

**Joint Statement of the U.S.-Japan Business Council and the  
Japan-U.S. Business Council on Adoption of a  
Defined Contribution Pension Plan in Japan  
November 7, 2000**

**1. Introduction**

The U.S.-Japan and Japan-U.S. Business Councils (the “Councils”) held their 37<sup>th</sup> annual meeting in Tokyo in July 2000. At that meeting, business leaders from both countries recognized the tremendous demographic changes taking place in Japan and the serious implications of those changes for Japan’s pension system. In light of the active debate on pension matters in Japan, the Councils decided to establish a joint study group to examine pension reform and other related issues in Japan. The study group was tasked with developing a joint set of recommendations regarding those issues to submit to the Japanese Government.

**2. Recommendations**

The Councils strongly recommend that the Japanese Government should:

- (1) as a good first step, pass legislation during the current extraordinary Diet session to introduce a Defined Contribution Pension Plan (“DC Plan”) into the Japanese marketplace as soon as possible; and
- (2) following its introduction, adopt certain modifications to the DC Plan as outlined in this statement in order to improve overall effectiveness and flexibility of the system.

**3. Recommendation for the Early Introduction of a DC Plan**

The Japanese Government has established welfare pension and healthcare systems of great benefit to the Japanese people. These national pension schemes, as well as corporate schemes, such as employee pension funds and tax-qualified pension plans, are significant components of the current Japanese pension system, and are expected to continue to serve important functions in securing the financial well-being of Japan’s retired population.

In view of the rapid pace of demographic and social change, providing only existing defined benefit pension plans will not likely meet the retirement needs of today’s young people adequately. From the plan sponsors’ perspective, as a result of the increasing mobility of workers, it is becoming more important to provide attractive compensation and welfare benefits, including adequate employee pension portability, in order to attract and retain highly qualified employees. Introduction of DC Plans, supportive of Japan’s changing business and social environment, would be of significant benefit to corporations and their employees as they provide a new supplement to existing pension schemes.

As a result of the structure of Japan's current pension system, corporate pensions have not been widely established throughout the economy, especially among small- and medium-sized companies. The current pension system also provides limited choices for self-employed workers. As the percentage of elderly within the population rapidly increases, while the number of new births decreases, it is becoming an urgent task to reform the current pension system to ensure a secure and comfortable retirement for Japan's future retirees. A DC Plan system is particularly significant for employees of small- and medium-sized companies, which generally are not covered by a corporate pension, and for self-employed persons as a supplemental income tool to the national pension system.

Looking at the experience in the United States, the introduction of a DC Plan has contributed significantly to meeting the retirement needs of both corporate employees and individuals. With regard to the large corporate sector, DC Plans began as a supplemental pension to existing defined benefit plans. For small- and medium-sized companies, the DC Plan has provided employers with a cost-effective means to provide for their workers' welfare. As a result, DC Plans currently are as important as defined benefit plans in meeting employee retirement needs in this important business segment. The introduction of DC Plans also was in tune with the needs of an increasingly mobile labor market. To some industries, such as high-tech or software where employees tend to change jobs more frequently than in other industries, the portability function of DC Plans proved to be effective in enabling those companies to attract top quality employees.

In addition to providing greater security to people who are inadequately covered by Japan's current pension system, another important benefit of the DC Plan is that it can be an effective tool for investment education and deepening financial knowledge. In part as a result of financial liberalizations introduced over the past few years, the thinking of Japanese consumers with respect to financial matters is increasingly changing from that of "savers" to "investors". Introduction of a DC Plan could well serve as a catalyst for this transformation in financial thinking. DC Plans encouraged U.S. workers to enhance their financial knowledge and investment know-how, thus enabling them to become more efficient investors. From a systemic perspective, the easing of access to capital markets by individual investors that accompanied the introduction of DC Plans promoted more efficient capital flows throughout the economy.

Finally, in order to prepare adequately for their future, people should begin to contribute to a retirement plan as early as possible. Therefore, it is critically important that the DC Plan be introduced into Japan at the very earliest opportunity.

#### **4. Recommendations for Future Improvement**

The Councils strongly support early passage by the Diet of the current legislation on DC Plans. In addition, the Councils believe that the adoption of certain modifications to the proposed DC Plan system would improve its overall effectiveness and provide greater flexibility to the Japanese pension system. As such, the Councils recommend that the Japanese Government adopt the following changes to enhance the proposed DC Plan

structure:

### (1) Allow Supplemental Contributions

As described in the Government's proposal, DC Plans are intended to foster increasing self-responsibility among the Japanese people with regard to preparation for their retirement years. A starting point for such a change in behavior is creating an environment where the Japanese people prepare for their own future without overly relying on assistance from the Government or their employers. In order to foster such a culture of self-reliance and to ensure they meet their retirement needs, it is important that the DC Plan be modified to allow supplemental contributions by employees within the maximum allowable contribution limits. In addition, employers should be allowed to make contributions to individual-type DC Plans established by employees of those firms who cannot afford to introduce their own DC Plan in order to give such employers the opportunity to assist their employees in preparing for their future.

### (2) Expand Eligibility for Participants

The Councils believe that participant eligibility under the DC Plans is too restricted under the current draft legislation. Dependent spouses and government employees are not eligible to participate, and employees of firms with a defined benefit plan, but no DC Plan, are also precluded from participating in a DC Plan.

In the United States, the work of spouses is regarded as a kind of employment and they are thus entitled to participate in Individual Retirement Account investment plans (IRA investment plans), which are similar to the proposed individual-type Japanese DC Plan. United States Government employees are also entitled to participate in a DC Plan and this, as a result, enables free job transfer between the public sector and private sector. The Councils believe that, like in the United States, both dependent spouses and government employees should be permitted to participate in DC Plans. In addition, the Councils urge the Japanese Government to permit employees of firms having a defined benefit plan, but no DC Plan, to prepare adequately for their retirement by permitting them to participate in individual-type DC Plans.

### (3) Provide Access to DC Plan Funds in Times of Financial Emergency

The Councils understand that, in order to accumulate sufficient financial resources to meet future retirement needs, it is important that participants build up assets in their pensions over long periods. However, based on experience in the United States, people will hesitate to participate in such a pension plan if they are not allowed to access their DC funds in times of financial emergency. In order to foster widespread participation in DC Plans among the Japanese public, it is important that the Japanese Government allow DC Plan participants to make withdrawals or obtain loans from the plan in times of financial emergency.

#### (4) Increase Contribution and Conversion Limits

While the details have not yet been released, in order to provide adequate flexibility to both plan sponsors and participants, and to ensure adequate opportunity for workers to prepare for their future retirement, the current contribution limits should be raised and conversion limits should be large enough across all market segments. As mentioned earlier, changes in Japan's economic structure and in individual lifestyles have significantly diversified the needs of employers and individuals. To satisfy such diverse needs, contribution and conversion limits need to be large enough to provide full flexibility. The system needs to have sufficient contribution flexibility to accommodate, for example, the irregular income flows of self-employed workers by allowing contributions to be made by those workers on other than only a fixed monthly basis.

#### (5) Additional Matters for Consideration

Although beyond the scope of this statement, the Councils believe that the Japanese Government in the future should undertake a comprehensive study of the impact of Japan's tax system on the new DC Plans, and whether those taxes further the Government's goals in introducing DC Plans. Included in such a study should be an analysis of how to handle the special corporate tax in relation to DC Plans.