Corporate Pensions in Japan

- tax-qualified (TQ) pension plans
- employees’ pension fund (EPF) plans
- defined benefit (DB) corporate pension plans:
  - contract-type (C-DB)
  - fund-type (F-DB)
- defined contribution (DC) plans:
  - corporate-type (C-DC)
  - individual-type (I-DC)
- “cash-balance” (hybrid) plans as EPF or DB plans
- retirement allowances in a lump sum
Employees’ Pension Fund Plans

(without EPF)

Employees’ Pension

National Pension

(with EPF)

Additional Benefit by Sponsor Company

Subcontracted Benefit

Employees’ Pension

National Pension

benefit from EPF

benefit from Gov’t
DB Plans (fund-type)

Sponsor Company
- Employer
  - agreement to establish a fund
- Majority Labor Unions, etc.

Fund
- Officers
  - (Directors, Auditor)
- Delegates
- bylaws

Beneficiaries
- claim
- award
- benefit

Trust Banks, Insurance Companies, etc.
- contract
DB Plans (contract-type)

Sponsor Company

Employer

bylaws

Majority Labor Union, etc.

Beneficiaries

Trust Banks Insurance Companies, etc.

contributions

contract

payment order

claim

award

benefit
Fund-Type Plan (EPF & F-DB) Governance

- closed pension funds; institutional type; foundation form
- governing bodies: EPF or corporate pension fund (CPF), assembly of delegates, board of directors, and auditors; no suitability requirements
- chief director: represents EPF or CPF and administer the plan; may designate an “executive investment director”
- must draw up “basic investment policy”; may set up an “asset investment committee”; must entrust asset management and investment to external financial institutions; may make “in-house” investments under some conditions

- plan member participation: a half of delegates, directors, and auditors are elected from the labor side
- other actors: certified pension actuaries, investment consultants
Contract-Type Plan (TQ & C-DB) Governance

◆ closed pension funds; contractual type; collective contractual form

◆ governing body: employer

◆ “basic investment policy” and “asset investment committee” (C-DB); financial institutions as external asset managers; employers cannot make investments on their own or make specific investment orders

◆ plan member participation: employer must obtain consent from a majority of employees to change bylaws, i.e., to choose new external asset managers, to change the basic investment policy, etc. (C-DB)

◆ other actors: certified pension actuaries; investment consultants
Fiduciary Duties: Duty of Loyalty

◆ general provisions: “in the interest of participants” or “to pursue the interests of participants”

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◆ “prohibited transaction” and “conflict of interest”

◆ detailed “fiduciary duty guidelines” for DB and EPF plans
Fiduciary Duties: Duty of Care

◆ “prudent man” rule (Civil Code Art. 644, etc.)

◆ diversified investments; law does not impose any limit on investment in employer stock or bonds

◆ designation and supervision of “other actors” such as financial institutions, etc.
Disclosure

◆ the 2001 reform has reinforced disclosure regulations

◆ disclosure to DB and EPF plan members: contents of bylaws, standard benefit formula, the number of participants and beneficiaries, the amount of annual contributions, the total amount of pension funds, funding situation, asset portfolio, investment performance, investment policy, etc.

◆ plan members’ rights to obtain documents (fund-type plans): financial statements, minutes of the assembly, etc.
DC Plans (corporate-type)

**Sponsor Company**
- **Employer**
  - labor-management agreement to set up bylaws
- **Employees**
  - employee A
  - employee B
  - employee C
- **Beneficiaries**

**Financial Institutions**
- **Banks**
- **Credit Unions, etc.**
- **Securities Company**
- **Insurance Company**
- **Agricultural Cooperatives, etc.**
- **Post Office**

**Operations Management Institution**
- individual investment order
- record keeping
- investment alternatives information, etc.

**Asset Management Institution**
- investment order
- contract

**Contributions (employer only)**

**Benefit**
DC Plans (individual-type)

Self-Employed, etc.

Employer

Employee A

Employee B

Beneficiaries

National Pension Fund Association

OMI A
(5 Products)

OMI B
(10 Products)

OMI C
(8 Products)

Operation Management Institution (OMI)

contract

Banks

Credit Unions, etc.

Securities Companies

Insurance Companies

Agricultural Cooperatives, etc.

Post Office

contributions

individual investment order

nomination

record keeping

investigation alternatives information

investment order

benefit

pay-as-you-earn
Corporate-Type DC Plan Governance

◆ governing body: employer

◆ operation management institutions (OMIs): keep records, choose and offer investment alternatives, etc.; employer may at the same time be an OMI; financial institutions can be registered as OMIs but sales persons cannot be engaged in OMI-related business

◆ asset management institutions

◆ plan member participation: make investments on their own; employer must obtain consent from a majority of employees to change bylaws, i.e., to choose new OMIs, etc.
Fiduciaries’ Role in C-DC Plans

◆ must offer three or more investment choices, including one with the warranty of the capital, “in the interest of participants” (duty of loyalty) “with the care, skill, prudence…” (duty of care)

◆ investment choices: regulated financial products; employer stock is not excluded

◆ designation and supervision of OMIs and asset management institutions

◆ “investment education”

◆ disclosure: contents of bylaws, account balance, past records of contributions and investment orders, etc.
Future Implications

◆ need for more employee-oriented disclosure regulation; a balance between accuracy and easiness to understand

◆ deregulation gives more discretion to fiduciaries and brings about more “in-house” investments; need to clarify the meaning of “in the interest of participants” or “to pursue the interests of participants” [Fischel & Langbein, 1988]

◆ governance by plan member participation… is it really working?; an intensive survey needed; asset investment should be more shareholder-oriented? [Usuki, 2001]
Thank You

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