A Proposal to Allow DC Plan Participants to Withdraw or Borrow Against Plan Assets in Emergencies

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I. Tight restrictions on early withdrawal of DC plan assets

Defined contribution pension plans (DC plans) enable their participants to accumulate assets in individual accounts on favorable tax terms. As a condition for these terms, withdrawals of assets before the age of 60 are normally only permitted in exceptional circumstances such as a participant's death or disability.

This is because the assets are intended to fund an income in retirement. However, the fact that participants are not allowed to withdraw assets when they lose or change jobs has been a major obstacle to the acceptance of DC plans by Japanese companies, which are more accustomed to paying a lump sum on severance. Japanese employer groups and financial service companies have therefore repeatedly called for the system to be reformed to allow participants of DC plans to make early withdrawals of assets. However, little progress has been made so far.

The Great East Japan Earthquake on 11 March 2011 changed the whole situation. As individuals and companies need to get back on their feet, the issue of how to finance them will become increasingly important. Indeed, DC plan administrators[1] have already received numerous enquiries or requests from participants affected by the earthquake about the possibility of withdrawing assets from their plan accounts in exceptional circumstances such as this.

This report proposes a solution in the form of an arrangement to allow participants of DC plans who are affected by the Great East Japan Earthquake to withdraw or borrow against assets in their DC individual accounts ("emergency withdrawals and emergency loans") to get back on their feet. Most DC participants are company employees. Inasmuch as companies will only be able to recover if their employees are

1 Plan administrators are responsible for providing services such as investment education and account management for the participants of DC plans. They also provide support for companies that sponsor such plans.

able to do so means that such an arrangement could also be seen as a form of assistance for companies[2].

II. Allowing emergency withdrawals and emergency loans

1. Emergency withdrawals

Emergency withdrawals would give those affected by the Great East Japan Earthquake temporary access to their own plan assets. They would remain plan participants. In other words, withdrawals of assets would not be treated as withdrawal from membership of the plans. In this sense, emergency withdrawals would be different from allowing participants to withdraw DC plan assets when they leave jobs.

We are fully aware that pension plan participants should not be given easy access to their assets. However, we would argue that, faced with this unprecedented disaster, DC plan participants should be given access to any assets they own to recover from the current situation. Indeed, doing so would enable them, at some point in the future, to resume saving for their old age.

The left-hand diagram in Figure 1 illustrates the procedure for emergency withdrawals in the case of company-type DC plans. It is a purely conceptual diagram and does not preclude other ways for implementing emergency withdrawals.

2. Emergency loans

Emergency loans would enable those affected by the Great East Japan Earthquake to borrow money free of interest against their plan assets. Unlike emergency withdrawals, there would be no movement of DC assets. Those availing themselves of this arrangement would naturally remain plan participants.

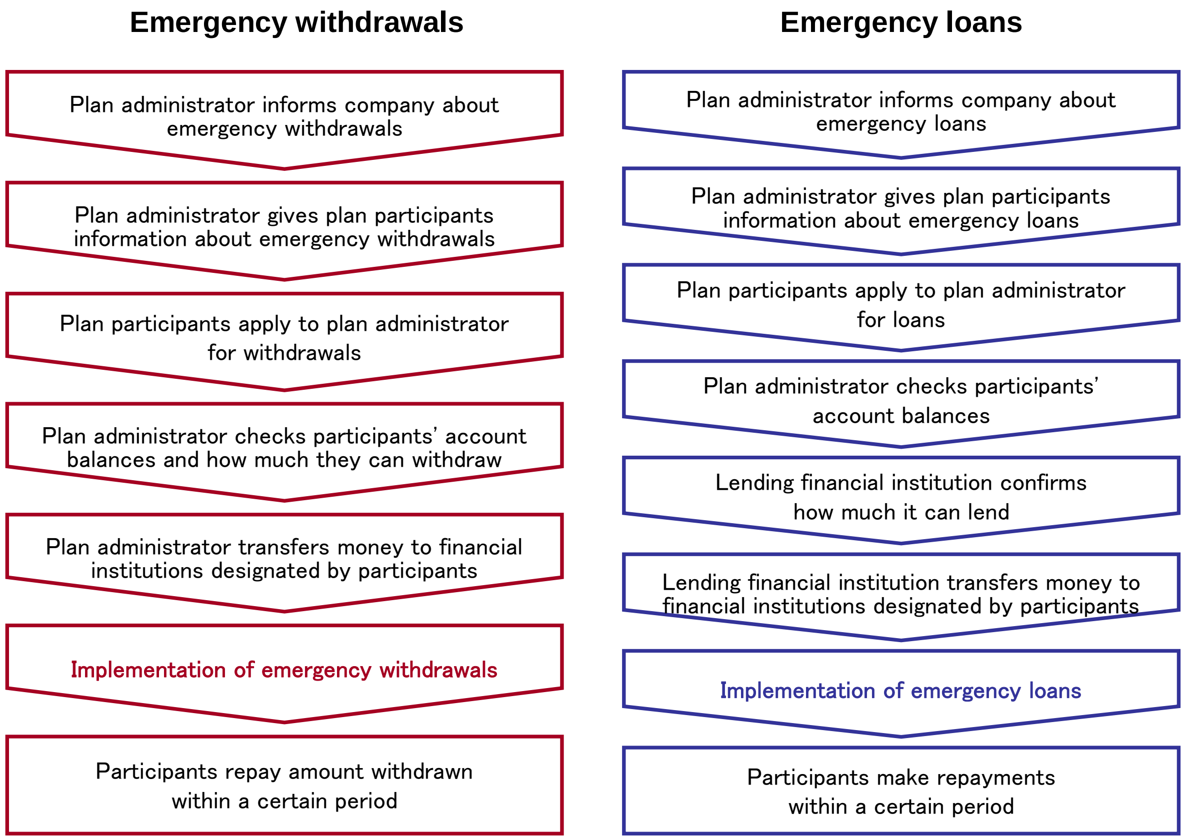
Loans could be made by a government-backed financial institution. Although the assets in DC plan accounts belong to plan participants, in reality participants are not allowed to withdraw them until they are 60. Thus, if participants were to borrow against these assets, it would be natural to look to government-backed financial institution to be the lenders. Another option would be for a government-backed financial institution to guarantee loans made for this purpose by private-sector financial institutions. We need to be flexible in devising such arrangements.

While emergency aid would be appropriate as the initial response for helping those affected by the disaster, it would not be possible to continue such aid forever. We need to have additional ways of funding to help people restore their lives.

The right-hand diagram in Figure 1 illustrates the procedure for emergency loans in the case of company-type DC plans. As with emergency withdrawals, this does not

[2] Defined contribution plans are sponsored by companies (i.e., employers) so any reform of the system should also benefit them.

Figure 1: Conceptual diagram of emergency withdrawals and emergency Loans



Note: Describes case of company-type DC plan.
Source: Nomura Institute of Capital Markets Research

preclude other ways of implementing emergency loans. The important point is that those who have been affected by the Great East Japan Earthquake are given access to funds.

3. The advantages and disadvantages of emergency withdrawals and emergency loans

Emergency withdrawal and emergency loans have both advantages and disadvantages.

As withdrawals would eventually have to be paid back, they would be similar to borrowing from one's own account. As paying benefits to plan participants is a normal part of plan administrators' operations, they might not find it difficult to deal with emergency withdrawals. The advantage of this arrangement would be that it would not require the involvement of additional players.

However, by their very nature, withdrawals would result in a temporary decline in the amount of assets in participants' accounts. As an average of 40% of all the assets in DC plans are in the form of deposits, there is a high level of liquidity. Nevertheless, some participants might have to sell assets held in other forms such as investment trusts.

On the other hand, one challenge for emergency loans would be to figure out which financial institutions would provide the loans. The larger the number of players involved, the more complicated the operation would become.

However, it would not involve the movement of any plan assets. As there would be no need to sell any plan assets, there would be no risk of investment opportunity losses. Provided the loans were free of interest, this method would be better than withdrawal in terms of maintaining the level of plan assets.

In view of these advantages and disadvantages, and provided that both arrangements were introduced, loans might be the primary option for eligible participants, followed by withdrawals as a secondary option. What is most important, however, is that we actually make reforms. We are fully aware that DC plan assets are intended to fund participants' retirement and therefore should be seen as a last resort when emergency aid has been exhausted. Our point is that, before the emergency aid is exhausted, we need to enable participants to access plan assets if they need to.

III. The significance of emergency withdrawals and emergency loans

The average value of the assets in the individual participant accounts of company-type DC plans as of March 2010 was roughly ¥1.25 million[3]. In our view, this is a sufficiently large amount to help participants affected by a disaster to get back on their feet.

In fact, emergency withdrawals and emergency loans could also be seen as a form of assistance for small and mid-size businesses. As of end-January 2011, 13,991 companies were offering DC plans. Of these, 56.7% were small businesses with fewer than 100 employees. Also, as of end-2010, 79,000 of the 122,000 holders of individual-type DC plans worked for companies without a company pension plan. We assume that many of these participants are employees of small businesses (Figure 2).

As we pointed out in the first section, participants of DC plans who have not yet reached the age of 60 are only allowed to withdraw assets in exceptional circumstances. However, if that means that they cannot withdraw assets even in the event of an unprecedented disaster like the Great East Japan Earthquake, DC plans could be considered unacceptably inflexible. In our view, emergency withdrawals and emergency loans could lead to greater acceptance of DC plans.

[3] This figure was derived by subtracting the ¥240 billion of assets belonging to plan participants in their sixties from the total net assets of the plans (¥4.5 trillion) and dividing the amount by the number of participants under the age of 60 (3,410,000).

Figure 2: DC plans in Japan

Number of plan participants

(participants)

Company-type DC plan	3,670,000
Individual-type DC plan	122,098
Self-employed, etc.	43,237
Private-sector employees	78,861
Total	3,792,098

Sponsor companies

Company size (number of employees)	Number of companies	Share
99 or fewer	7,926	56.7%
100–299	3,288	23.5%
300–999	1,854	13.3%
1,000 or more	923	6.6%
Total	13,991	100.0%

Note: Number of plan participants as of December 2010; number of companies as of January 2011.
Source: Nomura Institute of Capital Markets Research, based on data from Ministry of Health, Labour and Welfare's Pension Bureau

DC plans were introduced in Japan in 2001, six years after the Great Hanshin-Awaji Earthquake. In view of the massive amount of funds needed for post-earthquake-and-tsunami reconstruction, DC plan assets are quite small. But they exist today whereas they did not exist at the time of Hanshin-Awaji. We have been discussing in detail relaxing the rules for early withdrawal from DC plans ever since their introduction in 2001. Now, however, is the time to address a much more immediate and specific problem. Allowing emergency withdrawals and emergency loans as soon as possible would, in our view, help people get over their current difficulties.