

Japanese Pension System: Current Status and Need for Further Reform

Nomura Institute of Capital Markets Research

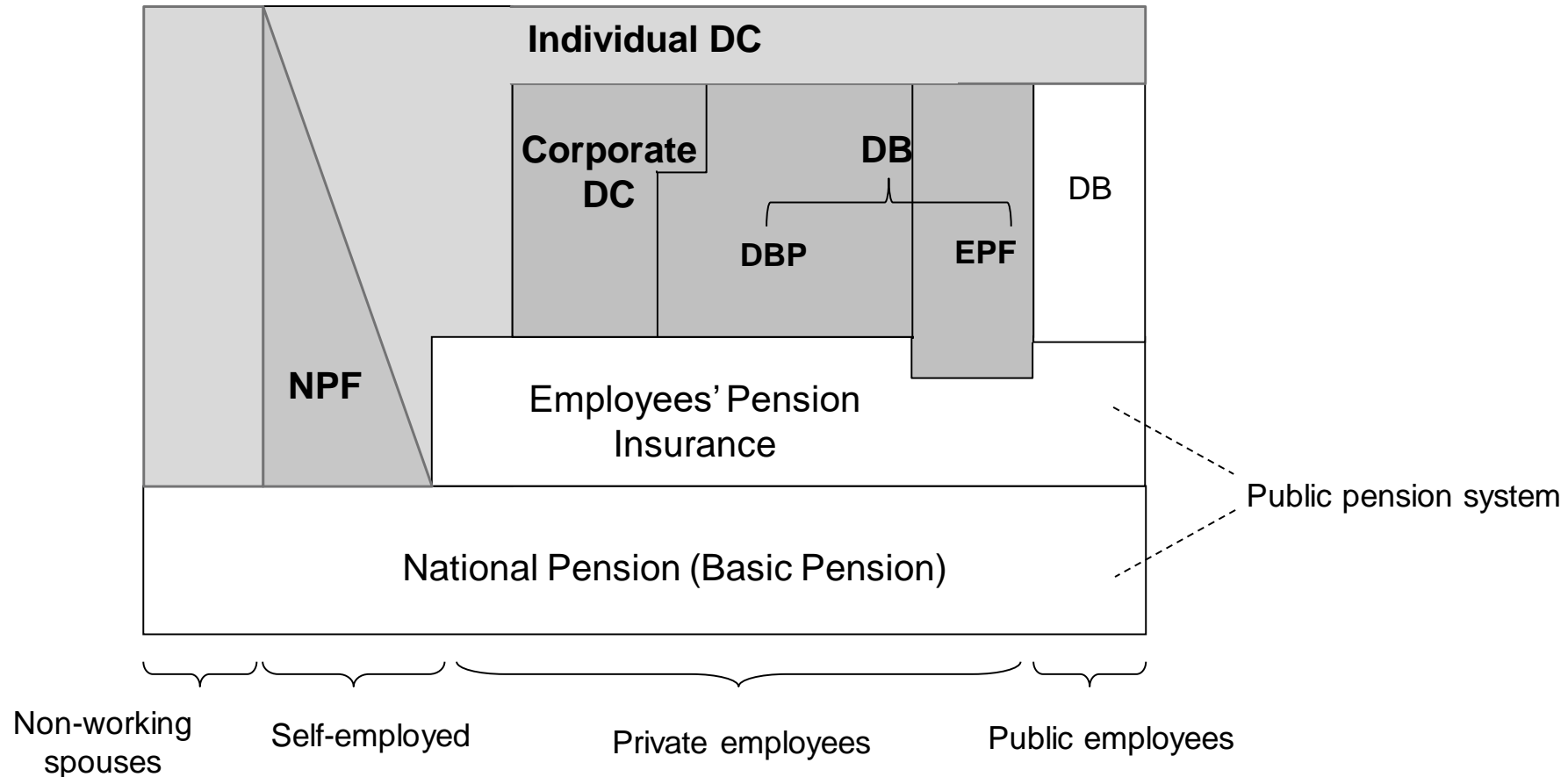
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Japanese pension system

- Japanese pension system consists of the public pension system covering everybody and various types of private pension plans.



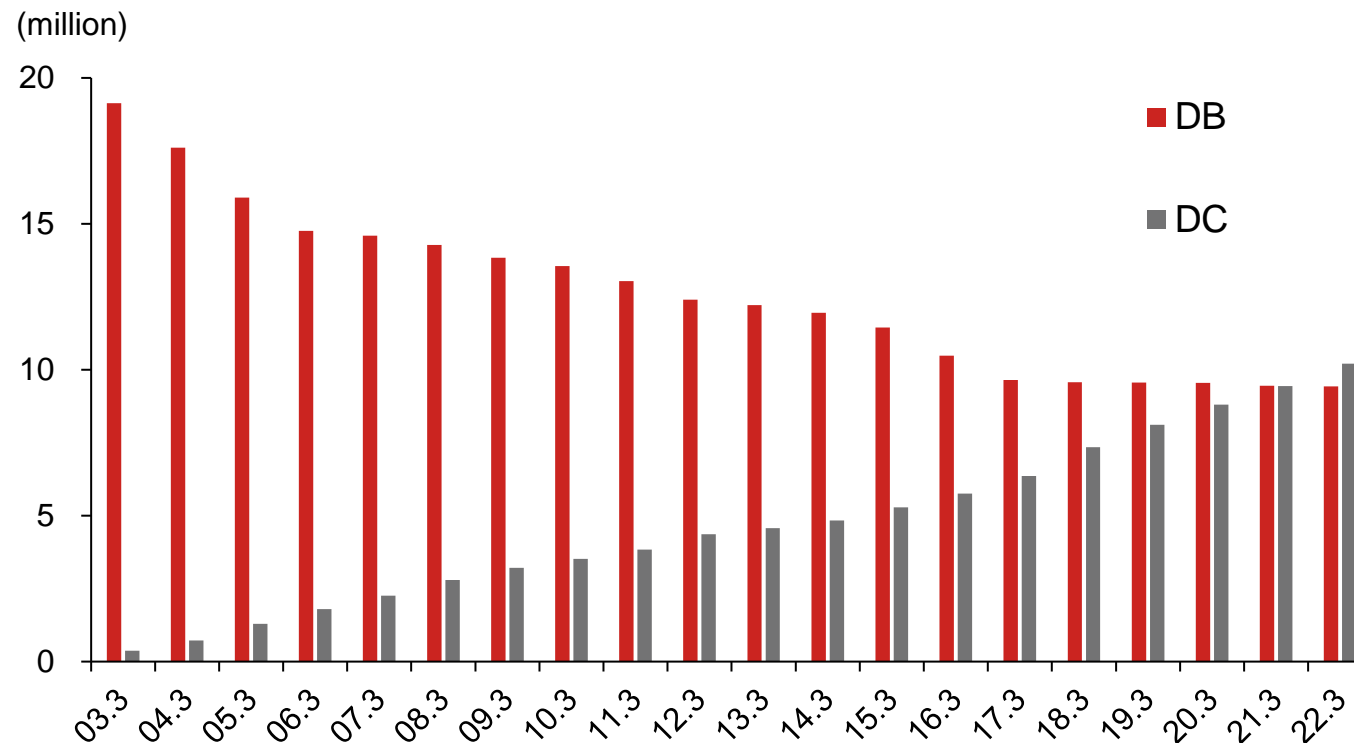
(Note) Gray areas are voluntary plans. DC=defined contribution, DB=defined benefit, EPF=Employees' Pension Fund, DBP=Defined Benefit Corporate Pension, NPF=National Pension Fund.

(Source) Ministry of Health, Labour and Welfare (MHLW), Nomura Institute of Capital Markets Research (NICMR)

Coverage of private pension plans

- While the importance of private pensions increases, the coverage of corporate pension plans has not been growing sufficiently.
- Measures to strengthen the private pension system, especially DC plans, are needed.

Number of private pension plan participants

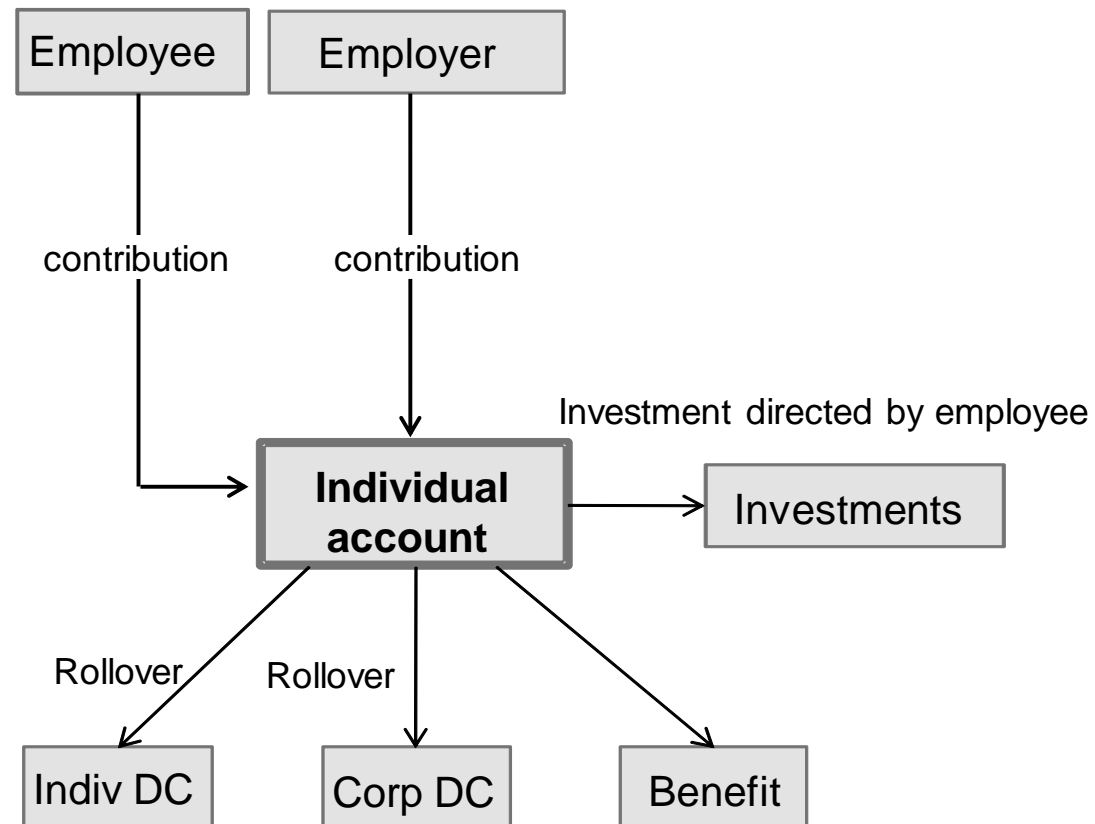


(Note) Not adjusted for participants in more than one plan. DC includes both corporate DC and individual DC.
 (Source) MHLW, NICMR

Basic structure of Japanese DC plans

- Employer and employee make contributions.
- Employee directs investments of his/her individual account assets based on the investment education provided by the plan administrator.

Basic structure of DC plans (corporate type)

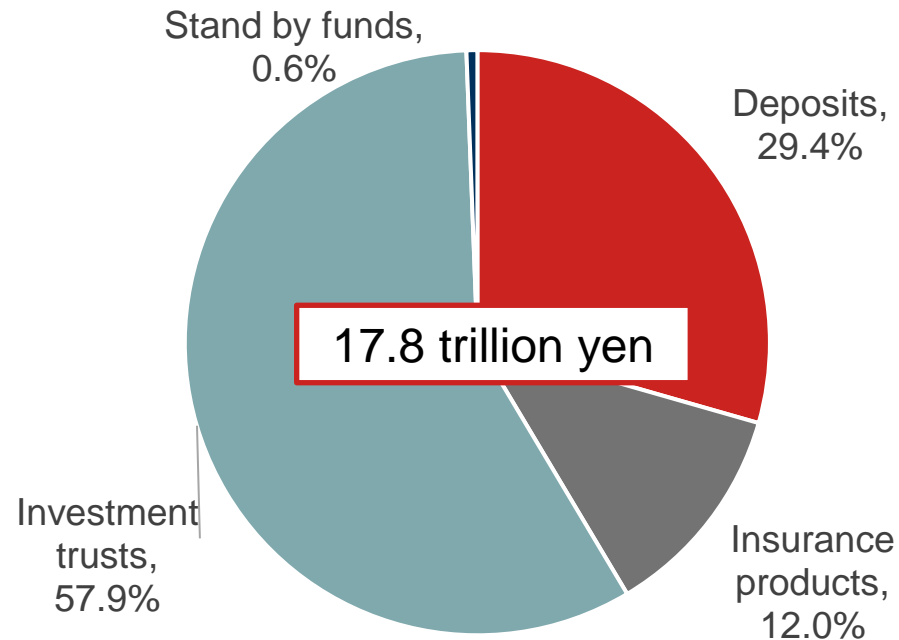


(Source) NICMR

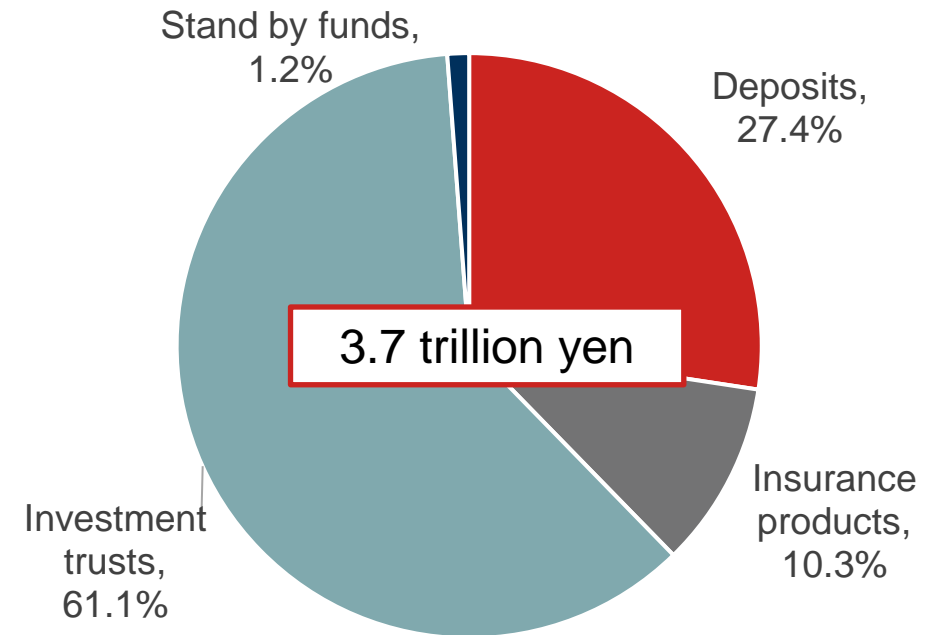
How DC participants manage their assets

- Around 60% of DC assets are in investment trusts.
- Supporting further investment diversification holds the key for successful asset accumulation in DC accounts.

Corporate DC plan asset allocation



Individual DC plan asset allocation



(Note) March 2022

(Source) Association of DC Plan Administrators, NICMR

- Japanese version of “DC default fund arrangement” was introduced by Revised DC Law and became available in 2018.

Basic features of the Japanese DC default funds

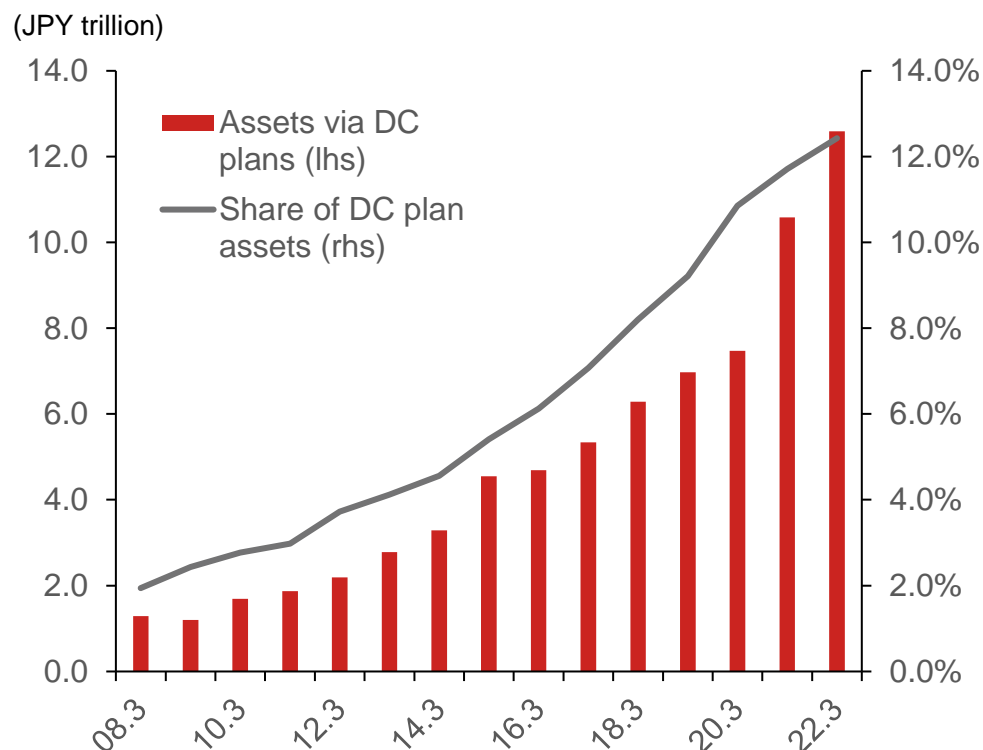
Designation	<ul style="list-style-type: none"> • Employer can decide whether to designate the default fund for the DC plan or not. • The default fund will be selected from the DC product lineup.
Product features	<ul style="list-style-type: none"> • Criteria for the default funds will be stipulated in the regulation. • The newly inserted section of the DC law includes the words such as “long term perspective,” “price fluctuation” and “securing profits.” • Plan administrators are to select the fund based on their professional knowledge.
Disclosures to participants	<ul style="list-style-type: none"> • Expected return and possible losses of the product • The reasons for designating the product • Treatment of participants without investment direction (as below)
Treatment of participants without investment direction	<p>Plan administrator notifies participants about the default fund when they join the DC plan</p> <p style="text-align: center;">↓</p> <p>A participant has not selected investment products after 3 months</p> <p style="text-align: center;">↓</p> <p>Plan administrator notifies the participant about making selection</p> <p style="text-align: center;">↓</p> <p>The participant still does not make selection after 2 weeks</p> <p style="text-align: center;">↓</p> <p>The participant’s account assets are invested in the default fund. The participant is regarded as having made the investment direction him/herself.</p>

(Source) Revised DC Law, NICMR

DC plan and the investment trust industry

- Share of investment trust assets via DC plans has reached 12% of total assets excluding ETFs.
- According to Investment Trust Association survey, 6.4% refer to DC investment as a trigger of interest in investment trusts.

Investment trust assets via DC plans



(Note) Share of DC investment trust assets in publicly offered investment trusts excluding ETFs

(Source) DC Plan Administrator Association, Investment Trust Association, Japan (JITA), NICMR

Trigger of interest in investment trusts



(Note) Provisional translation by NICMR

(Source) JITA, NICMR

Implications and discussion points

- Aging population puts pressure on the funding of pay-as-you-go public pension system. Enhancing sustainability will have to take priority.
- Private pension plans will have to play a larger role in enhancing pension adequacy.
- As private pension plans are voluntary, how to enhance their coverage is a challenge.
- Defined contribution plans are more promising in terms of adoption and coverage.
- Employers do not promise pension benefits in DC plans and participants assume investment risk, so it makes sense to have them decide on how to invest individual account assets. Adequate investment education and guidance, and utilization of default funds may hold the key.
- Individuals can gain experience in long term diversified investments via DC plans, which will have significant implications on their savings. It will also lead to an increase in capital market participants.

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