

## Recent DC plans & CB type design scheme trends in Japan

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### Abstract

Recently the annual growths of DC plan & CB type design scheme in Japanese corporate pension area are slowing down, those trends can be considered to be affected by such factors as having passed away of the initial demand, the change of labor market, the improvement of investment environment, etc. I have investigated the factors of the trends.

### 1. Introduction

In 2001 DC law was newly enacted and in 2002 CB type design was granted in Employee's Pension Funds and Defined Benefit Corporate Pension Plans. After those reforms, the number of employers who adopted those new types started to increase in Japan. But their increasing pitch has been slowing down recent years. I investigate factors of such trends in this paper.

In Chapter 2, I firstly investigate DC pension (corporate type) plan trend.

In Chapter 3, I secondly investigate CB type design plan trend.

Before investigation, I give the definition of DC & CB.

In this paper DC plan; "defined contribution pension (corporate type)" is defined as a pension in which the amount of the contribution is stipulated in the pension rules, in which participants have their individual accounts and the rights to choose investment funds and in which the amount of the benefits will vary according as its investment return in his/her own account.

Because of the definition above, DC pension plan has features that the corporations' main demand to DC pension plan is to shift down-side investment risk to employees and that DC pension is riskier for employees than DB-type pension.

CB type design; "cash balance plan design" is defined as a pension in which the amount of the contribution credit is stipulated in the pension rules, in which participants have their hypothetical individual accounts and in which the amount of the benefits will vary according as the experiences of pre-defined market interest rate. And there is another type of CB named "modified CB type design" in Japan. The "modified CB type design" is defined as a pension in which the severance lump-sum amount is stipulated in the

pension rules, in which severance lump-sum amount is changed to annuity payment and in which the exchange rate from severance lump-sum amount to annuity payment will vary according as the experiences of pre-defined market interest rates.

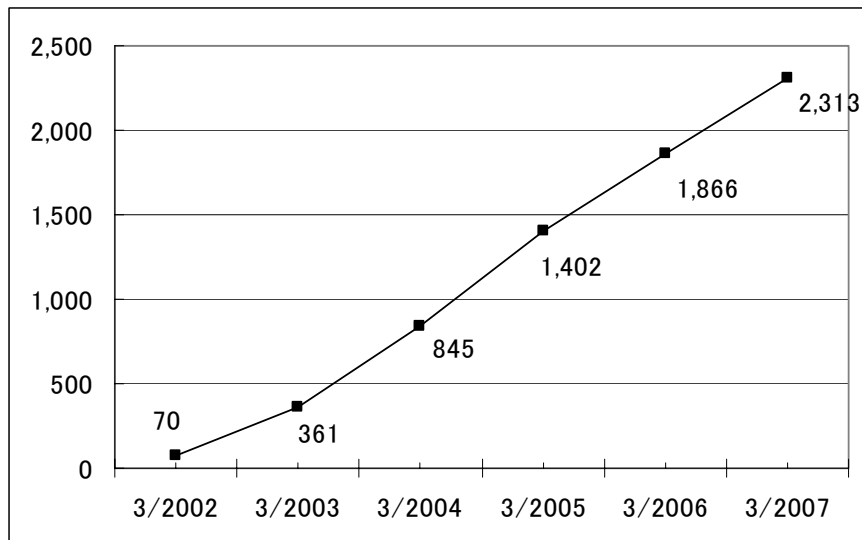
Because of the definitions above, CB type design and the “modified CB type design” have features that the corporation’s main demand to CB type design or the “modified CB type design” is to share down-side risk of the market midterm volatility with employees, that the benefits of CB pension and the “modified CB pension” are changeable according as the experiences of pre-defined market interest rates and that CB pension and the “modified CB pension” need more advanced administrations, so that they aren’t good for smaller companies.

## 2. Recent trends of growth of DC plan and their factors in Japan

### 2-1. Recent trends of growth of DC plan

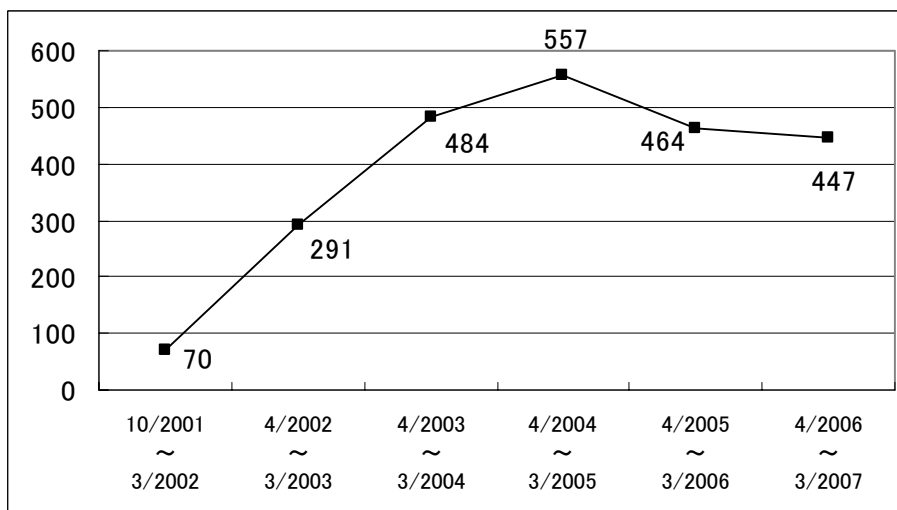
Japanese DC law was newly enacted in October 2001. I show the number of DC pension (corporate type) in Figure 1 from its start to 2007. Figure 1 shows that the number of DC pension increases every year, became 2,313 on March 31st in 2007.

Fig.1. DC pension (corporate type) plans



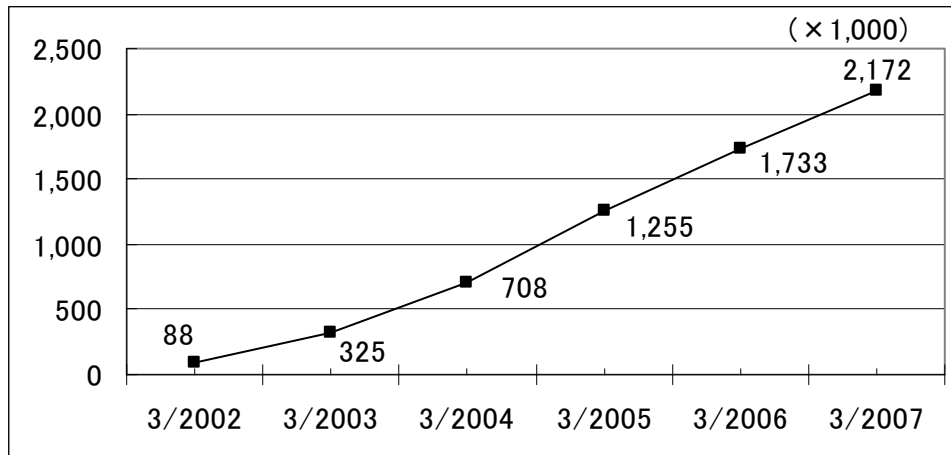
And I show the annual growth of DC pension (corporate type) plans in Figure 2. Figure 2 shows that the annual growth of DC pension plans decreases considerably after 2004.

Fig.2. The annual growth of DC pension (corporate type) plans



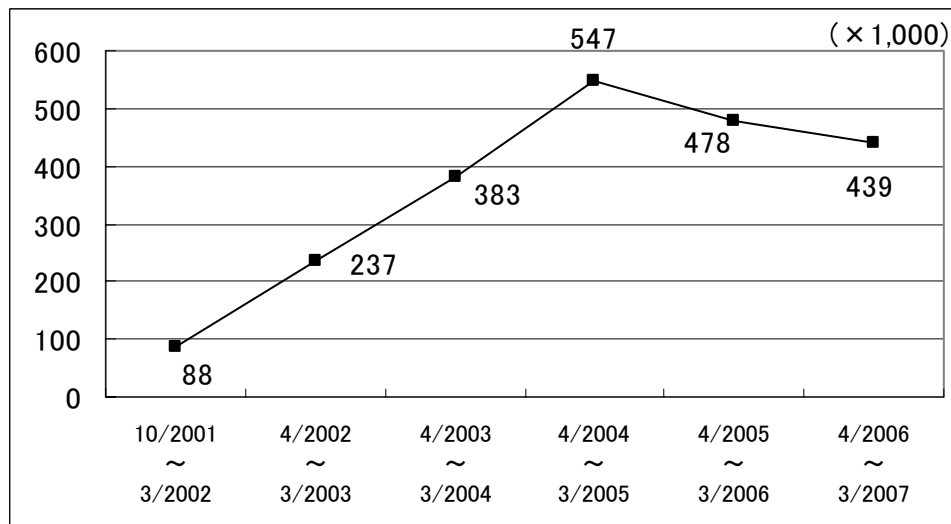
I show the number of participants in DC pension (corporate type) in Figure 3. from its start to 2007. Figure 3 shows that the number of participants in DC pension increases every year, became 2,172 thousands on March 31st in 2007.

Fig.3. The participants in DC pension (corporate type)



And I show the annual growth of participants in DC pension (corporate type) in Figure 4. Figure 4 shows that the annual growth of participants in DC pension (corporate type) decreases considerably after 2004.

Fig.4. The annual growth of participants in DC pension



In short, the growth of DC pension decreases considerably after 2004. I will analyze the factors of the trend in Section 2-2, 2-3 and 2-4.

## 2-2. End of DC plan establishment rush based on initial demand

DC law was newly enacted in October 2001. There must have been some initial demand to DC plans. In the initial few years DC plan was somewhat in boom and many

corporate executives were interested in DC plans. The establishments of DC plans based on such initial demand were over at 2004. Having passed away of the initial demand seems to be the biggest factor of the trend that the growth of DC plan has been slowing.

### 2-3. Factors concerning about circumstance of DC pension (corporate type)

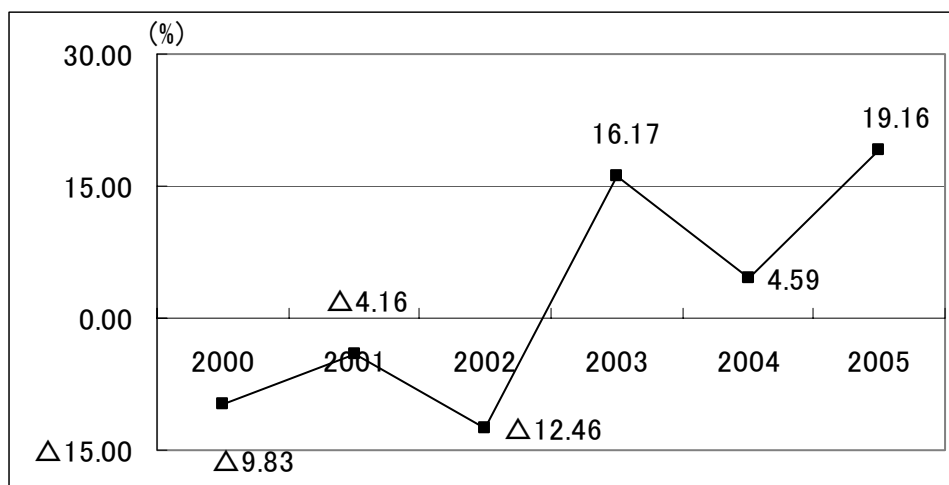
#### (A) Change of investment circumstances

I show the average rate of the investment return of member funds of Pension Fund Association from 2000 to 2005 in Figure 5. Figure 5 shows the rate of the investment return was below 0 from 2000 to 2002 and it dramatically improved at 2003.

It seems one other factor of the trend of the growth of DC plan.

Since the investment return has improved dramatically at 2003, corporate executives seem to have thought that the down-side risk of investment had reduced and that corporation's demand to shift its down-side investment risk to employees had also reduced.

Fig.5 Average rate of the investment return of member funds of Pension Fund Association



(\*) The statistical year starts in April ends in March.

#### (B) Change of labor market

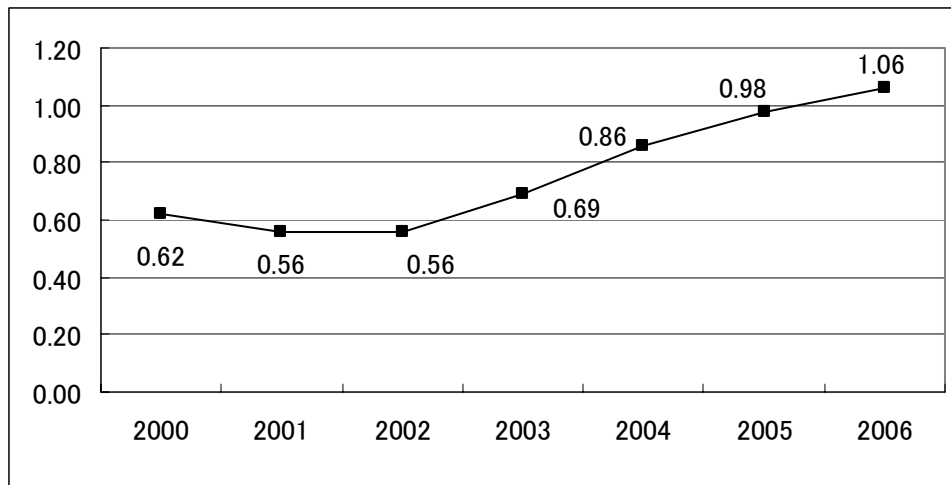
I show the ratio of job-offer to job-seeker in Japan from 2000 to 2006 in Figure 6. Figure 6 shows that job-offer had hover around low level before 2003 and that it has become much improved after 2004.

It seems the other factor of the trend of the growth of DC plan.

Since the labor market has become a sellers' market after 2003, corporate executives seem to have started to avoid shifting corporate pensions risk to employees. So they

have not been making transitions from DB-type pensions to DC.

Fig.6 The Ratio of job-offer to job-seeker in Japan



(\*) The statistical year starts in April ends in March.

#### 2-4. Room for improvement of DC pension (corporate type) system in Japan

Many organizations in Japan have made proposals in which some improvements of DC pension system are proposed to the Government.

I show some concrete proposals below;

##### (a) Deregulation of Restriction of lump-sum payment under 60 years old

While participants are under 60 years old, lump-sum payment is prohibited in almost all cases. In Japan there is a circumstance that the severance lump-sum payment has been the traditionally ordinal system.

##### (b) Deregulation of Limitation of Contribution Amount

The monthly contribution is restricted no more than 46,000yen by one employee who is not covered by any DB-type corporate pension, or, is restricted no more than 23,000yen by one employee who is covered by a DB-type corporate pension(s). In Japan it is a traditionally ordinal system of corporation pension that a severance lump-sum amount is changed to annuity payment and the average total severance payment of male employees who had graduated university is 27 million yen which is almost result amount of 70,000yen contributions per month with 1% investment return for 25 years.

##### (c) Repeal of Prohibition of employee contribution

Employee contribution is prohibited in DC pension on present regulation. If employee contribution is granted in DC pension, a lot of employees seem to use DC pension for saving for their old age .

(d) The regulation that a person who is no less than 60 years old cannot be an active participant should be abolished.

In Japan there are some circumstances that the normal age in which benefit of public pension starts is scheduled to be 65 years old from 60 years old and that the age limit is required to be older (ex. 60⇒65) by a law.

Those seem to be another factors of the trend of the growth of DC plan.

Since the rooms for improvement of DC pension system exists, the demand to DC pension in Japan seems to be weakened by them.

## 2-5. Summary of Chapter 2

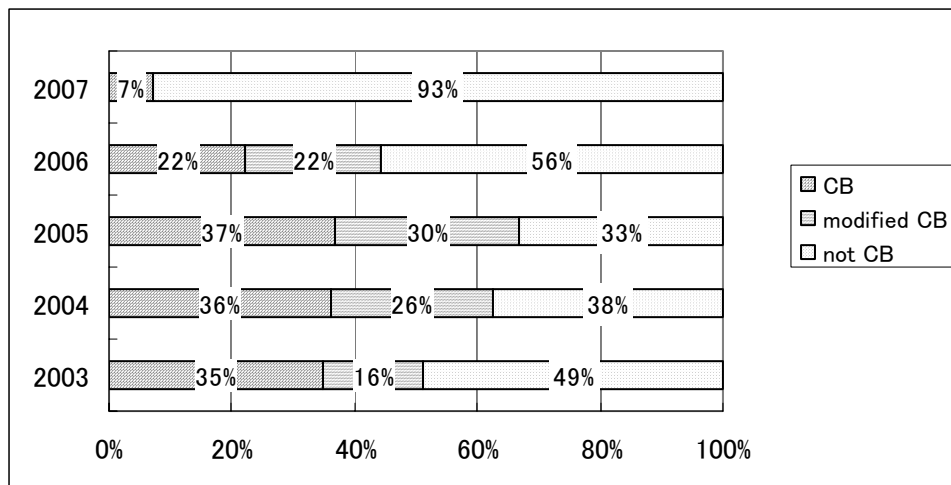
As far as Japanese DC market is concerned, the initial demand to DC pension seems to have passed away at 2004 [This is the biggest factor]. And the demand to DC pension seemed to be somewhat reduced by the change of the investment environment and labor market. And there remain some rooms for improvement of DC pension system, they seem to weaken the demand to DC pension in Japan.

### 3. Recent trends of growth of CB type design scheme and their factors in Japan

#### 3-1. Recent trends of growth of CB type design scheme

CB type design scheme was granted in April 2002. I could show the number of CB type design scheme but there is no statistics. Instead of showing the number of CB type design scheme, I show the percentage of CB type design and “modified CB type design” from 2003 to 2007 in Figure 7 in newly established DBCPPs (which are based on DBCPP law) whose main trustee is The Sumitomo Trust & Banking Co., Ltd. Figure 7 shows the percentage of CB type design and “modified CB type design” is over 50% between 2003 and 2005 and it dramatically decreases after 2005.

Fig.7 Percentage of CB type design and “modified CB type design”



(\*) The statistical year starts in April ends in March.

In short, the growth of CB type design decreases dramatically after 2005. I will analyze the factors of the trend in Section 3-2 and 3-3.

#### 3-2. End of CB type design plan establishment rush based on initial demand

CB type design scheme was granted in April 2002 in Japan. There must also have been some initial demand to CB type design scheme as DC type. In the initial few years many executives of large corporations seemed to be interested in CB type design plans. The establishments of CB type design plan based on such initial demand seemed to be over before 2006. Having passed away of the initial demand seems to be the biggest factor of the trend that the growth of CB type design has been slowing.

#### 3-3. Factors concerning about Circumstance of CB type design

##### (A) Change of investment circumstances

As I mentioned in 2-3.(A), the rate of the investment return has dramatically improved

at 2003.

It also seems one factor of the trend of the growth of CB type design.

Since corporate executives seem to have thought that the down-side risk of investment had reduced and that corporation's demand to share down-side risk of the market mid-term volatility with employees had also reduced.

(B) Prospect that interest rate will increase in Japan

The Bank of Japan had decided to encourage the overnight call rate to keep at around 0.50% after February 21st which had used to be 0.25% and was suggesting further increasing of call rate after that. In such a market circumstances long-term market interest rate started to increase slowly then it can be understood that corporate executives prospect that the interest rate will increase in two or three years.

It seems the other factor of the trend of growth of CB type design.

In the case that the interest rate increases, CB benefits to employees will increase in line with the interest rate. So such a circumstances seem to weaken the demand to CB pension in Japan.

### 3-3. Summary of Chapter 3

As far as Japanese CB market is concerned, the initial demand to CB type design scheme seems to have passed away before 2006 [This is the biggest factor]. And the improvement of investment return seemed to reduce the demand to CB type design in Japan. And the prospects that the interest rate will increase further seem to weaken the demand to CB type design in Japan.

Speaker;

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