

Recent DC plans & CB type design scheme trends in Japan



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Topics

- ◆ Introduction (Chapter1)
- ◆ Recent trends of growth of DC plan and their factors in Japan (Chapter2)
- ◆ Recent trends of growth of CB type design scheme and their factors in Japan (Chapter3)

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 have investigated factors of such trends.

Introduction

- ◆ Firstly I'll present DC pension (corporate type) plans trend.
- ◆ Secondly I'll present CB type design plans trend.

Definition of DC

- ◆ The “defined contribution pension (corporate type)” is defined as a plan where the amount of the contribution is stipulated in the pension rules, participants have their individual accounts and rights to choose investment funds, and the amount of the benefits will vary according as investment return in his/her own account.

Features of DC plan

- ◆ The corporation's main demand to DC plan is to shift down-side investment risks to employees
- ◆ DC pension is riskier for employees than DB-type pension.

Definition of CB type design

- ◆ The “cash balance plan design” is defined as a scheme where the amount of the contribution credit is stipulated in the pension rules, participants have their hypothetical individual accounts, and the amount of the benefits will vary according as the experiences of pre-defined market interest rate.

Definition of “modified CB type design”

- ◆ The “modified CB type design” is defined as a scheme where the severance lump-sum amount is stipulated in the pension rules, an annuity payment is calculated from the severance lump-sum amount by multiplying a certain rate, and the rate will vary according as the experiences of pre-defined market interest rates.

Features of CB & “modified CB”

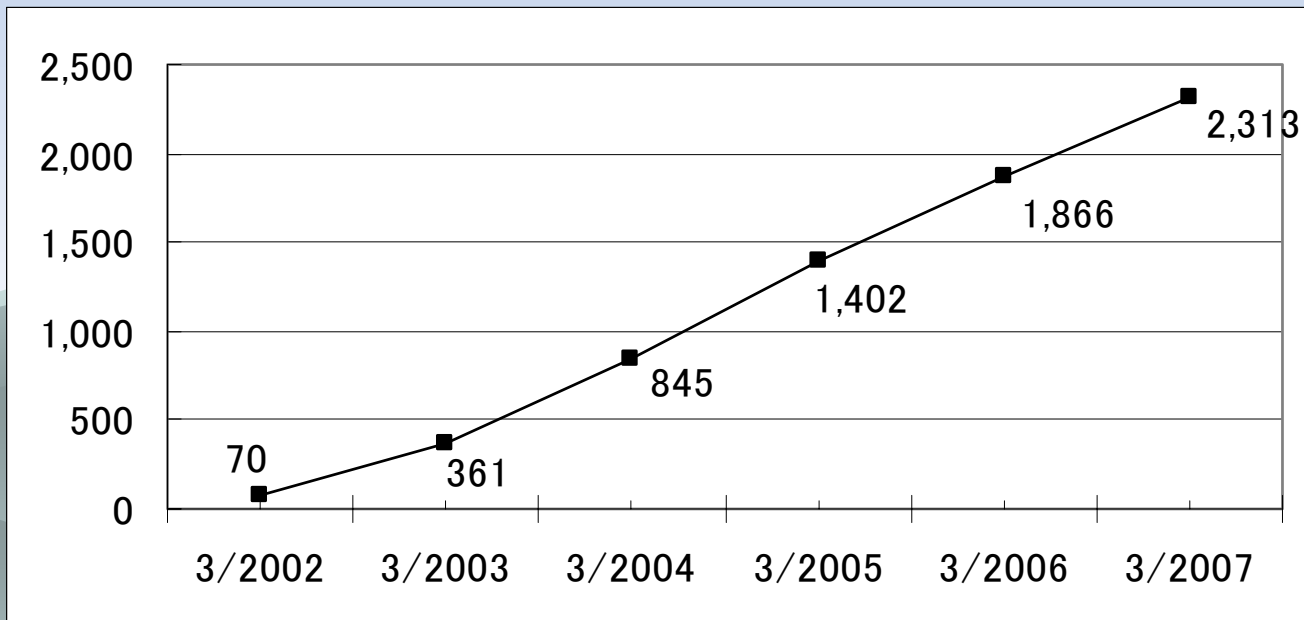
- ◆ The corporation’s main demand to CB type design or the “modified CB type design” is to share down-side risk of the mid-term market volatility with employees
- ◆ The benefits of CB pension and the “modified CB pension” will vary according as the experiences of pre-defined market interest rates.
- ◆ CB pension and the “modified CB pension” need advanced administrations, so they aren’t good for small or midsize companies.



Recent trends of growth of DC plan and their factors in Japan

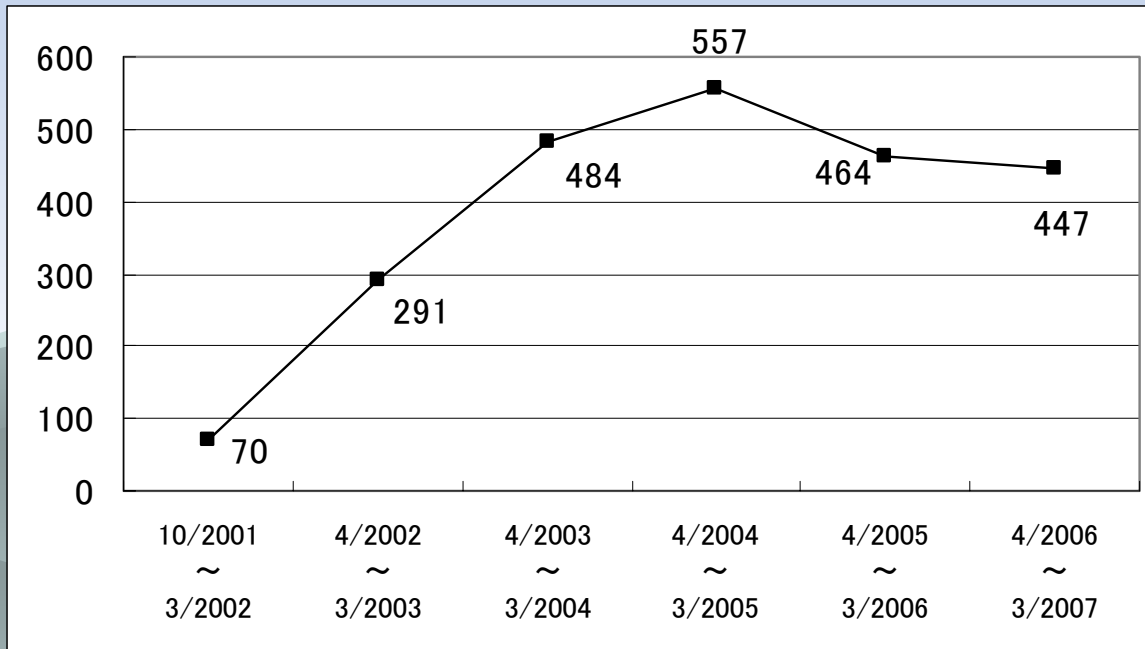
Recent trends of growth of DC plan

Fig.1. DC pension (corporate type) plans



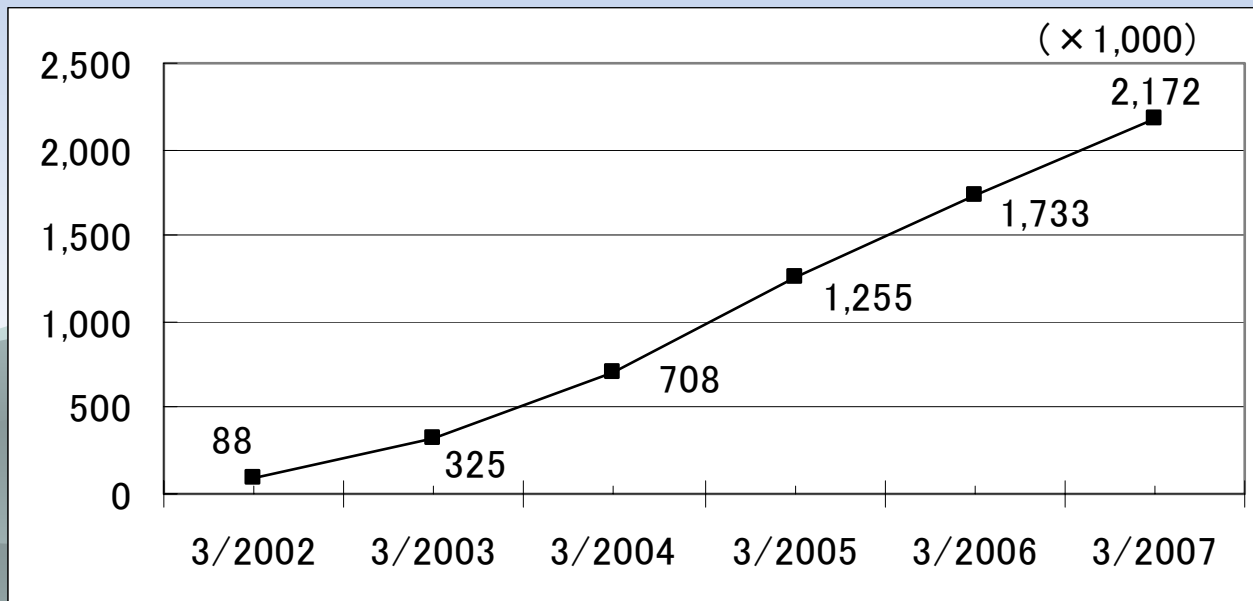
Recent trends of growth of DC plan

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



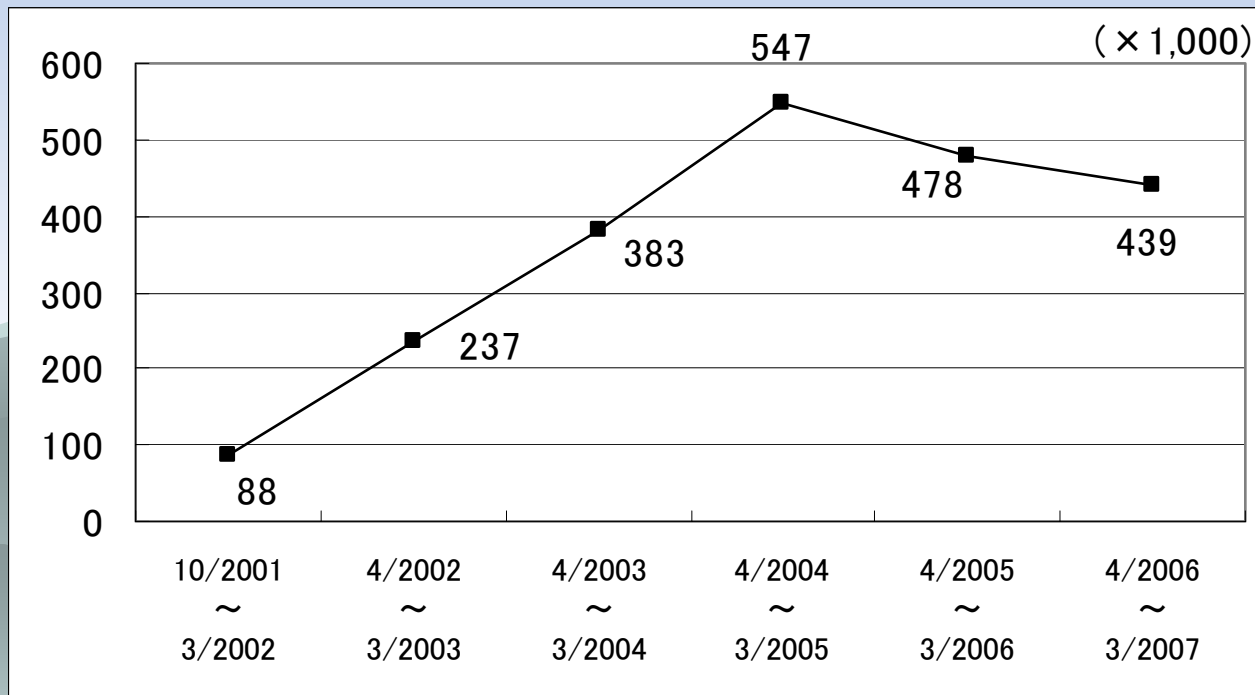
Recent trends of growth of DC plan

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



Recent trends of growth of DC plan

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



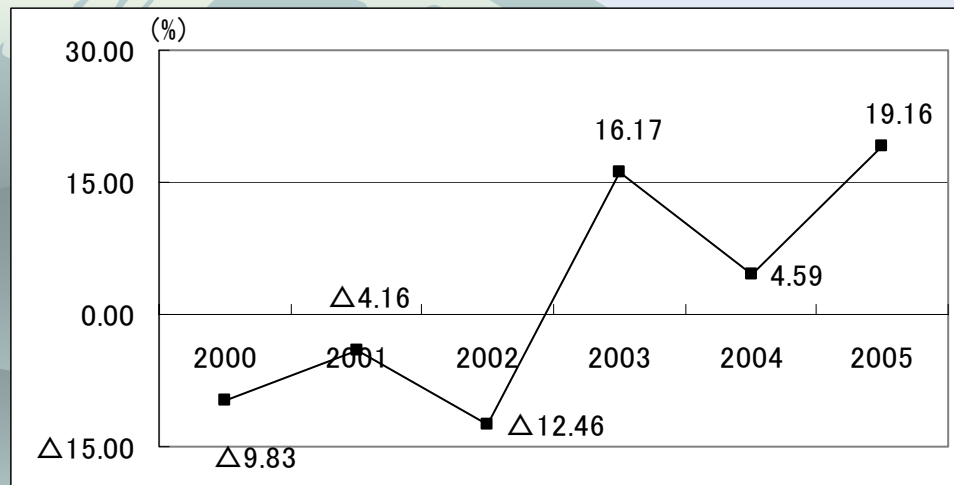
End of DC plan establishment rush based on initial demand

- ◆ 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 attracted by 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 slow-down of the growth of DC plan.

Change of investment circumstances

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

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

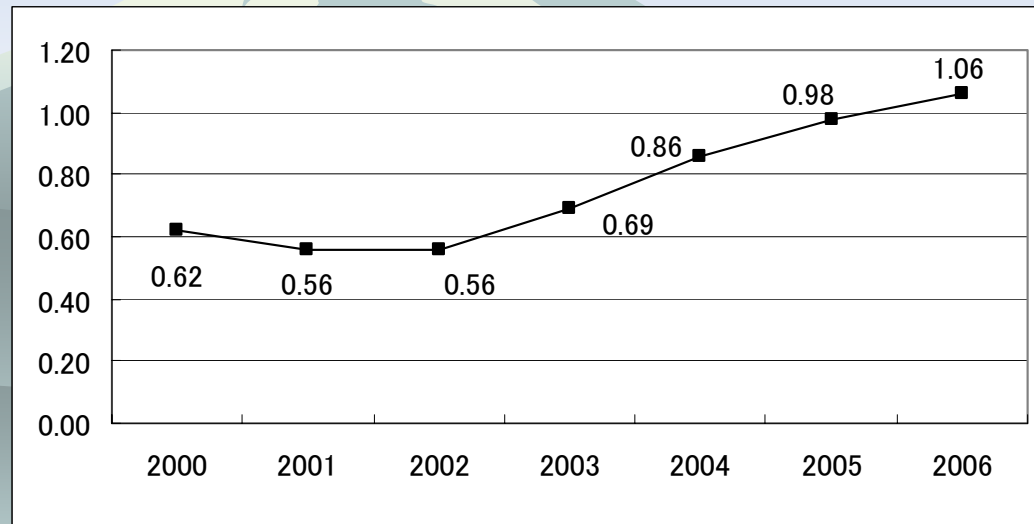


(*) The years start in April end in March.

Change of labor market

- ◆ Since the labor market has become a sellers' market after 2003, corporate executives seem to reduce to shift corporate pensions risk to employees.
- ◆ So they have reduced to make transitions from DB-type pensions to DC.

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



(*) The years start in April end in March.

Room for improvement of DC pension (corporate type) system

<Proposal> =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 the severance lump-sum program has been the traditionally ordinary system and almost all DC pension plans are shifted from all or a part of the severance lump-sum program.

Many organizations in Japan have made proposals to the Government about this improvement of DC pension system.

Room for improvement of DC pension (corporate type) system

<FACTORS>

<Proposal> =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 pensions, 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 ordinary system of corporation pension that an annuity is shifted from all or a part of a severance lump-sum program. And the average amount of original severance program of male employees who graduated university is 27 million yen which is equal to the result amount of 70,000yen contributions per month with 1% investment return for 25 years.

Many organizations in Japan have made proposals to the Government about this improvement of DC pension system.

<FACTORS>

Room for improvement of DC pension (corporate type) system

<Proposal> = Repeal of Prohibition of employee contribution.

- ◆ If employee contribution is granted in a DC plan, a lot of employees seem to use DC plan for saving for their old age .

Many organizations in Japan have made proposals to the Government about this improvement of DC pension system.

Room for improvement of DC pension (corporate type) system

<Proposal> =The regulation that a person who is no less than 60 years old cannot be an active participant should be abolished.

- ◆ The normal age in which benefit of public pension starts is scheduled to be 65 years old from 60 years old.
- ◆ The employment age limit is required to be older (ex. 60⇒65) by a law.

Many organizations in Japan have made proposals to the Government about this improvement of DC pension system.

Summary of Chapter 2

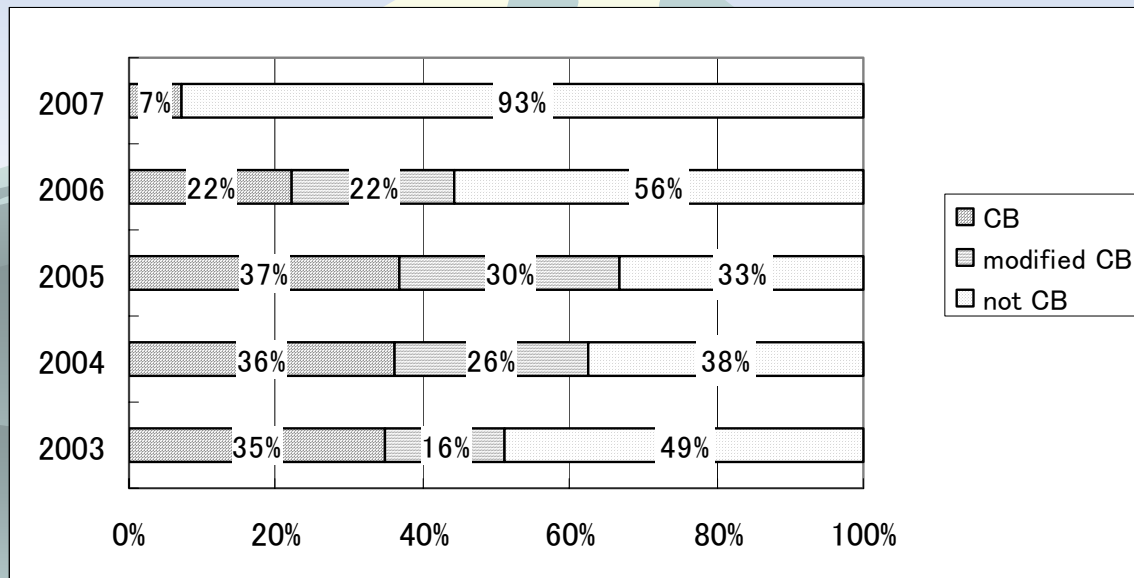
- ◆ The initial demand to DC pension seems to have passed away at 2004 [This is the biggest factor].
- ◆ The demand to DC pension seemed to be somewhat reduced by the change of the investment environment and labor market.
- ◆ There remain some rooms for improvement of DC pension system, they seem to weaken the demand to DC pension.



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

Recent trends of growth of CB type design scheme

Fig.7. Percentage of CB type design and “modified CB type design” in newly established DBCPP (which are based on DBCPP law) whose main trustee is The Sumitomo Trust



(*) The years start in April end in March.

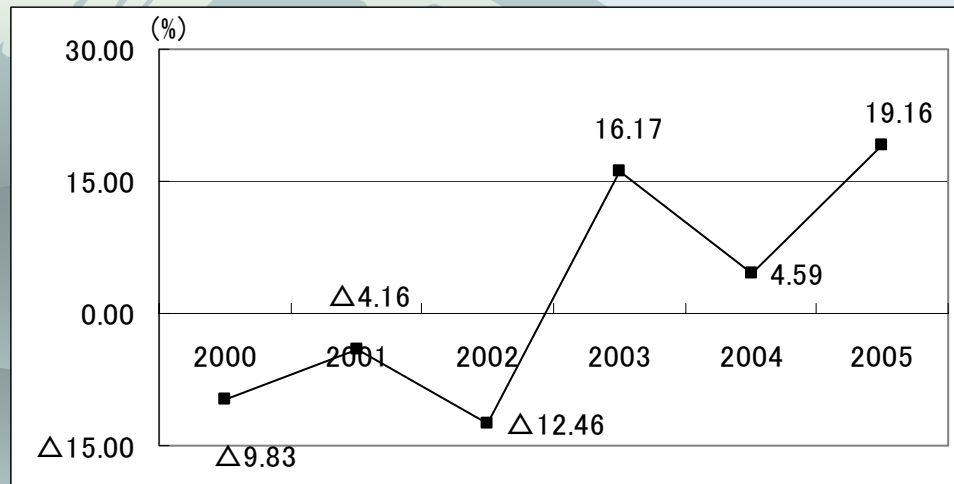
End of CB type design plan establishment rush based on initial demand

- ◆ CB type design scheme was granted in April 2002.
- ◆ 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 fascinated by 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 slow-down of the growth of CB type design.

Change of investment circumstances

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

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



(*) The years start in April end in March.

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 market circumstances corporate executives seem to prospect that the interest rate will increase in two or three years.
- ◆ In the case that the interest rate increases, CB benefits to employees will increase in line with the interest rate.
- ◆ So such circumstances seem to weaken the demand to CB plans.

Summary of Chapter 3

- ◆ The initial demand to CB type design scheme seems to have passed away before 2006 [This is the biggest factor].
- ◆ The improvement of investment return seemed to reduce the demand to CB type design.
- ◆ The prospects that the interest rate will increase further seem to weaken the demand to CB type design.