Proposal for Fundamentally Reforming Japan's Defined Contribution Pensions

Akiko Nomura
Senior Analyst,
Nomura Institute of Capital Markets Research

I. Introduction

Over 3.21 million people were enrolled in defined contribution (DC) pensions plans in Japan as of end-March 2009, including 3.11 million in corporate DC plans and 100,000 in individual DC plans. The number of businesses offering corporate DC plans has also grown steadily, and totaled 11,706 as of that date.

There are still a number of issues with the current system, however, as shown in Figure 1. Although there have recently been some efforts to reform the scheme, including allowing contributions from participants in corporate DC plans (sometimes referred to as “matching contributions”), there has been no progress in dealing with many of these issues[1].

In this paper, we present our proposals for a fundamental reform of defined contribution (DC) pension plans, without being constrained by existing approaches and frameworks. Our proposals can be broadly categorized as those expanding DC plan coverage, those offering further tax breaks, and those regarding investment instructions.

II. Proposal to expand DC plan coverage

1. Coverage by corporate pensions is declining

Corporate pensions in Japan are established voluntarily, and companies are under no obligation to provide their employees with any sort of pension, be it a defined benefit (DB) or defined contribution plan. We estimate that as of the end of FY2007,

[1] A proposal for reforming the Defined Contribution Pension Law was submitted to the Diet on 6 March 2009, but the proposal eventually died after time ran out. For details on the proposed bill, see the article by Akiko Nomura in the Spring 2009 edition of the Capital Market quarterly entitled *Kakutei Kyoshutsu Nenkin ni Kanyuusha Kyoshutsu (Matching Kyoshutsu) wo Dounyuu suru Kaiseihouan* (Proposed reforms would allow matching contributions by DC plan participants) (in Japanese).

Figure 1: Issues with defined contribution pension plans

Issue	Details	Recent trends
Contribution-related	• Allowing individual (matching) contributions by participants in corporate plans • Raising the maximum contribution limit	• This was included in a proposal to reform the Defined Contribution Pension Law submitted to the Diet, but the bill did not pass • Implementation is scheduled for January 2010 based on a revision to the Administrative Order
Expanding eligibility	• Allowing government workers to participate • Allowing spouses with no income (No. 3 insured persons) to participate • Allowing employees of firms that have a defined benefit (DB) plan but not a DC plan to participate in an individual plan • Raising the age limit for joining a plan to 60 or over	• Nothing in particular • Nothing in particular • Both the Ministry of Health, Labour, and Welfare and the Financial Services Agency requested that this be a part of the FY2009 tax reform, but it was not included in the broad tax reform package. • A proposal to allow enrollment up to age 65 if the company would accommodate that was included in a bill to integrate the pensions of government workers and private-sector salaried employees, but the bill did not pass
Early withdrawals	• A further easing of early withdrawal requirements	• A proposal for a partial easing of requirements was included in a bill to integrate the pensions of government workers and private-sector salaried employees, but the bill did not pass
Automatic transfer	• Dealing with the almost 120,000 automatic transfers that have occurred	• The Pension Fund Association launches council to deal with the problems of individuals that experienced automatic transfer
Special corporation tax	• Repealing, although the law is suspended until March 2011	• Extended for three years by 2008 tax reforms
Investment	• Providing for appropriate continuing education • Make it easy to exclude investment vehicles	• A handbook on investor education from the Pension Fund Association • An amendment to allow exclusion upon agreement between labor and management was included in a bill to integrate the pensions of government workers and private-sector salaried employees, but the bill did not pass

Source: Nomura Institute of Capital Markets Research

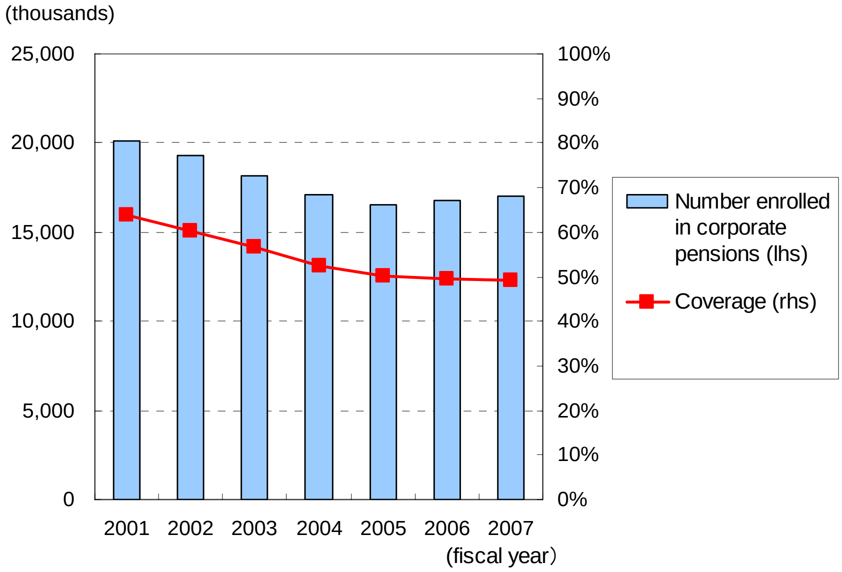
roughly 1.7 million individuals were enrolled in either a DB plan (which could be the Employees' Pension Fund (EPF), a Defined Benefit Corporate Pension (New DB), or a Tax-Qualified Pension Plan (TQPP)) or a DC plan[2]. The actual number of individuals covered is lower, since some individuals are enrolled in more than one pension plan. But even the higher number is less than half of the 34.57 million who are covered by Employees' Pension Insurance (EPI). Furthermore, although comparisons across fiscal years are difficult, the basic trend appears to be a decline in corporate pension coverage. (Figure 2).

One possible explanation for this is the scheduled phasing out of TQPPs by March 2012. With less than three years left until then, many TQPP accounts are being cashed out without being transferred into another type plan, for a variety of reasons. If this trend continues, all of the variants of corporate pension plans will wind up only

[2] The numbers for end-FY2008 are roughly the same, and absent any sharp change in the number of individuals covered by EPI over the past year, the trend of coverage is probably unchanged.

covering a portion of the most fortunate employees, leaving most Japanese employees out in the cold. With its declining fertility rates and aging population, Japan needs to expand the coverage of its corporate pensions, which supplement the public pension, but it seems to be moving in the opposite direction instead. We consider expanding the number of people covered by corporate pension plans an urgent issue for Japan's pension plans.

Figure 2: Corporate pension enrollment



Note: Simple total of the number of people enrolled in the Employees' Pension Fund, a Defined Benefit Corporate Pension plan, a Tax-Qualified Pension plan, or a Defined Contribution plan. Some individuals are counted more than once. Coverage is the total number of corporate pension enrollees divided by the number of EPI enrollees.

Source: Nomura Institute of Capital Markets Research, based on data from the Pension Bureau within the Ministry of Health, Labour, and Welfare.

2. Making DC pension plans obligatory

The failure of individuals to transfer in from TQPPs and the declining trend in coverage is essentially a reflection of the lack of attractiveness of corporate pension plans. The current approach to dealing with this problem seems to be to try to increase coverage by eliminating the problems associated with corporate pension plans to make them more attractive and increase the number of firms that offer a corporate pension plan. The same could be said of defined contribution plans. Our proposal to deal with this is to make access to participation in a DC plan obligatory. As we explain below, it is also possible to link this with reform of Japan's public pension system, which is being hit with the problem of aging demographics.

How do other countries deal with this? In Australia, for example, companies are obligated to contribute 9% of each employee's salary to that employee's individual account in a DC plan called Superannuation. This basically means that participation in a DC plan is mandatory. In Australia, however, the public pension provides a minimum standard of living, and this sets it apart from Japan's EPI. Superannuation, contributions to which are obligatory, is equivalent to the second tier of Japan's EPI. Making DC plans obligatory in Japan would mean an obligation over and above the EPI, and business owners may perceive that as a burden on them.

To deal with that, we propose counting a portion of EPI premiums as DC plan contributions. One country that is already putting a portion of public pension premiums into individuals' own retirement savings accounts is Sweden. Of the 18.5% public pension premium (with the employee and employer each paying half), 2.5% is placed into the individual's DC pension account, and each participant can choose from among over 800 investment products to invest those funds in. In Sweden, however, there is a centralized plan managed by a governmental institution, the Premium Pension Authority (PPA), whereas in Japan, we propose a decentralized approach with both corporate and individual DC pension plans.

Hence, an obligatory DC plan would also incorporate existing DC plans that were established voluntarily. This would mean no change at all for those companies that already voluntarily provide a corporate DC plan. For those companies that do not, however, it will create a new obligation to contribute to a DC pension.

Companies that offer only a defined benefit plan would not be required to establish a corporate DC plan. If they do not, however, we propose that the law be revised to allow employees of such companies to enroll in an individual DC plan, while obligating those companies to contribute to that plan. We explain this further below.

Although the proposed reform bill expired before it was passed during the 171st Diet session, if eventual reforms allow employees to make matching contributions to corporate DC plans, we think employees should be able to decide themselves whether to make such a matching contribution[3].

3. Contribution to an individual DC plan

One possibility is that a company could establish a corporate DC plan as a place to put their obligatory contributions. Making contributions obligatory would probably result in a number of companies voluntarily starting DC plans. There is a possibility, however, that many of the companies that have failed to provide a corporate pension thus far will continue to deem it too costly to offer a corporate pension.

Those companies would be required to make contributions to their employees' individual DC plans. Companies would make contributions through payroll deduction, which is basically the same as the current system for contributions to individual plans by employees of a company without a corporate pension.

A proposal by the Obama administration in the US to expand enrollment in pension plans would require companies without a corporate pension plan to provide a mechanism for automatic enrollment in IRAs, which are the US equivalent to Japan's individual DC plans (Figure 3). Employees would be required to make an IRA

[3] In that case, as well, the system could be designed to allow for an automatic contribution unless the participant specifically chooses not to contribute, i.e., opts out.

contribution through payroll deduction unless they opt out. Requiring automatic IRA enrollment has been talked about since the presidential election campaign, but its inclusion in the FY2010 budget has increased the likelihood that it will be adopted as policy. This was also mentioned in Financial Regulatory Reform: A New Foundation, the financial reform plan announced by the Obama administration on 17 June 2009, in the chapter entitled "Protect consumers and investors from financial abuse," and in the section on promoting retirement security for all Americans[4].

Figure 3: The Obama administration's proposal to expand retirement plan coverage

- The FY 2010 US Government Budget enhances the saver's credit on contributions to retirement savings and also requires employers to offer automatic enrollment in an IRA
- Obligation to offer automatic IRA enrollment:
    - Employers that do no offer a corporate pension plan must offer all employees automatic enrollment in an IRA
    - Employees can opt out
    - All companies that have been in business at least two years and have at least ten employees must comply
    - The default contribution rate for employees who do not choose otherwise is 3% of salary
    - Default investment products and low-cost investment options are prescribed by statute or regulation
    - Businesses are entitled to a temporary business tax credit
    - To be implemented from 2012

Note: The Saver's Credit provides for a tax deduction of between 10 and 50% of contributions to corporate pension plans or IRAs by taxpayers with adjusted gross incomes at or below certain limits ($27,750 for single taxpayers)
Source: Nomura Institute of Capital Markets Research, based on the FY 2010 Budget of the United States Government

4. Introducing a workplace version of individual DC pensions

There are probably some companies that cannot afford to offer their own corporate pension plan, but would be able to offer something close, provided the costs were lower than those of a corporate pension. For those companies, it may make sense to provide a new simplified workplace plan to fill the gap between individual plans and corporate plans.

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[4] This wording is attention-grabbing because retirement income security for seniors has not been a central issue in the debate over financial regulatory reform. For a complete analysis of the Obama financial reform plan, see Kei Kodachi, *Obama seiken ga teijishita Beikoku no Kin'yuseido Kaikakuan* (The Obama Administration's proposal for US financial regulatory reform), in the Summer 2009 edition (online version) of our Capital Market Quarterly (in Japanese).

In the US, for example, there is the SIMPLE IRA, a workplace version of an IRA that is less costly than a 401(k) plan but still offers access to a DC plan through the individual's employer. The objective is to encourage smaller businesses to offer pension plans. Although it does make the system more complex, we like this approach in that it takes smaller businesses into account by providing another choice besides the two choices currently offered of either a corporate pension or an individual DC pension.

This is based on the thinking that when possible, enrollment in a pension through the workplace is preferable to doing so individually. From the employer's perspective, corporate pensions are an effective tool for both raising labor productivity and retaining talented staff. From the employee's perspective, when trying to accumulate retirement savings on your own, not only are transaction costs high, the smaller asset base limits the choices within the portfolio. Thus both sides see a significant benefit from a corporate pension. Furthermore, corporate pensions are also an important component of policies aimed at expanding pension coverage. Pension plans offered at the workplace clearly offer a more efficient way to expand pension coverage than relying on individuals themselves to enroll on their own in plans that provide another layer over public pensions. In addition, we think individual DC plans offered by employers like the SIMPLE IRA would also be effective. Although one could also argue that mechanisms to promote corporate plans over individual plans may be necessary as a tax incentive, we have chosen not to address that in this article, given that corporate pensions are voluntary and based on labor-management agreements.

Figure 4: Pension plans for small businesses based on the IRA in the US

SEP (Simplified Employee Pension)	・ Company opens an IRA account for the employee. Can be offered in addition to other corporate pensions ・ There is no employee contribution ・ The contribution can vary each year ・ The maximum employer contribution for each employee is the smaller of either $49,000 or 25% of the employee's annual compensation. Thus no contributions are allowed on compensation over $245,000 ・ There is no need to file Form 5500 with the Department of Labor ・ Rules on fiduciary responsibility under the Employee Retirement Income Security Act (ERISA) do not apply
SIMPLE IRA （Savings Incentive Match Plan for Employees IRA）	・ Can be used by companies with 100 or fewer employees. IRA accounts are opened for employees ・ Both employee and employer contribute. Employer contributions to a SIMPLE IRA are in principle not allowed if the company offers another corporate pension plan ・ Employees can make contributions of up to $11,500 annually, with catch-up contributions allowed ($2500) ・ Employers can (1) make a 100% matching contribution (up to 3% of the employee's compensation; can be reduced to as low as 1% for up to two out of five years) or (2) make a contribution of 2% of the employee's annual compensation, whether or not the employee makes a contribution ・ Nondiscrimination testing (to confirm high-income employees are not favored) does not apply ・ There is no need to file Form 5500 to the Department of Labor ・ Fiduciary responsibility rules under ERISA do not apply

Note: Maximum amounts are for 2009.
Source: Nomura Institute of Capital Markets Research, based on various data sources

5. Public pension reform and making DC plans obligatory

Making DC plans mandatory is closely related to the debate surrounding public pension reform in Japan. One of the main disputes regarding public pension reform is how to pay for it. Recently politicians (Diet members) from both the LDP and DPJ, Keidanren, and some major newspapers have been proposing that the basic portion of the pension be funded with general tax revenues instead of social insurance premiums.

In regard to the fact that businesses' cost will be lowered by changing the source of funding from premiums to the consumption tax and thereby lower EPI premiums[5], Keidanren argued in its proposal in February 2009 that "it is only natural that the portion previously paid by employers be returned to employees by, for example, deducting the entire amount of reduction from the portion paid by employees. When DC plan contributions become mandatory, the level of contributions must be set at a level that is consistent with the sustainability of the public pension system. That said, one conceivable way to achieve this would be to contribute the amount returned to employees to each employee's DC pension account[6].

6. Expanding eligibility for enrollment in individual DC plans: Ensuring fairness at the individual level

Currently, employees of a company offering a defined benefit (DB) plan but no corporate DC plan are not allowed to enroll in an individual DC plan, even if they would like to. We propose changing the rules so that employees of such companies can enroll in individual DC plans, a reform we think is necessary to ensure fairness among salaried employees.

Employees that have a DB plan but not a DC plan clearly enjoy less favorable tax treatment than employees that have both (Figure 5, left panel). If matching contributions are allowed, it would give employees with a workplace DC pension plan a new opportunity to help themselves, thereby exacerbating the unfairness to employees who are not given such an opportunity. System reform is essential to level the playing field.

In addition, those employees who are currently without either a DB plan or a DC plan at their workplace are eligible to enroll in an individual plan, but the maximum that they can contribute is low (Figure 5, right panel) at only ¥216,000, compared with the ¥552,000 maximum contribution limit for employees with a corporate DC plan who likewise do not have a DB pension at their workplace. This inequality of opportunity would become even greater if enrollees in a corporate DC plan become

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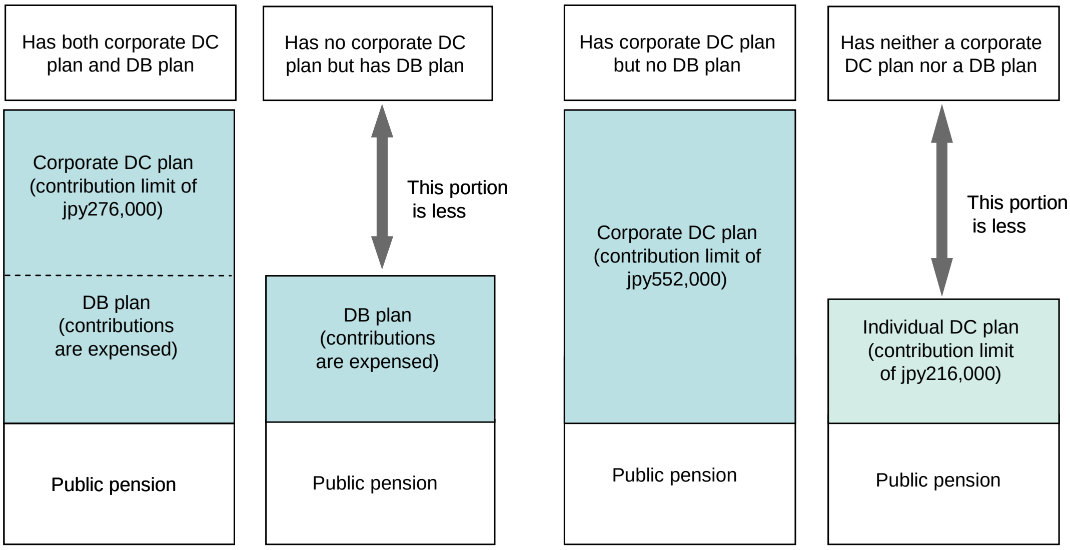
5 See Nippon Keidanren, *Kokumin Zentai de Saseau Keizokukanou na Shakaihoushouseido wo Mezashite -- Anshin, Anzen na Mirai to Futan no Sekkei* (Aiming for a sustainable social security system that everyone can continue to support -- Designing a safe and secure future and cost structure), 17 February, 2009 (in Japanese).

6 The Nikkei Shimbun published the second report from its pension reform study group in its newspaper dated 8 December 2008. This report proposed funding the basic pension with the consumption tax while shifting a portion of earnings-related premiums to a funded system with a premium rate of 1.5%.

able to take advantage of matching contributions. The maximum contribution for individuals without any corporate pension at their workplace who participate in an individual DC plan should be the same as for individuals without a DB plan but with a corporate DC plan.

Figure 5: Eligibility for enrollment in DC plans and tax rules: A lack of fairness at the individual level



Source: Nomura Institute of Capital Markets Research

There is thus a need to consider fairness at the individual level in regards to eligibility and tax advantages. Although some argue that this makes pension plan tax treatment essentially no different from saving incentives for individuals, that does not reduce the importance of a corporate pension plan, which provides an opportunity to save for retirement through the workplace.

7. Expanding eligibility to ensure true portability

We also think it is necessary to allow government employees and non-working spouses (No. 3 insured persons) to enroll in a DC plan. Proposed legislation to integrate the pensions of government workers and private-sector salaried employees has been shelved and there has been no progress in the debate over revising rules on the additional occupational pension for government employees, and this has prevented any decisions on whether government workers can enroll in a workplace DC plan. Nevertheless, even if this additional occupational pension takes the form of a DB plan, if the employees of private-sector companies with a DB plan but no DC plan are made eligible for an individual DC plan, the same opportunity should be offered to government workers.

The inability of No. 3 insured persons to enroll has already had a serious negative impact on the DC pension system. For example, under the current rules a woman enrolled in a corporate plan who quits working to get married and/or have children, although able to continue giving investment instructions for the assets that she has transferred over to an individual account, is currently unable to continue making contributions. So unless she meets the requirements for making an early withdrawal, her retirement funds are basically locked up. This hurts portability, one of the advantages of a DC plan, and makes the plan less attractive. Currently No. 3 insured persons receive public pension benefits without paying premiums themselves, and some argue against the idea of their being able to enroll in a DC plan, which would provide additional tax advantages. In light of the adverse impact such inability to enroll would have on the DC plans themselves, however, we think No. 3 insured persons should be allowed to enroll in an individual plan.

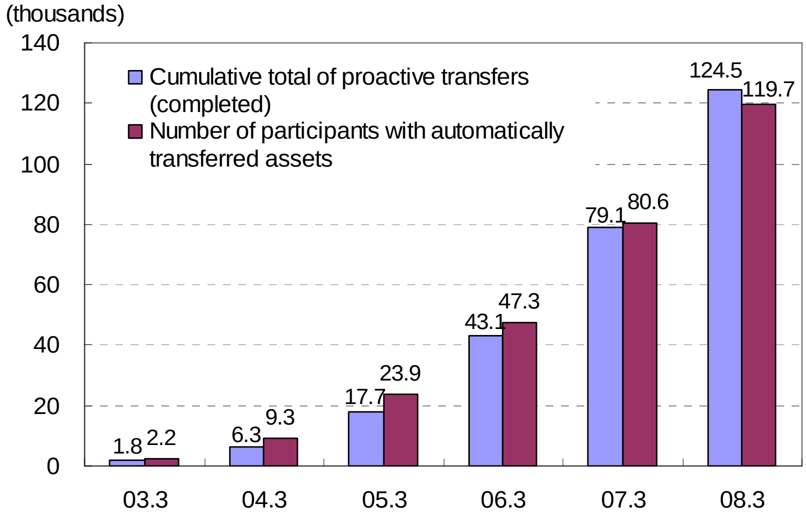
In the US, it is possible to enroll in an IRA regardless of employment status or whether the employer offers a pension plan. We do not think true portability can be achieved until everyone is allowed to enroll and to continue making contributions.

8. Expanding eligibility and the problem of automatic transfers

One of the biggest problems that the DC pension system is facing is the increase in people undergoing “automatic transfers.” Participants in corporate DC plans who lose their eligibility because of a job change or loss have six months to complete procedures for transferring their assets to an individual DC plan, after which their assets are automatically transferred to the National Pension Fund Association (NPFA). This is known as an "automatic transfer." Funds that are automatically transferred are placed in a non-interest-bearing deposit account, and the time spent in that account does not count toward any enrollment period. The number of people who have had their funds automatically transferred has grown steadily since DC plans were allowed, and stood at just under 120,000 by end-FY2007. In addition, up until FY2006 the number of automatic transfers exceeded the number of proactive transfers (Figure 6). It is probably not an exaggeration to say that the increase in the number of enrollees effectively abandoning their assets may be the worst unintended consequence of the DC plan.

Although efforts to better inform enrollees about the pension system are being made to cut down on the number of automatic transfers, the best solution to the problem is to expand eligibility. Restrictions on eligibility make the system more complex and difficult to understand, which in turn increases the number of people who do not follow the procedures to initiate transfer. Once they understand their assets will become locked up, they lose incentive to follow the procedures. Automatic transfers can only be eliminated by removing this obstacle and allowing people to continue contributing to and managing their retirement savings, however small the assets now in their individual accounts.

Figure 6: Transfer of assets to the National Pension Fund Association



Source: Nomura Institute of Capital Markets Research, based on the National Pension Fund Association's website

On the other hand, even if eligibility is expanded and it becomes practical to use the portability features of DC plans, there will always be participants who do not follow the procedures needed. It is unrealistic to expect everyone to behave rationally. The greater the participation in DC plans, the greater will be the diversity of employers and participants, and that will make it harder to achieve a 100% proactive transfer rate. Accordingly, the need for automatic transfer, which was initially introduced as an exceptional measure, will probably never go away, even if eligibility is expanded.

For that reason, we propose changing the destination of automatically transferred assets from the NPFA to an individual DC plan. We propose that corporate DC plans should require that if a participant does not instruct where to transfer the assets in that participant's individual account within six months of quitting or changing jobs, based on an agreement between labor and management, those assets shall be transferred to a predesignated individual DC plan. This would constitute an automatic transfer to an individual DC plan.

The selection of an individual plan to transfer the assets to could be handled using the same procedures used for choosing an institution for managing the assets. The Ministry of Health, Labour, and Welfare should establish rules regarding the criteria for selecting individual plan providers, plan specifics, and advance notice to participants. And it should be clearly stated that if assets are automatically transferred to an individual plan in accordance with those rules, the employer's responsibility ends at the time of transfer. One conceivable way to do this would be to regard automatic transfers as meeting requirements the same as if the participant initiated transfer procedures.

In the US, if the outstanding balance of a participant’s 401(k) account is no more than $1000, the employer can pay out those assets to the participant without the participant's consent. Likewise, if the assets total over $5000, the employer is obligated to continue managing those assets within the plan unless the participant initiates transfer procedures. If the participant does not initiate an asset transfer for accounts with assets between $1000 and $5000, said participant's assets must be transferred to a preselected IRA, and notice to that effect must be given. An agreement is reached beforehand between the employer and the IRA provider, and at the point that the assets are transferred in accordance with that agreement, the 401(k) plan has fulfilled its fiduciary responsibility. The employer is not responsible for monitoring whether the IRA provider is performing in accordance with the agreement.

Of course, each IRA provider makes its own business judgment as to whether it receives the transferred assets under those rules. There is a need to confirm whether the same is true in Japan if assets are to be automatically transferred to an individual DC plan. If there are multiple financial institutions that decide to enter the business of receiving these automatic asset transfers based on some perceived business opportunity, including for developing new clients, the resulting market competition should lead to more significant developments than just leaving the assets with the NPFA by default. A system of automatically transferring the assets to an individual plan would have this as an objective. Accordingly, there is a need to design the system so that providers view the receipt of automatically transferred assets as a positive business opportunity. It is necessary to make the procedures as easy as possible for the provider in the event, for example, that contact cannot be established with the participant. If that cannot be done, the idea of an automatic transfer into an individual plan would probably have to be abandoned.

III. Proposal on tax incentives

1. Current tax rules on DC pension plans

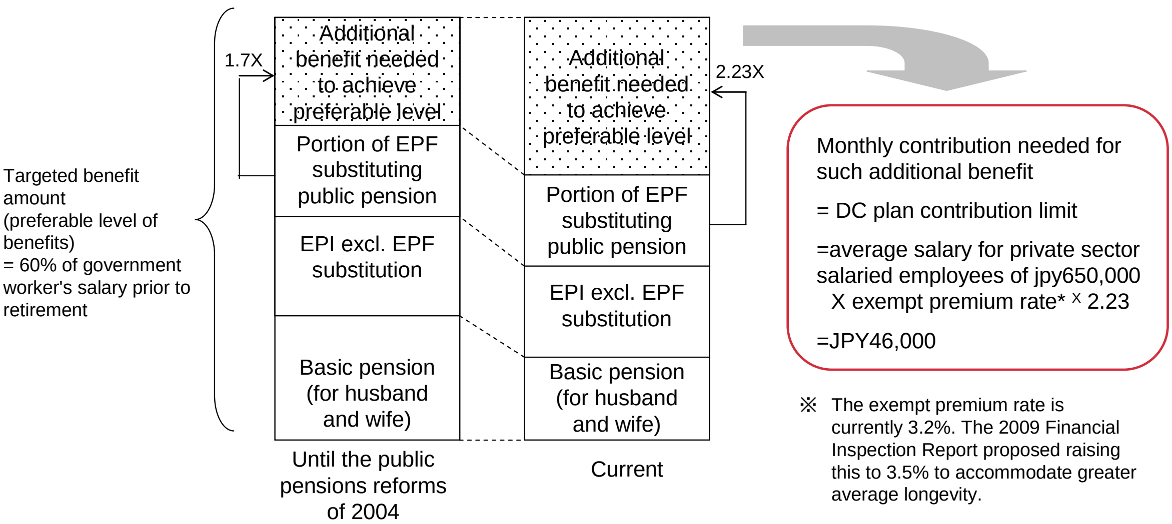
Contributions to DC pension plans are given favorable tax treatment. In the case of corporate plans, contributions are recorded as an expense by the company and are not counted as income for the participant. For individual plans, the contribution is tax deductible for the participant. Thus the entire contribution is tax-deferred up to the limit, which is currently set at a maximum of ¥552,000 annually for a corporate plan. When draft legislation introducing matching contributions was submitted in March 2009, there was also a proposal to slightly raise the contribution limit. When the change becomes effective, the maximum contribution for each participant will be raised from ¥552,000 to ¥612,000 for those enrolled only in a corporate DC plan, from ¥276,000 to ¥306,000 for those enrolled in both a DB plan and a corporate DC plan, and from ¥216,000 to ¥276,000 for those without a workplace pension who contribute to an individual plan[7]. Thus, even after the limits are raised, the highest annual contribution would be no higher than ¥612,000.

Contrast these contribution limits with those in the US, which allows for total annual contributions (employer and employee combined) of $49,000 (¥4.7 million), which is so high that corporations can effectively craft the optimal pension plan for their situation without giving much thought to contribution limits at all.

The specific circumstances and mindset in each country, including the level of public pension benefits, need to be taken into account when setting contribution limits. The approach taken in Japan is to provide tax incentives for the level of contributions needed to bring total pension benefits, including public pensions and corporate pensions, to a desirable level (Figure 7). That is, to set the DC plan contribution limit at a level that will achieve a desirable benefit stream. The contribution limits for DC plans were raised in 2004, because pension reform that year lowered the level of public pension benefits and therefore raised the amount of supplement needed to achieve the desirable level. The latest proposal to raise the limit reflects the impact of greater longevity pointed out in the 2009 Financial Inspection Report on the public pension.

It would probably be difficult to substantially raise the contribution limit while sticking with the same approach.

Figure 7: Approach to setting limits on DC plan contributions



Source: Nomura Institute of Capital Markets Research, based on data from the Pension Bureau within the Ministry of Health, Labour, and Welfare.

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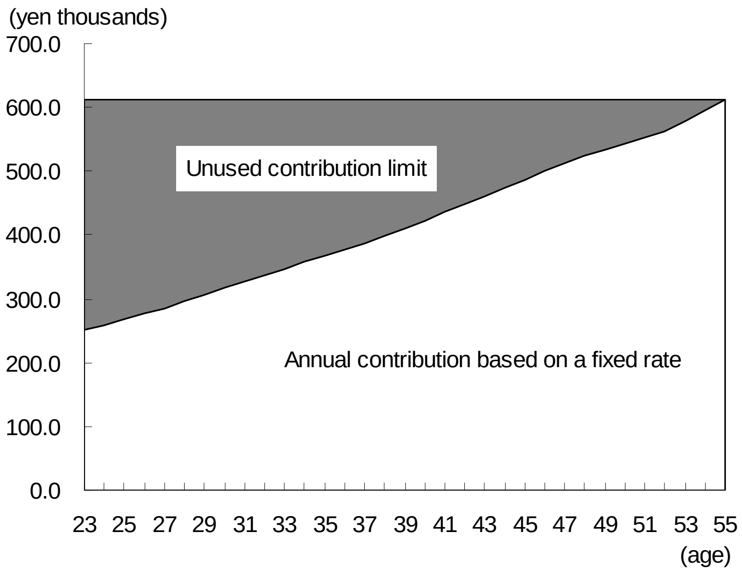
7 This increase would be via a revision to an Administrative Order, and thus could be approved irrespective of whether the proposed amendment to the Defined Contribution Pension Law is passed.

2. Proposal for a lifetime contribution limit

Furthermore, most participants are unable to actually contribute the full amount allowed anyway. Corporate contributions are typically established as a percentage of compensation (called a fixed-rate contribution), and this results in younger workers, who normally have lower salaries, not fully using their contribution limits (Figure 8).

If matching contributions were allowed, participants would be able to use up more of their contribution limit on their own accord. This is another reason why we think the introduction of matching contributions is essential. We do not think, however, that the amount of the matching contribution should be capped at the amount of the employer contribution, as called for in the proposal submitted to the Diet. We think it is simply unfair for those employees fortunate enough to have larger employer contributions to have a larger scope for making their own contributions than the less fortunate employees who work for companies that make smaller contributions to their pension.

Figure 8: Diagram of annual contribution limits based on fixed-rate contributions



Note: Diagram assumes the contribution limit is reached when compensation is at its highest.
Source: Nomura Institute of Capital Markets Research

Meanwhile, even if the rules were to allow matching contributions high enough to raise the total contribution (counting the employer's) up to the legal limit, in many cases it is likely that younger workers, who have relatively less leeway to divert money to savings, would be unable to contribute enough to get the full tax benefit.

This is because the contribution limit is reset every year. The problem could be eliminated by allowing the unused portion to be carried over to the following year. In that vein, we propose making the contribution limit cumulative by allowing the unused contribution allowance to be carried over throughout a worker's working career. In other words, we propose a lifetime contribution limit. For example, the interest and other income generated by the first ¥5.5 million in principal kept in a *zaikei chochiku* (an employee's asset-building savings scheme; includes pension and home) is tax-exempt. Although *zaikei chochiku* are different because contributions were not deducted from taxable income, the approach we propose is similar in that the limit is based on a cumulative amount rather than an annual contribution[8].

The UK also provides tax incentives for pensions, including a high annual contribution limit of GBP245,000 (for 2009/2010) and a lifetime limit of GBP1.75 million (Figure 9). Measures that went into effect in April 2006 simplified the UK's pension rules and expanded the tax incentives. The UK approach may provide a good model for Japan, i.e., set a lifetime limit on DC plan contributions but also set an annual limit to keep the contribution in any particular year from being excessively high.

Figure 9: Pension taxation in the UK

- Tax incentives went into effect from April 2006
- Broader application and simplification of pension taxation
- Annual contribution limit
  - Common to both DB and DC plans. Applies to the total contribution from both employee and employer
  - Before-tax contributions up to 100% of compensation possible up to limits in table below. Contribution up to GBP3,600 allowed for individuals with no income
- Lifetime accumulation limit
  - Contribution and investment growth are not taxed until the accumulated amount converted to the lump sum retirement payouts reaches the limit
- Lump sum withdrawals
  - up to 25% of balance at time of retirement allowed

(GBP 1000s)

Tax Year	Annual tax exempt contribution	Lifetime accumulation limit
2006/07	215	1500
2007/08	225	1600
2008/09	235	1650
2009/10	245	1750
2010/11	255	1800

Source: Nomura Institute of Capital Markets Research, based on Pension Advisory Service materials

8 Based on this partial similarity with *zaikei chochiku* and the connection with the after-tax contributions we propose below, it could be argued that the rules for DC plans (particularly individual plans) and the rules for *zaikei chochiku* should be reconciled. We would not rule that out, but think that the best approach would be to look at establishing an amount that encompasses both the existing limits on DC plan contributions and the ¥5.5 million limit on *zaikei chochiku*. In other words, we think it is important to avoid reducing tax incentives that encourage individuals to become more self-reliant just for the purpose of reconciling and simplifying the rules.

The UK uses combined limits that include DB plans, but we think it would be difficult to use the same approach in Japan, which does not have benefit limits for DB plans. Besides, in the case of Japan, if the lifetime contribution limit changed every time a participant changed jobs and went to work for a new employer with a different corporate pension plan, the management of contribution limits would become too cumbersome. To simplify the system, we propose establishing a standardized limit of ¥552,000 annually. Nevertheless, management of a combined limit with an individual plan is conceivable, provided that it can be kept simple.

Using current levels as a basis, the lifetime contribution limit would be ¥552,000 times the number of years of participation. Assuming 38 years from graduating college until age 60, that would equal ¥20.976 million. Using ¥612,000 annually as a base, the lifetime limit would be ¥23.256 million. Even using the current contribution limit as a base, the ability to spread the limit out over the entire working career would result in a substantial tax benefit.

3. Abolishing the special corporation tax

We start this section with a simple summary of various approaches to pension taxation.

Taxation in Japan is based on the principle of comprehensive taxation, wherein all income is added together and a progressive tax rate applied. Under a pure comprehensive income tax, various sources of income are not singled out but totaled together and then taxed. Savings and investments are made from after-tax income, and the investment profits (interest, dividends, and capital gains) are taxed again when they are received. On the other hand, no taxes are incurred when withdrawing assets. Using T for taxed and E for tax-exempt for the three stages of contribution to savings, investment growth, and withdrawal, Japan uses a TTE approach.

In contrast, under an expenditure taxation approach, it is consumption that provides the tax base. The contribution to savings and investment are seen as delaying consumption into the future, and not taxed at that point. Investment profits are not taxed either, and it is not until assets are withdrawn that taxes are applied (EET). Current consumption and future consumption are taxed equally, and thus taxes could be considered neutral in regard to intertemporal consumption and savings behavior. The EET approach to pension taxation seen in the US and elsewhere is based on an expenditure taxation approach.

The timing of taxation under such an approach could be both the EET described above as well as TEE (after-tax contributions that grow tax free and are not taxed at withdrawal). Although the two are theoretically the same, each actually has advantages and disadvantages. Participation in EET is more likely in that it does not carry with it the political risk that a change in tax rules will expose benefits to taxation, as in the case of TEE. On the other hand, TEE is the more attractive option when fiscal conditions are bad enough that EET would be difficult to implement. In addition, under a progressive income tax, declines in tax revenue can be minimized under TEE, given that income is normally higher when working. However, EET provides individuals with greater incentives to both enroll and make contributions. The decision as to which is better ultimately comes down to expectations regarding the political climate and fiscal situation in the future[9].

Japan's corporate pensions defer taxation at the time of contribution, are taxed during the period of investment through the special corporation tax, and are taxed when benefits are paid after applying the public pension deduction (if received as an annuity) or a retirement payout deduction (if received as a lump sum). Although the special corporation tax has been suspended since 1999, it is basically a tax on the asset balance (at a rate of 1.173% before it was suspended) rather than a tax on investment profits, and would apply to both corporate and individual DC plans. Among DB plans, the EPF is exempt up until it reaches the "desirable level," but both new DB plans and Tax-Qualified Pension Plans (TQPPs) would be subject to the special corporation tax.

The special corporation tax rate is set based on the thinking that it equates to interest arrears on the profit from not paying tax at the time of contribution. Interest arrears are collected together with the normal taxes when taxes are paid late[10]. Japan's tax code could thus be seen as being based on the thinking that deferring tax at the time of contribution is the same as paying taxes late. This thinking needs to be revised to take into account the importance of building wealth for retirement. Specifically, the country needs to openly acknowledge that pensions should benefit from either an EET or TEE approach to taxation. This means that the special corporation tax needs to be abolished.

4. We propose allowing after-tax contributions

In addition, we propose allowing after-tax contributions to DC plans, i.e., introducing TEE taxation. Under TEE, the contribution limit is not a limit on the tax-deductible contribution, but rather an actual limit on the amount that can be contributed.

It has often been argued that if the special corporation tax is repealed, the public pension deduction and retirement payout deduction when receiving benefits would also have to be eliminated (otherwise all three stages -- contribution, investment, and withdrawal -- would be untaxed). Thus some people in favor of the abolition of the special corporation tax pre-empt such argument by saying that eliminating those tax breaks at the time benefits are received is acceptable if necessary. Nevertheless, because changing the rules on the taxation of benefits would have a direct impact on people who have already retired or are close to retirement, we think a variety of interim measures would have to be implemented, including a fairly long period between announcement of the change and actual implementation.

9 R.Holzman and R.Hinz, "Old-Age Income Support in the Twenty-first Century: An International Perspective on Pension Systems and Reform," World Bank, 18 February 2005.

10 In principle a daily interest charge per ¥100 of ¥0.02.

In that respect, there is a possibility that there would be less of a challenge if the timing of tax incentives were reversed such that contributions were taxed, but investments and benefits were not (TEE). In addition, as we noted above, given that TEE puts less pressure on government finances than EET, it also looks attractive in light of Japan's fiscal situation. In any case, if the special corporation tax could be permanently eliminated by taking this approach, it would remove a major uncertainty regarding the taxation of corporate pensions.

The US has already implemented a system of after-tax contributions combined with tax-free investment growth and withdrawals. When IRAs were introduced in the US, they were initially governed under the EET approach of before-tax contributions and investment growth, and taxation when benefits were withdrawn, but then the Roth IRA was added in 1997. The Roth IRA allows for annual contributions of up to $5,000. Although contributions are not deducted from taxable income, investment profits are untaxed, and five years after the account is opened withdrawals are also tax free for participants who are at least 59 and 1/2 years old or meet certain conditions. The number of IRA accounts has grown steadily since they were introduced, and by 2008 18.6 million households (16% of the total) owned one. Tax reform legislation passed in 2001 added a corporate pension version of the Roth called the Roth 401(k), starting with the 2006 tax year.

Once after-tax contributions are introduced, it creates the issue of how they should relate to existing plans based on pretax contributions. If moving solely to a system of after-tax contributions, one approach would be to abolish the system based on pretax contributions after a grace period, and then encourage people to shift from that system to one based on after-tax contributions. This creates the problem of greater system complexity, however, given the widespread use of plans based on pretax contributions, and thus we think the most realistic approach would be to offer both systems and allow the companies or individuals a free choice between the two[11].

5. Expanding the use of defined contribution pension plan money

DC plans provide tax benefits as a way to build wealth for old age. Consequently, there are strict rules governing early withdrawals. In principle, early withdrawal prior to age 60 is not allowed except in the case of the participant's death or disability, with only very limited exceptions, such as a short enrollment period (three years) or a small balance (¥500,000). See Figure 10.

Japan's corporate pension rules have strict requirements regarding early withdrawals from DC plans, but because of the history of DB plans having originated in lump sum retirement payout schemes, the rules allow for early lump-sum withdrawals from corporate DB plans. Nevertheless, given that over 25% of transfers into DC plans are from lump sum retirement payout schemes, and given that corporate

[11] Under plans based on after-tax contributions, participants would bear the presumptive taxation of the funds they are unable to withdraw at the time they make the contribution. Along these lines, one could argue that the most appropriate system is one in which the employee is free to join or not.

DB plans and DC plans are provided with tax breaks for the same objective of building wealth for old age, we think it is inconsistent for the two plans to have early withdrawal rules that are polar opposites.

Figure 10: Requirements for early withdrawal in Japan and the US

Early withdrawal from DC plans (Japan)

- When participant dies or becomes disabled
- When assets total ¥15,000 or less for individuals who leave a company and drop out of a corporate pension plan
- Individuals who are not enrolled in a corporate pension plan, not qualified to enroll in an individual plan (can give investment instructions but cannot make contributions), and either

  (1) had a total contribution period of 1 month to three years, or

  (2) have total assets of no more than jpy500,000

Early withdrawal from an IRA (US)

- Early withdrawals are allowed from IRAs under the following conditions
  - Aged 59.5 years or older
  - When participant dies
  - When participant becomes disabled
  - For medical costs
  - To pay health insurance premiums when unemployed
  - To pay higher education costs
  - To purchase a home for the first time
- Early withdrawals that do not meet these conditions are taxed at the person's income tax rate plus a 10 percentage point penalty

Source: Nomura Institute of Capital Markets Research

Nevertheless, many argue that strip out the "for old age" justification for DC plans and they are no different than savings, and this explains why talk over allowing early withdrawals from DC plans never makes any headway, even when pointing out the inconsistencies noted above. What does "for old age" actually mean? Establishing a minimum age of 60 years is merely one approach, and it is conceivable that the requirements for the early withdrawal of assets in a DC plan could be eased so as to effectively allow any use of funds that helps to build wealth for old age. For example, spending on health care and nursing care seems to be consistent with the objectives of pensions. For plan participants who are faced with a large health care expenditure at age 55, using their assets in a DC plan to restore health and enrich their lives after they turn 60 is consistent with the objective of building wealth for old age. We see no logical necessity to equate early withdrawal requirements with tolerating withdrawals for completely unaccounted for uses. We think it would be sufficient to allow early withdrawals that are for uses that are consistent with the "for old age" objective.

In the US, early withdrawals are authorized for expenditures on higher education and to purchase a home. We think the debate over old-age income guarantees in Japan needs to broaden beyond health care and nursing care to cover spending on future generations, namely spending on the education of children and grandchildren. Spending to educate the second or third generation could be seen as contributing to the development of their human capital and thereby increasing the likelihood of receiving support from future generations. Social security and education are mutually related policy issues.

We think it would be worthwhile to consider introducing stand-alone tax-advantaged savings vehicles to cover higher education costs, separate and apart from broadening DC plans to include that use. The US offers 529 plans, which give parents and grandparents tax incentives for setting aside savings to pay the higher education costs (college and graduate school) of their children and grandchildren. Japan's aging demographics make it imperative to invest in the education of future generations, and we think Japan needs to introduce rules that support the accumulation of funds to pay education costs.

IV. Proposal regarding investment instructions for DC plans [12]

1. Regulating investment advice

Each participant in a DC plan receives investment education and then chooses, from a menu or investment products, where to invest the assets in their own individual account. This investment education includes basic knowledge of a broad range of investments, but what participants are evidently most interested in knowing is what percentage of their contributions to invest in which investment products. Because neither employers nor plan administrators are allowed to give recommendations or advice regarding specific investment products, the investment education is limited to big picture issues, such as providing typical asset allocations based on the participant's age group.

Although investment advice is not prohibited by law, the lack of clarity regarding provider requirements, the criteria for selecting a provider, and the contractual agreements needed to avoid problems remains a major impediment that is preventing them from offering this service, even though there is demand from plan participants. We propose establishing the rules needed to clarify any uncertainties and effectively facilitate the provision of investment advice. The major points of contention are listed in Figure 11.

Looking first at the employer's responsibility, because it is possible that a participant will suffer a loss as a result of following investment advice, there is a need to make it clear that the employer is responsible only for selecting and monitoring the investment advisor, not for the results of that advice. Looking next at the requirements for providing investment advice, we think it should be prohibited in principle for the entity that administers the DC plan to also provide investment advice. Some would argue that the plan administrator has direct contact with plan participants and thus is well positioned to offer investment advice, but because the plan administrator selects products, has a duty of loyalty to the plan participant under the Defined Contribution Pension Law, and is often affiliated with the provider of investment products and the company that manages those products, the thinking has been that doing both presents a potential conflict of interest. On the other hand, although neutrality is important, if

[12] This section touches on the article by Akiko Nomura in the 1 June 2009 issue of the Jurist, entitled *Kakutei Kyoshutsu Nenkin no Genjou to Kadai* (Current status and issues with defined contribution pensions) (in Japanese).

the requirements for providers are overly strict, there is a possibility there may wind up being no providers at all. We think it is appropriate to allow companies within the plan administrator's group to provide advice, while at the same time requiring disclosures that make it possible for plan participants to assess said advisor's level of neutrality[13].

Although investment instructions may be based on the advice of others, it is up to the plan participant whether such advice is accepted and acted upon, and thus we see no conflict with the principle of self reliance.

Figure 11: Key points regarding regulation of investment advice

1: Fiduciary responsibility of employer

- Clarify that employers are responsible for selecting and monitoring providers, but are not responsible for the advice they give.

2: Requirements of investment advisors

- Require registration of investment advisory and agency businesses.
- In principle, plan administrators are not allowed to provide other services.
- Services can be provided by other companies within the plan administrator's group, but neutrality of advice must be ensured (see 3).

3: Ensuring neutrality of advice

- Ensure neutrality by using commission schedules that are independent of the results of advice, by generating advice using a non-arbitrary computer model or by other appropriate methods
- When advice is offered by a company in the plan administrator's group, require disclosure of that fact prior to the advice being dispensed

4: Attractiveness of the investment advice business

- It is preferable for multiple providers to enter the investment advisory business. The regulatory burden should be minimized.

Source: Nomura Institute of Capital Markets Research

2. Rational behavior and management of a DC pension

Investment advice is a way to provide a specialist's assistance to participants with an interest in giving investment instructions for the DC plan. Thus, investment advice is unlikely to be effective to uninterested parties, i.e., to participants who have no interest in DC pension rules or investment instructions even after receiving investment education. A different approach is required for those without any interest.

The rules governing investment instructions for a DC plan assume that the participant continues to act as a rational investor for an extended period of time until retirement. Until the 1990s, 401(k) plans in the US were operated under a similar assumption. As it became apparent early this decade that achieving such rationality was difficult, however, there was a change in approach to one assuming irrational behavior. With the advent and increased use of automatic enrollment and the opt-out approach, enrollment, setting of the contribution rate, and allocation into target-date funds or similar professionally managed funds are all done automatically unless the participant specifically choose not to enroll, set their own contribution rate, or choose specific investment products.

13 If a group company can be allowed, then we think there is room for debate over allowing a different division of the company administering the plan to provide investment advice, provided that firewalls are erected.

If the participant invests in a target-date fund, the rebalancing of the portfolio to reflect market price changes and the adjustment of asset allocation to reflect the decline in the number of years until the participant retires, along with other asset management tasks, can be entrusted to the funds' portfolio manager. This is a convenient fund for participants who have had investor education and understand the basic principles of investing, but do not have the time to devote to such tasks.

3. Shifting to the opt-out method and use of target-date funds

Japan is the same as the US in that it is unrealistic to expect all participants to behave as rational investors over an extended period until retirement. Although more than half of the assets in a DC plan are invested in such safe assets as deposits and guaranteed interest contracts (GIC), it is not clear that all participants would choose such a conservative allocation if they really understood they were agreeing to such a low yield with a possibility of receiving substantially lower long-term returns compared with a more diversified portfolio. Many of the firms that have introduced DC plans in the process of revising their existing retirement benefits packages have set the DC plan contributions at a level that would ensure the same level of benefits as under the old plan, based on an assumed yield. This assumed yield averages over 2%, more than what can be currently earned on a savings deposit account. Companies may well be concerned over whether participants are investing their money in savings deposits with the full understanding of what those low yields mean for the benefits they finally receive.

In that regard, we propose that the entrusting of asset management to specialists be made the core approach to giving investment instructions for DC plans in Japan. Those participants who want to choose their own investments should continue to be offered a multitude of different types of investment products, but those participants who wish to delegate the investment activity to specialists should know that they are welcome to do so and should be offered an investment product that includes such delegation. The same product would be designated as the default product as well.

One method of entrusting investment to specialists would be to invest in balanced funds with a high probability of achieving the assumed yield, based on their past performance. Nevertheless, employees who join the company after the introduction of the DC plan do not necessarily have to use the assumed yield as a benchmark, and more universally speaking, just as with 401(k) plans in the US, target-date funds are probably the best choice among the general products currently available. A good term for the case in which most participants wind up investing in target-date funds while retaining the authority to give their own investment instructions would be "collective investing with the right to opt out."

For this to work would probably require at a minimum the regulatory response outlined below.

(1) Establish a rule stating that, "provided certain conditions regarding proper product selection and monitoring are met, when using target-date funds and other

investment products with the potential to lose principal as the default it shall be deemed the same as if investment instructions were given by the participant." This would assure that neither the employer nor the plan administrator need bear responsibility for investment losses.

(2) Establish a rule that allows the employer or plan administrator to give participants the option of entrusting investment activities to a specialist if they wish, without violating any prohibitions within the Defined Contribution Pension Law against recommending specific investment methods.

4. The significance of defined contribution pension plans

DC plans were introduced at the end of the 1990s primarily in response to the needs of corporations, which were increasingly feeling the burden of defined benefit plans. In that vein, there was a tendency to emphasize the shift of investment risk to the participant and the self-reliance associated with that. Investor education was also emphasized, because it was necessary to encourage greater self-reliance.

As noted above, almost eight years have passed since Japan introduced DC plans, and it is starting to become clear that it is not always realistic to depend on a model geared around using investor education to encourage all plan participants to issue investment instructions and take responsibility for building their own wealth. The existence of participants who show no interest in taking on that responsibility is not going to be completely eliminated by providing investor education. On the other hand, the number of people participating in DC plans is growing steadily, and unless rational investment behavior is achieved, there is also going to be steady growth in the number of people who do not build up sufficient wealth for their old age.

There are a variety of ways for individuals to take responsibility for themselves and give investment instructions for their DC pension. One approach that should be allowed is one in which the first choice is to entrust investment tasks to a specialist, while still offering those participants who are adamant about putting together a portfolio on their own the ability to opt out of that default and choose from a number of investment products.

Investor education will remain just as important as it is now, if not more important. If participants invest in target-date funds without any understanding of the basics, it will merely expose the employer, the plan administrator, and the asset manager to reputation risk. Nevertheless, laying the groundwork for knowledge through investor education is clearly no guarantee that participants will continue to behave as rational investors for decades on end. Investor education is for laying the groundwork for knowledge. The investment activity itself is done by a specialist (portfolio manager) through a target-date fund.

Eliminating excessive (unrealistic) expectations of investor education would probably cause a change in the way resources related to investor education are deployed. Even now, education on pension rules accounts for a large portion of investor education, but investor education may develop into something with a broader mandate, to include a company's entire benefits system and the even broader concept of life planning.

Japan's corporate pensions derived from lump-sum retirement payouts. Those payouts came from the company's retained earnings, and were at risk of disappearing if the company went bankrupt. In contrast, the assets owned by corporate pensions (DB plans) are kept separate from company assets and accumulated outside of the company, thereby strengthening the right to receive benefits for plan participants in general. On top of that, in a DC plan, each participant owns their own account, and after three years of participation has the right to the funds in their account. The distinguishing of assets and assignment of rights to benefits at the individual level is one advantage of DC plans for its participants, and may be their defining feature, in our view.

V. Conclusion

A summary of the proposals in this article are in Figure 12.

Japan's aging demographics are inevitably lessening the role of public pensions, and DC plans, an important component of corporate pensions, are playing an increasingly important role. We have proposed some regulatory reforms that are needed to accommodate that, in some cases breaking with the approaches taken in the past.

Corporate pensions that allow employees to enroll in a pension plan through the workplace are a more efficient way for individuals to build wealth for their old age than is their doing so on their own, by giving them greater bargaining power with financial service providers, for example. Expanding the coverage of corporate pensions is critically important to the task of helping Japan's private-sector salaried employees become more prepared for old age. It is up to the company whether to provide a corporate pension plan in Japan, however, and we think making such plans mandatory would represent too radical of a change from the current system. We therefore have proposed making it mandatory for companies to contribute to either a corporate or an individual DC plan, giving them credit toward this with a portion of their EPI premiums.

Individual DC plans are not as common as their corporate versions, and still relatively unknown. Partly because individual plans do not offer the opportunity to sign up multiple participants all at once as corporate plans do, financial service providers have been less motivated to provide them. Nevertheless, if the proposals outlined above wind up playing a key role in expanding the coverage of individual plans, it should invigorate the individual DC plan business and naturally raise the quality of the products and services being offered.

Figure 12: Summary of proposal for complete overhaul of rules governing DC plans

Participation (coverage)	・ Private-sector salaried employees (participants in the EPI) must enroll in some form of DC plan (make DC plan contributions mandatory) 　・ Corporate DC pension plan 　・ Workplace version of individual DC pension 　・ Individual DC pension plan ・ Government workers can participate if their additional occupational pension is converted to a DC plan, and if not they can voluntarily enroll in an individual DC plan. ・ The self-employed and No. 3 insured persons can voluntarily enroll in an individual plan ・ Change the destination of automatically transferred funds from the NPFA to an individual plan
Tax rules	・ Set personal (lifetime) contribution limits 　・ Avoid unused tax exemptions 　・ Ensure fairness ・ Abolish the special corporation tax ・ Introduce after-tax contributions
Benefits	・ Keep the objective of pensions while expanding allowed uses 　・ Health care and nursing care 　・ Higher education? ・ However, establishing a plan for higher education costs is an important issue worth separately considering
Investment	・ Allow investment advice 　・ Aimed at participants interested in giving investment instructions who want to receive advice and design their own portfolio ・ Use the opt-out method and make target-date funds the core investment 　・ Assume that not all participants behave rationally 　・ Make investment in target-date funds the default option for participants other than those who opt out in order to build their own portfolios

Source: Nomura Institute of Capital Markets Research

Regarding taxation, we propose sticking with the current approach of exempting from taxes that level of contributions needed to achieve a desirable level of benefits counting the public pension, but switching to a lifetime contribution limit, so as to allow individuals to fully use their exemption throughout the course of their working careers. This is based on the thinking that, given the obvious diversity of individual work patterns, fairness requires looking at tax exemptions at the individual level. We also noted that, given the importance of corporate pensions, it is worth considering abandoning the TTE taxation pattern of taxing contributions, taxing investment returns, and not taxing benefits and adopting either an EET pattern of not taxing contributions or investment returns and taxing benefits, or a TEE pattern of taxing contributions and not taxing investment returns or benefits. In either case, this means eliminating the special corporation tax. We also proposed introducing plans based on after-tax contributions (TEE).

On the benefit side, because the objective of providing tax relief on pensions is to help build wealth for old age, we proposed allowing for early withdrawals for reasons that are consistent with that objective, such as to pay for health care and nursing care. If the concept could be broadened to include investment in later generations, higher education costs should also be considered. We also mentioned the need to consider introducing an entirely separate plan to encourage savings for higher education.

Regarding asset management, we proposed that while participants should maintain their authority to give investment instructions, investment in target-date funds and similar managed solutions should become the core approach. We also noted that although discussion of DC plans tends to focus on investment-related issues, their more important aspects may be that assets are separated at the individual level and that individuals are vested with the right to receive those assets.

This paper does not discuss which corporate pension plans are better than others. It would be possible to approach this by making a value judgment on which system is best suited to supplement the public pension, and then provide differing levels of tax relief to reflect that. Because the decision to provide a corporate pension is up to each company, however, if the rules are not designed to meet the needs of both labor and management, it will create a mismatch between what the rules require and the needs on the ground that will wind up blocking wider adoption of corporate pensions. In addition, each company will have its own opinion on the type of corporate pension that is most appropriate in their case, and even that opinion will change over time. We do not think it would be an easy matter to come up with the answer to that question, and have not tried to do so here.

We would be happy if some of our proposals wind up contributing to the debate on expanding DC pension plans.