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Challenge of Japanese Small and Mid-sized Companies' Pension Plan

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Disclaimer

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Today's Presentation

(1) Current DB Pensions of Japanese Small & Mid-sized Companies (SMCs)

(2) Enactment of DB Corporate Pension Act 2001

(3) SMCs' DB Pension Design Examples

(4) For Permanent Development

(1) Current DB Pensions of Japanese SMCs

- Unstable 3 Legs Essentially Expected to Secure Income after Retirement

- 3 Types SMCs' DB Corporate Pensions

- The Defect of TQPP Scheme to Exposure
  → Expiration

Unstable 3 Legs Essentially Expected to Secure Income after Retirement

- 1) Social Security Pension (SSP)
  2) Corporate Pension Plans (CPPs)
  3) Personal Annuities (PAs)
- Benefit levels of SSP are steeply decreasing.

Projections for SSP Benefits Levels

FY	2009	2025	2050
Benefit/Income	62.3%	55.2%	50.1%

Notes:

Benefit/Income = total annual benefits amount of model beneficiaries / average annual income amount of active workers
beneficiaries (a couple) = husband (age 65, covered by SSP for 40 years) + his wife (age 65, a dependent spouse)
active workers = workers at the time the couple receives the benefits

Source: The Ministry of Health, Labour and Welfare 05.2009

Unstable 3 Legs Essentially Expected to Secure Income after Retirement

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(Reference) Japanese SMCs

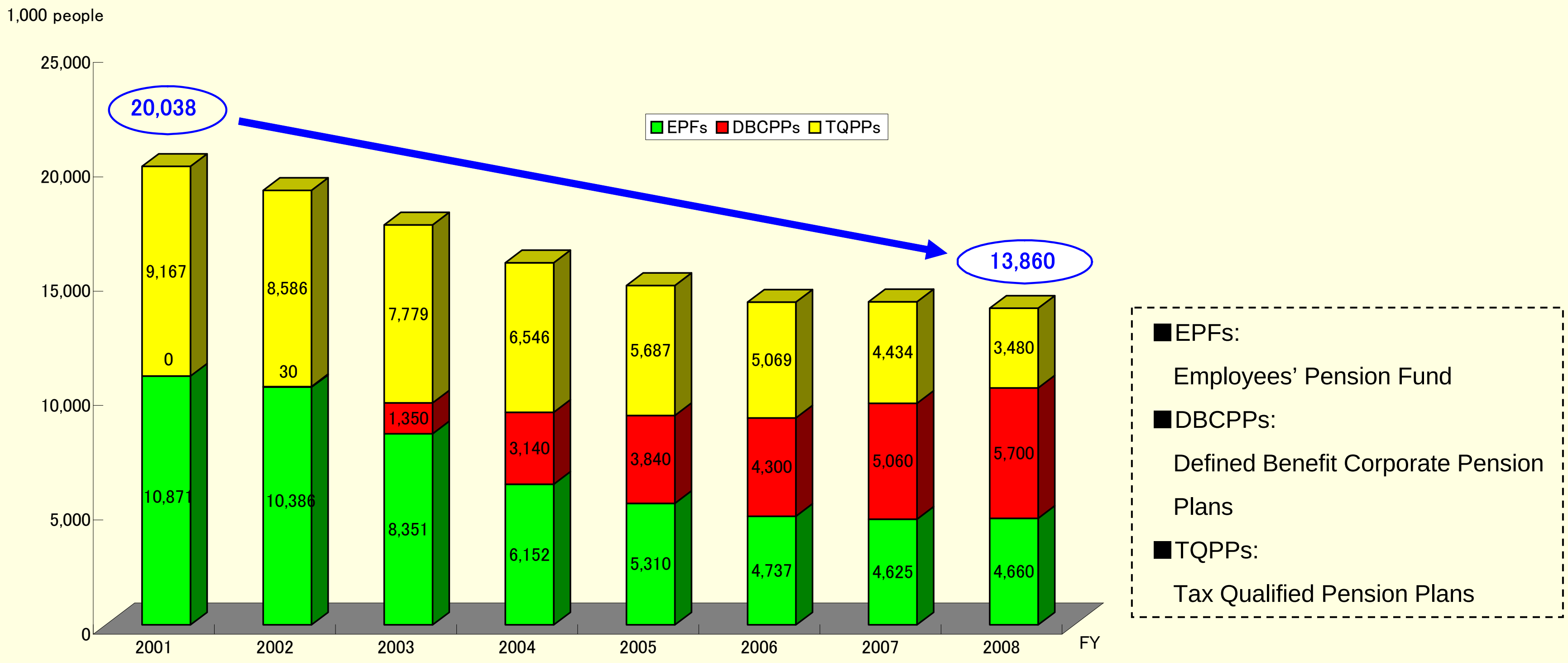
■Approximately 70% of Japanese workers belong to SMCs.

Size	SMCs	Large	Total
# of Companies	4,197,719	12,351	4,210,070
	99.7%	0.3%	100.0%
# of Workers	27,835,550	12,291,430	40,126,980
	69.4%	30.6%	100.0%

Source: 2008 White Paper on Small and Medium Enterprises in Japan

Unstable 3 Legs Essentially Expected to Secure Income after Retirement

- # of participants that DB type pension plans cover is dramatically decreasing.

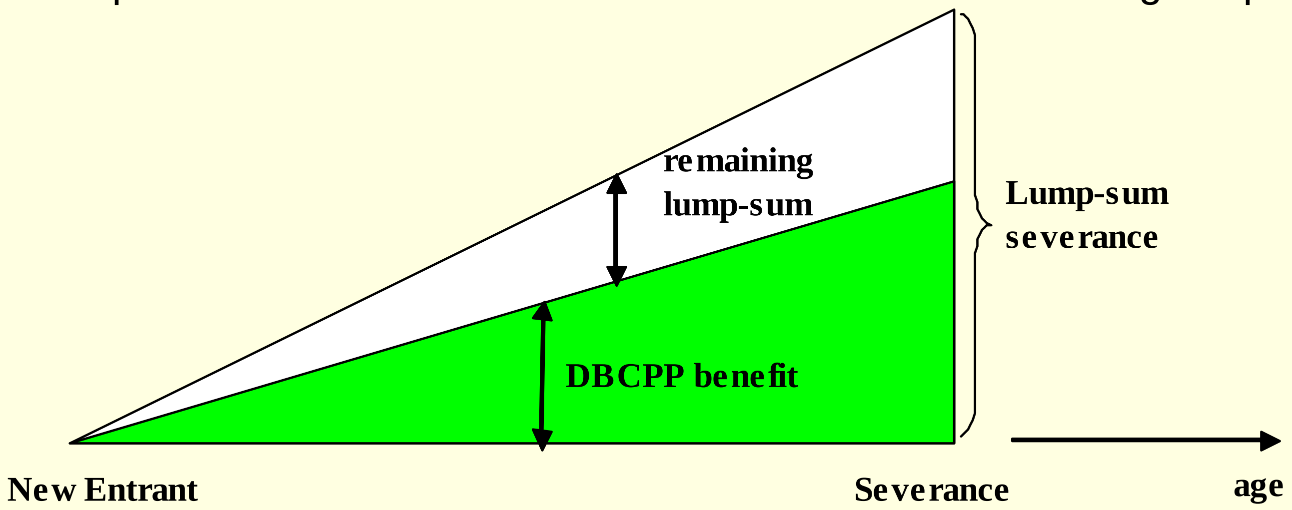


Source: Pension Fund Association, The Life Insurance Association of Japan

3 Types SMCs' DB Corporate Pensions

- 1) Tax Qualified Pension Plans (TQPPs) 1962
  2) Defined Benefit Corporate Pension Plans (DBCPPs) 2002
  3) Employees' Pension Funds (EPFs) 1965
- DBCPP is one of the succeeding plan to TQPP. →Slide 11
  Both of them are usually made up of partly / wholly conversion of sponsors' lump-sum benefits.

Lump-sum severance benefit = DBCPP benefit + remaining lump-sum



3 Types SMCs' DB Corporate Pensions

- Differences between TQPPs & DBCPPs

For employers, TQPPs are more convenient than DBCPPs.

⇕

For employees, TQPPs' lack of pension rights protection is crucial.

1) From the viewpoint of employers

	TQPPs (1962)	DBCPPs (2002)
Main purpose	#1. Favorable tax treatment #2. Employee welfare	#1. Employee welfare #2. Favorable tax treatment
Funding requirements (*)	—	○
Reporting & disclosure	—	○
Adopting CBPs	×	○
Review of actuarial assumptions	△ Every 5 (or 3) years as a rule	○ Every 5 (or 3) years & at any other necessary time

Notes:
CBPs: Cash Balance Plans
(*) Financial situation check conducted by actuaries. Employers must increase their contribution when the plan unfunded

3 Types SMCs’ DB Corporate Pensions

- Differences between TQPPs & DBCPPs

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For employees, TQPPs’ lack of pension rights protection is crucial.

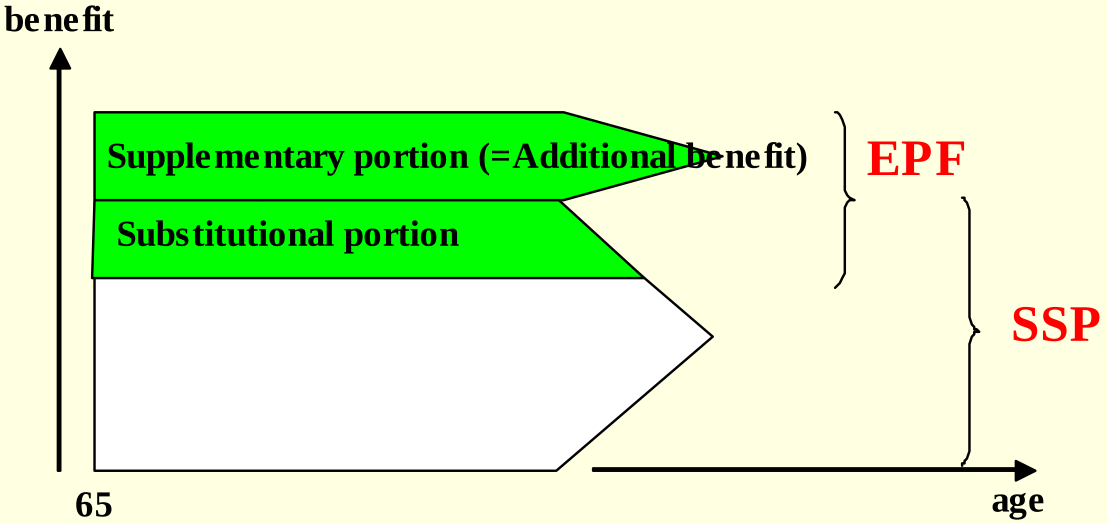
2) From the viewpoint of employees

	TQPPs (1962)	DBCPPs (2002)
Character	Alternative option of receiving lump-sum benefits	Income security after retirement
Pension receipt	Employees can receive annuity even if they are still young. (e.g.; age 45)	After retirement (usually age≧60)
Lump-sum option	○	○
Protection of pension rights	×	○
Portability of pension rights when job change (*)	△ (Usually transfer between particular companies only)	○

Note: (*) transfer pension rights & assets

3 Types SMCs' DB Corporate Pensions

- EPFs are also separated into 3 groups.
  1) Single-Employer Funds
  2) Allied-Employer Funds
  3) Multi-Employer Funds ← established by an association of SECs
- In 09.2009, Multi-Employer Funds represent 80% of all EPFs. (*)
- As for Benefit design of EPFs,
  - Modeled after the British system.
  - Supplementary portion is similar to the design of TQPPs & DBCPPs.



(*)As for # of plans.

Source: Pension Fund Association

The Defect of TQPP Scheme to Exposure → Expiration

- The revision of Japanese corporate accounting standard in 2000 changed many TQPP sponsors' behavior dramatically.

- Some employers were forced to terminate their TQPPs with unfunded liabilities.

Crucial Fault

= Employees' pension rights could be easily stolen.

↓

- Enactment of DB Corporate Pension Act 2001
  - TQPP scheme will be abolished in 2012.
  - DBCPP scheme, one of the succeeding schemes, was designed to resolve such faults.

(2) Enactment of DB Corporate Pension Act 2001 - Dawn of Transition From TQPPs -

- Introduction of *New* DBCPP scheme

- Transition of SMCs' TQPPs
  - Solutions provided by Japanese Life Insurers -

Introduction of *New* DBCPP scheme

- Japanese pension legislation was modeled after the U.S. one.
  1) Funding Requirements
  2) Fiduciary Responsibility
  3) Reporting & Disclosure
  were introduced to resolve the TQPP faults.
- TQPP scheme will be abolished in 2012.

FY 2001	
TQPPs	73,582

65% Decrease

FY 2008	
TQPPs	25,441

Transition

(# of Plans/Employers)

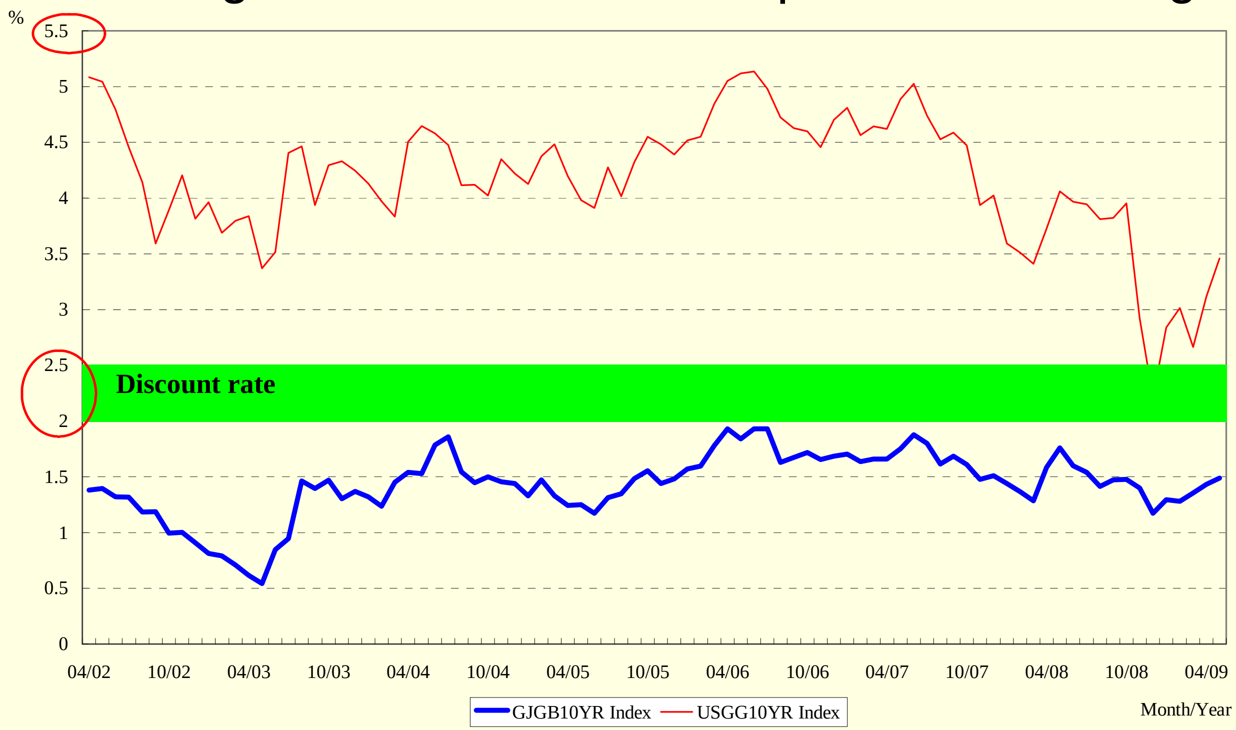
～ FY 2008	
EPFs	82(03.2009)
DBCPPs	6,363(03.2009)
DCPPs	5,229(02.2009)
SERAMA	16,080(02.2009)
Others (e.g.;Termination)	

Retain Pensions

Notes
DCPPs: Defined Contribution Pension Plans
SERAMA: The Smaller Enterprise Retirement Allowance Mutual Aid scheme
(= Lump-sum scheme that the government supports)
Source: The Ministry of Health, Labour and Welfare, The Life Insurance Association of Japan

Introduction of *New* DBCPP scheme

- When companies deliver employees' benefit rights to DBCPPs, they
  - adopt lower discount rate(2.0～2.5%). ⇔Many TQPPs adopt 5.5%
  - change their attitude toward plan asset management.



Source: Bloomberg

Transition of SMCs' TQPPs

- Solutions provided by Japanese Life Insurers -

- In Japan, there seems to be many SMCs that want to continue DB type pensions.
  - **- Japanese Pension scheme derived from lump-sum benefits.**
  - **- Benefit formula of Lump-sum are full of variety.**
  - **- Converting the whole of Lump-sum to pension scheme seems to be too much.**

⇒ Desire for a mix of Pension & Lump-sum (= Partly Conversion)

- To help SMCs that want smooth change their TQPP to DBCPP, Life Insurers started to provide "Ready-made Plans".
  - - Simple benefit formula
  - - Few actuarial assumptions
  - - Easily comprehensible to both employers & employees
  - - Reasonable administration service fees

⇒ "Ready-made Plans" are expected to meet the needs of SMCs.

(3) SMCs' DB Pension Design Examples

- Simple Plan Design that Life Insurers Offer
- Transfer of TQPP Assets to Multi-employer EPFs
- Financial Status of "Ready-made" DBCPPs

Simple Plan Design that Life Insurers Offer

- “Ready-made plans” are designed so that SMCs can adopt without constraint.

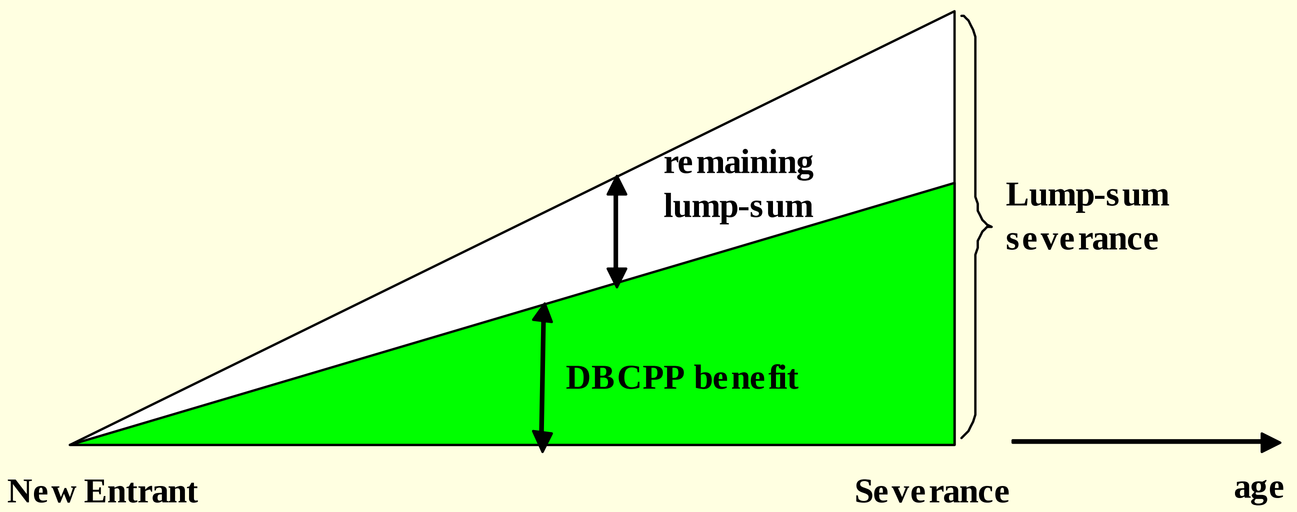
- Companies can reduce their labor for pension funding methods. Simple actuarial assumptions are acceptable.

	Feature
Benefit formulas	Very simple
Asset management	Every option of investments - Life Insurers' GA only - Mix of Life Insurers' GA & Trust Banks' contructs …
Funding methods	"Simplified standard" is applied. - e.g.; withdrawal rate = 0% over every age
Plan design	Partly conversions of lump-sum severance benefits are often seen.

Simple Plan Design that Life Insurers Offer

- "Ready-made plans" are designed so that SMCs can adopt without constraint.
- Companies can reduce their labor for pension funding methods. Simple actuarial assumptions are acceptable.

Lump-sum severance benefit = DBCPP benefit + remaining lump-sum



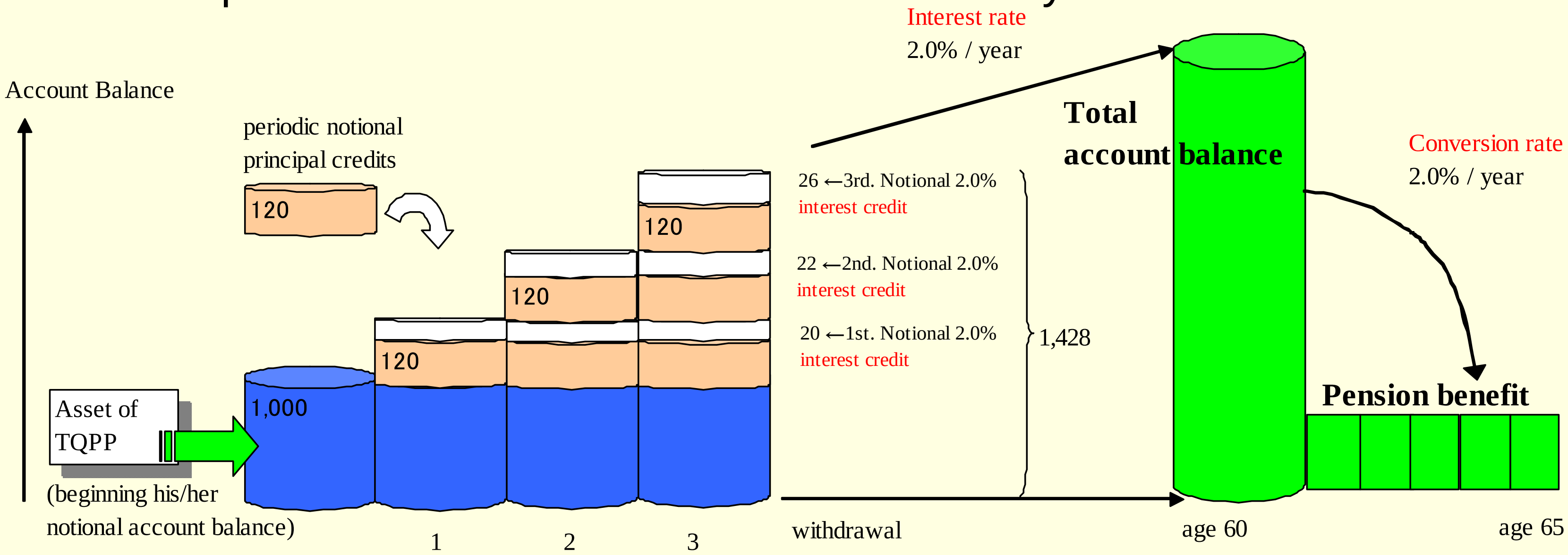
Simple Plan Design that Life Insurers Offer

(1) Simple Cash Balance Plan

- All interest rates are same is the key feature.

  1)Interest credit rate 2)Interest rate 3)Conversion rate 4)Discount rate

Contribution per person = periodic notional principal credits to him/her
Companies can handle their contribution easily.



Simple Plan Design that Life Insurers Offer

(2) Fixed Amount Benefits Plan

- Simple design. Benefit is service related.
- Life Insurers usually prepare a variety of benefit tables.

Sample Plans (Lump-sum benefit, Yen)

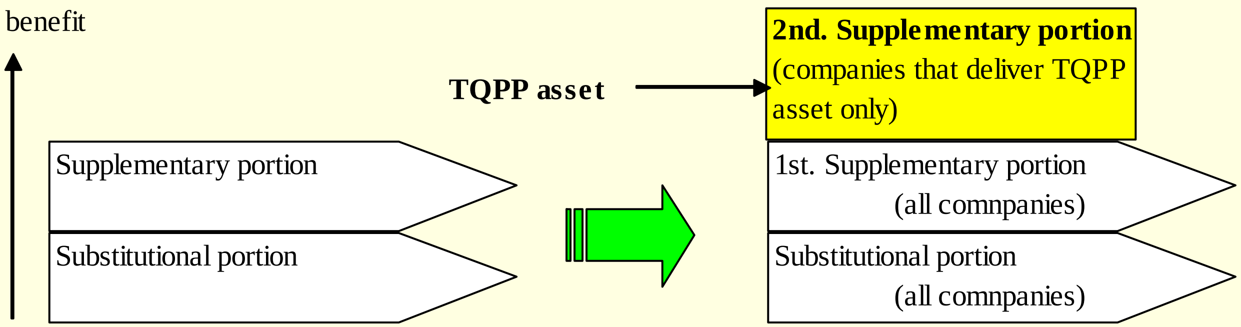
Years of service	Reason for severance			
	Retirement	Withdrawal by personal reason		
		design A	design B	design C
3～ 9	1.0M	0.3M	0.4M	0.5M
10～19	5.0M	2.5M	3.0M	3.5M
20～29	10.0M	8.0M	8.0M	10.0M
30～	15.0M	15.0M	15.0M	15.0M

Transfer of TQPP Assets to Multi-employer EPFs

- Existing EPFs are becoming the successors of discontinued TQPPs.
- Some SMCs seem to be anxious about managing their DBCPPs "by themselves".

  → Multi-employer EPFs are expected to be the key.
- Neither "Example 1" nor "Example 2" has grown significantly.

Example(1) Additional of 2nd. portion

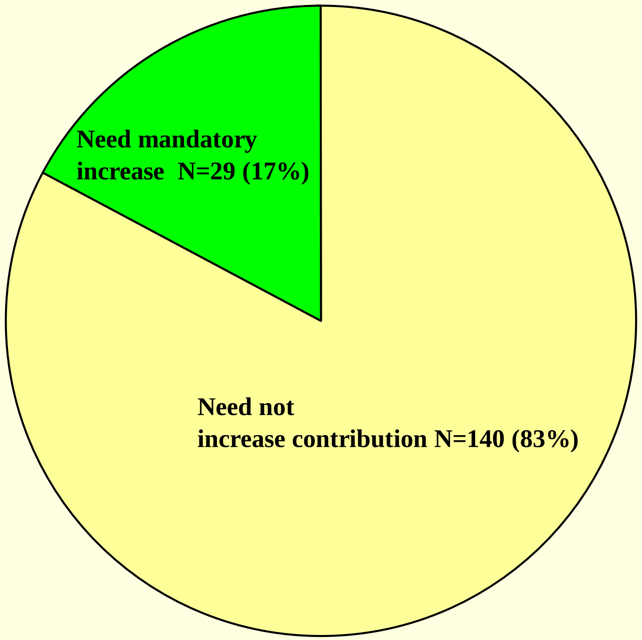


Example(2) Establishment of another DBCPP by existing EPF

Transfer of TQPP Assets to Multi-employer EPFs

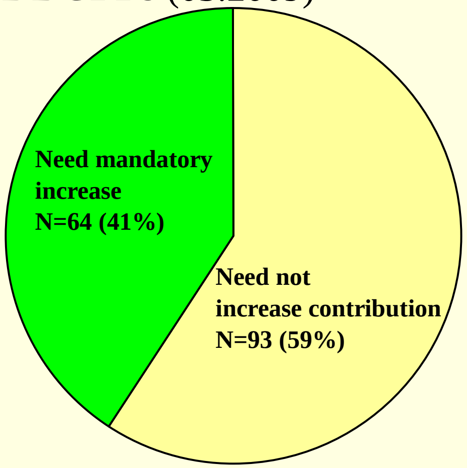
- In the "freefall" capital market since 2007, even some of the "Ready-made" DBCPPs, especially those adopt high-risk investment, are facing mandatory contribution increase.

"Ready-made Plans" (06.2008～05.2009)



(Reference)

All DBCPPs (03.2009)



Source: Dai-ichi Life

(4) For permanent Development

- SMCs are Facing with Difficulties

- For Development

(4) For permanent Development

- DB type pension plans of SMCs are facing with some difficulties.
  - TQPP scheme will be abolished in 2012. → Transition
  - Risk of mandatory contribution increase
  - Revision of accounting standard

- In order to develop DB type pension plans of SMCs,
  - Cooperation of the related parties is indispensable.