

Pensions, Benefits and Social Security  
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**Future prospects for Koseinenkinkikin, one  
type of Defined-benefit Employee Pension  
Fund in Japan**

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# 1. Employees' Pension Fund (Koseinenkinkikin)

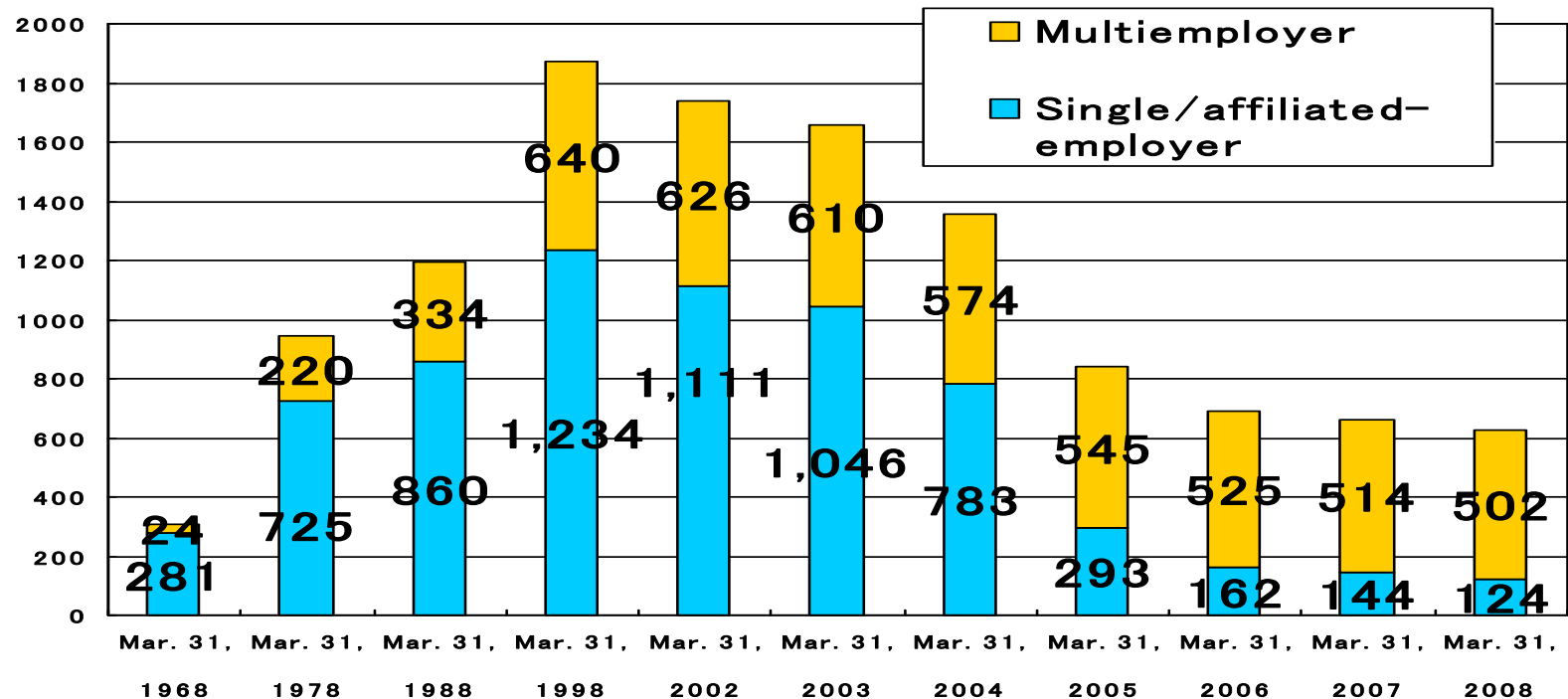
- A type of defined-benefit (DB) employee pension fund prevalent in Japan

## *Two Key Characteristics:*

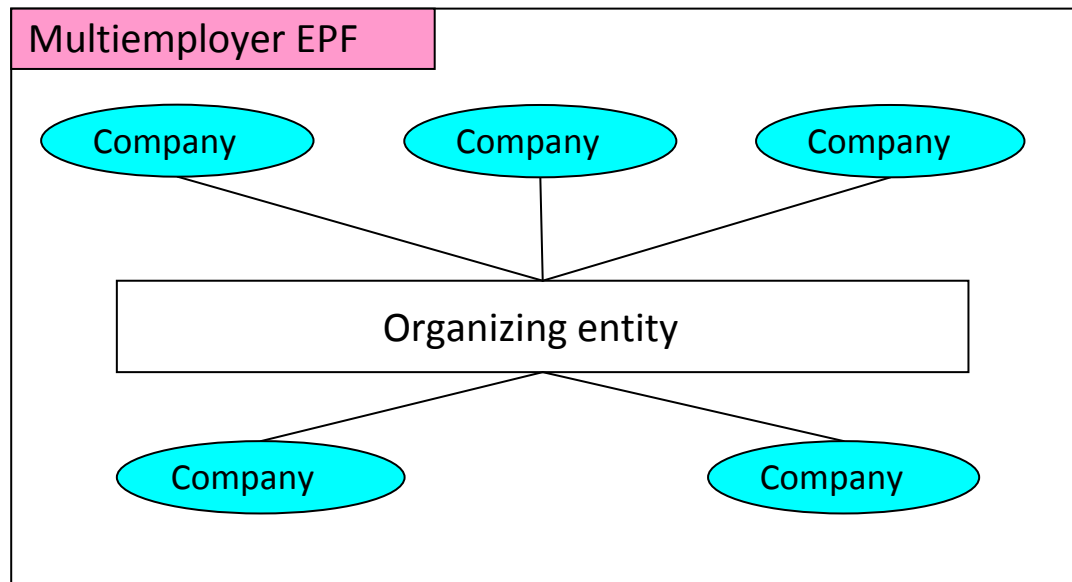
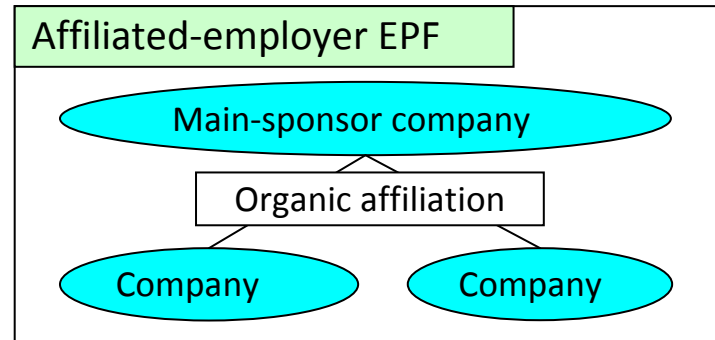
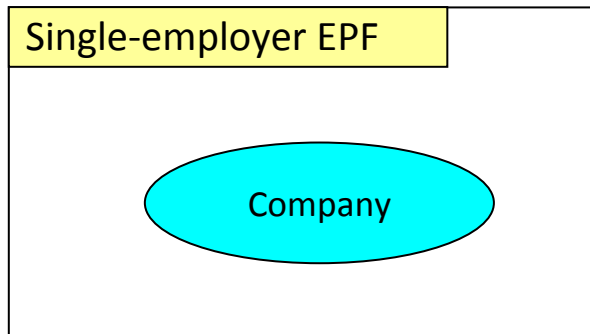
- Partial substitute for the public pension system, Employees' Pension Insurance
- Multiemployer EPFs

# 1-1 History of EPFs

- EPFs were first established in 1965 pursuant to the Employees' Pension Insurance Act.



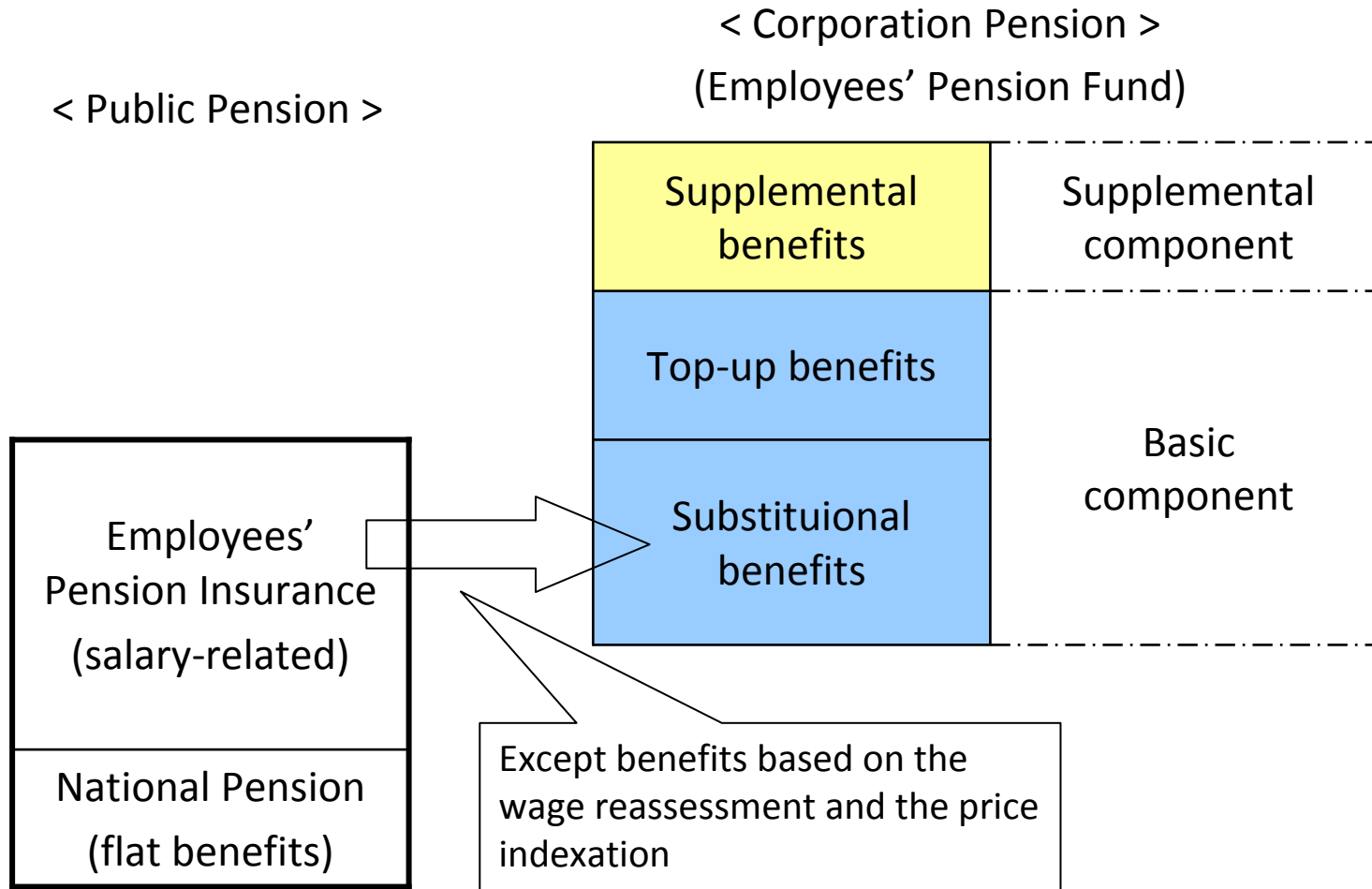
# 1-2 Types of EPFs



# 1-3 Establishment Requirements

- Number of Participants
- Benefit Level
- Benefit Payment Requirements

# 2. Substitutional Provision



## 2-1 Characteristics

- Expansion of pension assets through inclusion of the substitutional component
- SMEs join multiemployer EPFs
- Neutralization of pension finances
  
- Substitutional benefit obligations recognized as corporate liabilities

## 2-2 Financing of Substitutional Component

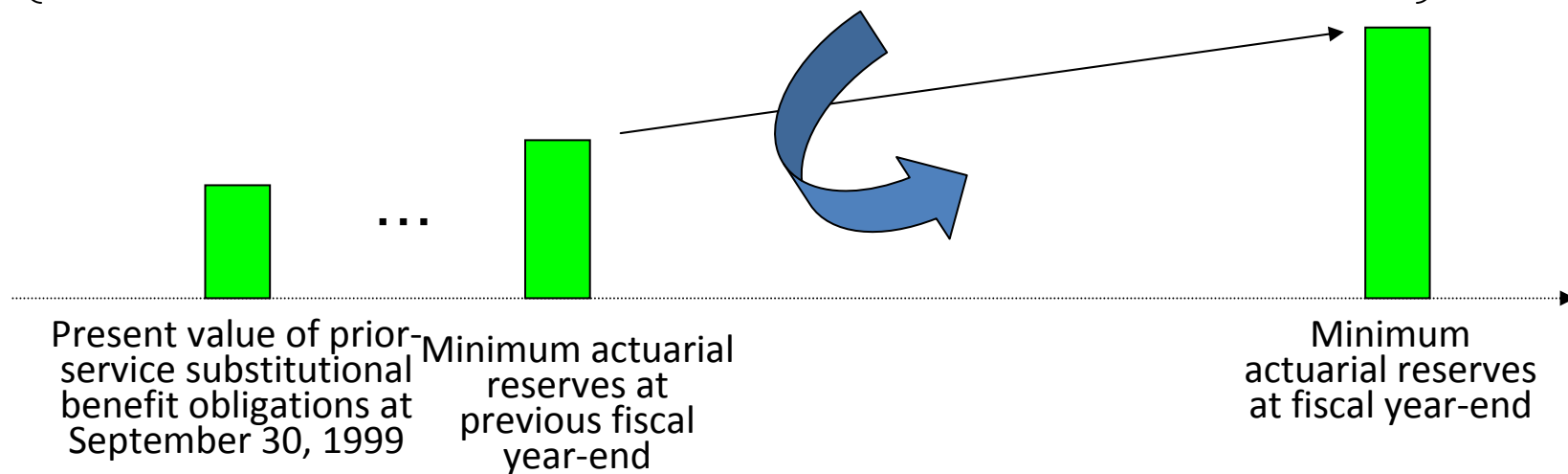
Benefit Component		Liability Valuation
Supplemental component		Actuarial liability
Basic component	Top-up component	
	Substitutional component	Minimum actuarial reserves



# 2-2-1 Minimum Actuarial Reserves

- Substitutional benefit liabilities

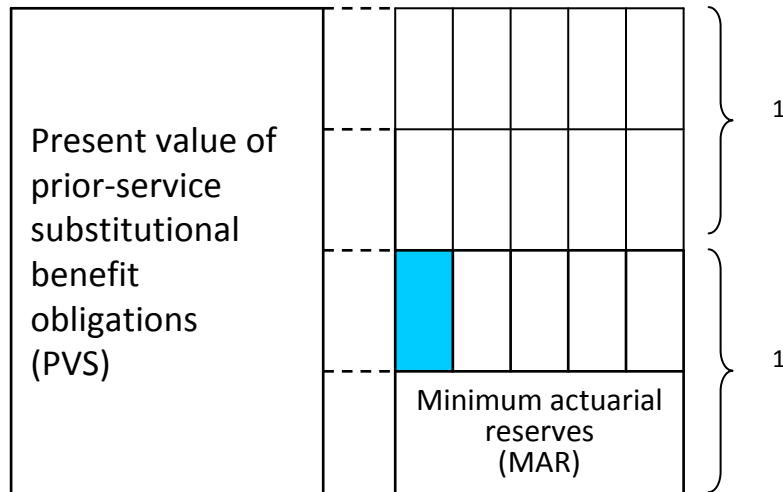
- + income associated with substitutional component
- outgoings associated with substitutional component  
(inclusive of interest\*)
- + interest\* on MAR at previous fiscal year-end
- \*Calculated based on the EPI Reserve Fund's rate of return



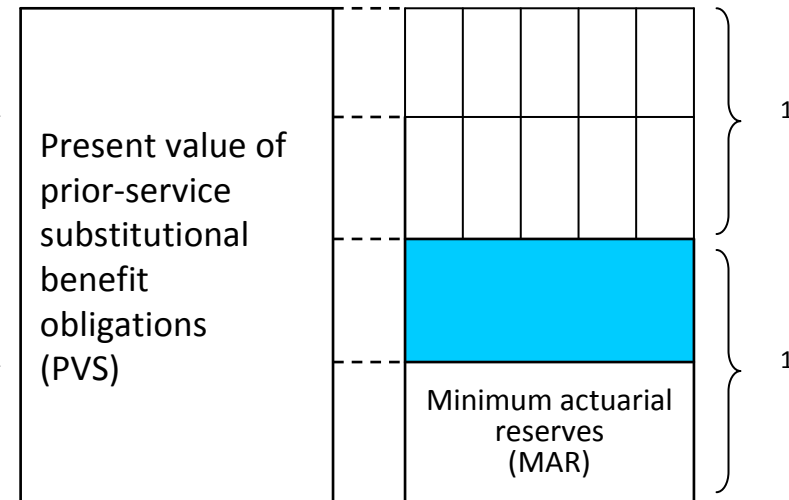
# 2-2-2 Neutralization of Pension Finances

Employees' Pension Insurance  $\Rightarrow$  Employees' Pension Fund

- $PVS \times 0.5 > MAR > PVS \times 0.25$



- $PVS \times 0.25 > MAR$



Employees' Pension Fund  $\Rightarrow$  Employees' Pension Insurance

- $PVS \times 1.5 < MAR$

## 2-2-3 More Precise Neutralization

Fiscal year ended (ending) March 31,	EPI Reserve Fund's actual rate of return		Applicable period (January 1 – December 31)	Interest rate applied
1998	4.66	21-month lag		
1999	4.15			
2000	3.62		1999	4.66
2001	3.22		2000	4.15
2002	1.99		2001	3.62
2003	0.21		2002	3.22
2004	4.91		2003	1.99
2005	2.73		2004	0.21
2006	6.82		2005	4.91
2007	3.10		2006	2.73
2008	-3.54	21-month lag	2007	6.82
2009	-6.83		2008	3.10
2010			2009	-3.54
2011			2010	-6.83

## 2-2-4 Exempted Contribution Rate

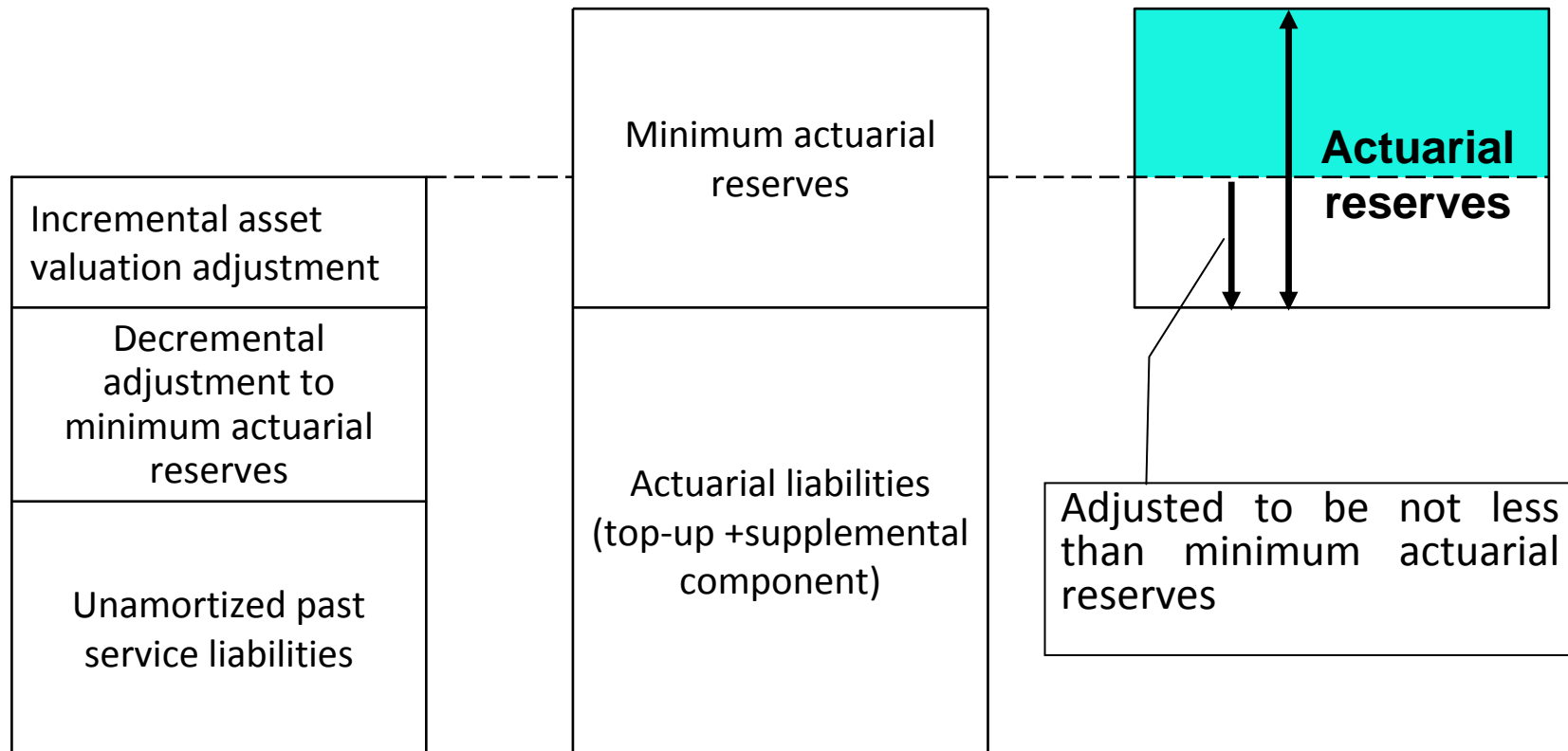
- Companies enrolled in an EPF are exempt from paying the government pension insurance premiums associated with this substitutional portion of benefits.
- Substitutional Contribution Rate  $\leq$  Exempted Contribution Rate
- Exempted Contribution Rate subject to minimum and maximum limits

## 2-2-5 Expected Return

- Neutralization of Pension Finances
- Assumed interest rates (AIR) used to calculate exempted contribution rates and expected returns (ER)
- $AIR < ER$ : surplus  $\Rightarrow$  adjustment (EPF  $\rightarrow$  EPI)
- $AIR > ER$ : deficit  $\Rightarrow$  adjustment (EPI  $\rightarrow$  EPF)

## 2-2-6 Ongoing Basis

- Net assets  $\geq$  Actuarial reserves
- Actuarial reserves  $\geq$  Minimum actuarial reserves



## 2-2-7 Discontinued Basis

- Net assets  $\geq$  max(minimum funding requirement, \* 105% of minimum actuarial reserves)
  - \* Calculated as 90% of minimum funding requirement until March 31, 2012
- Using actuarial valuation as an asset valuation method, EPFs may use actuarial assets in recalculating their contribution schedule.
- Incremental and decremental adjustments to minimum actuarial reserves are disregarded. We suggest they be taken into account.

## 2-3 Other Recommended Improvements

- Elimination of Additional Contributions If Substitutional-Component Contributions Equal Exempted Contributions
- Safeguards against Exempted Contribution Rate Declines
- Simplification of Complexity
- Expansion of EPI Coverage
- Apportionment of Assets upon Dissolution



# 3-1 Multiemployer EPFs' Prevalence

- Account for roughly 80% of the total number of EPFs
  - Most single-employer and affiliated-employer EPFs elected to transfer back to the government their rights and obligations associated with the substitutional portion of benefits.

## 3-2 Requirements for Establishment of Multiemployer EPF

- Minimum number of participants is 5,000 (3,000 for EPFs established before April 1, 2005)
- Existence of an organizing entity

## 3-3 Significance of Multiemployer EPFs

- Many SMEs lack the wherewithal to independently run a corporate pension plan
  - Enrollment in a multiemployer EPF offers benefits

# 3-4 Benefit Design Issues

- Can multiemployer EPFs revise their benefits to match the current socioeconomic environment?
  - They must comply with onerous requirements if wishing to reduce benefits
- Can multiemployer EPFs construct their benefit designs to facilitate SMEs' enrollment in multiemployer EPFs?

## 3-5 Pension Finance Issues

- Is the contribution burden fairly distributed among companies?
- Are EPFs' assumed interest rates too high in the current asset management environment?
- Are multiemployer EPFs collecting lump-sum payments for funding deficits when companies exit an EPF?

## 3-6 Measures in Response to Abolishment of Tax-Qualified Pension Plans

- Tax-qualified pension plans are slated to be abolished on March 31, 2012
  - Tax-qualified pension plans can be converted or merged into EPFs

## 3-7 Other Issues

- Delinquent contributions
- Recommended asset management approach for multiemployer EPFs

# 4-1 Future Simulations

## Simulation I

Fiscal year	Expected rate of return : 5.5%					Expected rate of return : 5.0%			Expected rate of return : 4.5%		
	Net assets	Actuarial liability		Funding level		Net assets	Funding level		Net assets	Funding level	
		before adjustment	after adjustment								
	A	B	C	A/B	A/C	A'	A'/B	A'/C	A''	A''/B	A''/C
2008	73,990	114,042	100,000	0.649	0.740	73,990	0.649	0.740	73,990	0.649	0.740
2013	84,371	108,512	106,053	0.778	0.796	82,245	0.758	0.776	80,140	0.739	0.756
2018	90,609	110,259	107,424	0.822	0.843	85,548	0.776	0.796	80,680	0.732	0.751
2023	99,525	114,035	110,768	0.873	0.898	90,533	0.794	0.817	82,127	0.720	0.741
2028	113,391	120,958	117,186	0.937	0.968	99,065	0.819	0.845	86,077	0.712	0.735
2033	131,344	129,500	125,159	1.014	1.049	109,794	0.848	0.877	90,824	0.701	0.726
2038	149,314	135,346	130,335	1.103	1.146	118,037	0.872	0.906	91,350	0.675	0.701



# 4-2 Future Simulations

## Simulation II

Fiscal year	Expected rate of return : 5.5%					Expected rate of return : 5.0%			Expected rate of return : 4.5%		
	Net assets A	Actuarial liability		Funding level		Net assets A'	Funding level		Net assets A''	Funding level	
		before adjustment B	after adjustment C	A/B	A/C		A'/B	A'/C		A''/B	A''/C
2008	65,104	114,342	100,000	0.569	0.651	65,104	0.569	0.651	65,104	0.569	0.651
2013	62,790	97,762	94,739	0.642	0.663	61,060	0.625	0.645	59,359	0.607	0.627
2018	58,389	91,450	87,962	0.638	0.664	54,554	0.597	0.620	50,892	0.556	0.579
2023	57,498	89,000	84,975	0.646	0.677	51,054	0.574	0.601	45,086	0.507	0.531
2028	60,570	90,184	85,538	0.672	0.708	50,767	0.563	0.593	41,980	0.465	0.491
2033	67,025	93,857	88,498	0.714	0.757	52,813	0.563	0.597	40,488	0.431	0.458
2038	75,615	98,712	92,529	0.766	0.817	55,562	0.563	0.600	38,750	0.393	0.419

## 4-3 Future Simulations

- If the rate of return is 4.5%, the overall funding level will decrease.
- EPFs who are underfunded relative to the average funding level may find it difficult to recover the funding deficit in future if they do not use contributions to amortize part of the investment return shortfall.
- A 5.5% return over the long term appears unrealistic in the current asset management environment, so it is advisable to lower assumed interest rates.

# 5 Conclusion

- EPFs have the potential to function effectively as catch-all pension plans for SMEs.
- The EPF scheme must be periodically improved as needed and the government must comprehensively protect the EPF scheme in the interest of social security.

***Thank you very much***