Defined Contribution (DC) Pension System Ready for Reform

－Growing Need to Improve Investment of DC Assets－

Akiko Nomura
Senior Analyst,
Nomura Institute of Capital Markets Research

I. DC system reform attracting increasing attention

1. Corporate pensions face difficult environment

With Japan facing continued population aging and dwindling of its birthrate, the nation's public pension system is planning to initiate a benefits control mechanism called the "macroeconomic slide" from fiscal 2015[1]. This mechanism is a necessary measure for increasing the sustainability of Japan's public pension system. Nonetheless, public pension benefits will continue to decrease in substance over the long term and private pension plans will become an increasingly important part of asset formation for one's senior years[2].

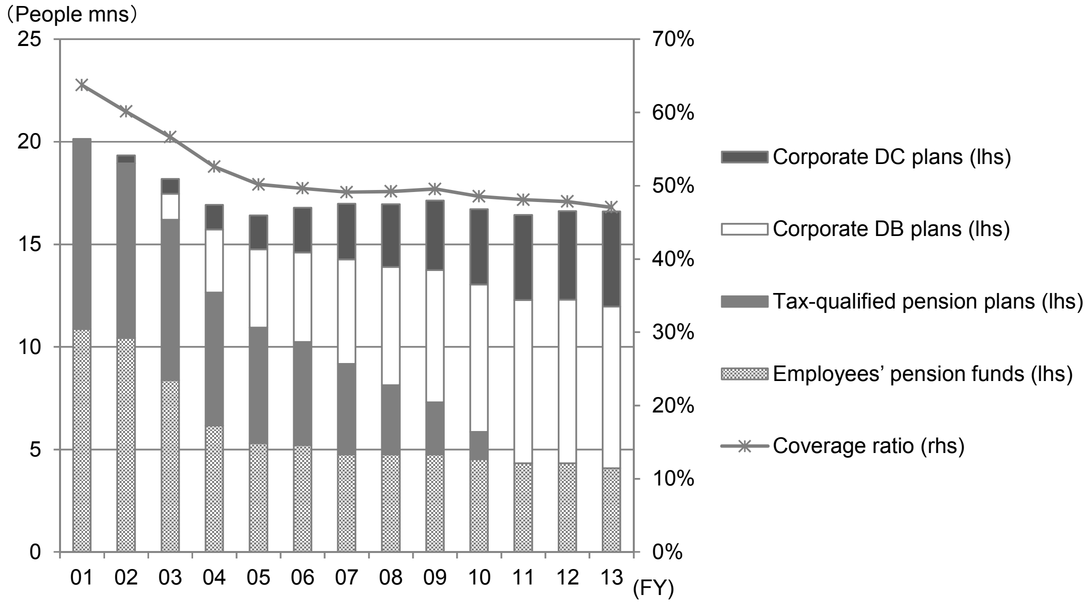
Private pension plans are provided and operated by private-sector organizations, with corporate pension plans the most common type. However, in recent years participants in private pension plan and the plans' coverage ratio have either remained static or actually declined (Figure 1). One reason for this trend has been the decrease in the number of participants in defined benefit (DB) pension plans, the traditional type of corporate pension plan. Defined contribution (DC) pension plans were introduced in Japan in 2001 and have seen an increase in participant numbers, but this increase has not been enough to offset the decrease in DB pension plan participants.

Discussions spurred by the AIJ Investment Advisors scandal led to revision of the Employees' Pension Insurance Act and accelerated the return of the substitutional component (*daiko henjo*) of employees pension funds (EPFs) to the government and

[1] The "macroeconomic slide" was introduced by the 2004 public pension reforms but was not implemented for 10 years because of Japan's deflationary economy. See Akiko Nomura, "Success of Government Growth Strategy Holds Key to Sustainability of Japan's Public Pension System – Implications from 2014 Actuarial Valuation Results," Nomura Journal of Capital Markets Autumn 2014.

[2] The government's "Basic Policies for Economic and Fiscal Management and Reform 2014," approved by Cabinet Decision on 24 June 2014, also lists "promotion of corporate pension plans" as one of the topics to be considered when discussing pensions as part of social security reform.

Figure 1: Trend in number of participants in corporate pension plans



Note: Coverage ratio is the number of participants in corporate pension plans divided by the number of people enrolled in the Employees' Pension Insurance. The data is not adjusted for enrollment in multiple plans. Consequently, the actual number of participants and the coverage ratio are lower than shown above.

Source: Nomura Institute of Capital Markets Research, based on Ministry of Health, Labour and Welfare data.

the dissolution of those funds, which were one type of DB plan[3]. Over the next several years, Japan must encourage companies which offer EPFs to switch to other types of private corporate pension plans and realize a net increase in participants in private pension plans. Toward this end, the pension system needs to be revised in a manner that will make corporate pension plans easier to use and increase the number of companies offering such plans.

2. DC system reforms proposed by the government's growth strategy

The Japan Revitalization Strategy – 2014 Revision (Growth Strategy Part 2) approved by a Cabinet Decision on 24 June 2014 takes up the issue of revising the private pension DC system. The strategy's plans for vitalizing Japan's financial and

[3] Employees' pension funds (EPFs) include a public pension substitutional component (*daiko*) that is managed on behalf of the government. The AIJ Investment Advisers scandal of 2012 unveiled the problem of funding shortfalls in many EPFs' substitutional component. Legislature revising the EPF law and other related laws included a provision for the dissolution of EPFs and the return of the substitutional component (*daiko henjo*), including a "special dissolution rule " that will be applied for five years to facilitate the dissolution of underfunded EPFs and the return of the substitutional component to the government. According to the Ministry of Health, Labour and Welfare, 25 EPFs were dissolved in April–September 2014 and seven EPFs returned the subsititutional component to the government. Of the 499 EPFs still in existence as of end-September, 317 have received informal permission to dissolve or return the substitutional component.

capital markets include the “Establishment of a cycle in which abundant household assets flow toward growth money.” Under this heading the revitalization strategy states that “To further popularize defined contribution pension plans, the Government will consider improvements in the investment of defined contribution pension assets as a whole, with a view to helping citizens become self-supporting, as well as examining how to ensure flexibility regarding lifestyles (for example, by removing the limit on employees’ matching contribution to less than the amount of the employer contribution and increasing the use of defined contribution pension plans among SMEs). The Government will conduct these deliberations in conjunction with a review of the public pension system as a whole, including third-tier pensions.”

More specific proposed revisions to the DC system were earlier spelled out in the “Japan Revival Vision” released by the Liberal Democratic Party’s Headquarters for Japan’s Economic Revitalization on 23 May 2014. This vision outlines seven pillars for Japan’s revival. The third pillar, “Strengthening Human Capacity”, proposes creating a “Better Lifestyle through Reform of Defined Contribution Pensions” by (1) reviewing constraints on employees’ matching contributions, (2) spreading the use of the corporate DC system to employees of small and medium-sized enterprises (SMEs), and (3) improving DC participants’ investment decisions in line with the Japanese economy’s exit from deflation.

II. Corporate Pension Subcommittee of the Social Security Council discussions

The topic of expanding the private pension system is now being discussed by the Corporate Pension Subcommittee of the Social Security Council, a Ministry of Health, Labour and Welfare (MHLW) body. The Subcommittee released its draft agenda at its seventh meeting on 25 July 2014 and began discussions on the topic at its eighth meeting on 11 September. The discussion topics are broadsweeping, ranging from a revision of the current system to the introduction of new types of schemes (Figure 2). However, topics related only to DB are few, with the emphasis clearly on improving and expanding the use of the DC system.

Here, we provide an overview of the discussion topics we consider most important to revising the DC system. For more details on the current status, pending issues, and needed reforms of Japan’s DC system, see the “For Reference” table at the end of this report.

Figure 2: Discussion topics for Social Security Council's Corporate Pension Subcommittee

Item	Discussion topic	Concerned systems
I. Expanding the use of corporate pensions, etc.		
(1) Initiatives for corporations in general	・ Secure equal-footing between DB and DC systems to enable a variety of system designs that correspond to individual company conditions	DC
	・ Establish procedures for transfers between systems and improve portability to meet needs caused by corporate restructurings, etc.	DC
(2) Initiatives for SMEs	・ Introduce new frameworks to lighten the burden on SMEs offering corporate pension plans (including making additional contributions possible, lowering system-operating costs for DB plans, and reducing investment education and administrative costs for DC plans)	DB, DC
	・ Conceive a system design that assumes sustained participation and supervision by management and labor and combines features of DB and DC plans (taking into consideration examples from other countries and proposals from corporate pension–related organizations)	DB, DC
II. Responses to diversifying needs		
(1) Flexible and resilient system design	・ System design that assumes sustained participation and supervision by management and labor and combines features of DB and DC plans	DB, DC
	・ Suitable frameworks for management/labor participation/supervision and the roles/responsibilities of other related parties in the case of system design diversification	DB, DC
(2) Responses to diversifying life courses	・ Increase portability/transferability among systems; reduce asset-transfer costs	DC
	・ Positioning of schemes allowing individuals to join corporate pension plans and suitable scope for application of individual-type DC plans	DC
III. Ensuring proper governance		
	・ Most suitable framework for sustained labor/management participation/supervision that provides clear indication of the overall operating policies of corporate pension plans	DB, DC
	・ Flexible operating rules that deal with system risks, such as need to quickly eliminate shortfalls in accumulated pension plan assets	DB
	・ Suitable frameworks for management/labor participation/supervision and the roles/responsibilities of other related parties (fiduciary responsibilities, etc) in the case of system design diversification	DB, DC
	・ Effective investment education programs that correspond to system designs	DC
IV. Others		
(1) Revision of current system	・ Measures that enable participants in DC plans to select investment assets that are appropriate to their individual needs (discussions need to take into consideration the "Japan Revitalization Strategy – 2014 Revision")	DC
	・ Simplification of DB/DC plan application procedures, etc.	DB, DC
	・ Measures that make it easier for workers to continue participation in corporate pension plans when changing jobs, such as strengthening cooperation among retirement benefit systems and enhancing plan portability	DB, DC
	・ Treatment of employees' matching contributions	DC
(2) Relation to public pension system and tax system, etc.	・ Positioning of corporate pension plans and corresponding tax systems so as to ensure income during retirement years, assuming a certain level of public pension benefits (proper form for corporate pensions and other private-sector plans must be examined from the dual perspective of retirement lump sum benefits and old age benefits while keeping in mind the system's legally stipulated purpose of securing income during people's senior years).	DB, DC
	・ Increase portability/transferability among systems; reduce asset-transfer costs	DC
	・ Positioning of schemes allowing individuals to join corporate pension plans and most suitable scope for application of DC plans	DC

Note: "Concerned systems" column was added by the author to indicate which systems were most likely to be subject to revisions in accordance with the "Discussion topics".
Source: Nomura Institute of Capital Markets Research, based on materials from the 8th Meeting of the Corporate Pension Subcommittee of the Social Security Council (11 September 2014)

1. Equal-footing for DB and DC plans and higher limits on contributions to DC plans

Under the broad topic of “Expand the use of corporate pensions, etc.”, the Subcommittee has included the specific discussion topic of “Secure equal-footing between DB and DC systems to enable a variety of system designs that correspond to individual company conditions.” We think this could be watershed development, as DB and DC plans to date have not achieved this equal footing despite both being private pension systems that should be treated similarly.

Most symbolic of the current unequal footing of the two systems is the contribution limits applied to DC plans. DB plans do not have any limits on benefits to be received, as management and labor are allowed to freely determine pension benefit amounts and set premiums at the required level, with the entire premium being tax deductible. DC plans, however, are subject to strict contribution limits. Because DC contribution limits are set at insufficient levels, corporations often are unable to provide a combination of DB and DC plans that fits their needs. Consequently, raising contribution limits is the system reform most needed from the perspective of securing equal footing for DC plans.

2. Initiatives for SMEs and relaxation of requirements for early withdrawals

The Corporate Pension Subcommittee began discussing initiatives for SMEs as part of its deliberations on “Expanding the use of corporate pensions” at its meeting on 11 September 2014. Discussion topics related to DC plans included the following:

(1) Joint implementation of investment education programs: Entrusting investment education for DC plan participants to the Pension Fund Association (PFA), etc.

(2) Creation of a simplified DC system (tentative name): Introduction of a simplified DC system featuring simple system establishment procedures and ease of operation.

(3) Creation of a system enabling small employers to make contributions into employees’ individual DC accounts: Introduction of system enabling additional contributions to employees’ individual DC accounts by employers.

The common thread in these discussion topics is recognition of the need to lower costs related to the establishment and operation of DC pension plans by SMEs. In addition, the third topic clearly indicates that the Subcommittee is considering measures to benefit employees of SMEs, regardless of their pension plan’s format. Such flexible thinking should be welcome.

Lowering costs has previously been pointed out as a key to expanding the introduction of DC plans by SMEs. For example, at the 10 January 2013 meeting of the Social Security Council’s Pension Subcommittee’s advisory panel on the Employees’ Pension Fund System, the Association of DC Plan Administrators presented specific proposals to simplify DC plan operating procedures[4]. We think the first reforms could well be based on input from these actual plan administrators.

Discussions about a new system aside, we think the current private pension plan system would be adopted by more SMEs if the requirements for early withdrawals from DC plans were relaxed. The strict regulations regarding withdrawals from DC plans before the age of 60 are considered to be the major reason why SMEs are hesitant to introduce such plans. For example, introducing a system that allowed withdrawals during times of hardship, which could be defined as a major natural disaster or other similar event, would be a reasonable exception to the rule that easy withdrawals are not acceptable in the case of pension plans.

In addition, the current DC system limits matching contributions by employees to an amount equal to or less than the company contribution. This restriction puts DC plan participants employed by companies that are not able to make large contributions at a disadvantage to employees of companies that are able to make large contributions by limiting their opportunity to save for retirement relative to the opportunity provided to employees of larger companies. In general, this restriction is unfair to the employees of SMEs that do not have the resources to make large contributions to corporate pension plans. The restriction limiting employees' matching contributions to amounts equal to or less than their company's contribution should therefore be eliminated post haste.

3. Responses to diversifying needs and expanding eligibility for participation in individual-type DC plans

Discussion topics on the agenda of the Social Security Council's Corporate Pension Subcommittee include "Suitable scope for application of individual-type DC plans" under the broader topic of "II. Responses to diversifying needs". Expanding eligibility for participation in individual DC plans and allowing anyone to use such plans is a system reform that should be implemented as a response to diversifying needs, including changing lifestyles and more varied work/career patterns. At present, individuals who do not qualify for participation in individual plans cannot make premium contributions. Participants in corporate DC plans who quit their job or are laid off are no longer eligible to participate in the corporate plan and must transfer the assets in their corporate DC account into an individual DC plan. If they are not eligible for the individual-type DC, they can no longer contribute to the account and those assets become locked. This restriction also diminishes the benefit of making pension assets portable. Thus, expanding eligibility for participation in individual DC plans would also be an effective means for increasing portability, another one of the subcommittee's discussion topics.

Concurrently, the Abe administration is seeking to promote greater involvement by women in the economy, while halting the decline in Japan's birthrate. However,

[4] See Association of DC Plan Administrators, "Kōsei nenkin kikin seido no minaoshi ni tsuite (shian) ni kansuru iken" (Opinion on the Proposed Revisions to the Employees' Pension Fund System) (10 January 2013) (in Japanese).

getting a larger number of women to play a greater role in the workforce while also taking time out to give birth and raise children will require the provision of more diverse work patterns and greater emphasis on work-life balance. A private pension system that enables women to continue saving for retirement throughout their lives no matter when or how often they change their jobs or workplace would potentially help promote women's participation in the economy while also addressing the falling birthrate issue[5].

4. Introduction of a hybrid system and concerns about increased system complexity

The Subcommittee listed "System design that assumes sustained participation and supervision by management and labor and combines features of DB and DC plans" as a topic for discussion when considering "Responses to diversifying life courses" and "Initiatives for SMEs". At its eighth meeting on 11 September 2014, the Subcommittee proposed further examination of "a structure that combines the guarantees of a DB system with a structure for investing assets as a group, based on the joint decision of management and employees and assuming investment education programs were implemented as needed."

While expanding options is one way to respond to diversifying needs, that approach raises concerns that Japan's pension system, already criticized for being complex, will become even more complicated and, consequently, difficult to use. The topic therefore should be discussed thoroughly, including whether or not there is a real need for additional options. Meanwhile, investing DC plan assets as a group is complicated by the fact that it is fundamentally impossible to take away the right to make choices about investments from the plan participants who shoulder the investment risks. One way around this obstacle would be to construct a governance structure that includes management and employees. However, devising such a structure requires care be taken to avoid creating an overly complicated system prone to high operational costs.

5. Focus on reform of DC investments

Another discussion topic on the Corporate Pension Subcommittee's agenda is "Measures that enable participants in DC plans to select investment assets that are appropriate to their individual needs."

The current allocation of corporate DC plan assets shows that about 60% are invested in low risk–low return principal-secured instruments, such as bank deposits and insurance products (Figure 3). As a result, assets are unlikely to increase much given current interest rate levels. This allocation raises concerns about plan

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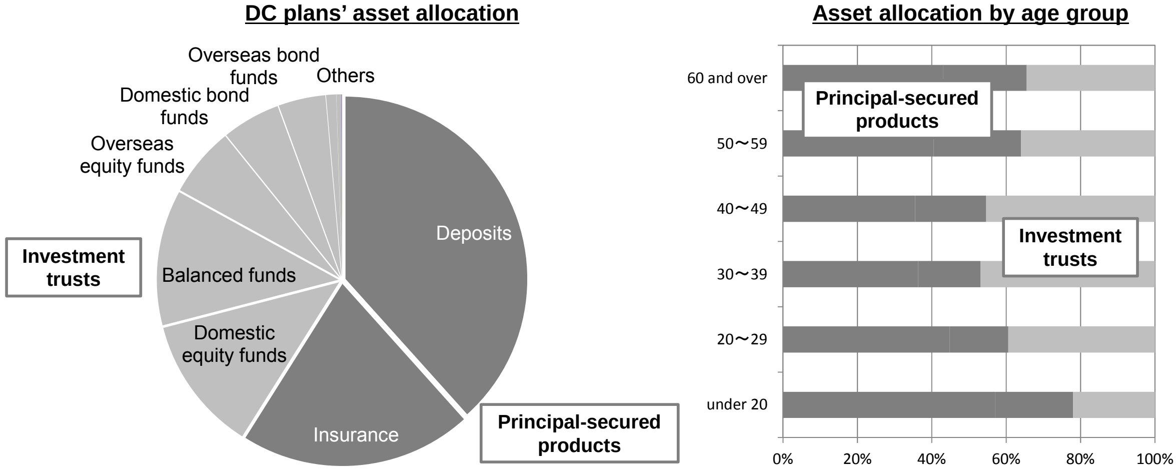
5 For more on women and DC pension plans, see Akiko Nomura, "Josei no rōgo no shotoku kakuho ni okeru kakutei kyoshutsu nenkin" (Direct Contribution Pension Plans as a Means for Women to Secure Income during Elderly Years), Gekkan Kigyō Nenkin (Monthly Corporate Pensions), July 2014 (in Japanese).

Figure 3: Current allocation of corporate DC pension plans (March 2013)



Source: The Association of DC Plan Administrators

participants' understanding of the impact of such low yields on their retirement asset formation as well as the ability of DC plans to fulfill the role of retirement asset formation.

However, this does not mean that system reforms to date have ignored the need to address the issue of DC plan participants' ability to make informed decisions[6]. For example, the 2011 Amendments to Pension Laws to Support Securing Pension Benefits included a revision to the provision in Article 22 of the Defined Contribution Pension Act that clarifies employers' responsibility to provide "continuing" investment education for plan participants. Also, in March 2013 the official interpretation memorandum on the law governing administration and operation of DC plans was revised to include "life planning" as part of required investment education. In addition, in cases where employees do not issue specific investment instructions and their pension contributions are invested into a pre-designated product, that product must not be limited to principal-secured instruments, and consultations between management and employees during the fund selection process must include funds that provide diversified risk, asset and investment timeframe positions by investing in a number of different asset types,.

However, such measures are by no means a sufficient response to the situation illustrated in Figure 3. A number of key measures have yet to be taken, including the introduction of investment advice, which was postponed by the March 2013 revised official interpretation memorandum. The Abe administration is focused on supporting household asset formation and increasing households' supply of long-term funds to support economic growth by, for example, promoting the expanded use of the Nippon Individual Savings Account (NISA) system, a tax-free system for small investments

6 See Akiko Nomura, "Kakutei kyoshutsu nenkin no un'yō kaizen ni muketa seido kaisei no ugoki" (Progress of system reforms aimed at improving defined contribution pension plan investments) Nomura Institute of Capital Markets Research, Summer 2013 (in Japanese).

by individuals. As the Corporate Pension Subcommittee has already pointed out the need to discuss the topics in its agenda while giving due consideration to the "The Japan Revitalization Strategy – 2014 Revision", future deliberations could well focus on further improvements to the investment of DC plan assets. In the next section of this report, we present recent global trends in DC pension plan operations and investments and outline the reforms we believe are required in Japan.

III. DC investment reform growing in importance

1. Global trends in DC investment

Investment education for DC plan participants is the best way to improve their investment behavior. However, the greater the number of DC plan participants the more complicated that challenge becomes. It is unreasonable to expect all plan participants will be able to use investment education programs to make the most appropriate and sound investment decisions. While the provision of investment education remains a major premise, we think that plan participants will still need support when they turn that education into action.

Responding to that need, many other countries have created default funds that enable plan participants to put their pension fund assets in long-term diversified investments that include products deemed suitable for the investment of employees' DC plan assets. In Japan, default funds are positioned as a temporary, exceptional repository for pension assets until the plan participant instructs the pension plan administrator how to invest his/her assets. Time deposits are generally used for this purpose, but in overseas DC plans, more investment-oriented instruments are positioned as the core repository for such assets. In other words, a default fund generally includes products considered as suitable for pension fund investments, and the system enables participants who are not particularly interested in creating their own portfolio to invest in the default fund.

According to the International Organisation of Pension Supervisors (IOPS)[7], the suitability of default funds depends on each country's pension system. In a December 2012 publication entitled "Supervising Default Investment Funds," the IOPS stated that evaluations of a default fund's suitability should take into consideration such factors as (1) the DC plan's position relative to the pension system as a whole (i.e., is it a core option or an incidental one), (2) the risk tolerance of the country's average citizens, (3) market and economic environment factors (e.g., the stage of development of the country's financial and capital markets, inflation levels, etc.), and (4) the knowledge and experience of the fund's fiduciaries (who are responsible for selecting the default investment product) (Figure 4)[8].

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7 At present, about 70 countries participate in the IOPS.
8 IOPS, "Supervising Default Investment Funds," IOPS Working Paper on Effective Pensions Supervision, No. 18, December 2012.

Figure 4: Factors to consider when setting/assessing a default fund (IOPS)

1. Default fund purpose	Purpose of a default fund involves a decision between asset protection and securing adequate pension benefits. Nature of the pension system—i.e., mandatory basic pension system or voluntary supplemental system—must also be considered. In general, life-cycle funds are designed to be appropriate for the broad mass of pension fund members, and therefore may be considered suitable as the default fund in all types of pension systems.
2. Risk appetite of plan participants	Investment decisions will be made for plan participants who do not indicate their own investment preferences. These decisions must take into account participants' risk profile.
3. Investment objective & risk tolerance	Fund investment goals and risk levels must take into account the risk tolerance level of plan participants.
4. Liquidity & cash flow	Default fund design must take into account the liquidity and cash flow needs of the pension plan. Such considerations will include the age (number of years to retirement) of plan participants and whether participants can switch to more liquid investment choices.
5. Diversification	Diversification is an extremely important consideration for a default fund. However, is difficult to make a general statement about appropriate diversification levels.
6. Cost	Cost and fees are important considerations when selecting investment products. Transparency of costs is also important. However, the lowest-cost fund is not necessarily the one that will provide the best returns and therefore default funds cannot be selected simply for their low fees.
7. Market & economic conditions	Market and economic conditions differ from country to country. Default fund selection should therefore take into account the stage of capital market development and inflation levels in the particular country.
8. Governance	Pension fund governance structures should also be taken into consideration when setting the default fund. If the knowledge and experience of the trustees/fiduciaries is limited, they should not select a product they do not understand as the default fund.
9. Communication	Default funds should be simple enough for ordinary plan participants to understand. Communication is crucial to securing plan participants' understanding.

Source: Nomura Institute of Capital Markets Research, based on IOPS working paper on "Supervising Default Investment Funds," December 2012.

Figure 5 provides an overview of default fund systems in the US, the UK, and Australia. In the US, the widespread automatic enrollment into 401(k) plans has led to the establishment of qualified default investment alternatives (QDIAs). In the UK, the introduction of the automatic enrollment for virtually all workers has led to government guidance on default funds. In Australia, laws on default funds have been revised to reflect the accumulation of superannuation assets caused by compulsory enrollment.

While each country's default fund system reflects its unique circumstances, in all three countries the legislative and executive branches of the central government (the authorities in charge of pension regulations) have set forth certain rules for the investment of DC pension assets. It can be said that these three countries have taken clear stances on what they consider to be suitable investments for DC plan assets and indicated their commitment to DC pension plans despite the fact that future events could subject those decisions and related laws to criticism as being unsuitable.

Figure 5: Overview of default funds in the US, UK, and Australia

	Laws and regulations	Background
US	Pension Protection Act of 2006, Department of Labor's Rules on Qualified Default Investment Alternatives (QDIAs)	・ Basically, American workers join 401(k) plans voluntarily and receive investment education to enable them to create their own portfolios from a wide variety of investment products. However, as 401(k) plans have become the mainstream corporate pension plan, automatic enrollment in 401(k) plans has become more widespread. As many of these auto enrollees were considered to have relatively little interest in making investment decisions, default funds became more important, and pension plans increasingly shifted their default funds to target date funds (TDFs) and similar investment trust products. ・ Previously, because default funds were established for use by plan participants who did not provide explicit instructions for investing their pension assets, employers could be exposed to fiduciary liability if the fund suffered losses. The Pension Protection Act expressly states that employers would be considered to be fulfilling their fiduciary responsibility as long as their default fund is compliant with regulations that the Department of Labor (DOL) would establish. ・ DOL adopted the rules for QDIA in 2007. The DOL's mention of TDFs as an example of an appropriate investment product has led to the steady increase in 401(k) plans using TDFs as default funds.
UK	Dept. of Work & Pensions (DWP), "Guidance for offering a default option for DC automatic enrolment pension schemes"	・ Since the latter half of the 1990s, the UK has seen a prominent shift from DB pension schemes to DC pension schemes. The coverage ratio for private pension plans has simultaneously fallen. The 2008 revision of the UK's Pensions Act introduced an automatic enrollment system. Employers, starting with large corporations, have been required to enroll employees in a qualifying pension schemes since October 2012. ・ Automatic enrollment schemes are required to have a default fund option. These default funds must be compliant with DWP guidance. This guidance sets forth the best practices to be followed when designing a default fund, including the fund's objective, its suitability for employees, its affordability, and the need to manage risk by diversifying asset allocation (while taking into account to a reasonable extent the number of years to retirement for plan participants).
Australia	MySuper regulations established by the MySuper Core Provisions	・ Australia has a compulsory enrollment private pension system called superannuation funds. Almost all superannuations are now DC plans, and about 40% of all assets are invested in default funds. ・ In 2012, a growing awareness of the importance of default funds as superannuation assets continued to increase led the Australian government to revise its pension legislation and introduce the MySuper Provisions. To qualify as a MySuper product, a fund must have a single diversified investment strategy or a lifecycle-based product. ・ Superannuation funds must have MySuper products approved by the Australian Prudential Regulation Authority (APRA), Australia's financial industry regulatory authority. A list of approved MySuper products is available on the APRA website.

Source: Nomura Institute of Capital Markets Research, based on various materials and the legislation documents of each country

2. DC investment reforms needed in Japan

Japan needs to implement DC plan investment reforms suitable to its unique situation. Such reforms must be made while keeping in mind the obligation of pension plans in Japan to offer one or more principal-secured products. None of the three countries discussed above requires the inclusion of a principal-secured product, and plan participants who do not make a conscious choice about the investment of their contributions do not seem to question the investment of their contributions into a mutual fund even if the fund's performance results in a temporary loss of principal. While poor investment performance may lead to dissatisfaction among plan participants, they would have to ask themselves if a better result could have been obtained had they given their own investment instructions.

DC plans in Japan, however, must offer a principal-secured product, and plan participants therefore must decide between investing contributions in a principal-secured product or investment trusts with higher risk-return profiles. Consequently, employers in Japan are not completely free from the concern that employees whose contributions were automatically invested in the default fund could claim that they were not given the opportunity to invest in a principal-secured product. Moreover, given the fact that only about 5% of Japan's household financial assets are invested in investment trusts, it would be hard to say that the average Japanese person is familiar with such products. Given this situation, even if we assume that default funds are destined to become the core investment option of DC pension plans in the long run, it will probably be easier for DC plans to gain acceptance in Japan if, for the time being at least, the DC product selection process is made as simple as possible and plan participants retain the right to make explicit decisions about the investment products purchased with their contributions.

The proposal on pension plan investment products presented by the Japan Securities Dealers Association at the 4 July 2014 meeting of the Social Security Council's Corporate Pension Subcommittee reflects that thinking (Figure 6). The proposal defined "pension-investment-oriented products" as products that allow plan participants to employ investment techniques, including managing risk through asset and time diversification, and support investment decisions suitable to the accumulation of assets for one's retirement years. These investment products include target date funds, target risk funds, and balanced funds. The proposal also states that pension-investment-oriented products must meet requirements established by a public entity and be certified by that entity. Employers should be required to provide participants in their corporate pension plans with both pension-investment-oriented products and principal-secured products, leaving the plan participants with a simple choice between those two options. Simplification of the investment decision should make it easier for SMEs to adopt DC plans, which would contribute to higher DC pension coverage ratios for employees of SMEs.

Another method for supporting plan participants' investment choices would be to provide investment advice on an individual basis. As was noted earlier, the introduction of a system for investment advice was proposed by the March 2013 revision of the DC Pension Act's official interpretation memorandum but was soon

Figure 6: Proposal for "Pension-investment-oriented products"

Thinking behind pension-investment-oriented products	
(1)	A plan design that makes it easier for DC pension plan participants to select instruments appropriate for the investment of DC assets.
(2)	Investment-oriented products are defined as products that allow plan participants to employ investment techniques, including managing risk through asset and time diversification, that support investment decisions suitable to the accumulation of assets for one's retirement years. For example, these instruments enable plan participants to choose to invest in products with risk tolerance levels deemed suitable to the participant's age or products with risk tolerance levels assumed to be equal to the maximum degree of loss that the participant can tolerate.
(3)	Plan design should take into consideration appropriate measures to protect investors, such as sufficient disclosures that enable ex-post facto evaluations of product suitability for plan participants.
(4)	When selecting investment products for DC pension plans, the responsible public entity (committee, etc.) as designated by the Defined Contribution Pension Act and its enforcement ordinance must ensure the transparency of the selection process by, for example, establishing standards that contribute to plan participants' investment of pension contributions and monitoring of product evaluations, certifications, disclosures, and investment performance.
(5)	The pension plan administrator must demonstrate to plan participants, through investment education programs, etc., that although the investment products do not guarantee principal they are based on a life plan designed to accumulate retirement assets over the long term and will enable each participant to make selections appropriate to the investment of their pension fund contributions.

Source: Materials presented by the Japan Securities Dealers Association at the sixth meeting (on 4 July 2014) of the Corporate Pension Subcommittee of the Social Security Council (the materials were based on "Kakutei kyoshutsu nenkin no seido kaizen teian ni tsuite," a joint proposal for improving Japan's DC pension system drafted by the JSDA and the Japan Investment Trusts Association (JITA) dated Jan. 31, 2013).

withdrawn owing to the lack of time for conducting sufficient discussion on the topic. Before such a system can be introduced, the contents of such advice and the qualifications of advisers, among other system considerations, must be established. Nonetheless, we look forward to the eventual realization of a system for providing individual advice to pension plan participants.

Japan also needs to find a core investment method for DC pensions that best suits its individual circumstances and will be readily received by participants. The use of TDFs is gaining acceptance abroad but awareness and understanding of such funds still remain low in Japan. However, understanding of the need for revising DC investment as plan participants get closer to retirement age seems to be increasing. In May 2015, SC Holdings, a Fukuoka-based company whose businesses include operating after-school learning centers providing individual tutoring, reportedly adopted an AllianceBernstein TDF as the default fund for its corporate DC plan[9]. We think that if supplemented by appropriate investment education programs, the use of TDFs in DC plans could become more popular in Japan.

IV. Conclusion

As noted in the Cabinet Decision paper "Japan Revitalization Strategy (2104 revision)," the government is ready to begin deliberations on improving Japan's DC system, indicating an unprecedented opportunity for system reform.

The Ministry of Health, Labour and Welfare's tax system reform requests announced on 29 August 2014 included a request for tax-related measures necessitated by revision of the corporate pension system. In addition, the government's "Outline of Tax Reforms for FY2015" approved by the Cabinet on Jan. 14, 2015, recommends the expansion of the individual-type DC pension scheme.

The most urgent need, of course, is to find a new home for participants in employees' pension funds that are going through the dissolution process or the return of the substitutional portion to the government. From September to November 2014, the Corporate Pension Subcommittee held several meetings, with discussions centering on tax issues first. The subcommittee will wrap up discussion of remaining issues in December or early in 2015.

When the Corporate Pension Subcommittee was established in October 2013, its first mission was to discuss the issues related to the employees' pension fund problem. Since April 2014, however, the subcommittee's deliberations have been dedicated to corporate pension system issues, which we think indicates the elevated status of corporate pensions in Japan's overall pension system. Discussion topics include system reforms necessary to secure income for Japan's elderly, using benefits from both public and private pension plans. The same issue faces other countries, with some, such as the UK, seeking to raise the coverage ratio by requiring automatic enrollment in private pension plans. We hope Japan will also seize the opportunity being currently presented to undertake discussions of fundamental system reforms, including greatly expanding the role of private pensions.

9 "Araiansu, DC-muke tāgetto-gata tōshin no teian kyōka: Mizuho gin ga unkan no anken de hatsu saiyō" (AllianceBernstein strengthening proposal of target-type investment funds to DC pension plans: Plan administered by Mizuho Bank becomes first to adopt AB fund) (in Japanese), Nenkin Joho, 5 May 2014.

[For Reference] DC system issues

Subject	Issue	Effect	Needed system reforms
Contributions	・Low limits on contribution amounts ✓ Corporate plans: ¥55,000/mo if employee is enrolled in DC plan only; ¥27,500/mo per account if enrolled in both DB and DC plans ✓ Individual plans: ¥68,000/mo for self-employed individuals, ¥23,000 for company employees w/o a company plan	・Low DC limits are problematic for companies, restricting how they combine DB and DC plans or switch to a DC only system	・Raise the limit on contributions ・Allow unused portion of contribution limit to be carried forward; introduce a lifetime contribution limit
	・Employee contributions (matching contributions) cannot exceed the employer's contribution	・Employees' ability to save for retirement is limited; system is unfair to employees of SMEs that cannot afford to make large contributions ・Individuals whose income may vary from year to year do not have the option to make larger contributions in high-income years	・Eliminate the restriction limiting employees' matching contributions to level of company contribution
Eligibility	・Following types of individuals are not allowed to enroll in individual DC plans: ✓ Employees of private companies that offer DB plans but not DC plans ✓ Government employees ✓ Category 3 insured persons (non –working spouses of employees) ✓ People over 60 (with some exceptions)	・Impedes individual's own efforts to save for retirement ・Makes for complicated system ・Unequal treatment of employees of companies with DB plans but no DC plans and employees of companies offering both plan types ・Locks up assets that have been transferred, diminishing the true benefit of portability	・Expand eligibility and create a system open to anyone who wants to join
Early withdrawals	・Withdrawals before age 60 are strictly restricted	・Withdrawals are not possible even in times of distress, making the system hard to use for both individuals and companies	・Introduce system allowing withdrawals during well-defined times of distress
Special corporate tax	・Suspended until March 2017	・Taxation on pension assets rather than investment income is excessively severe as investment yields could become negative; also limits buildup of pension assets	・Repeal the special corporate tax
Investment choices	・60% of DC assets are invested in principal-secured instruments, which over the long term are unlikely to provide sufficient post-retirement income	・Plan participants are not practicing long-term diversified investments, raising concerns that they are not building a sufficient asset base for retirement	・Strengthen investment education, provide investment advice ・Assist participants in selecting investment options, offer a default option

Source: Nomura Institute of Capital Markets Research