Taking Japan's Defined Contribution Pension Plans to the Next Level[1]

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I. Introduction

Issues that inevitably come up when discussing pension reform in Japan nowadays are aging demographics and self-reliance. With the birthrate declining more than expected and people on average living longer, the balance between the working generations who provide support and the retired generations who receive support has broken down, making it imperative that the public pension system undergo a serious overhaul. Legislation for the integrated reform of Social Security and taxes, passed into law on 10 August 2012, included reforms of the public pension system. This legislation was nothing more than a way point, however, and the debate over reforming public pensions is ongoing.

However that debate ends up, as long as the population continues to age, the role that public pensions play in preparing for old age will inevitably decline for many of Japan's citizens. This is making it more important for people to make their own arrangements for old age.

Private pensions are one way to assist in these self-help efforts via tax incentives. By private pensions, we mean all pension plans provided by the private sector, including corporate pensions that companies provide to their employees and individual pensions that people enroll in on their own. Although our focus here is on the corporate pension system, all types of private pensions will become more important in Japan in the future.

Defined contribution (DC) pensions, the main subject of this report, are one type of private pension introduced as a result of legislative changes in 2001. Defined benefit (DB) pension plans, the traditional form of corporate pensions, place a greater burden on the companies, since they may require additional employer contributions to cover underfunding, and are thus unlikely to become more prevalent than they are today. DC plans, in contrast, have not been around for very long, and although they have a number of regulatory issues, they have the potential to be used by a greater number of people if those issues can be solved.

[1] This article is a reprint, with permission from Nomura Securities, of an article in the fall 2012 edition, Volume 75, No. 4, of Zaikai Kansoku (in Japanese).

We think the spread of DC plans could also provide a conduit for greater investments in mutual funds and an increase in the supply of growth money. It is expectations of these secondary effects that help to explain why an expansion of DC plans was included in the Comprehensive Strategy for the Rebirth of Japan, the Cabinet Decision issued on 31 July 2012.

In this paper, we summarize the current status of DC plans and their drawbacks, and consider the regulatory reforms that will be needed to ensure they become more widespread in use.

II. Current status of defined contribution plans

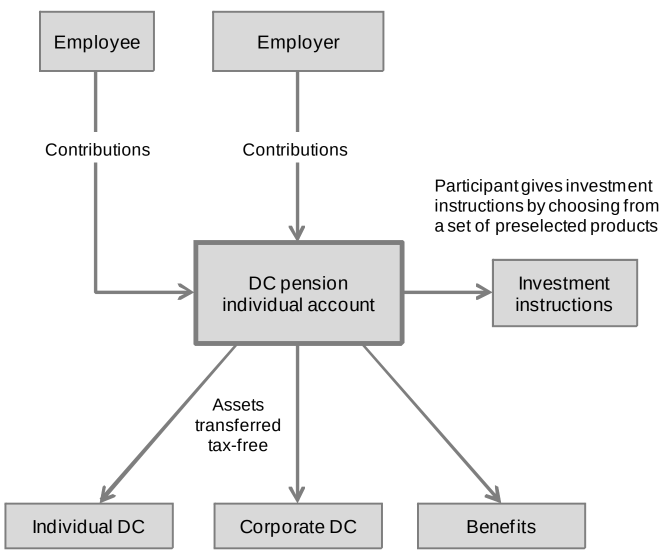
1. Pension plans based on individual accounts

DC plans are a type of private pension that provides a tax incentive to help people accumulate assets for old age. There are two types of DC plans, corporate DC plans provided by companies for their employees, and individual DC plans that can be joined by the self-employed and by employees at a workplace without a corporate pension.

Their basic structure is shown in Figure 1. Each participant has their own individual account, and the employer makes contributions to each individual account. Thanks to the 2011 legislative changes explained below, participants have been allowed to make contributions to their individual accounts since January 2012.

Participants can choose the investments in their individual accounts from a number of preselected products. The average number of investment products is 18, and includes bank deposits, insurance products, and mutual funds. Because plan

Figure 1: Basic structure of defined contribution (DC) pensions



<Basic tax treatment>

When making contributions	• Corporate DC • Employer contribution: Deductible (no personal income tax) • Employee contribution: Deductible • Individual DC: Deductible
When investing	• Special corporate tax is levied in principle, but currently suspended
When receiving benefits	• Taxed after a public pension deduction or retirement income deduction

<Maximum contribution>

Private-sector company employee	• If the company only offers a DC pension plan: ¥51,000 per month • If company offers both a DB and DC plan: ¥25,500 per month • If company offers no pension plan (individual DC): ¥23,000 per month
Self-employed person	• ¥68,000 per month

Note: Figure shows design of corporate DC plans.
Source: Nomura Institute of Capital Markets Research

participants can only choose their DC investments from this product lineup, it is very important that appropriate investment products are included in the lineup. This is normally done by a financial services provider hired by the company as plan administrator. The top five plan administering companies based on the number of enrollees they serve are Mizuho Financial Group, Sumitomo Mitsui Trust Bank, Defined Contribution Plan Consulting of Japan (a subsidiary of the Mitsubishi UFJ Financial Group), Nippon Life, and Nomura Securities[2].

Employers are required to provide investment education to DC plan participants to enable even those with no investment experience to give their own investment instructions. This education includes an overview of the pension plan as well as basic knowledge on investing, including the concepts of diversification and long-term investing. Because in most cases the employer's main business is not investment services, this training is normally provided by the plan administrator.

When the employee changes jobs, their individual account is rolled over into either a corporate DC pension or an individual DC pension. Although a person cannot be enrolled in both types of DC plans (corporate and individual) at the same time, once they become a DC plan participant, they are able to hold tax-advantaged pension assets in a individual account throughout their work career.

The tax advantages of a DC plan are that the contributions are made with pre-tax funds and investment gains are untaxed, with taxation not occurring until the benefits are paid out. There are limits on the amount of the contribution. For example, for a corporate DC plan that is the only pension plan at the company, the maximum monthly contribution is ¥51,000 per participant (Figure 1).

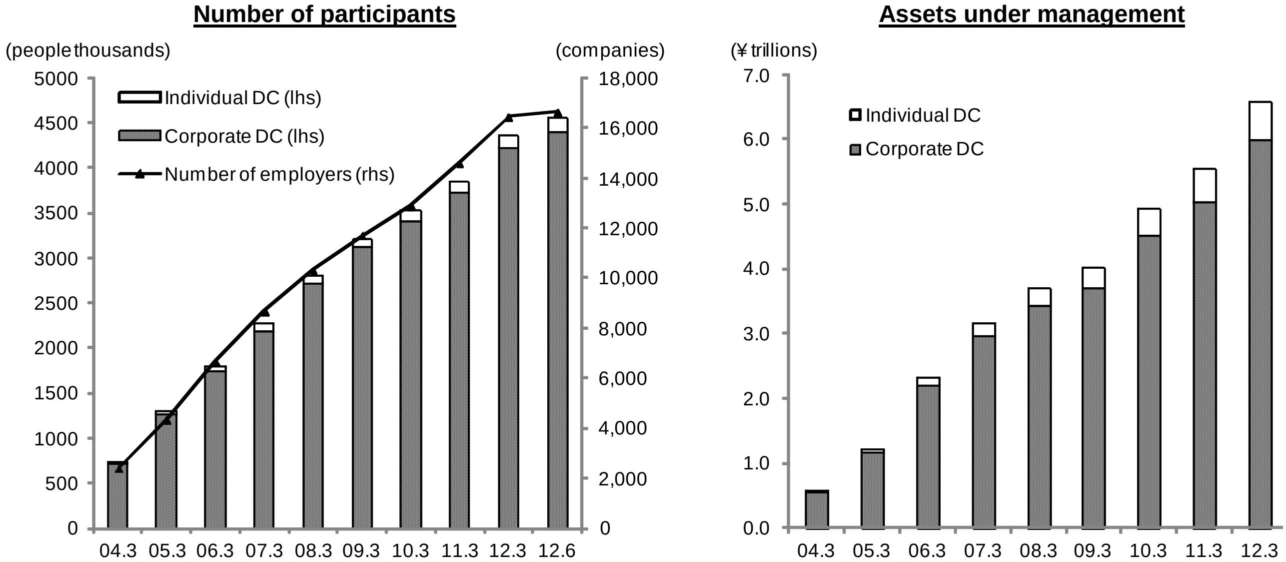
In principle, DC plan assets can only be withdrawn on or after age 60. Until reaching that age, the only circumstances under which a withdrawal can be made are if the enrollment period is short (up to three years), the balance is small (up to ¥500,000), or upon the participant's death or disability. The tax advantages are offered because it is a pension, so the limits on withdrawals are very strict.

2. DC plans making steady inroads

DC plans were first implemented in October 2001, and the number of participants along with the amount of plan assets have grown continuously over the decade since (Figure 2). There were 16,629 companies offering the plans as of July 2012, and there were 4.54 million enrollees as of June 2012, of which 4.4 million were enrolled in corporate DC plans, which equates to roughly 13% of all private-sector salaried employees (i.e., those covered by Employees' Pension Insurance). As of end-March

2 For the status of DC plan administrators, see "Most recent DC plan assignments (end-March 2012)" in the 6 August 2012 edition of Nenkin Joho (in Japanese).

Figure 2: Number of DC plan participants and assets under management



Source: 6 August 2012 issue of the Nenkin Joho, the Ministry of Health, Labour and Welfare (in Japanese) and Nomura Institute of Capital Markets Research.

2012, 30% of all listed companies offered a DC plan[3]. Total plan assets were ¥6.6 trillion.

Many companies introduced DC plans at the same time that they revised their existing retirement plans, be they DB plans or lump-sum retirement payouts. As shown in Exhibit 3, 61% of companies that introduced a DC plan transferred a portion of the assets under their existing retirement plan to the DC plan. The transferred assets mostly came from tax qualified pension plans, with the switch apparently motivated by the abolishment of those pensions from March 2012. In addition, 34% of the companies offering a DC plan also offer another corporate pension plan at the same time. The larger the company, the more likely it is to offer multiple pension plans, and that number is 64% for companies with at least 1000 employees.

3. Significance of DC pensions today

The fact that the amount of the retirement benefit depends on the participant's investment instructions and the plan participant rather than the company bearing the investment risk are often cited as the defining characteristics of a DC plan, but those two attributes alone do not tell the entire story. What we think makes DC plans significant in today's world, when self-reliance by individuals is becoming increasingly important, are (1) the rights to pension assets are secured at the

[3] Calculated by Nomura Institute of Capital Markets Research, based on data from the Pension Bureau at the MHLW and from each stock exchange. 38% of the companies listed on the TSE-1 offer a DC plan.

Figure 3: Pensions at companies that have introduced DC plans

Assets transfers from other retirement benefit plans

<Are assets transferred?>

	Yes	No
Up to 99 employees	51.4%	48.6%
100-299 employees	73.5%	26.5%
300-999 employees	75.6%	24.4%
1000 or more employees	70.7%	29.3%
Total	61.1%	38.9%

<Source of transfer if assets transferred>

	Tax-qualified pension	Lump-sum retirement benefit
Up to 99 employees	77.1%	34.2%
100-299 employees	81.2%	36.3%
300-999 employees	73.0%	47.0%
1000 or more employees	52.2%	58.9%
Total	75.7%	38.8%

Parallel use with other corporate pensions

<Are other plans used in parallel?>

	Yes	No
Up to 99 employees	23.9%	76.1%
100-299 employees	40.1%	59.9%
300-999 employees	51.0%	49.0%
1000 or more employees	64.2%	35.8%
Total	34.0%	66.0%

<If there is a parallel plan, what kind?>

	EPF	Defined benefit corporate pension plan
Up to 99 employees	61.9%	40.4%
100-299 employees	60.3%	43.2%
300-999 employees	40.6%	67.2%
1000 or more employees	18.6%	87.6%
Total	51.7%	52.5%

Note: As of July 2012.
Source: Nomura Institute of Capital Markets Research, based on data from Pension Bureau at the Ministry of Health, Labour and Welfare

individual level, (2) the pensions are portable, and (3) investment education is provided.

1) Rights to pension assets are secured at the individual level

As noted earlier, each DC plan participant establishes their own individual account. Employees become fully vested after no more than three years of service. The individual accounts are the property of the plan participant, and thus unaffected in the event of the employer going bankrupt.

Under a DB plan, the company promises a pension benefit to the employee, but the amount of that benefit can be reduced if the company's business deteriorates and at least two thirds of plan participants agree. Normally, it is the benefits of the plan participants who are still working that are cut, but pensioners can also have their benefits reduced. In other words, the promise of benefits under a defined benefit plan is only as good as the company itself, and thus is subject to uncertainty over whether that company can remain healthy over the numerous decades spanning the working and retirement periods.

DC plans provide superior protection of benefits in that sense because it is the individuals, including currently working plan participants, who own the assets in the individual accounts. DC plans have had this advantage since they were first introduced, but there has not been much awareness of this fact. Over the past 10 years, however, there have been examples of companies, including large ones that have failed with underfunded pension plans thereby forcing a reduction of benefits, including for pensioners. As uncertainty rises and more attention is paid to intergenerational fairness, there seems to be a renewed awareness that the biggest advantage of a DC plan is that it secures the right to pension assets on an individual level.

2) Pension portability

As noted earlier, the individual account assets in a DC plan stay with the plan participant when they change jobs, and thus it is a pension system that deals well with labor market mobility. Now that the size of Japan's labor force is declining (from 67.93 million in 1998 to 65.9 million in 2010), the employment of women and seniors is often cited as a way to deal with the smaller labor force. We think it is necessary to allow workplace flexibility in order to eliminate the "M curve" and promote the employment of women, and because the more portable DC plan is neutral in regards to how people work, it supports greater diversity in the way people work. These advantages are not being sufficiently leveraged, however, because of the various restrictions currently in place on who can participate in a DC plan. We discuss these problems later in this paper.

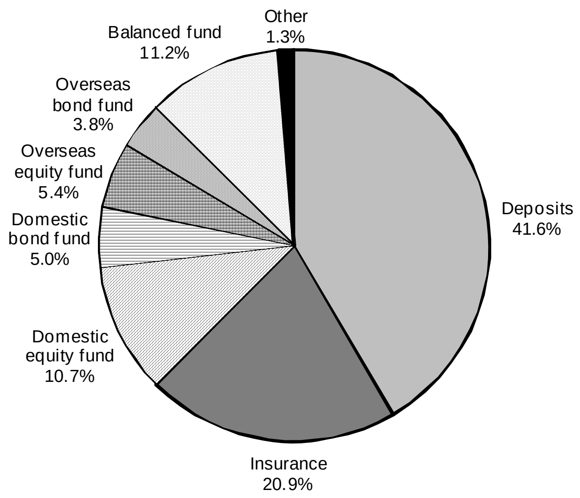
3) Investment education

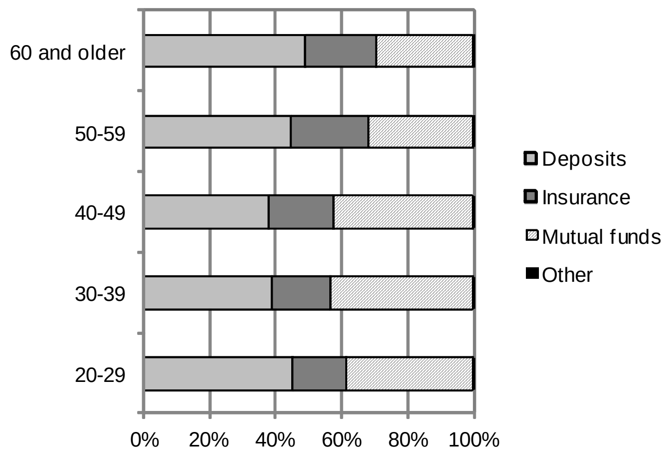
DC plan participants make their own decisions on what to invest their individual account assets in, but in Japan, where over half of all household financial assets are held in cash and deposits, many people are unfamiliar with managing assets. The investment instructions for a DC plan are a matter of long-term investing with the clear objective of accumulating assets for old age. It is unlikely that this will come easy for most people.

This makes it necessary to create an environment whereby plan participants can make reasonable investment decisions. The key here is providing an investment education. Because corporate DC plans are offered through the workplace, it is possible to offer systematic investment education, including making sure all participants attend seminars, for example. This education is not aimed merely at providing knowledge, but also at getting participants to realize that it is up to them to decide how to invest contributions made to their own individual accounts. This type of investment education has never been offered in Japan before, and its longer-term impacts are unknown.

Looking at how DC plans are currently invested, however, as shown in Figure 4, as of March 2011, 42% of all DC plan assets were in bank deposits, 21% in insurance products (with a guaranteed yield), and 37% in mutual funds and other. This means that over 60% of the assets were concentrated in deposits and insurance products. The

Figure 4: Investment instructions for DC plans





Note: As of March 2011.
Source: Nomura Institute of Capital Markets Research, based on materials from the Association of DC Plan Administrators

age cohort with the highest share of assets invested in mutual funds at 43% is the 30-39 bracket, which still has 20-30 years until retirement. Judging from these numbers, it does not appear that access to investment education has led to a large number of plan participants practicing long-term investment diversification. We will discuss this point more below.

III. The conditions surrounding Japan's pension system

1. Public pension reforms postpone constraints on benefits

We summarize here the conditions surrounding both public and corporate pensions in Japan.

Public pension reforms implemented in 2004 capped premiums and constrained benefits. For the Employees' Pension Insurance used by private-sector salaried employees, the contribution rate was raised in a graduated fashion up to a maximum of 18.3%, and the impact from demographic aging was dealt with by limiting benefits using a mechanism known as the "macro economic slide." This marked a departure from the previous approach, under which it was uncertain just how high the premium rate could ultimately be raised. It provided, however, for revising the entire pension system if, based on a fiscal checkup, the replacement rate (pension benefit relative to the average income of working generations) drops below 50%.

These reforms were thought to have assured the long-term stability of public pension finances. Nevertheless, a fiscal checkup run five years later in 2009 show that

Figure 5: Overview of public pension reforms

Areas of reform	Integrated Social Security and Tax Reforms	Legislation related to the Integrated Social Security and Tax Reforms
Securing funding source	• Permanent funding for basic pension payment from general revenue: After hike of consumption tax rate it becomes permanent funding source.	• Passage of legislation raising the consumption tax rate.
	• Revise standard maximum compensation.	• Postponed.
	• Lower benefits of high-income people to fund additional benefits for low-income people.	• Included in bill to strengthen pensions, but eliminated in revisions made in the lower house. Decided to continue studying.
Strengthening the minimum guarantee function	• Additional benefits for low-income people.	• Included in bill to strengthen pensions, but eliminated in revisions made in the lower house. Bill submitted to provide supplemental benefits to low-income seniors and passed.
	• Shortening period of eligibility for benefits.	• Included in bill to strengthen pensions and passed.
	• Expand EPI coverage to part-time workers.	• Included in bill to strengthen pensions and passed.
	• Exempt workers on maternity leave from paying premiums.	• Included in bill to strengthen pensions and passed.
Restraining benefits	• Eliminate exception to price indexing in which benefits paid out are higher than they would be normally.	• Created bill separate from integrated reform legislation and passed.
	• Revise the macroeconomic indexing formula so that it also reflects deflation.	• Postponed.
	• Raise the age at which benefits begin.	• Postponed.
Integrating EPI and mutual aid pensions	• Integrate EPI and mutual aid pensions.	• Legislation for integration passed.
Other	• Revise the rules for Category 3 insured (non-working spouses).	• Postponed.

Source: Nomura Institute of Capital Markets Research, based on the 17 February Cabinet Decision, Outline of Comprehensive Social Security and Tax Reforms, and on summaries of each draft bill

although keeping the replacement rate at 50% was possible, the assumptions used may have been overly optimistic. In addition, because of deflation, the macro economic slide mechanism was never invoked.

During the lower house elections held in 2009, the Democratic Party of Japan (DPJ) made comprehensive public pension reform one of its major policy issues. It proposed revising the current system, which comprises three separate programs, the national pension, the EPI, and mutual aid pensions, and transitioning to a new pension system for all citizens, made up of a pension proportional to income and a minimum guaranteed pension. It subsequently failed to provide specifics over implementation of the new system, however, and the 17 February 2012 Cabinet Office Decision on the integrated reform of social security and taxes only included measures to reform the current system, leaving implementation of a new pension system to be dealt with later (see Figure 5).

Two specific bills were submitted to the 180th regular session of the Diet covering some of the broader reforms included in the Decision, one aimed at strengthening the minimum guarantee features and another aimed at integrating EPI and mutual aid pensions. Both bills, along with legislation raising the consumption tax rate, were passed into law on 10 August 2012. Debate over a number of other issues, including measures to constrain benefits, did not reach the floor of the Diet, and instead was relegated to a newly formed national conference on social security reform.

2. Environment for DB plans becoming increasingly difficult

Thus describes the ongoing debate over reforming public pensions, but because many of the issues that have been put off concern ways to constrain benefits, it seems fairly certain that public pensions will play a smaller role for most citizens. It therefore makes sense for people to make use of corporate pensions and other private pensions to prepare for old age. It also makes sense for the government to help people become more self-reliant and rein in spending on public welfare.

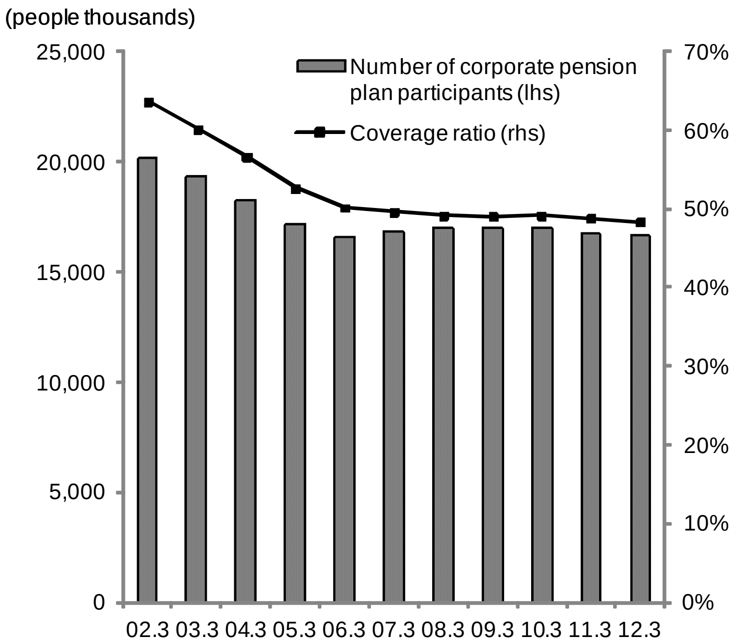
Of the different types of private pensions, corporate pensions are particularly efficient at increasing both the number of plan participants and the pension coverage ratio (the percentage of the population enrolled in a pension plan). Recently, however, the coverage ratio for corporate pensions has been either flat or in declining trend, as shown in Figure 6. Turning this trend around will probably require measures to strengthen corporate pensions.

The lack of growth in the number of corporate pension enrollees can be largely attributed to the decline in the number of DB plan participants. Because we have no data on those employees enrolled in multiple pension plans, the exact figures are unknown, but it appears that the number of DB plan participants has been declining in recent years. The amount of assets held in such plans has also shown no growth (Figure 7). The advent and spread of DC plans has not been enough to offset the impact that the decline in DB plans has had on corporate pension enrollment overall[4].

Conditions for DB plans are clearly difficult. Investment performance was weak in the 1990s, and has been volatile since the turn of the century. When pensions become underfunded, corporations must make additional contributions, which puts pressure on earnings and crowds out other investment opportunities. In addition, it is impossible to foresee these funding shortfalls, and the uncertainty itself can be a burden for the company.

4 The corporate pension reforms of 2001 enabled DC plans and also revised rules for DB plans. It was decided to eliminate tax qualified pension plans by March 2012 because they did not sufficiently protect the benefits of participants, and a new defined benefit corporate pension was introduced. Companies were also given the option of returning their substitutional portion of the EPF to the government (called "daiko henjo"), and many chose to do so.

Figure 6: Corporate pension coverage ratio

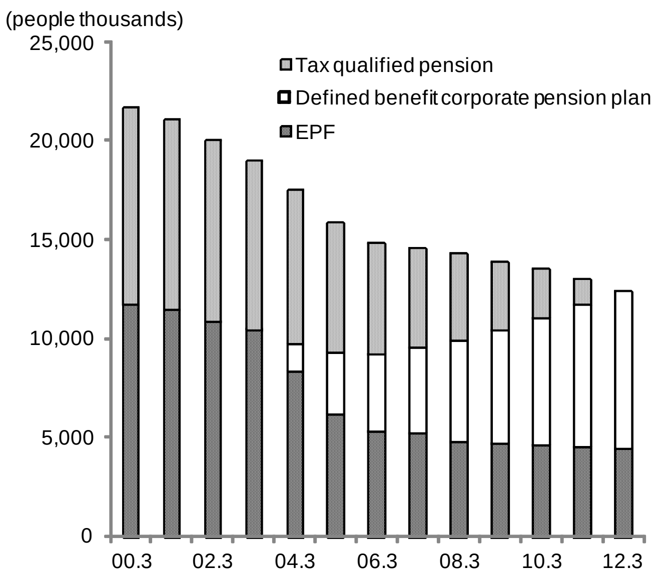


Note: Individuals enrolled in multiple plans are double counted. The coverage ratio is the number of participants in a corporate pension divided by the number of people enrolled in Employees' Pension Insurance.

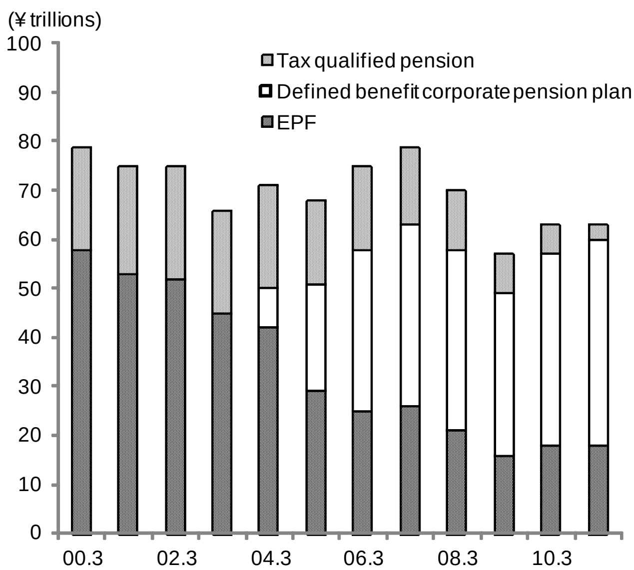
Source: 16 July 2012 issue of Nenkin Joho, the Ministry of Health, Labour and Welfare (in Japanese), Nomura Institute of Capital Markets Research.

Figure 7: Number of enrollees and assets under management in DB plans

Number of participants



Assets under management



Note: Individuals enrolled in multiple plans are double counted.

Source: 16 July 2012 issue of the Nenkin Joho, the Ministry of Health, Labour and Welfare (in Japanese), Nomura Institute of Capital Markets Research.

In addition, beginning in March 2001 retirement benefit accounting standards were introduced that required the parent company to reflect pension funding shortfalls on their balance sheet, and this strengthened disclosures of the funding status of DB plans. Retirement benefit accounting does not apply to DC plans, which do not promise a set level of benefits and therefore do not generate liabilities. Retirement benefit accounting was introduced in response to the globalization of accounting standards, but wound up pushing many companies into revising their DB pension schemes and introducing DC plans.

Further revisions of pension accounting standards gained momentum globally starting in the 2000s. According to Nomura Securities, Japan's listed companies had a total pension funding shortfall of ¥26.6 trillion in FY 2011, of which ¥12.6 trillion had not yet been recognized on balance sheets[5]. Because pension benefit obligations are long-term promises, when funding shortfalls emerge it seems acceptable to amortize them over an extended period instead of taking a charge for the entire amount. This accounting treatment, known as delayed recognition, makes it difficult to see the true status of pension funding, however, and both international accounting standards and US GAAP are steadily shifting to immediate recognition, whereby the entire amount of the funding shortfall is reflected on the balance sheet. In order to harmonize, Japan announced revisions to its retirement benefit accounting standards in May 2012 that would move to the immediate recognition of all funding shortfalls from March 2014. Given the possibility that this could result in a reduction of capital at some companies, we think it may lead to another round of DB plan revisions.

In 2012, the AIJ investment advisors scandal sparked a debate over the Employees' Pension Fund (EPF), a key component of DB plans. A key feature of the EPF is that a portion of the public pension is managed on behalf of the government; this is called the substitutional, or "daiko," portion. Once it became possible in FY 2002 for companies to return this portion to the government, many companies opted to do it, a procedure called "daiko henjo." Currently, the core of the EPF consists of multi-employer type funds, most of which are sponsored by a group of small and medium enterprises.

The EPF requires first and foremost that sufficient assets be held in order to meet the benefit obligations of the daiko portion, but it is that level of funding that is actually in dire straits. According to the Ministry of Health, Labour and Welfare (MHLW), over 35.8% of EPFs had a daiko shortfall, i.e., an unmet retirement obligation in the substitutional component, as of March 2011 (and based on preliminary data that number was 50% as of March 2012). Because the sponsoring companies are small and medium enterprises, however, they have limited ability to make additional contributions.

In addition, the assumed rate of interest established for each fund as the target investment yield has been lowered on numerous occasions at the large firms since the end of the 1990s to reflect the market environment, but because such lowering

5 See Kengo Nishiyama, “Status of Retirement Benefit Obligations (FY11),” Nomura Equity Research, 10 August 2012.

increases the amount that the company must contribute to the fund, it is difficult to do for multi-employer type EPFs, a situation that often winds up encouraging high-risk investing.

Furthermore, even if a company decides to abolish the EPF, doing so is often difficult, because of the requirement to eliminate funding shortfalls when either returning the substitutional component (daiko henjo) or dissolving their plans. Because that component is a part of the public pension, benefit reductions based on an agreement with the plan participants and beneficiaries are not an option.

An expert panel on the management of the EPF was formed in April 2012 to discuss these various problems affecting the EPF. A report published by the expert panel on 6 July 2012 proposed strengthening investment guidance and promoting more disclosure, and the MHLW is making headway in revising regulations based on those proposals, but a number of issues remain to be dealt with, including how to respond to the problem of daiko shortfalls, the sustainability of the EPF, and the nature of pensions for small and medium enterprises.

In light of the situation outlined above, we think it will be difficult to reverse the trend shown in Figure 7 and achieve substantially wider use of DB plans than is currently the case. Meanwhile, use of DC plans has been growing steadily over the past decade. Further support for regulatory reforms will be needed for this growth to continue, however. In the next section, we look specifically at issues with DC plans and the regulatory reform that is needed.

IV. The need for DC regulatory reform

1. The significance of recent pension-related legislation and further regulatory reforms

The most significant legislative change since the introduction of DC plans was the pension reform bill passed by the Diet in August 2011. The new law allows for employee contributions in corporate DC plans. Although attempts were made to reform DC-related legislation in 2007 and 2009, the proposed reforms never made it to the Diet floor, and thus were never implemented. The August 2011 pension reform bill was basically another attempt at success by repackaging those previous proposals.

The introduction of employee contributions has been the Holy Grail of reformers since DC plans were introduced. While DC plans are pensions grounded in the idea of people helping themselves, it was previously only the company that could make contributions, but plan participants themselves are now finally able to voluntarily make contributions to their individual accounts, and can deduct that amount from their taxable income. This provides a valuable opportunity to accumulate assets tax free, and should make DC plans more interesting to enrollees.

The employee contribution is just an option when designing DC plans, however, and companies are not required to include it. This means that companies need to amend their DC plan documents so that employees can actually make their own contributions. As of July 2012, 1121 companies had already allowed employee contributions. To make sure that employees do not lose a valuable opportunity to save on their taxes, companies that already have a DC plan need to quickly change their plan design so as to allow employee contributions, and those planning to implement DC plans need to design their plans that way from the outset.

Although allowing employee contributions is in itself significant, the fact is that such contributions currently have two constraints: they (1) must meet a statutory cap on the total of both the employer and employee contributions and (2) cannot be any higher than the employer contribution. Of these two, we should get rid of the second constraint as soon as possible. Although there are concerns that employers would substantially cut their contributions if the amount of the matching contribution were completely liberalized, under the current constraints, employees at companies making only a small contribution have less room to contribute on their own than do employees of companies that make larger contributions, and this constraint winds up exacerbating the gap they have with those more fortunate employees.

In addition to introducing employee contributions, the August 2011 pension reform bill clarified the obligation to offer continuing investment education (explained later), raised the maximum age eligible to join corporate DC plans for some participants (from 60 to 65), and partially eased the requirements for lump-sum retirement payouts. DC plans currently still have several other drawbacks, however. Figure 8 shows some of the main regulatory issues and their impact. These include, in addition to the constraints on employee contributions noted above, the low maximum contribution, numerous restrictions on who is eligible to enroll, and severe restrictions on early withdrawals before age 60[6].

All of these issues have served as a barrier to the spread of DC plans, and the converse of that is that eliminating these issues will make DC plans more attractive, paving the way for them to spread further. Below, we make a number of proposals for reforming the rules governing DC plans.

2. Raising the contribution limit and setting a lifetime contribution limit

1) The thinking behind setting a DC contribution limit

First, we look at the thinking behind limiting DC plan contributions. The maximum contribution to a corporate DC plan that is the company's only corporate pension, ¥51,000 per month, was set based on the contribution required to achieve a “desirable level of benefits” counting both the public pension and the DC plan. This desirable level of benefits was the original approach used in designing the EPF. In other words,

6 Although not dealt with in this paper, the special corporate tax noted in Figure 8 is a tax on invested pension assets, and was at a rate of 1.173% before it was suspended. Because the tax is on the asset balance rather than investment returns, it will have to be paid even when returns are negative. Its suspension has been repeatedly extended since it was first suspended in 1999, but it needs to be completely eliminated to promote the spread of private-sector pensions.

Figure 8: Major issues for DC plans

Type of issues	Issues	Impact
Contribution	<u>Maximum contribution is low.</u> • Corporate (where the only corporate pension is a DC plan): ¥51,000 monthly • Corporate (where both DB and DC plans are offered): ¥25,500 monthly • Individual (employees without a corporate pension): ¥23,000 monthly • Individual (self-employed, etc.): ¥68,000 <u>Restrictions on employee contributions</u> • Restricted to no more than the employer contribution.	• Companies face difficulties when they try to design corporate pensions that are the best fit for them and their employees because the maximum DC contribution is low. • Individuals without a stable income cannot make large contributions in high-income years even if they want to. • These increase inequality among salaried employees.
Eligibility	<u>Various restrictions on who can enroll.</u> • Employees at a company with a DB plan but without a DC plan cannot participate in an individual DC plan. • Government employees cannot participate. • Category 3 insureds (non-working spouses) cannot participate. • With some exceptions, persons aged 60 and older cannot participate.	• This becomes a barrier to self-help efforts. • This makes the rules more complicated. • This winds up locking up assets that have been transferred, which keeps them from being truly portable.
Early withdrawals	<u>Withdrawals before age 60 (early withdrawals) are severely restricted.</u> • The only withdrawals allowed are upon the death or disability of the participant and from inactive participants who had been contributing no more than three years and have assets of no more than ¥500,000.	• This makes it more difficult for companies to adopt DC plans, as they are typically compared with a lump-sum retirement payout. • Withdrawals in times of need are impossible, and enrollment is difficult for individuals.
Special corporate tax	<u>The special corporate tax suspension expires in March 2014.</u> • If the tax is reinstated, it will result in a tax on assets in both DC and DB plans.	• The possibility of negative investment returns makes this taxation an overly heavy burden, and this is a barrier to the development of pension plans.
Investment instructions	<u>A high percentage is in deposits and insurance products.</u> • Over 60% of DC plan assets are invested in low-risk, low-return vehicles.	• There are concerns whether sufficient retirement assets can be built up over the long term. • When an assumed rate of return is set, it is possible that many employees will not achieve that return and thus fail to build assets equivalent to the pre-DC benefit level.

Source: Nomura Institute of Capital Markets Research

the EPF aims to achieve a desirable level of benefits from the combination of three components, the public pension, the substitutional component, and the additional component. With a DC plan, the contributions required to achieve a desirable level of benefits are figured based on the employee's compensation and certain other assumptions, and the maximum DC contribution is set at this level.

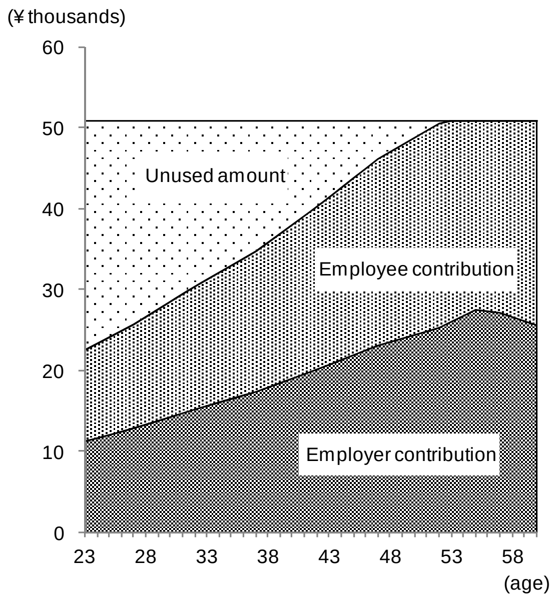
Although the maximum DC contribution has been raised twice thus far, in both cases it was done based on this approach. In other words, it was deemed necessary to raise the maximum DC contribution in order to achieve a desirable level of benefits because the level of benefits from the public pension was reduced as a result of public pension reforms in 2004 and the public pension fiscal checkup in 2009. The maximum monthly contribution to corporate DC pension plans was first raised from ¥36,000 to ¥46,000, and then raised again to ¥51,000.

If a person made the current maximum contribution of ¥51,000 per month, or ¥612,000 per year, starting with their first job after graduating college and until they reached six years old, the amount of their contributions alone would exceed ¥20 million. This is no small sum. Despite this, the maximum DC contribution is viewed as inadequate because it is unrealistic to assume consistent and continued contributions at the maximum statutory amount throughout a worker's entire career.

Most companies currently tie their DC contributions to the employee's salary increases and promotions[7]. Thus plan contributions start out low in the employee's younger years when their compensation is normally low, and increase as that compensation rises. If the pension is thought of as a part of compensation, it makes sense that plan contributions would be higher for employees that contribute more to the company, i.e., for more highly compensated employees.

When setting plan contributions using this approach, however, the employer's contributions would normally be below the statutory maximum during a worker's younger years, as shown in Figure 9, thereby creating a difference between actual contributions and the maximum contribution, i.e., leaving some of the maximum

Figure 9: Unused portion of DC contribution limit



Note: 1. The compensation used to calculate the contribution amount is the basic compensation for calculating severance payments for college graduates in regular employment according to the Institute of Labor Administration's "Rousei Jihou Bessatsu 2005 Nenban Taishokukin Nenkin Jijou" (Labor administration newsletter supplement on severance payments and pensions, 2005 edition).
2. We assume an employer contribution rate of 7% and the statutory maximum employee contribution, which is the same amount as the employer contribution.

Source: Nomura Institute of Capital Markets Research

7 See Pension Fund Association, Kigyou Nenkin ni Kansuru Kiso Shiryou (Key data on corporate pensions), December 2011. A 2010 survey showed that 85% of companies set up DC plans that tie contributions to salary increases and/or promotions.

unused. Although it depends on the level of employer contributions, even assuming the plan participant continues to make their own contributions, it would likely be difficult to completely work down this unused portion. It is this residual (unused) portion of the maximum that lowers the effective maximum contributions to a DC plan.

2) The lifetime maximum approach

The inadequacy of effective DC contribution limits may prevent companies from designing what they deem a suitable pension plan and also may take away any opportunity for people to become self-reliant. We propose allowing participants to roll over any unused portion of their limit from a given year into later years as one way to effectively increase the contribution limit, given the situation outlined above.

The idea is to establish a lifetime maximum contribution that applies to a participant's entire working career. This is similar in concept to the asset-building pension scheme, wherein interest and principal growth, including from asset-building residence savings, is tax free up to a total of ¥5.5 million.

This approach aims to increase the amount that can be contributed while maintaining the monthly maximum contribution at ¥51,000. Using the previous example, this would make it possible to make total contributions of over ¥20 million during the period from college graduation until age 60.

As noted in the introduction, an expansion of DC plans was included in the Comprehensive Strategy for the Rebirth of Japan, the Cabinet Decision made on 31 July 2012. One of the to-dos for FY2012 was to consider ways to deal with unused DC maximums, and it appears that policymakers already acknowledge an approach whereby that unused portion can be carried over into the next year. We propose raising the effective contribution limit by allowing the rollover of unused contributions[8].

3. Expanding eligibility

Current rules restrict who can participate in DC plans based on the employment status, type of workplace, and the pension system at that workplace, but these restrictions wind up creating inequities among people in their ability to use a DC plan. It also makes the plans more complex, which in turn makes it harder for participants to take advantage of portability, a strength of DC plans.

By participate, we mean being able to open a DC individual account, contribute to it, and give investment instructions. Individuals who cannot make contributions but

[8] In lieu of this approach, an argument could be made to substantially raise the maximum contribution by moving away from thinking in terms of a desirable level of pension benefits. This would probably not be very easy to achieve, however, given that it could only be revised after demonstrating a logic more compelling than one based on a desirable level of benefits.

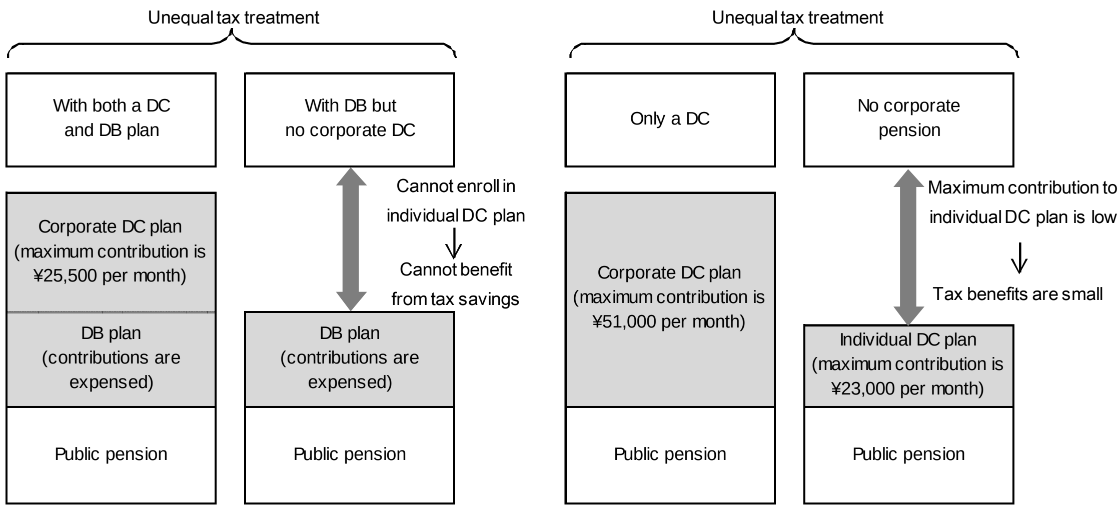
can only give investment instructions are known as inactive participants. Because of restrictions on who can participate in DC plans, some DC plan participants can wind up becoming inactive participants as a result of changing employers. According to the National Pension Fund Association, there were 195,000 such people as of March 2011[9].

Eliminating these restrictions on participation to enable more people to use DC plans would put more emphasis on self-reliance and help prepare for a lessened role of public pensions, which is consistent with the direction that Japan's pension reform needs to take. Below, we propose opening up DC participation to (1) private-sector employees of companies that have a DB plan but not a DC plan, (2) government employees, (3) non-working spouses (including full-time housewives), and (4) individuals in their 60s.

1) Private-sector employees of companies that have a DB plan but not a DC plan

Under the current rules, employees who work at a company that offers a DB pension plan but not a corporate DC plan cannot contribute to an individual DC plan even if they want to. The reasoning behind this is that by virtue of their participation in a DB plan they already receive sufficient tax exemptions. Given that the specifics of DB plans vary greatly based on the company's situation, however, it does not seem right to completely deny people the opportunity to improve their own situation by using an individual DC plan. In addition, because some people are employed by companies that offer both DB plans and DC plans, not all private-sector employees have equal access to tax breaks (the left side of Figure 10). People should be given equal opportunity to help themselves, and we think such differences are hard to justify.

Figure 10: Unequal tax treatment of DC plans



Source: Nomura Institute of Capital Markets Research

9 Out of the 230,420 inactive participants in individual DC plans, the number who are not

Employees of a private-sector company that has a DB plan but not a DC plan should therefore be allowed to contribute to an individual DC plan.

There is also a problem with the inequality of the maximum contribution, which is only ¥23,000 for plan participants employed at a company without a corporate pension, a lower amount than for employees of a company that only offers a DC pension plan (right side of Figure 10). Employees of a company without a corporate pension should have the same ¥51,000 maximum contribution that employees of a company with only a corporate DC pension have.

2) Expansion to government employees

Neither government employees nor non-working spouses are allowed to enroll in DC plans. Both groups should be.

When DC plans were introduced, it was thought necessary that the employer's contribution for government employees should go through the advisory process with the National Personnel Authority. In addition, the mutual aid pension programs for government employees have an occupational portion that is equivalent to private-sector corporate DB pensions. These were both reasons why government employees were not allowed to enroll in individual DC plans. Under a law integrating Employees’ Pension Insurance and the mutual aid pensions for government employees that was passed on 10 August 2012, however, it was decided to eliminate the occupational portion, and replace it with a separate scheme.

Unlike when they were first introduced, DC plans have steadily become more common in private-sector corporations and are expected to be used by more and more companies moving forward. This should make it possible to use DC plans as the follow-on pension plan for government employees. A report published on 5 July 2012 by an expert panel established under then Deputy Prime Minister Katsuya Okada to look at retirement benefits and the occupational portion of mutual aid pension programs argued that a system along the lines of a cash balance plan, a type of DB plan, would be appropriate, but this merits further debate[10].

Just as in the private sector, we think there is merit in using DC plans to diversify the government employee pension system, both for the taxpayers who provide the funds and for the government workers who are enrolled. Because insufficient asset accumulation does not trigger additional contributions under a DC plan, it eliminates uncertainty over financing government and of course uncertainty for taxpayers. In

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yet 60 years of age. (source (in Japanese) is http://www.npfa.or.jp/401K/status/)

[10] The expert panel's report included numerous references to the inappropriateness of DC plans. For example, it cited the possibility of investment based on insider trading or the use of nonpublic information as one area of concern when introducing DC formats for government employee pensions. Because DC investment instructions are primarily focused on mutual funds rather than individual stocks, we see no reason why concerns over insider trading would be an issue. It would generally be very difficult for DC plan participants to anticipate in advance how nonpublic information would affect the net asset value of a mutual fund and to thereby profit by trading ahead of other investors.

addition, because assets are placed in individual accounts in a DC plan, participants are at less risk of political pressure to change the system or reduce benefits. As a point of reference, the 1986 reforms in the US introduced DC plans for Federal employees, who now have both DB and DC pension plans.

3) Expansion to non working spouses

An often-cited reason for why non working spouses (category 3 insureds) were excluded from participating in DC plans is that they do not directly pay public pension premiums. With the labor participation rate of females (in 2010) at 70.4% for those aged 20-24 and 78.7% for those aged 25-29, however, those becoming non-working spouses immediately after graduating college without ever working are now in the minority, and not allowing participation by people who become non-working spouses after having enrolled in a corporate DC plan has a serious negative impact on DC plans, enrollment in which needs to be expanded.

In the case just noted, the non working spouse would normally become an inactive participant, and their DC assets would become locked up. Given that the amount of these assets can be small and that account management fees are charged, it could be difficult to maintain these assets over the long term.

We therefore recommend that working spouses be able to contribute to individual DC plans for their dependent spouses. This would allow non-working spouses to continue building up assets while they are category 3 insureds without their assets becoming locked up, and allow them to help themselves fund their retirement whenever they reenter the work force. This also has the advantage of supporting work diversity from the pension side by facilitating the resumption of employment after leaving the labor market for such reasons as raising children.

4) Enrollment by those in their 60s

The August 2012 pension reform legislation included changes to allow enrollment in pension plans up to the age of 65 for workers who work past the age of 60 as a result of changes in employment law related to seniors, but it is important to raise the maximum age for DC plan enrollment for everyone, given that the age at which public pension benefits start will be increased to 65. Working until age 65 is also being encouraged. The age for enrollment in DC plans must first be raised to 65, and if the age at which public pension benefits start getting paid is raised again, the enrollment age should also be raised.

It has been noted that the health of people in their 60s varies, and not everyone is able to continue working until age 65. For that reason, we think it is appropriate to offer a very flexible plan design that maintains the current rules allowing withdrawals beginning at age 60, but also allowing contributions until age 65. In the US, withdrawals from DC plans are possible as a rule beginning at age 59.5, while contributions can be made until age 70.5.

4. Easing the conditions for early withdrawals

Under current DC pension rules, early withdrawals before age 60 are only allowed when the participant dies or becomes disabled, when the enrollment period is short (up to three years), or when the individual account assets are small (up to ¥500,000). In Japan measures to promote individual savings are considered unnecessary and thus are not granted. Hence, to clarify the principle that DC plans are not savings but a pension, and thus should receive favorable tax treatment, fairly strict limits have been placed on withdrawals.

What has become clear over the 10 years since DC plans were first introduced, however, is that the strict conditions for early withdrawals have made it difficult to secure the agreement between labor and management needed for companies to implement DC plans. Lump-sum severance payments are common in Japan, and it is not uncommon for a portion of the lump-sum to be transferred to a DC plan; this makes DC plans, which cannot be withdrawn when leaving or changing jobs, less flexible.

The debate over easing the conditions for early withdrawal has thus far revolved mostly around making it possible to withdraw assets from a DC plan when quitting or changing jobs, as is the case with a lump-sum severance payment. It is hard to square this with the fundamental argument that it is a pension rather than savings, however. We would thus like to slightly change the concept to allow withdrawals in times of need.

This is because having the option to make an early withdrawal is desirable, given that every one could experience an unforeseen event during the long period of time before turning 60. Accordingly, by defining hardship situations in which pension assets may have to be drawn down and allowing a withdrawal when such conditions are met, it is possible to adhere to the principal behind pensions while also tolerating early withdrawals. After the March 2011 earthquake and tsunami, DC participants meeting certain conditions were allowed lump-sum payments. Events that qualify as hardship could include, in addition to natural disasters, large expenditures on medical or long term care. By allowing withdrawals in times of need, DC plans become more useful, which in turn should accelerate their growth.

5. Measures to support and improve DC investments

DC plan participants decide for themselves on how to invest the assets in their individual accounts, and this requires that they be given investment education[11]. Additionally, as DC plans become more prevalent in the pension space, there will inevitably be arguments over how to get the greatest number of participants to engage in what is generally the most rational investment behavior based on the knowledge

[11] See Naohiko Matsuo, "Positioning and issues for DC viewed as a financial scheme," DC Wave, Vol. 7, 2012. It analyzes DC investment education from the perspectives of both the Defined Contribution Pension Act and the Financial Instruments and Exchange Act.

they gain from investment education. We outline below some issues with DC investment instructions and offer some suggestions for improvement.

1) DC investment instructions and the assumed rate of return

As we already noted, 60% of DC assets are invested in either savings deposits or insurance products with a guaranteed yield (Exhibit 4). This is not a problem as long as the participant fully understands when making a decision that these are low-risk investments, and thus provide low returns, since this was the individual's choice. It is important to keep in mind, however, that in many cases DC plans have what is called an assumed rate of return.

The assumed rate of return is the expected rate of return that is attainable over the long term per the participant's investment instructions for his account. As noted above, many of the companies that offer a DC plan shift a portion of their existing retirement plan to the DC plan. When doing so, they often set the DC contributions using an assumed rate of return, and demonstrate that pension benefits are as good as the previous ones, provided that the employee achieves that assumed rate of return over the long term. This makes it possible to avoid seeing the introduction of a DC plan as a disadvantageous change to retirement benefits.

According to a 2010 survey by the Pension Fund Association, 74% of the companies surveyed had established an assumed rate of return. Participants in these companies' DC plans will not receive benefits equivalent to what they would have under their previous retirement benefit plan if they do not generate this expect yield over the long term. The same survey found the average assumed rate of return was 2.16%, which would be difficult to achieve using bank deposits, at least in the current market environment. Neither employers nor the plan administrators are confident that participants fully understand this, and there is concern that there could be a raft of denunciations of employers and plan administrators by participants unable to get their expected retirement benefits.

2) Using ongoing education and “default products”

The most obvious way to raise the understanding of participants is to strengthen investment education. DC investment education can be thought of in two phases, with the first phase being when the DC plan is initially offered and when new employees join the plan, and the second being the ongoing education that is given after that. Over the last 10 years, a consensus has emerged, and expertise has been accumulated, regarding the content and techniques for providing that first phase. In contrast, because each employer is in a different situation and each plan participant has a different level of interest and understanding, companies are still experimenting with the ongoing education phase in terms of the most appropriate content, frequency of training, and interval between sessions.

It is within this context that the August 2011 pension reforms created a clear obligation to provide ongoing investment education. Article 22 of the Defined Contribution Pension Act requires that companies make an effort to provide DC investment education, and this obligation explicitly includes ongoing education. We expect a lively debate regarding the content and approach to ongoing investment education that would be deemed to meet this obligation. We do not think there is any one answer to this, but expect to see progress toward standardizing and raising the overall level of the education through the sharing of best practices.

There are in fact limits to investment education, however. Even if they are given knowledge through investment education, we think it is unreasonable to expect all plan participants to remain rational investors during the long period of time until they retire. For those plan participants who do not act on that knowledge, the problem arises as to whether, given that the system is one of personal accountability, this does not go beyond being a problem for the individual, or whether some type of assistance needs to be provided.

This problem has already been debated in the context of 401(k) plans in the US, which is what Japan's DC pensions are modeled on. The 401(k) plans of the 1990s were wholly based on personal accountability, whereby participants were provided with investment education and investment products, and it was up to them to take action. As 401(k) plans became the major form of corporate pensions, however, awareness grew over the problem of leaving participants who do not make rational investment decisions to fend for themselves.

This led, via regulatory reform, to an approach that is largely built around investing in “default products.” The default products in a DC plan are the pre-designated investment products into which contributions are invested in the absence of any investments instructions from the participant. In Japan's DC plans the term "default" is used to refer to the destination of contributions that are temporary or exceptional, and deposit or insurance products are normally so designated. In contrast, a default product in the US refers to the product that participants who may have investment knowledge but do not act on it can invest in, and thus it plays a central role in DC investments.

DC investing focused on default products channels contributions into products that invest in pre-designated long-term diversified instruments unless the participant gives explicit investment instructions otherwise. Participants who want to choose their own investments can still exercise their right to choose from the lineup of products offered. Using default products, even those people who are not proactive are given the opportunity to achieve some investment diversification and pursue a long-term balance of risk and return.

Be aware that investment education becomes all the more important in that case. The purpose of this approach is to assist participants who are unable to act even when they have been given the knowledge, with an important assumption being that investment education will help participants understand the default products that their contributions are being invested in.

We think that Japan needs to strengthen its ongoing investment education while also introducing the US concept of a default product. Although not currently prohibited by law, it is unclear exactly how products should be selected and explained to participants, and both employers and plan administrators have yet to take on that role. Establishing rules that clarify these points will be helpful in revising the regulations governing DC investments.

In fact, the report from the growth finance promotion committee upon which the Comprehensive Strategy for the Rebirth of Japan was based included a request for the MHLW to send out a notice regarding an investment approach that could be construed as a US-style default product[12]. This is a very timely policy, and we look forward to their sending out a notice that is very effective. At the same time, it will be interesting to see what sort of longer-term impact such regulatory changes have on DC investment instructions.

3) Risk money supplied by individuals and DC plans

As already noted, both the Comprehensive Strategy and the report from the growth finance promotion committee are full of measures aimed at enhancing DC pension rules. One reason for this is that it is understood that wider use of DC pension plans had led to an increase in mutual fund investing by individuals. Because pension plans involve long-term asset management, their development should supply long-term investment money to capital markets. In the case of DC plans, this money is likely to be channeled through mutual funds.

Although Japan currently has the world's ninth largest mutual fund market, it is still fairly undeveloped at only 13% of GDP, versus 77% in the US and 50% in France (as of end-2011). The entrance of a new type of investor, DC plan participants, is of great significance for Japan's mutual fund market.

In the US, investment in mutual funds by way of 401(k)s and other types of DC pension plans grew throughout the 1990s, and now accounts for 41% of a mutual fund market exceeding $12 trillion in assets (Figure 11). A survey of mutual fund investors carried out by a US investment company industry association found that 62% of mutual fund investors made their first investments in a workplace DC plan. On the other hand, just 32% of mutual fund shareholders only own mutual fund shares through a workplace DC plan, which suggests that many mutual fund investors have started to invest in mutual funds through other channels after being introduced to them through DC plans[13]. It is probably safe to say that the great popularity of mutual funds

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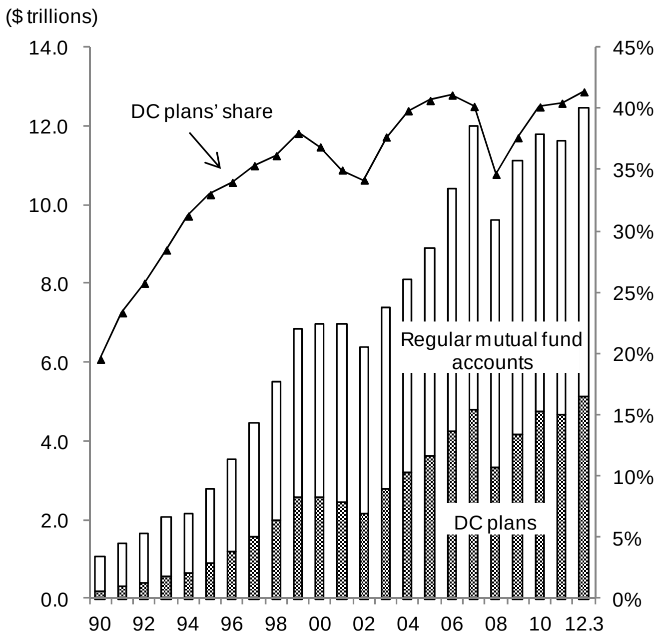
12 This called for the MHLW to issue a notice during FY 2012 advising that, to provide an option for those without sufficient investment experience and those who find it difficult to give their own investment instructions, investments can be made using an adequately diverse and predetermined investment approach, even in the absence of investment instructions, when provided for in the plan documents, along with reservations in that case. See the report from the growth finance promotion committee dated 9 July 2012.

13 For more US data, see Investment Company Institute (ICI), “The U.S. Retirement Market, First Quarter 2012” (http://www.ici.org/info/ret_12_q1_data.xls) and also ICI, Profile of Mutual Fund Shareholders, 2011, ICI Research Report, February 2012.

Figure 11: DC plans' share of US mutual fund market



Note: DC share is the amount of mutual fund assets owned though a DC plan (including 401(k) or IRA) as a percentage of all mutual fund assets outstanding.
Source: Nomura Institute of Capital Markets Research, based on ICI data.

with individual investors and the growth of the US mutual fund market would probably not have been possible in the absence of DC pensions.

We think these conditions in the US are gradually becoming better understood in Japan[14]. For example, the Financial System Council is now looking at revising the Investment Trusts Act to create an environment whereby Japanese can make more effective use of their assets, and the summary report that came out of that process (in July 2012) also noted the desirability of having a debate over the role of DC plans[15].

For DC plans to become as important to the mutual fund market as they are in the US, it is essential to achieve growth in both plan assets and the number of plan

14 See, for example, Masahiko Igata, "Progress in market-based finance in the US: Economic and systemic background and significance," a document dated 2 December 2011 that was presented at the Financial System Council's working group on the longer-term future of Japan's financial industry. (http://www.fsa.go.jp/singi/singi_kinyu/w_group/siryou/20111202/05.pdf). Also see Nomura Institute of Capital Markets Research ed., *Mutual Funds in the United States*, Nikkei Publishing, Sep. 2008.

15 The need to change the bias that individual financial assets now have toward deposits in order to increase the supply of risk money from individuals has long been recognized as a challenge for Japan's financial and capital markets, and the wider use of and growth in mutual funds has been seen as the key to that. The debate gained momentum with the New Growth Strategy decided by the Cabinet in June 2010, which included reforms to regulations governing mutual funds, and in March 2012 the Financial System Council established the Working Group to Review the Investment Trust and Investment Corporation Act. The final report published in December 2012 pointed out that it is desirable to debate the role of DC plans in the mutual fund market.

participants. If wider use of and growth in DC plans can be achieved by implementing the measures described in this report, the measures will in turn become more likely to result in the growth of mutual fund investing through DC plans and of the size of Japan's mutual fund market.

V. Conclusion

We have explained how as the role of public pensions get smaller and private-sector pensions become more important, traditional DB plans are unlikely to become more prevalent, and thus how it is important to strive for the wider adoption of and growth in DC pension plans by eliminating the problems associated with those plans.

This debate over making more use of DC plans is not unique to Japan. Although the specifics of each country’s pension system are different, efforts are being made to expand DC pensions as a way to deal with the shrinking role of public pensions worldwide.

According to the OECD, aging demographics have led many developed countries to engage in major public pension reform since the 1990s. The specific reforms proposed, which include raising the age at which benefits begin and restraining the growth of benefits, have increased the importance of private-sector pensions. At the same time, there has also been a shift from DB to DC plans in those countries like the US, the UK, and Australia where private-sector pensions are relatively more developed.

The global financial crisis has had a serious impact on all types of pensions, whether public or private and whether they were DB or DC plans, while at the same time bringing into relief the importance of offering multiple types of plans with differing characteristics. Increasing the coverage ratio of private-sector pensions that supplement public pensions is still a challenge, and one focus is on experiments with automatic enrollment being tried in the UK. In this approach, employers are obligated to automatically enroll employees in a pension plan, which makes their employees private-sector pension participants unless they specifically opt out. DC plans are being chosen as a plan for those at a workplace that does not offer a pension plan, and this is raising the importance of DC plans within the broader pension space.

It is within this context that the OECD, recognizing the importance of DC plans everywhere, published 10 recommendations in a document entitled Roadmap for the Good Design of Defined Contribution Pension Plans (Figure 12). Recommendations 1 through 6 and 10 were primarily related to plan participation and the formation of assets, and although there are differences in degree, these recommendations are also being acknowledged in Japan, and are at the center of the debate that has begun. Our proposal to raise the maximum contribution equates to recommendations 2 and 3, while the use of a default product for investing is in recommendation 5. It is encouraging that the direction of the debate over reform in Japan is not diverging from the global trend.

Figure 12: OECD's roadmap for improving DC plans

	Recommendation
1	Ensure the design of DC pension plans is internally coherent between the accumulation and payout phases and with the overall pension system.
2	Encourage people to enrol, to contribute and contribute for long periods.
3	Improve the design of incentives to save for retirement, particularly where participation and contributions to DC pension plans are voluntary.
4	Promote low-cost retirement savings instruments.
5	Establish appropriate default investment strategies, while also providing choice between investment options with different risk profile and investment horizon.
6	Consider establishing default life-cycle investment strategies as a default option to protect people close to retirement against extreme negative outcomes.
7	For the payout phase, encourage annuitization as a protection against longevity risk.
8	Promote the supply of annuities and cost-efficient competition in the annuity market.
9	Develop appropriate information and risk-hedging instruments to facilitate dealing with longevity risk.
10	Ensure effective communication and address financial illiteracy and lack of awareness.

Source: "The OECD Roadmap for the Good Design of Defined Contribution Pension Plans," OECD, June 2012.

During the first 10 years DC plans were used in Japan, most of the energy was focused on raising awareness of and encouraging wider adoption of the plans. Recognizing the need to make the plans more attractive, little by little reforms have been made over that decade related to contributions, plan eligibility, and early withdrawals. Over the next 10 years, while continuing to deal with the issues that remain, there is a need to tackle new challenges, including the improvement of DC plan investments. Wider use of and growth in DC pensions will also bring additional benefits, including increased financial literacy among individuals and an increased supply of risk money channeled through mutual fund investments. The potential of DC pensions must be unlocked through steadfast revisions to the system.