

New Trend of severance and retirement benefits in Japan

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Abstract

Defined Contribution (DC) pension plans were introduced to Japan as a new option for retirement income security in 2001. Although not so many employees are covered by DC pension plans compared to Defined Benefit (DB) pension plans until now, it seems that some change will occur in the near future.

Japanese laws and regulations for occupational pension plans changed drastically in 2014. This change will compel the almost all of existing Employees' Pension Funds (EPFs) to be abolished in 5 years. EPFs, which are DB type plans, used to be dominant in the field of corporate pension plans until the beginning of this century. But many big companies changed their EPFs into Defined Benefit Corporate Pension Plans after the enforcement of the Defined Benefit Corporate Pension Act in 2002. As a result, EPFs now covers mainly the employees of Small and Medium-sized Enterprises (SMEs).

Last year's amendment has the possibility to cause the decline in the coverage ratio of occupational pension plans of SMEs' employees. In order to decrease such influences, the Ministry of Health, Labour and Welfare, is trying to make the regulations to be much easier to adopt DB and DC pension plans for SMEs. That is, there may be new trend that more and more SMEs will adopt DC.

As the pension benefits have more importance than the lump sum benefits for old age life even if it is from DC, this direction will be welcomed.

Keywords

Occupational pension plans, DB pension plans, DC pension plans, Employees' Pension Fund

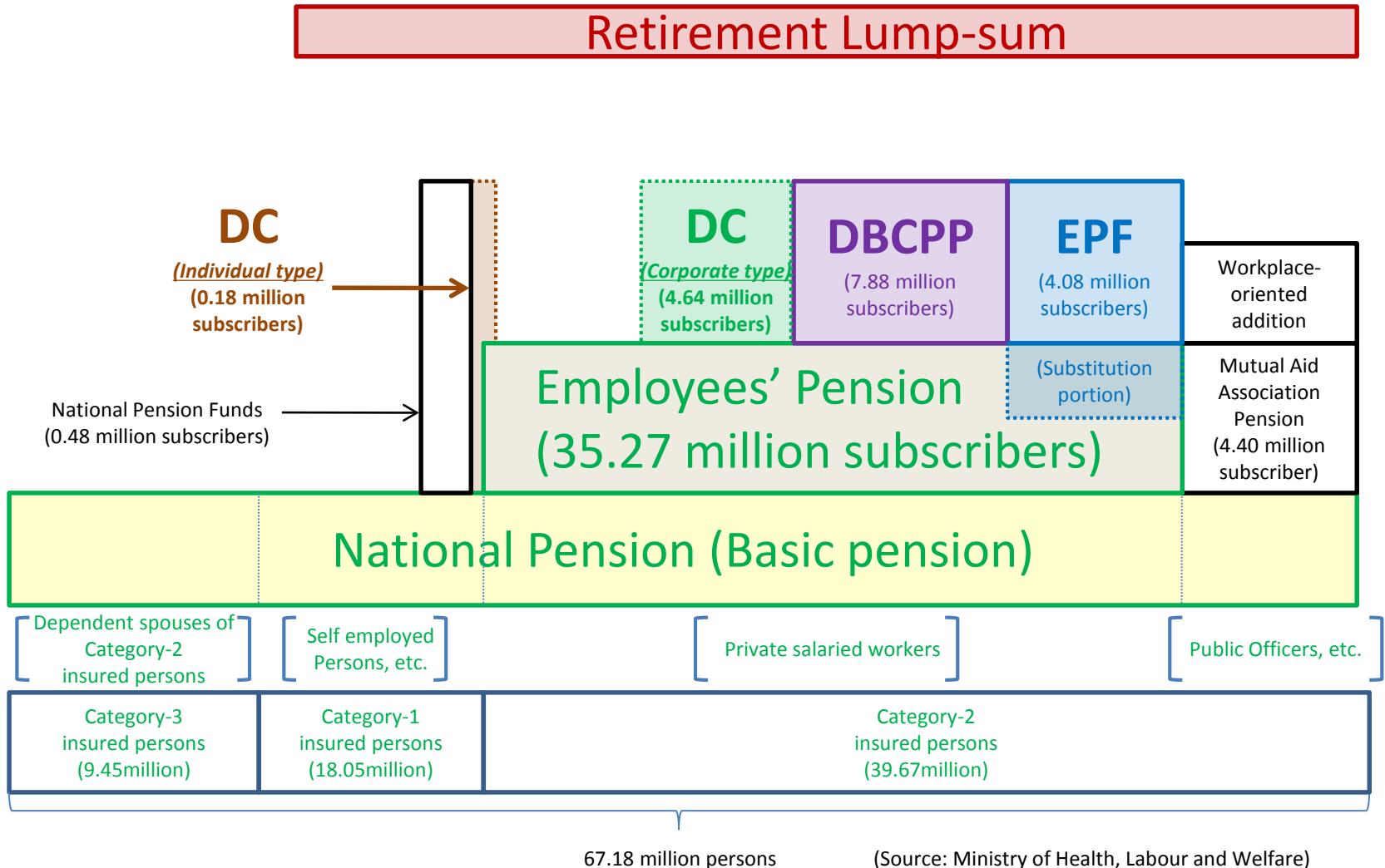
Tokyo is 7 hours ahead of Oslo.



The national flag of Japan is a white field with a rising sun.

Overview of the Retirement benefits System in Japan

(The figures are as of end of March 2014)



Brief History of the Employee Benefit Arrangements in Japan

- **Development of the Lump-sum benefits**
- **Introduction of Tax Qualified Pension Plans**
- **Introduction of Employees' Pension Fund**
- **Introduction of two Acts (DCPA and DBPA)**

Development of the Lump-sum benefits

- Providing a lump-sum payment at severance or retirement became fairly common in private sector by the early 20th century.
- Lump-sum payments are Defined Benefit type.
- Favorable tax treatment for lump-sum benefits was granted in 1952.

Introduction of Tax Qualified Pension Plans

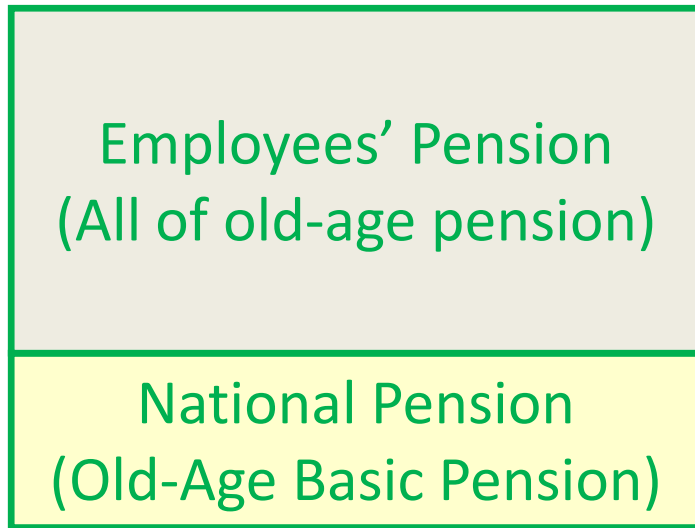
- Tax Qualified Pension Plans (TQPPs) were introduced in 1962.
- TQPPs were Defined Benefit type corporate pension plans.

Introduction of Employees' Pension Fund Schemes

- In 1965, the Employees' Pension Insurance (EPI) was amended and the Employees' Pension Fund (EPF) scheme was introduced.
- The first EPF was established in 1966.

Structure of Employees' Pension Fund Benefits

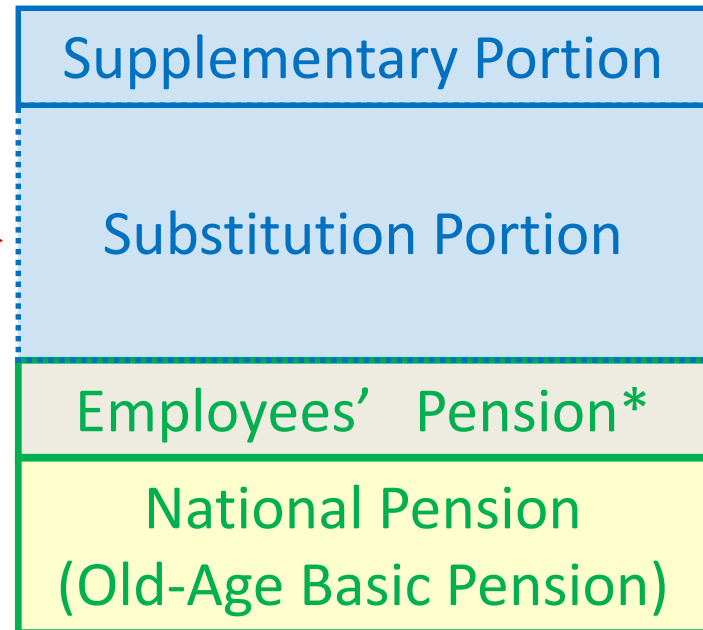
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**All benefits will be paid
by State**

Substitution is not a
contracting out of the EPI.

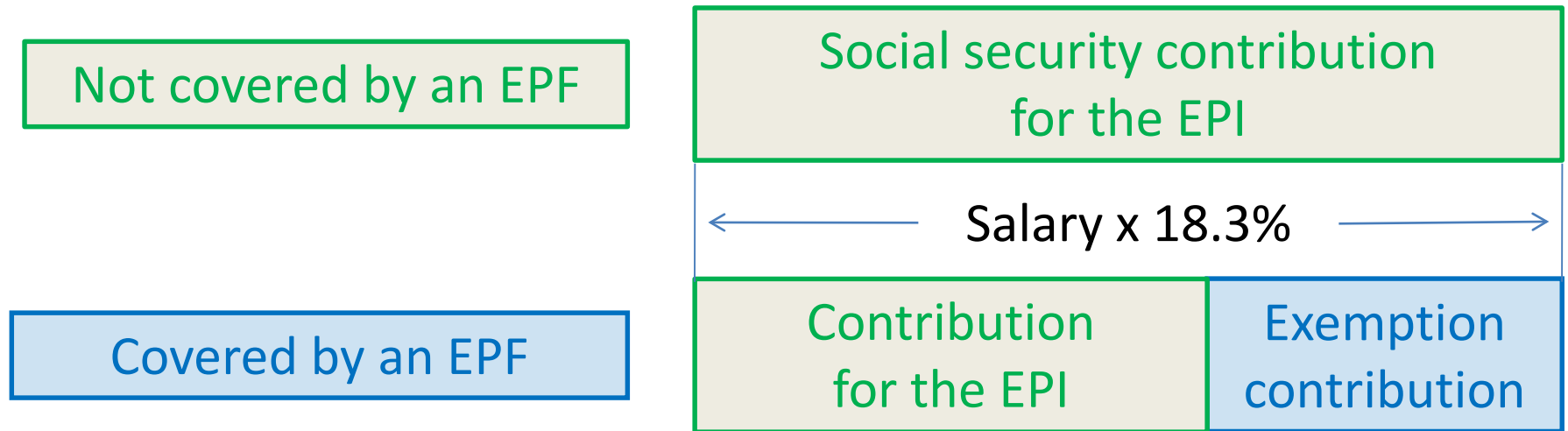
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**Supplementary portion and
Substitution Portion
will be paid by the fund**

*Price and wage indexation portion

Exemption contribution for EPFs

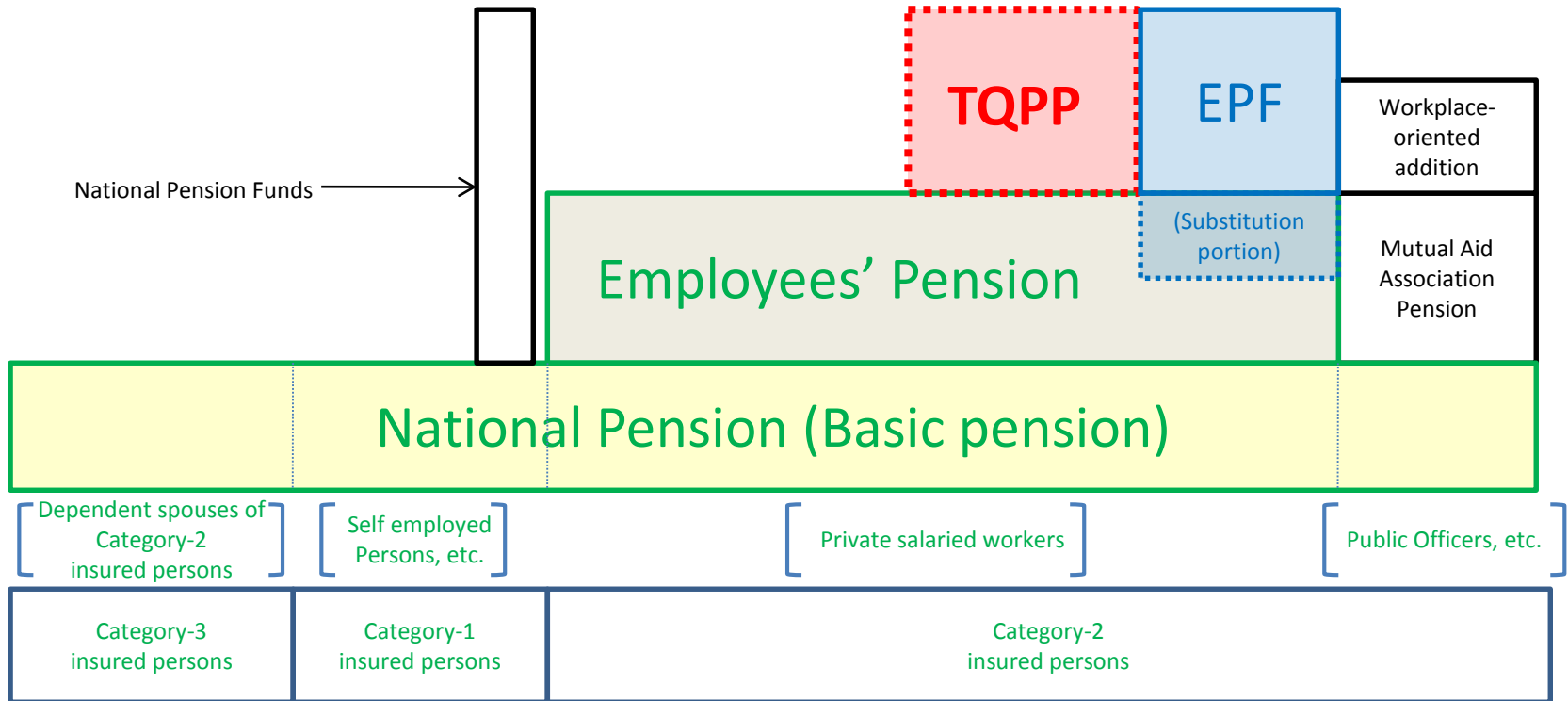


The employer and employees covered by an EPF pay part of social security contribution (exemption contribution) into the EPF, instead of to the EPI.

Three types of EPFs

- Single-Employer Funds established by a single employer
- Allied-Employer Funds established by affiliated employers within a group of businesses, and
- Multi-Employer Funds established by an association of many companies joined together under certain conditions as plan sponsors.

Pension System before 2001



Introduction of two Acts (DCPA and DBPA)

- In June 2001
 - Defined Contribution Pension Act (DCPA), and
 - Defined Benefit Corporate Pension Act (DBPA)

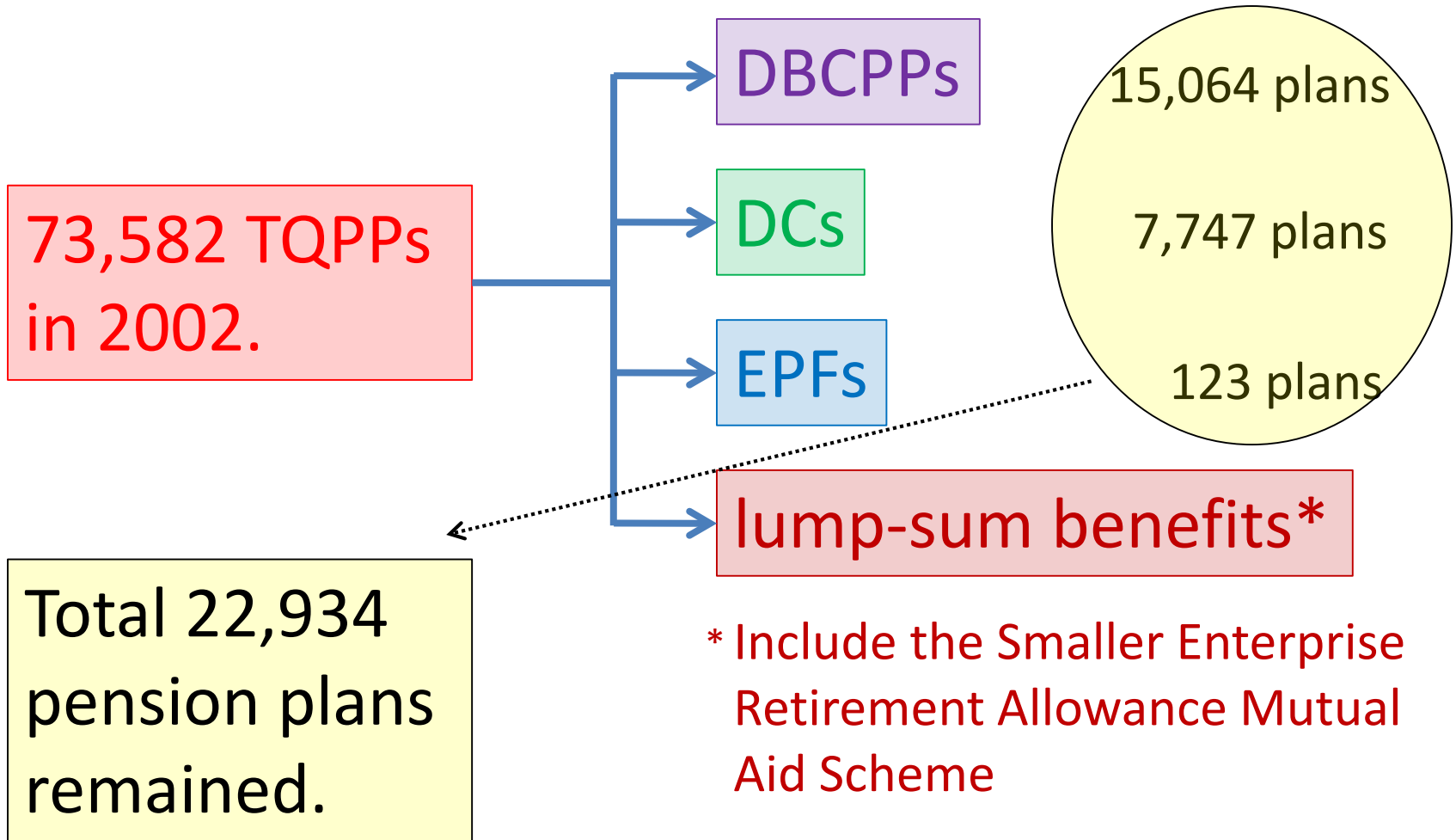
Two type of DC

- Occupational type DC pension plans cover
 - Employees in private sector
- Individual type DC pension plans cover
 - Employees in the private sector without corporate pension plans, and
 - Category-1 insured persons of National Pension (Self-employed persons, etc.)

Defined Benefit Corporate Pension Act (DBPA)

- The DBPA provides
 - (1) Funding requirements,
 - (2) Fiduciary responsibility, and
 - (3) Reporting and disclosure.
- The TQPPs, with inadequate funding requirement, were determined to be changed into other plans or abolished by the end of March 2012.

Changes of TQPPs



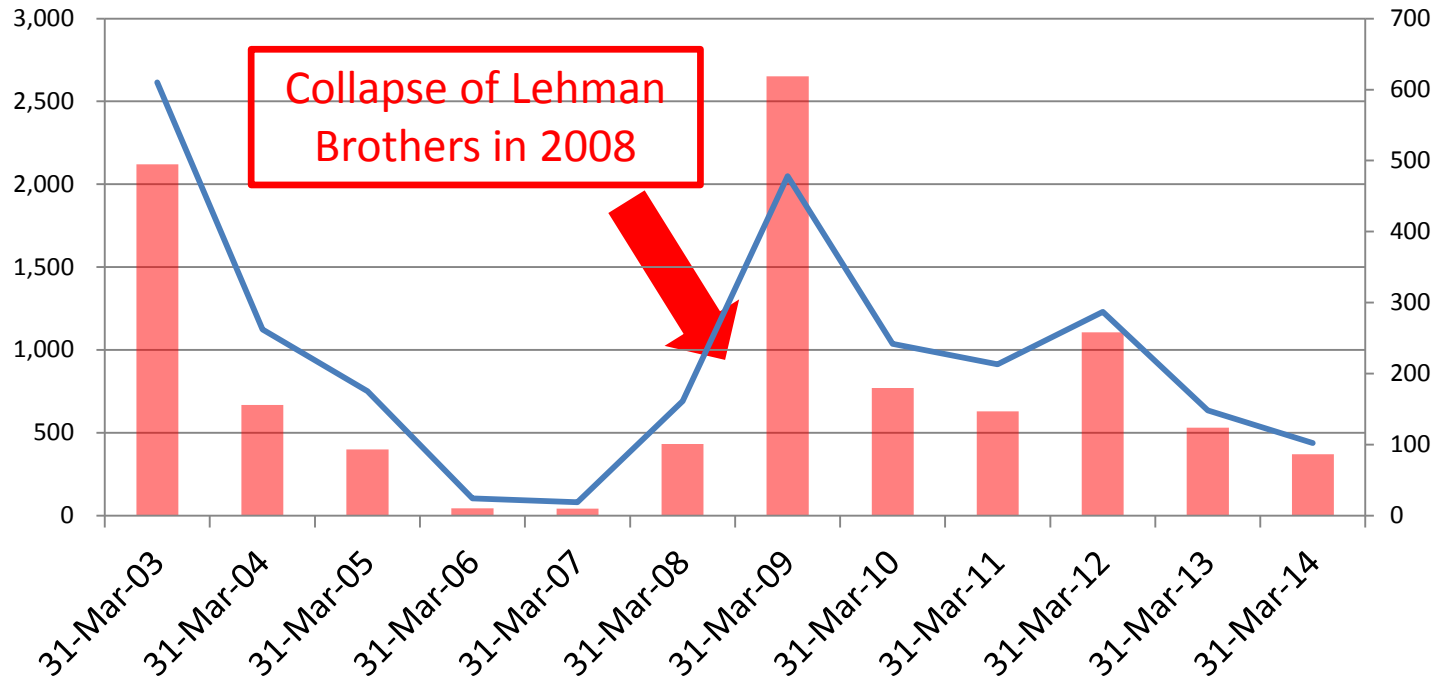
Impact of DBPA

- 73,582 TQPPs covered 9.17 million in 31 March 2002.
- Only one third of employers which had provided TQPPs continued to make pension benefits available to their employees in 2012.

Funding status of Minimum Reserve of EPFs

- Since EPFs receive exemption contributions from the EPI, the government considers that there are deposits for EPI in EPFs. That amount is named Minimum Reserve.
- After the financial crisis, number of EPFs whose assets were less than their Minimum Reserves (in deficit) increased drastically.

EPFs in deficit



	31-Mar-03	31-Mar-04	31-Mar-05	31-Mar-06	31-Mar-07	31-Mar-08	31-Mar-09	31-Mar-10	31-Mar-11	31-Mar-12	31-Mar-13	31-Mar-14
Total deficit (billion yen)	2,120	667	399	43	41	432	2,651	770	629	1,106	530	371
Number of funds in deficit	610	262	175	24	19	161	478	242	213	287	148	102

Here deficit means that the assets are less than the Minimum Reserve.

(Source: Ministry of Health, Labour and Welfare)

Viewpoint of the MHLW

- When an EPF change into other corporate pension plans or is abolished, its assets equivalent to its Minimum Reserve should be returned to the government.
- If an EPF fails to return the required amount, financial position of EPI will be damaged.
- The Ministry of Health, Labour and Welfare (MHLW) became very cautious of soundness of EPI.

AIJ scandal

- In 2012, the authorities found the frauds of AIJ Investment Advisors CO., LTD.
- AIJ's clients lost over 180 billion yen by this scandal in total. AIJ's main clients were pension funds.
- This fraud triggered the revision of EPI Act.

Revision of the EPI Act

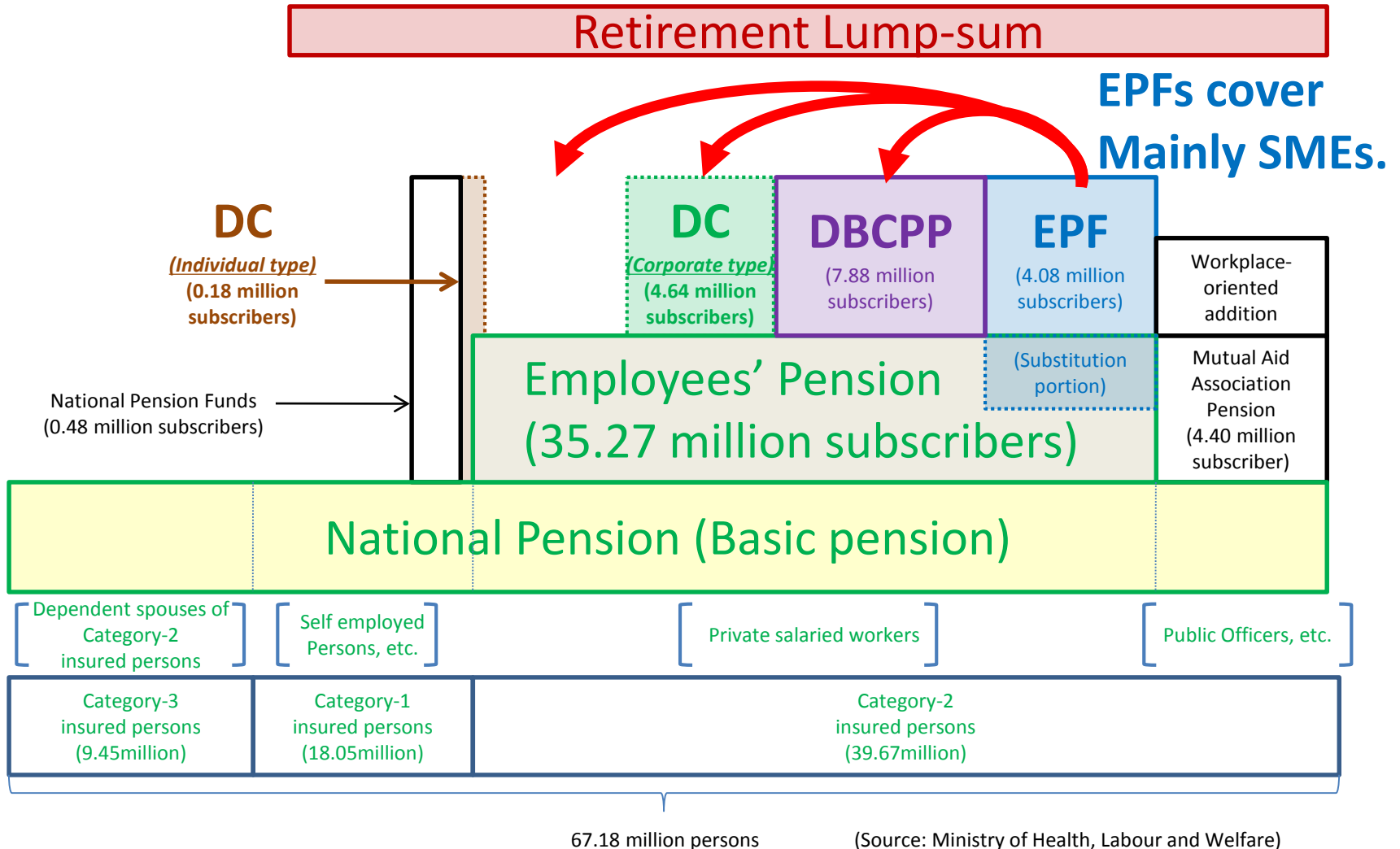
- The Amendment of the EPI Act to secure the soundness and reliability of public pension system came into force on 1 April 2014.
- One of the aims of this Act is not to allow EPFs to be underfunded of the Minimum Reserve.
- Almost all of EPFs are now forced to change into DBCPPs or DC plans or to be abolished by the end of March 2019.

Current Status of EPFs

- There are 531 EPFs that cover 4.20 million employees as of 31 March 2014.
 - 27 Single-Employer Funds,
 - 38 Allied-Employer Funds, and
 - 466 Multi-Employer Funds
- More than 80% of the EPFs are Multi-Employer plans which cover mainly the employees of Small and Medium-sized Enterprises (SMEs).

Almost all of EPFs will vanish by march 2019

(The figures are as of end of March 2014)



Effects on SMEs

- In the past, by March 2012 the TQPPs were forced to change into other plans.
- Facing that requirement, many employers chose lump-sum benefits, which made pension coverage ratio smaller among the employees of SMEs.
- Such cases can occur again by revision of the EPI.

The Committee's Report

- In October 2013, Social Security Council in the MHLW organized the **Corporate Pensions Committee**.
- The Committee discussed many aspects of corporate pension plans, including the deregulation of plan designing.
- On 16 January 2015, the Committee published a report. Some opinions are concerned with the provisions of pensions for employees of SMEs.

Revision of the DC Pension Act

- A bill to revise Defined Contribution Pension Act was submitted to the Diet on 3 April 2015.
- It adopted some opinions in the committee's report:
 - **Contributions by small-scale employers to the individual type DC**
 - **Extension of eligibility for individual type DC, and**
 - **Change of the regulations on maximum contribution**

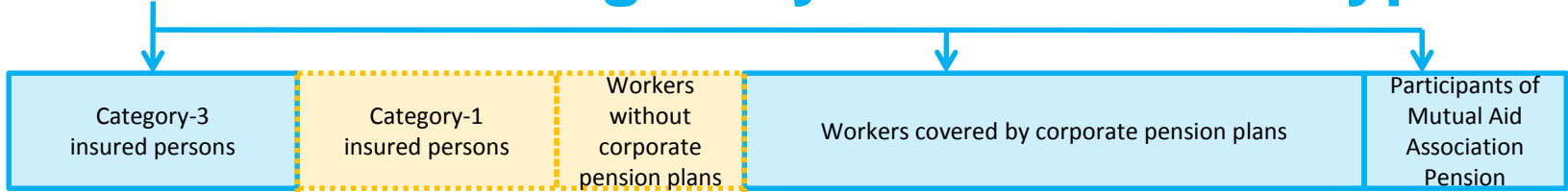
Contributions by small-scale employers to the individual type DC

- Contributions by employers to the individual type DC are not allowed under the current law.
- It is proposed to admit such contributions by small-scale employers who don't run other corporate pension plans.
- This change will make it possible to receive increased pension benefits.

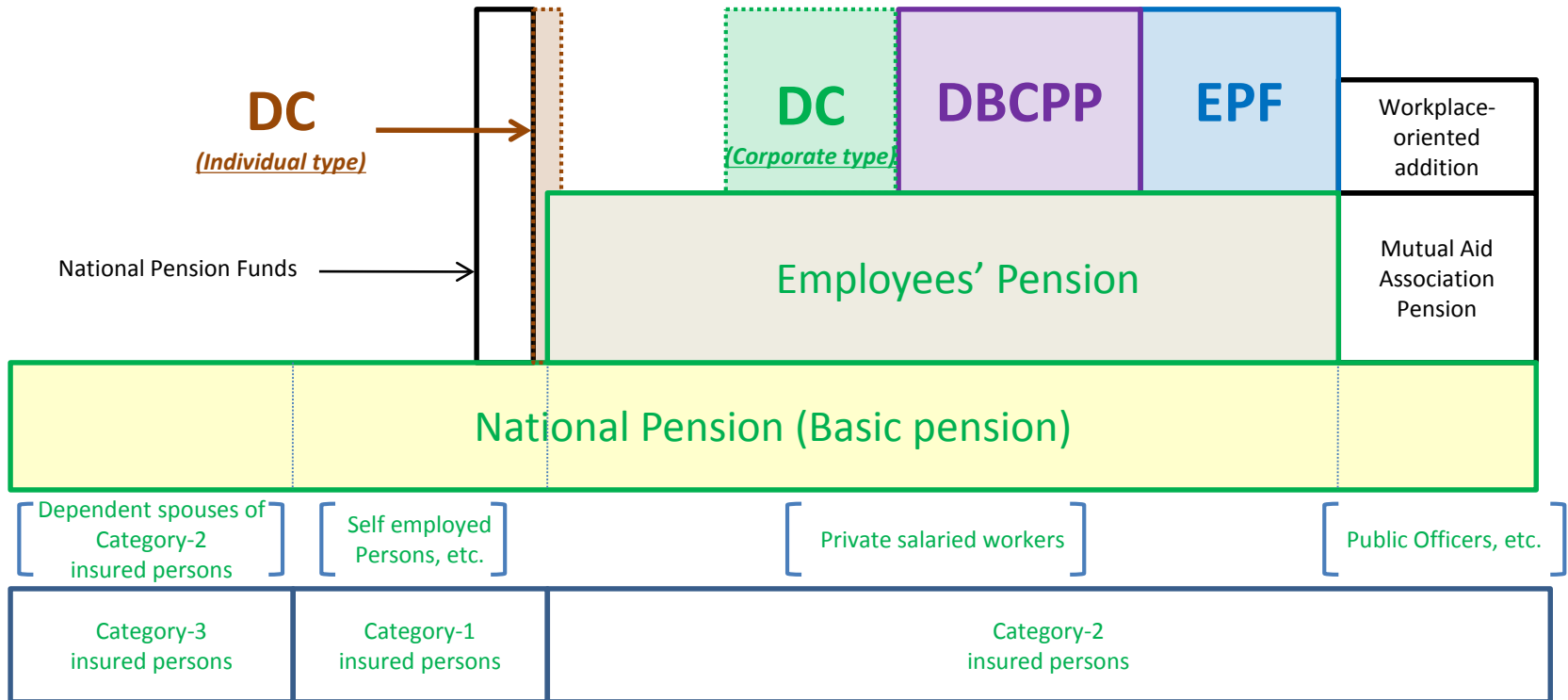
Extension of eligibility for individual type DC

- To include
 - Category-3 insured persons (Dependent spouses of private salaried workers and public officers),
 - Workers covered by corporate pension plans, and
 - Participants of Mutual Aid Association Pension (public officers).

Extension of eligibility for individual type DC



Eligible for individual type DC under current Law



Change of the regulations on maximum contribution

- From monthly basis to annual basis.
 - For example, maximum contribution amount for corporate type DC plan for the employees without EPF or DBCPP is now 55,000 yen per month.
 - It means that if the contribution for a participant failed to be paid for one month, that amount will never be used in the future period.
 - New change eliminates such inconvenience.

Other discussions not proposed in the Bill

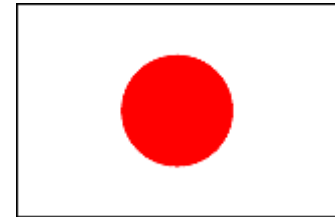
- The committee's report proposed other measures to make it easier for SMEs to have pension plans for their employees; for example:
 - Introduction of collective DC plan.
 - Education on investments by outsiders for DC participants.
- Continuous discussions on such plans are desirable.

Concluding remarks

- Almost all of EPFs will fade out. Without effort to promote easily installable DC plans, pension coverage in SMEs may decline rapidly.
- As the pension benefits have more importance than the lump sum benefits for old age life even if they are from DC plans.
- **Easing the procedure of making DC pension plans is welcome.**

Thank you!

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