

The Current Issues of Pension Schemes in Japan

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Abstract

Currently, one of the major issues of the pension schemes in Japan is the reduction of coverage. The public pension schemes, which should be a pension insurance system as a whole covering the entire population, have been experiencing the reduction of coverage. Moreover, it can be understood that the non-regular workers who have increased substantially in number due to the economic globalization and have been driven away to the National Pension (NP) scheme can also be regarded as a typical phenomenon of the reduction of coverage in a broad sense, since these workers should primarily be covered by the Employees' Pension Insurance (EPI) scheme. Of course, the same phenomenon is more remarkable in the field of occupational pensions. In this paper, we analyze the major factors and explore several possible solutions.

Keywords

coverage, public pension scheme, occupational pension scheme, DB scheme, DC scheme

1. The current issues of the pension schemes in Japan

The major issue is the reduction of coverage.

(1) Reduction of coverage in the public pension schemes

The public pension schemes in Japan comprise a pension insurance system as a whole covering the entire population based on the principle of social insurance, and all citizens in Japan have the subscription duty. However, the recognition of general public on the duty is scarce, probably because the education about social security is insufficient. Under such a situation, several cases of mal-administration of the system have been revealed, including the cases that insurance records of many participants were not properly managed. In addition, mass media utilized it for the purpose of raising viewership and a political party utilized it for the purpose of winning the general election. Not only the mal-administration but also these behaviors aggravated people's distrust to the public pension system and inflamed the people's anxiety over the national system of income security. As a result, for example, many people have misunderstood that the public pension scheme had already failed financially, and some self-employed workers began purchasing annuity products from the market instead of paying premiums to the National Pension (NP) scheme, and the NP scheme has suffered reduction of coverage. It should be reminded that an exemption system of paying premiums according to the income status is incorporated in the NP scheme, and low income itself does not justify escaping the coverage of the NP scheme.

Many non-regular workers, who increased in number by the economic globalization, are driven away to the NP scheme instead of being covered by the Employee's Pension Insurance (EPI) scheme, which should be applied primarily. The trends of the number of non-regular workers in these 25 years clearly shows an increase of non-regular workers in Japan, while the increase in the number of category 2 insured population has not caught up with the increase. As a result, many non-regular workers were driven away to the NP scheme. In Japan, the benefit level of the EPI scheme is higher than that of the NP scheme, since many workers covered by the EPI scheme are employed by companies with a mandatory retirement age while for the self-employed workers there is no mandatory retirement age and they also have their own properties in many cases. Thus, many non-regular workers would not be able to ensure adequate old-age income in the future, as a result of not being covered by the EPI scheme. It can be regarded as a typical example of the reduction of public pension coverage in a broad sense.

Table 1.

Number of Non-regular Staff						
(in ten thousand)						
year	① Number of employees excluding company executives	Number of regular staff	② Number of non-regular staff	② ÷ ① (%)	③ Category 2 participants (Workers in Private sector)	③ ÷ ① (%)
1985	3,998	3,343	655	16	2,723	68
1990	4,369	3,488	881	20	3,100	71
1995	4,780	3,779	1,001	21	3,328	70
2000	4,903	3,630	1,273	26	3,219	66
2005	4,924	3,333	1,591	32	3,302	67
2010	5,095	3,381	1,714	34	3,441	68

(Note)

Number of employees:
Until the year of 2000 the numbers are the average of February. From 2005 onwards, they are the average of the 1st quarter of the year.
(Source : "Labour Force Survey" by the Ministry of Internal Affairs and Communications)

Number of Category 2 participants:
The numbers are the end of the fiscal year. A fiscal year starts on 1 April and ends on 31 March.
(Source : Ministry of Health, Labor and Welfare)

(2) Reduction of coverage in the occupational pension scheme

In the occupational pension scheme in Japan, in parallel to the slowdown of economic growth accompanying with the maturation of the society, two factors promoted termination of occupational pensions and caused reduction of coverage of occupational pensions. One factor is that corporate earnings and pension asset returns have fallen significantly and another factor is that the accounting cost have increased substantially by the introduction of the international accounting standards.

Traditionally in Japan, employees of the small and medium-sized enterprises (SME) have accounted for the large proportion of the workers covered by occupational pension schemes. However, two major policy changes in field of occupational pensions, namely, abolition of the tax-qualified pension plans (TQPPs) and government's proposal of

phasing out the Employee's Pension Funds (EPF) scheme, narrowed the scheme options which are available for SMEs and thus caused reduction of coverage of occupational pensions.

Table 2.

Number of the Insured Persons							
(in ten thousand)							
year (End of the fiscal year)	occupational pension scheme					② Category 2 participants (Workers in Private sector)	① ÷ ② (%)
	Tax- Qualified Pension	Employees' Pension Funds	Defined- Benefit Corporate Pension	DC (occupational type)	① sum		
2000	968	1,140			2,108	3,219	65
2001	917	1,087		9	2,013	3,158	64
2002	859	1,039	3	33	1,934	3,214	60
2003	778	835	135	71	1,819	3,212	57
2004	655	615	314	126	1,710	3,249	53
2005	569	531	384	173	1,657	3,302	50
2006	507	474	430	219	1,630	3,379	48
2007	443	463	506	271	1,683	3,457	49
2008	349	439	570	311	1,669	3,444	48
2009	250	431	647	340	1,668	3,425	49
2010	126	430	727	371	1,654	3,441	48
2011	0	411	801	422	1,634	3,451	47
(Note)							
Since there is institutional duplication adoption, an application rate is a high numerical value. Moreover, the smaller enterprise retirement allowance mutual aid (SERAMA) scheme is excepted, but the influence on proportional change is restrictive.							
(Source : "Ministry of Health, Labor and Welfare", " Pension Fund Association")							

In addition, it is expected that the increase of non-regular workers also causes reduction of coverage in the field of occupational pensions.

(3) Issues we consider in this paper

Under the situation of expected gradual decrement of the level of public pensions, we will consider about "what should be the overall framework (architecture) of the pension schemes in Japan, including the public, occupational and individual pension schemes", and "what roles pension actuarial professions should play for ensuring adequate coverage of pension schemes for every workers", based on the characteristics of the

system of Japan.

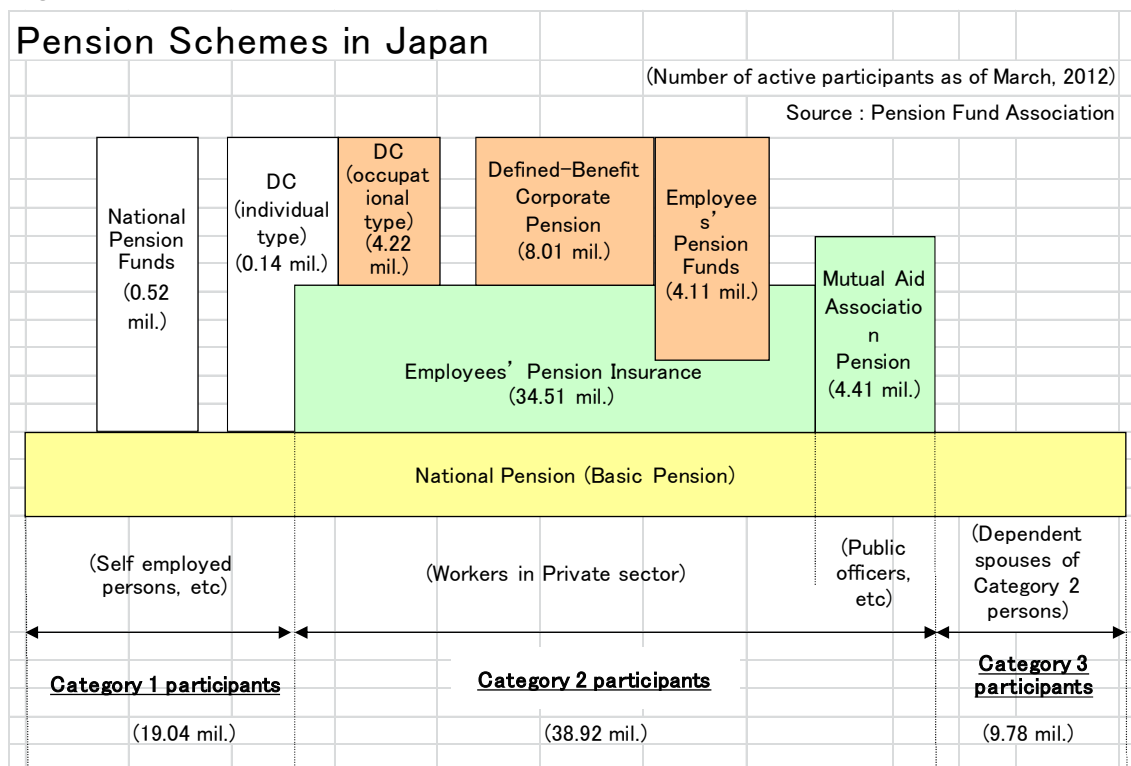
There is no one-size-fits-all solution applicable for all countries. We expect that the experience and the measures of Japan would become reference of countries around the world.

2. The feature of the system of Japan

(1) Pension Schemes in Japan

The public pension system provides income security for the entire population based on the concept of social insurance, and every citizens have the duty of subscription.

Figure 1.



Many non-regular workers are driven away to the NP scheme instead of being covered by the EPI scheme, which should be applied to them primarily.

(2) The special features of the employment system in Japan

With reference to HAMAGUCHI (2009), one of the special features of the employment system in Japan is that prevailing employment pattern is not “a job type” but “a membership type”. “A membership type” is a system based on age and maintained by “periodic recruitment of new university graduates as an entrance to the workforce and

the seniority-based wage system", and "the mandatory retirement age as an exit." However, this type of employment is only applied to full-time workers. They are required to do unlimited kinds of jobs like the European and American elite layer, and they are treated according to their age-specific life styles. In addition, it is common that a retirement lump-sum plan is prepared for the workers aiming at maintaining their life after retirement to some extent. It is generally understood that this is the background that the post retirement occupational benefit system in Japan has developed mainly with DB structures.

However, it is expected that the number of "job type" full-time employees with limited job ranges will increase further and therefore the structure of post retirement benefit plans will be changed accordingly. ("A job type" full-time employment will probably be a common employment style from the global perspective, where employees only work along with a contract and they are not required to respond to further demands beyond the contract. As a natural consequence, they will only be treated corresponding to their jobs explicitly stated in the contract.)

(3) The feature of the social security system

As for the Japanese social security systems, such as the pensions and the medical insurance, it is one of the special features that companies have played the central role between the government and individuals. Along with the modernization of the country, individual firms substituted the role of social security when social security systems were absent, until public social security systems were prepared gradually in the process of socialization of family support, where private support were substituted to public support. (Since the employers' organizations were not firm enough to play a role expected in so-called corporatism, which is a political system that national policy decisions are formulated with the participation of large companies or employers' organization, basically individual companies provided the programs. Labor unions are also company-specific and are not industry-specific organizations as in the West. Under these circumstances, it is sometimes said that Japan does not have "social" principles but has "corporate" principles.)

In the field of pensions, companies played major roles by providing lump-sum retirement benefit plans, until the time that benefit levels of public pension schemes were improved. For this reason, improvement of the benefit levels of the public pension scheme for private sector workers could only be realized on condition that the Employees Pension Fund scheme are introduced and each EPF substitutes a part of public pensions as a mean of adjusting retirement lump-sum benefits with public

pension benefits through the substitution system. Currently, abolition of the EPF scheme is proposed by the government due to fiscal deterioration of EPFs in recent years but we should not forget that the EPF scheme has played the important role in spreading occupational pension plans in Japan. Thus, it is considered that the configuration of public and private systems will differ country by country according to the development stages and development processes of a country.

As a reference, in the medical field, Japan has prepared medical organizations (hospitals and clinics) relying mainly on private sectors. This is a major difference from the European systems based on public hospitals. For example, even if medical institutions were concentrated in some areas, it would be difficult to rearrange the distribution of medical institutions compulsorily as a social policy. In order to change a policy, the government must have deliberations with private sector stakeholders and reach an agreement widely.

With reference to FUJII (2009), among the 23 advanced countries, DB plans in Japan have “a moderate size” in comparison to the size of their sponsoring entities. Let us look at the averages of the ratios of the total benefit obligations to the equity capital of the sponsoring company, since they show the relative size of the DB plan to the sponsoring company. Britain is 120.9%, the U.S. is 63.0%, and Japan is 27.7%. Moreover, while in Japan, most of the companies have the ratio of 50% or less although there are companies with the ratio of more than 100%, in the UK and the U.S., overwhelming companies have the ratio of more than 100%. As a result, many companies in the U.S. have stopped providing DB plans and buyout transactions have been common in the UK.

3. What should we do with regard to the pension schemes in Japan

(1) Diversity is important

Enhance the diversity of plan administrators: In a whole country, enhancing the diversity of plan administrators improves the sustainability of the pension system as a whole, which is same as biodiversity. If a problem occurs in a part of the pension plans which are managed by a small group of companies, then such a “structural” reform as creating a pension system managed by a large group of companies is often proposed, but it is an error. In our opinion, when managed by a large group of companies, it may become an excessive burden. It is because when the pension system was managed by a large group of companies, then it may fall into the situation of so-called “too big to fail” when the plan is in a financially distressed status. Consequently, tax injection might be required and it may lead to a big public financial burden. On the other hand, if the

pension system is divided into small portions and each portion is managed by a small group of companies, then it is expected that even if a small number of the plans became underfunded and were difficult to be maintained, majority of the plans would remain financially healthy and thus overall sustainability of the system might be enhanced. This is because painful measures such as benefit reduction and increasing premium rates are only applied to the small groups of companies concerned. Currently we have potential concerns about the question of the continuity of the National Pension Funds and Pension Fund Association in the case of abolition of the EPF scheme and the Smaller Enterprise Retirement Allowance Mutual Aid Scheme, and all of them are examples of “too big to fail”.

Diversity of the schemes with regard to risk characteristics: Pension systems with different risk characteristics share risks differently, so adopting schemes with different risk characteristics will improve the sustainability of the system as a whole from the perspective of individual companies. (pure DC scheme, pure DB scheme, pure-public PAYG scheme, etc.)

(2) Middle (income) class workers should be the primary target of public pension policies

In order for the society to develop steadily, it is essential to maintain the middle class of workers. Therefore, the primary target of public pension policies should be middle class workers.

Population of Japan is 130 million, and is too big for covering all the people under one system. In addition, a public pension scheme tends to turn into a minimum income security system under the environment of low economic growth. And income gap among elder population tends to be expanded if preparation of old age income is left to individual workers. By this reason, it is important to keep the system primarily targeting at middle class workers by encouraging the middle class workers to manage the pension system collectively by themselves.

As for the system for middle class workers, it is desirable to manage the system by some “intermediate organization” between the government and each individual. Such an “intermediate organization” should be an organization to which individual members have a sense of belonging, and can share the principle of mutual aid. Such an organization can be managed proactively by the members and they will make constant efforts voluntarily for themselves.

Several examples of “the intermediate organizations” are: large companies, labor unions, employer organizations, consumer organizations, NPOs, NGOs, and various professional organizations

Companies will play the role of the intermediate organization for their full-time employees. But under the environment of diversified employment system, it will be essential to create such an organization with which workers, including non-regular employees, can enter into some kind of psychological contracts, based on mutual reliance and expectation about preparing old age income together.

(For reference)

John Maynard Keynes said : The ideal scale of the unit of government and an organization is between an individual and a state.

Alexis-Charles-Henri Clérel de Tocqueville said : In order to solve man's social problems, all are not expectable in individual self-reliance. On the other hand, the state does not have sufficient physical strength which gives help in any cases to individual political demand and economic difficulties. An "association" has the power which combines the individual who tends to shut himself up in self husks and tends to become scattering, and makes the technology in which people are adapted for the common good study. The autonomous bodies are the best school which makes self-government study. The democratic country can become skilled in the technology of pursuing together the object of common (for reservation of a group which makes the grade of a risk the same of mutual help and stability) desire, and can connect to increase of public interest. Moreover, an association has a role which protects the right of the minority of democracy society from the majority's despotism which irresponsible egoism produces.

(3) Concrete Measures

a. Social Policy

The coverage of the EPI scheme should be expanded gradually so that non-regular workers are covered by the scheme, by relaxing the present restrictions on monthly working hours etc., while paying attention to the additional burden to the companies, in order to improve the situation that non regular workers are driven away to the NP scheme. The 2012 Pension Reform has slightly expanded the coverage, but still there are many non-regular workers who are not covered by the EPI scheme.

The TQPP scheme, which was introduced before the creation of the EPF scheme, was abolished by the reason that the scheme is not equipped with proper measures of benefit protection, not because the needs for the scheme diminished substantially. It was originally intended to encourage converting the TQPP plans to other type of pension plans, the number of plan termination became greater than the number of plan conversion to other pension systems, and it caused reduction of the coverage of

occupational pensions in Japan. Reduction of coverage was especially remarkable among SMEs. If we learn from the lesson, adequate consideration should be given before determining abolition of the EPF scheme, such as detailed comparison with the funding levels of other pension systems as the National Pension Funds and those of the pension plans around the world such as the U.S. and possible improvements of the current system.

b. DB

As mentioned above, DB plans in Japan are with “a moderate size” in comparison to the sponsoring companies, which contrasts with the situations in the UK and the U.S. Therefore, we can expect that DB plans in Japan have high sustainability from the viewpoint of accounting. One of the reasons why DB plans in Japan are with “a moderate size” might be that many DB plans in Japan do not offer life-long benefits and indexation. Then, a possible idea is allowing a DB plan of just saving lump sum amounts. It only plays the role of complementing public pensions, giving up covering longevity risk. For example, this type of DB plans does not offer life annuities and price indexation. In this case, this plan does not provide pensions any more. Then the lump sum amounts prepared via the plan will be withdrawn as fixed term annuities filling the gap between the retirement age and pensionable age of public pensions or used for purchasing annuity products from the market.

c DC

Under the environment of high market volatilities like in these days, we tend to choose a low risk portfolio using a DC plan. Such high risk aversion is just because we are too sensitive to the market risks. However, DC plans are preferred by those with enough income, and DC plans tend to extend the gap. Moreover, employers tend to be indifferent to the maintenance of the DC plan because individual members have the responsibility of maintaining personal accounts, and as a result the benefit level tends to become inadequate.

d. Others

It is expected that workers changes jobs frequently and thus enhancing portability will become an important point of scheme design. In addition, it will be needed to introduce an individual account scheme like the IRA in the U.S. for complementing the occupational pensions.

We consider that the appropriate combination of the above systems is a realistic

solution in Japan.

4. The role which an actuary should play

In a DB plan, premium rates are revised through actuarial valuations. Moreover, at the time of economic fluctuations, the benefit design might be modified to maintain the real value of benefits. Thus, after the plan was started, the plan is reviewed and problems are corrected in due course. Advising on the plan designs and calculating the premium rates required from the actuarial viewpoints is a traditional role of actuaries.

Moreover, if a problem occurs in a pension system, the plan participants and the sponsor tend to complain. In such cases, actuaries are expected to play a role of proposing rational solutions and encouraging constructive communications among them.

In Japan, one of the backgrounds that have caused reduction of coverage is that some politicians, who should promote measures to which people feel a sense of relief, provoked the breakdown of the pension system. For this reason, more fundamentally, education on pension systems to the public is also important. Pension actuaries should play a role proactively in the field of educating pension systems to the public.

5. Conclusion

We must not forget the original social objective of the pension scheme of providing wider range of people with adequate pensions.

From this viewpoint, when there is a problem in the present system, and even if it seems that the problem can be fixed by implementing a certain reform, we believe that it is indispensable to consider carefully whether the reform might damage the original social objective. And we also believe that it is essential to continue improving the present system gradually so that the side effects of the reform can be contained in a minimum range, giving consideration to the relation of the pension system to the whole social system of the country.

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