it will continue in the future. If investment yields on pension assets lower due to sluggish share prices like these days, shortage in funds will expand. Therefore, companies will have to review the contribution rate on the basis of this standard, and they will have to raise the rate accordingly. In case the company's corporate pension plan has a long history and large amount of assets, it will be often required to raise the contribution rate according to the standard.

Meantime, the comparison between the amount of pension assets and the minimum amount for funding standard is called actuarial valuation of discontinuance standard. It is the standard for examining whether the employee's rights to receive pensions are secured if the corporate pension plan were terminated as of now. Shortage in funds necessary for pension payments must be funded in a short time period. If it is not so long since the company started providing a corporate pension plan and the amount of pension assets is small, the company is often required to raise the contribution rate according to the standard.

However, the sluggishness of the stock market has continued so long that many corporate pension plans will infringe these standards regardless of the length of the history of corporate pension plans. Actuarial valuations of continuance standard and discontinuance standard have been introduced to employees' pension plans since fiscal 1998. Many employees' pension plans are likely to be forced to raise the contribution rate in fiscal 2000 due to poor performance of asset management. Consequently, some of the companies that are providing an employees' pension plan are asking the Ministry of Health, Labor and Welfare to relax the standards for actuarial valuation, for the purpose of protection of beneficiary rights.

The introduction of actuarial valuations of continuance and discontinuance standards is inevitable for the protection of beneficiary rights of the corporate pension plan. However, if it is required, to strictly observe the rule corporate pension plan itself cannot be maintained. It is necessary to discuss in depth how to set a level for actuarial valuations of continuance and discontinuance standards.

(2) Clarification of Fiduciary Responsibility

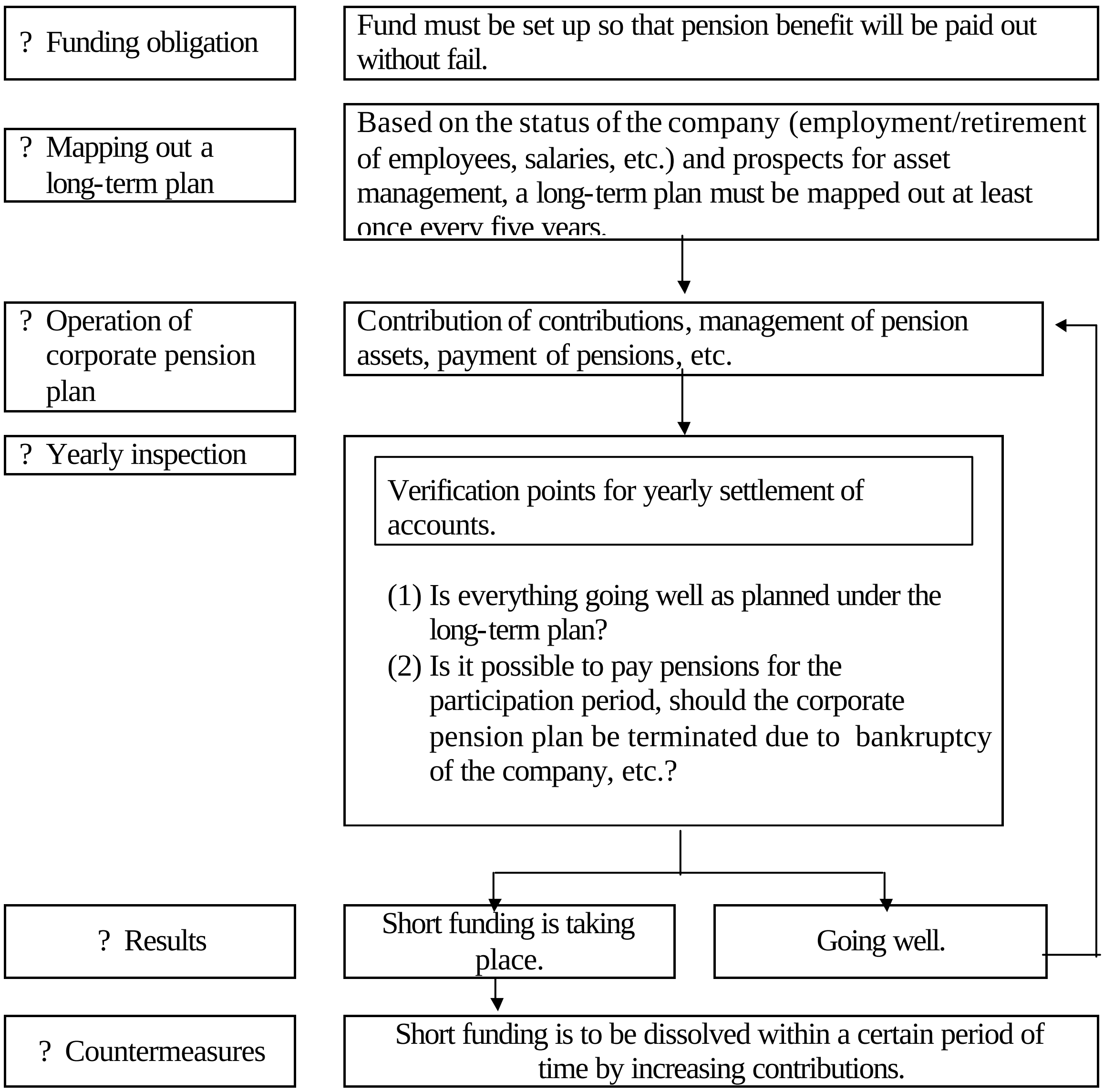
Even if pension assets are funded as scheduled, beneficiary rights might be infringed unless management/running of the plan are properly carried out. Under the law concerning defined benefit corporate pension, act bylaws for fiduciary responsibility of plan sponsors, directors and asset management institutions are set.

The act of concluding a contract on asset management for the purpose for gaining profit for the third-party is prohibited.

(3) Information Disclosure

Even if a system, where funding obligation and fiduciary responsibility are required, is introduced, those concerned in the corporate pension plan themselves must closely watch the status of management of the corporate pension plan with an awareness of the issues in order to implement them without fail. The law concerning defined benefit corporate pension provides that employees must be well informed of the contents of pension rules, and information on general situations such as financial status of the company must be disclosed to them.

(Chart 4) System for establishing a pension assets fund



4. Taxation

The existing Japanese taxation system on corporate pension plans is applicable to the following three stages, i.e., at the time of contribution of contributions, at the time of managing pension assets and at the time of pension payment.

At the time of contributing contributions, all of the contributions to be born by the plan sponsor are entered in the loss account (necessary expenses) and exempted from taxes. At the time of managing pension assets, special corporation tax of 1.173% per annum is imposed on pension assets. At the time of paying a pension, income tax is imposed on part of the pension amount paid to the beneficiary, but it is virtually tax-exempt due to a tax break.

Contributions the company contributed are considered to be salaries for employees. Imposing income tax on the salaries is postponed to the time of payments of pensions. Interests on that part of funds are collected as special corporate tax that is imposed at the time of managing pension assets. Because an employees' pension fund plan is substituting a part of the public pension plan, it is exempt from tax, in principle. As for the tax qualified retirement pension plan, taxation has been frozen since 1999 in consideration of the recent poor corporate earnings results.

As far as the corporate pension plan to be newly introduced under the law concerning the defined benefit corporate pension plan, the government was considering not to impose tax on pension assets at the beginning in order to encourage a shift from the tax-qualified retirement pension plan, where the protection of participants' rights was insufficient, but it was eventually decided to impose tax.

Following the introduction of the law concerning the defined benefit corporate pension plan and the law concerning the defined contribution corporate pension plan, both the Japan Federation of Employers' Associations, the representative of plan sponsors, and the Japanese Trade Union Confederation, the representative of labor unions, have been asserting that fundamental review on pension taxation is necessary. The point of their assertions is that tax imposed on pension assets should be abolished and tax should be imposed only at the time of paying a benefit. The reason for requiring the abolishment of tax imposed on pension assets is it is necessary to enhance the corporate pension plan by companies' own efforts under the circumstances where benefits from public pensions are to be reduced in the future and the role of the corporate pension plan is regarded important in terms of securing life after retirement. The reason for imposing tax at the time of pension payments is based on the following: in the income taxation system, pension beneficiaries are treated more favorably as compared with the employment income group, and because pension beneficiaries are to have income when they receive pensions, it is natural to impose income tax on them at this point.

The direction of issue in the future is that taxes at times of contribution and management be abolished and tax at the time of pension payment be imposed. Reviewal is being made accordingly however, it depends on policies relating to social security, political and economic situations, so the point in the future is how to proceed discussions.

Many in charge of the corporate pension plan reviewal are of the opinion that: "Unless the direction of taxation is settled, we are unable to start a reviewal on the corporate pension plan in earnest."

5. How to Deal with the Return of Obligation to Pay a Part of Public Pensions in the Employees' Pension Plan

(1) The Reason Why Companies Think that Adoption of Employees' Pension Plan is Disadvantageous

One of the purposes of establishing the law concerning the defined benefit corporate pension plan is to allow an employees' pension fund to return its' obligation to the state to pay public pensions on behalf of the government.

As already mentioned, many employees' pension funds are being dissolved one after another recently. One of the features of the employees' pension plan lies in the fact that they pay part of the benefits of public pension plans on behalf of the state in addition to benefits they designed. This is the reason why companies regard the implementation of the employees' pension plan as being a demerit.

The employees' pension fund pays part of the benefits of the public pension plan on behalf of the state. Contributions companies owe to the state are paid to the employees' pension fund instead. Therefore, the scale of pension assets the employees' pension fund may hold become larger as compared with that of the tax-qualified pension plan. Due to a prolonged sluggish management environment, the scale of fund shortage has expanded, and companies are forced to raise contributions many times due to the arrangement made for protecting participants' rights, which is required in managing the employees' pension plan.

In the accounting standard relating to retirement benefit introduced from fiscal 2000, it is understood that the part of public pensions the employees' pension plan pays out on behalf of the state is deemed as the company's liabilities. As a result, whether the company is providing an employees' pension plan or not will affect corporate operating results.

Also, an employees' pension plan is influenced by the system revision to be carried out by the public pension plan every five years. Even if companies have set up a retirement benefit plan based on their long-term management strategies, the employees' pension plan may be changed due to the system revision of the state regardless of the intention of companies. For instance, many companies had introduced the employees' pension plan since the establishment of the plan in 1966 due to the feature of system, where companies could run the plan by lower costs than paying contributions to the state. However, the system was revised, and the merit companies receive has diminished. While the authorities created systems causing profit or loss, they changed them halfway. Companies think that problems lie in the attitude of government where they created systems generating profit or loss, and then changed them half way.

(2) Method of Calculating Amount to be Returned to the State

With the shift of an employees' pension plan a corporate pension plan, which has been newly introduced under the law concerning the defined benefit corporate pension plan, the return of the paying obligation of public pensions, which was being undertaken by the employees' pension fund on behalf of the state, will be materialized. In this case, a part of pension assets is to be returned to the state, following the return of the paying obligation of public pensions. It is assumed that the amount to be returned to the state should be calculated as the current value of the amount necessary for the eventual payment of public pensions, which is undertaken by the employees' pension fund on behalf of the state. In this case, setting the discount rate is an important factor. The employees' pension plan has been required since its establishment to always secure a certain amount, corresponding to the current value of the amount necessary for paying public pensions calculated on the basis of a discount rate of 5.5% per annum. The government, however, lowered the discount rate, which is used for calculating the contribution rate necessary for managing the public pension plan, from 5.5% to 4%. Therefore, the discount rate applicable for calculating the amount of pension assets to be transferred to the state as a result of the return of payment obligation, is expected to become lower than 5.5%. In this case, the company will have to transfer to the state a larger amount than reserves for the employees' pension plan to the state. Consequently, it may be necessary for the employees' pension plan to substantially raise the contribution rate after returning the payment obligation for public pensions.

(3) Method of Return

In returning the obligation to pay public pensions, it is made by paying money in principle to returning a part of pension assets to the state. It is made also by returning physical securities. However in selecting of issues it is required to select the name of which index-linked investment is possible so that management of the public pension plan is not affected. Specifically speaking, in the case of returning by shares, they may be returned as composition of issues, which is linked to the Nikkei stock average and the Topix.

(4) Schedules until Return and Transitional Measure

At present, the Ministry of Health, Labor and Welfare intend to implement the return of substitutional benefit from the autumn of 2003, and is going to set a grace period of two years or longer because it is necessary to enhance the Social Insurance Agency's system for processing administrative jobs. Data of participants are managed by the agency. Meanwhile, until the time before return is implemented, a transitional measure is set to allow the employees' pension fund to stop paying part of the public pension funds on behalf of the state as from the date after obtaining approval from the Minister of Health, Labor and Welfare.

6. Payment Guaranty Scheme

Under the existing employees' pension plan, if there is a shortage in funds when the employees' pension plan is terminated due to the bankruptcy of the company and others, the shortage is to be compensated by contributions from the other employees' pension funds.

Payment guaranty activities of employees' pension plans have been introduced since 1989, and it has been run as a mutual aid project, in which all of the employees' pension plans shall participate. The problem lies in the fact that the coverage of amount guaranteed is extremely small. Despite this, contributions were raised from fiscal 1997 to about four times those of before because the number of those employees' pension plans that dissolved due to prolonged sluggishness of corporate earnings. As a result, unpleasant feelings about this system have been left among participating companies. The payment guaranty activities of the existing employees' pension plan cover additional portion of pensions companies set up respectively with the maximum amount set at 30% of the amount of the public pension. An additional portion of the pension amount set by companies respectively however has to be 30% or more of the public pension amount. Many funds do not have a shortage in funds if the level is equivalent to 30% of public pensions although short funding is taking place according to the level set by the pension rules. Therefore, even if the employees' pension plan has been dissolved, it is, in many cases, not covered by the payment guaranty activities, and many employees' pension funds think that it is no use to participate in the system. At the time when the plan was introduced, the coverage of the guaranty amount was set at 30% of the public pension amount based on the following reasons:

(1) Japan is not in a climate where corporate pension plans provided by failed companies, receive assistance from other companies.
(2) The guaranty level of up to about 30% of the public pension amount is so low that few companies are likely to dissolve their employees' pension funds anticipating cover by the payment guaranty activities.
(3) If the coverage is expanded, the financial status of an employees' pension fund and the company have to be checked and the contributions rate also has to be set accordingly.

In establishing the law concerning the defined benefit pension, introducing a similar scheme as the payment guaranty activities of employees' pension plan was examined. Reflecting the intention of the economic circle, however, the introduction of the scheme was postponed this time. From a viewpoint of promoting the protection of participants' rights of the participants of corporate pension plans and beneficiaries, however, those concerned have decided to continue examining the possibility of introduction while paying attention to avoid morale hazards and others.

(Table 4) Comparison of Defined benefit-type corporate pension plans

	Employee's pension plan	Defined benefit corporate pension plan (Fund-type, rule-type)	Tax-qualified pension plan
Condition on the number of persons	500 persons or more in principle.	Fund-type: Number of persons required by law Rule-type: None	None
Qualifications	Supplementary portion - Pension plan: Essential for those who have been participating for 20 years or more. - Lump Sum payment: Essential for those who have been participating for 3 years or more. Substitutional benefit - Pension plan: Participating one month or longer	- Pension plan: Essential for those who have been participating for 20 years or more. - Lump Sum payment: Essential for those who have been participating 3 years or more.	Not allowed to pay pension to those who leave the company prior to retirement age. (It is possible to provide a system, where pension will be paid to only those who retire from the company due to the age limit.)
Types of benefit	Retirement benefits Pension or lump sum Survivors benefits Pension or lump sum Disability benefits Pension or lump sum	Retirement benefits Pension or lump sum Survivors benefits Pension or lump sum Disability benefits Pension or lump sum	Retirement benefits Pension or lump sum Survivors benefits Pension or lump sum
Pension benefit	Payment period: Lifetime in principle Start of payment: 60 years of age at the latest	Payment period: 5 years or more Start of payment: At a time of reaching a certain age in the range between over 50 years old and less than 65 years old.	Payment period: 5 years or more Start of payment: Not while young (Not allowed for 40 year olds or younger)
Level of benefit	Additional benefit of 30% or more of substitutional benefit	No specific standard	No specific standard
Actuarial valuation	Re-calculation Every 5 years Settlement of accounts - Securing actuarial reserve - Securing minimum reserve	Re-calculation At least every 5 years Settlement of accounts - Securing actuarial reserve - Securing minimum reserve	Re-calculation At least every 5 years Settlement of accounts There is no provision for securing actuarial reserve
Payment Guaranty Scheme	Providing	Under study	None
Fiduciary responsibility	There are provisions.	There are provisions.	There is no specific provision.
Information disclosure	Necessary to disclose financial statements, etc. to participants.	Necessary to disclose business outlook relating to corporate pensions.	There is no clear provision.

Chapter III Effects Caused by the Law Concerning Defined Contributions Pension

1. Background of the Establishment of the Law Concerning Defined Contribution Pension

At present, the main corporate pension plans that Japanese companies are providing include the defined benefit-type employees' pension plan and tax-qualified retirement pension. From 2001, a defined contribution pension plan is to be introduced. A desire to introduce a defined contribution pension plan has been growing among those concerned since around 1996. It took nearly six years before the establishment of the law concerning a defined contribution pension, the background of which is as follows.

(1) Introduction of a Defined Benefit Corporate Pension Plan Financed by the Existing Retirement Lump Sum System

In introducing a defined benefit corporate pension plan in the first-half of the 1960s, the authorities decided to admit contributions companies contribute under the corporate pension plan as losses (necessary expenses) if certain conditions are satisfied. Following this, the defined benefit corporate pension plan has spread among companies centered on major firms.

Until then, companies were generally paying retirement benefits as a lump sum but not pension to retired employees. Companies designed a defined benefit corporate pension plan to be financed by a part of the retirement lump sum. Therefore, many major companies are providing both a retirement lump sum system and defined benefit corporate pension plan as their retirement benefit system.

(2) Feature of Japanese Retirement Benefit System

As a feature of the Japanese retirement benefit system, it is pointed out that few plans are designed on the precondition of employees' mobility.

Lifetime employment and long-term service have been commonly seen in Japan so far. Therefore, the level of retirement benefit, in many cases, is set lower when years of service are short, and extremely higher when years of service are long. Consequently, if the employee repeatedly changes job after working for a short period of time, the total retirement benefit they receive in their lifetime will become extremely small.

Meantime, the defined benefit corporate pension plan has not well spread among small and midsize companies as compared with major firms. In many cases, they are not providing even a system to pay out a lump sum.

(3) Changes of Environment Surrounding Employees

Against the backdrop of younger generations' weakened sense of belonging to the company, and the recent changes of employment practices due to severe international competition and a change in industrial structure, the mobility of employment is accelerated. As mentioned earlier, major companies were usually hiring employees on the precondition of lifetime employment and long-term service. Recently, however, the number of cases where they hire employees midway through the year and actively transfer employees to other companies increase.

Also, the system of wages payable to employees is changing from one based on the precondition of long-term service to the merit system. Some companies are introducing new systems, e.g., 'advance payment of retirement benefit,' which reduces the amount of retirement allowance but adds it to salaries instead.

(4) The Collapse of a Bubble Economy and the Introduction of a New Accounting Standard

The collapse of a bubble economy in Japan in the 1990s has resulted in a sharp fall in share prices and the Bank of Japan's super-low-interest-rate policy. As a result, the defined benefit corporate pension plan sees new short funding every year and companies are forced to bear increasing contributions repeatedly.

A new accounting standard started to be introduced from April 2000. If the company is providing a defined benefit-type retirement benefit plan, they are now required to enter a shortage in funds calculated on the basis of projected benefit obligation, in their financial statements as liabilities. In calculating the contribution rate in a corporate pension plan, most companies had been adopting the discount rate of 5.5% per annum. Under the new standard, however, the discount rate used for calculating projected benefit obligation is required to set on the basis of the yield on long-term bonds with high credibility. Consequently, companies had to adopt a discount rate, which is much lower than 5.5% per annum, and enter enormous amounts of short funding as liabilities.

(Table 5) Economic environment in Japan

	Official discount rate	10-year government bonds	TOPIX
FY 1986	4.00%	5.486%	1265.93
FY 1987	2.50%	4.874%	1871.19
FY 1988	2.50%	4.965%	2147.90
FY 1989	2.50%	5.011%	2469.15
FY 1990	5.25%	6.746%	2227.48
FY 1991	6.00%	6.316%	1970.73
FY 1992	4.50%	5.266%	1418.52
FY 1993	2.50%	4.288%	1431.87
FY 1994	1.75%	4.219%	1563.21
FY 1995	1.75%	3.473%	1307.89
FY 1996	0.50%	3.132%	1636.88
FY 1997	0.50%	2.364%	1373.26
FY 1998	0.50%	1.518%	1251.70
FY 1999	0.50%	1.732%	1267.22
FY 2000	0.50%	1.710%	1705.94

* Official discount rates and prices of the TOPIX are those as of the end of March.
The yield on 10-year Japanese government bonds is the average yield to subscribers of JGBs issued in the year.

(5) Issues of Defined Benefit-type Retirement Benefit Plan

Issues of the defined benefit-type retirement benefit plan in Japan can be itemized as follows:

1) Because the benefit level is set on the precondition of long-term continuous service, the employee will be disadvantaged if he/she changes employment after working for a short time period.

2) Individual's share of pension assets is not clear, and the portability of pension assets at the time of changing employment is insufficient.
3) Employees do not get used to new retirement benefit plans such as advance-payment system for retirement allowance.
4) When the company is providing a defined benefit corporate pension plan, it will have to take investment risk, which would lead to deterioration in corporate earnings, if the economic environment deteriorates.

In order to avoid these issues, which stem from the implementation of a defined benefit-type retirement benefit plan, calls for requiring to arrange laws for the purpose of promoting the introduction of a defined contribution pension plan had been mounting from both management and labor.

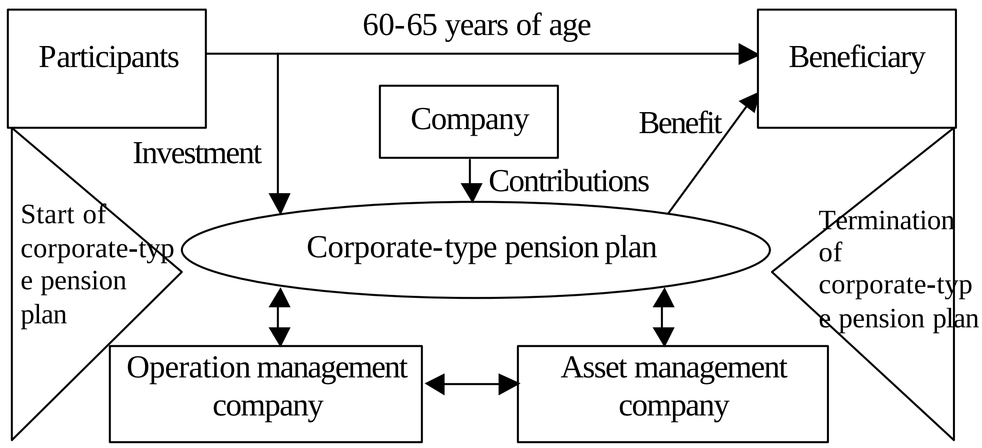
Some Japanese economists and mass communications reported: "The booming stock market in the United States is attributable to the spread of the defined contribution pension plan. Pension assets of the defined benefit corporate pension plan are in the status of over funding." Consequently, those concerned have been asserting that Japan should promote the introduction of a defined contribution pension plan.

2. Mechanism of Defined Contribution Plan

There are two types of defined contribution plan: corporate pension which is introduced by corporations for participation by employees, and personal pension introduced by the Federation of National Pension Funds for participation by individuals. For both of these types, the maximum amount of contribution is specified according to the corporate pension plan and contributions are managed by participants on their own responsibility. The mechanism of corporate pension and personal pension as well as the relevant tax system (maximum amount of contribution) are described below.

(1) Corporate pension

(Chart 5) Scheme of corporate-type pension plan



Under the defined contribution plan for corporate pension, each corporation makes rules and pays contributions. The participants (employees) manage the contributions on their own responsibility and, when they reach the age specified by the rules, begin to receive benefits. The mechanism is illustrated in Fig. 5. Fig. 5 will be briefly explained below, followed by an explanation of the key points of the corporate pension.

In starting a corporate pension plan, the plan sponsor makes rules with the approval of a majority of employees. The rules must be submitted to the Health, Labor & Welfare Ministry to be authorized. The rules specify matters concerning the plan sponsor, administrative management organizations, asset management organizations, eligibility for participation, methods of calculating contributions, methods of managing contributions, the amount of benefits, etc. When a corporate pension is launched, the plan sponsor pays contributions which are then managed by participants. When participants reach the age of 60, they can claim payment of benefits. Benefits are to be received in the form of annuities as a rule, but may be received in a lump sum in cases specified by the rules. When a corporate pension plan is to be closed, the plan sponsor must obtain the approval of a majority of employees and an authorization by the Health, Labor & Welfare Minister.

1) Eligibility for participation

If the plan sponsor is to allow participation of only eligible employees, eligibility for participation must be specified in the rules. Such eligibility should not be unduly discriminating against specific persons. For example, eligibility based on the type of job or the number of years of service are not considered as discriminatory but that based on age is considered as discriminatory.

2) Contribution

In a corporate pension plan, the plan sponsor pays contributions. There is no system such as the one in which contributions paid by participants are complemented by contributions paid by the plan sponsor. The amount of contribution to be paid may be a fixed amount, a certain percentage of salary, or a fixed amount plus a certain percentage of salary. Determining the amount of contribution according to the participant’s age is not considered reasonable and is not permitted.

3) Administrative management

Administrative management should be undertaken by the plan sponsor as a rule but all or some of the work may be entrusted to administrative management organizations. Administrative management is divided into record-related business and management-related business. The record-related business is the business of recording each participant's attributes, asset size and other data, preserving such records and reporting these records and coordinating and reporting instructions on the management of contributions. The management-related business covers selection of method of managing contributions, presenting it to participants and providing information on the method of management. Most plan sponsors in Japan are expected to entrust administrative management business to companies specializing in this kind of business.

4) Investment products

Companies engaged in management-related business must present at least three investment products to participants. At least one of them must be a principal-guaranteed product. Administrative management organizations have the responsibility of providing information on investment products, by using such media as printed material, telephone, the Internet, etc. Corporations operating corporate pension plans should keep monitoring such information.

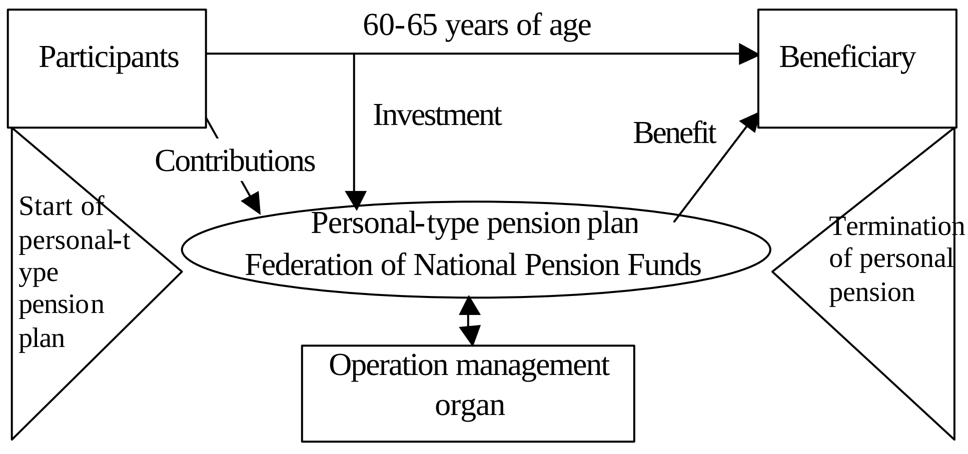
5) Benefits

There are broadly three kinds of benefits -- old-age benefit, disability benefit, and lump-sum death benefit. As a rule, participants can claim payment of these benefits when they reach the age of 60. They can receive old-age benefits in a lump sum if so specified by the rules. Participants who retire before working for three years and whose participation period is shorter than three years are entitled to receive a lump-sum withdrawal benefit at the time of retirement. Participants who have worked for three years or more cannot receive a lump-sum withdrawal benefit at the time of withdrawal but will receive old-age benefits upon reaching the age of 60.

(2) Personal pension

Personal pension is a defined-contribution pension plan chiefly for self-employed people and is operated by the Federation of National Pension Funds. The Federation of National Pension Funds is a public corporation established jointly by national pension funds. Like the Employees Pension Fund Association, it was established for the purpose of ensuring payment of annuities and survivors' lump-sum benefits to withdrawing participants and participants of dissolved funds. Eligible for participation in personal pension plans are not only self-employed people but also the employees of corporations which have no corporate pension plans such as a defined contribution plan, employees pension fund or tax-qualified pension plan. The rules of personal pension plans are made by the Federation of National Pension Funds, and contributions are paid by participating individuals. Participants manage contributions on their own responsibility and, when they reach the age specified by the rules, begin to receive benefits. The mechanism of personal pension is illustrated in Fig. 6. Participants in a personal pension plan pay monthly contributions. They can effect payment only in those months for which they pay national pension premiums. In other words, there is no payment of contributions to a personal pension plan without the payment of the premium on the national pension plan. Management of contributions paid and benefits for personal pension plans are the same for those for corporate pension plans.

(Chart 6) Scheme of personal-type pension plan



(3) Tax system (maximum amount of contribution)

The tax system for defined contribution plans is as follows.

At the stage of payment of contribution:

Contributions paid by participants are eligible for deduction from income.

Contributions paid by corporations are included in deductible expenses.

At the stage of management of contribution:

Pension assets are subject to special corporation tax.

At the stage of receipt of benefits:

Benefits in the form of annuities are eligible for deduction from income, like other forms of public pension benefits.

Benefits in the form of a lump-sum payment are taxable like retirement income.

At the stage of payment of contribution, participants in a personal pension plan are eligible for income tax credit, and contributions to a corporate pension plan may be entered as deductible expenses. Limits are set on the amount of contribution eligible for deduction from income and the amount of contribution treated as deductible expenses according to each case. The tax system will be explained below with particular reference to the maximum amount eligible for tax credit. The maximum amount was set as follows.

Corporate-type pension plan
In the case that the company is not providing
corporate pension plan (defined benefit-type) .... \432,000 per year (\36,000 per month)
In the case that the company is providing
corporate pension plan (defined benefit-type) .... \216,000 per year (\18,000 per month)

Personal-type pension plan
Self-employed, etc. .... Amount: After deducting contributions to the National Pension Fund, etc. from an annual \816,000 (a monthly \68,000)
Corporate pension plan (defined benefit-type) ... In the case that the company is not providing corporate-type of defined contribution pension
........................\180,000 per year (\15,000 per month)

When a corporation operates a defined contribution plan and does not operate any other corporate pension (such as a defined benefit plan), the maximum contribution is 432,000 yen a year (32,000 yen a month). This limit was set at a level equivalent to 1.7 times the substitutional benefit, which is the target level of the topping-up benefit of employees pension funds. The standard remuneration 620,000 yen multiplied by 35 per mill (35/1,000) multiplied by 1.7 roughly equals 36,000 yen. When a corporation operates another corporate pension plan in addition to a defined contribution plan, the maximum contribution is 216,000 yen a year (18,000 yen a month). This is the level calculated by subtracting 0.86, considered as the average level for employees pension funds, from 1.7. The basic idea is to put the maximum tax-free amount at the same level regardless of whether a corporation has a defined benefit plan or not.

The maximum amount of contribution to be paid by self-employed people has been brought into line with the maximum amount of contribution paid for national pension funds. The maximum amount of contribution to be paid by an employee working for a corporation which operates neither a defined benefit plan nor a defined contribution plan is set at 180,000 yen a year (15,000 yen a month). This limit was set in view of the fact that, in about 90% of cases, the amount of contributions paid to employees pension funds is 15,000 yen or less. This is roughly the average contribution paid by corporations to employees under various corporate pension plans.

(4) Other matters

Mention will be made on the shift from a defined benefit plan to a defined contribution plan. When the defined contribution pension system is introduced, corporations may switch from their employees pension fund and tax-qualified pension plan to a defined contribution plan.

One thing to be noted here is that there is a limit to the amount transferable. The maximum amount transferable is the balance of reserve (with a certain yield) that would have been set up under a defined contribution plan during the actual period of the defined benefit plan. The yield for fiscal 1996 and preceding years was 5.5% per annum and the yield for subsequent years is calculated from the yield on 10-year government bonds.

Another thing to be noted is that, if a corporation is to replace its defined benefit plan by a defined contribution plan, it must first cover the reserve shortfall by either lowering the benefit levels or setting aside additional reserves.

3. Defined contribution pension system of the future

The advantages and disadvantages of introducing the defined contribution pension plan as well as the challenges to be faced will be discussed below.

(1) Advantages of the defined contribution pension plan for employers

If a corporation operating a defined benefit plan introduces a defined contribution plan, it can avoid the risk of suffering loss from the management of pension assets. More than 30 years have passed since the employees pension fund plan and the tax-qualified pension plan were introduced. In many corporations, the balance of pension assets has grown quite large over the years. They can avert the risk of causing loss to pension assets by shifting to the defined contribution pension plan. By doing so they can also reduce the retirement pay obligations. Under the newly introduced retirement benefit accounting system, obligations arising from defined benefit plans are entered in the balance sheet. In defined contribution plans, annual contributions are treated as expenses and not as obligations. Accordingly, if a defined benefit plan is replaced by a defined contribution plan, the retirement pay obligations will be reduced.

(2) Advantages of the defined contribution pension plan for employees

One advantage to employees is the portability of pension assets. Under the defined benefit pension plan, employees switching jobs cannot carry pension assets with them. They can do this with the defined contribution pension plan. Portability should be a boon to company employees in Japanese society today where switching jobs has become common.

Another advantage to employees is that they can select investment products according to their own judgment and preferences. Under the defined benefit pension plan, it is corporations or their funds that have selected products for management of pension assets. In the defined contribution plan, employees can act on their own discretion and on their own responsibility. They are given a wider choice.

(3) How the defined contribution pension plan is introduced and how participants' rights are protected

There are three conceivable cases in which the defined contribution pension plan is adopted by corporations in Japan, as indicated below.

1) The system is introduced into a corporation having no retirement benefit system.
2) The system is introduced to provide an additional benefit to beneficiaries of a defined benefit plan.
3) The system is introduced while the existing defined benefit plan is scaled down.

Case 1) applies to small or midsize corporations having no lump-sum retirement benefit payment system and young corporations.

Case 2) is not likely to apply to many corporations, considering the current Japanese economic situation, although it poses no problem for employees.

Case 3) is a good choice for those plan sponsors who wish to solve various problems of the defined benefit pension system, such as the worsening investment environment resulting in the increasing burden of payment of contributions and the introduction of new accounting standards resulting in the deterioration of corporate finances. Many defined benefit plans currently in force are saddled with massive reserve shortfalls, and a big question is how to guarantee the participants' rights stemming from their past service. It has been a relatively simple matter in Japan to lower the levels of benefits paid under the retirement benefit system retroactively. It is necessary to build a framework that prevents the benefit levels from being lowered without a good reason.

(4) Investor education

The Japanese keep most of their savings in the form of bank and postal deposits and only a small part in the form of risk assets like stocks. This tendency has become stronger since the domestic stock market slackened after the collapse of the bubble economy. Even if the defined contribution pension plan is introduced, investment in risk assets like stocks is still very unfamiliar to the Japanese public. To popularize the defined contribution pension plan, it is necessary to educate employees on investment.

(5) Commission for administrative management

One question with the defined contribution pension plan is how to meet the cost of the record-related business and management-related business. If a portfolio is composed only of low-risk assets in Japan today where interest rates are on very low levels, its investment yield from which the cost of administrative management has been subtracted may fall below zero. Corporations should join forces in the development of systems and in other matters to reduce the cost of administrative management.

Conclusion

As long as the economic situation remains stuck in the mire, the pension system will pose a difficult question to corporations and employees alike. It is necessary to review not only the pension system but the whole retirement benefit system operated by corporations in Japan where structural reforms are now in progress. In this connection, two laws -- the defined benefit corporate pension law and the defined contribution pension law -- were instituted in fiscal 2001. These laws assure the protection of participants' rights and give both employers and employees a wider choice in making use of the retirement benefit plan. It is important for employers and employees to discuss fully how the retirement benefit plan can be designed in the best way possible.

It is earnestly hoped that the corporate pension plan, which plays a key role in improving post-retirement life, will continue to make progress.