Japan Update: Retirement, Benefit and Employment Issues

April 2012

Defined Contribution Law Revised

Background

On August 4, 2011 a pension law was passed to allow employees to contribute to defined contribution (DC) plans for the first time in Japan. Before the passage of this law, only employer contributions to a DC plan were permitted based on the thinking that DC is an employer-provided pension plan. As a result of the legal change, it is possible from January 1 of this year to design a DC plan that also incorporates voluntary employee contribution. Existing DC plans are not required to make any changes unless the employer wishes to introduce this new design feature.

Current Market Practice

Since the introduction of DC to Japan in 2001, all DC plans have been designed with the employer paying monthly contributions to the individual DC accounts of their employees up to a limit set by the government as follows:

- Up to JPY 51,000 (US$630*) per month for each employee if there is no concurrent externally-funded defined benefit (DB) plan in place.
- Up to JPY 25,500 (US$315*) per month in case there is a concurrent externally-funded DB plan in place.

*Based on an example rate of JPY81 = US$1

It is quite common especially among Japanese affiliates of foreign multinationals to have a DC plan designed with the employer contribution rate defined as a fixed percentage of pay subject to the relevant DC contribution limit. Amounts that would be over the DC limit are often credited to an alternative retirement plan.

In addition to the regular contribution cap, employers must stop paying contributions when the DC participant reaches age 60. This has been an issue at companies where retirement benefits continue to accrue after age 60. In this case employers tend to use an alternative retirement plan to cover this portion of the promised benefits.

Major Changes

The legislative change affects the following:

1. Employee contribution is now permitted from January 1, 2012 and full tax-deduction advantages are provided to the employee.
2. Employee contributions cannot exceed employer contributions AND the limit on combined employer and employee contributions will remain the same as present.
3. It is not allowed to design the employee contribution using a fixed percentage of pay approach.
4. Currently, it is not allowed to pay contribution to DC when the employee has reached age 60; a new administrative, regulation will be issued in the near future to allow companies to design a DC plan where contributions can be paid even after age 60 (up to maximum age 65).

5. The DC sponsor is urged to provide continuing investment education to the plan participants.

The fact that the current legal DC contribution limits remain unchanged despite the fact that employee contributions are now added, as well as the requirement of not allowing the fixed percentage of pay approach in determining the amount of the employee contribution would pose a challenge in terms of the plan design or redesign work. Employee consent is also required to introduce this design feature.

At any rate, it can be said that the introduction of the tax-advantageous employee contribution feature for the first time in Japanese pension history would present an opportunity for employers to reconsider their existing DC plans or to think about introducing new DC plans.

As at the end of February 2012, there were 28 plans with employee DC approved by the authorities although this represents a small proportion of the over 4,000 DC plans in existence (Source: Ministry of Health, Labor and Welfare).

**Actions for Employers**

- There is no requirement to change existing DC plans, so it is up to each employer to decide whether to introduce the employee contribution feature.

- There is a need to redesign the existing DC plan if a DC sponsor would like to pay contributions to their employees beyond age 60 (note that the administrative regulation has not yet been issued)

- Monitor for updates on the timing of the new administrative regulations regarding the possibility to raise the age limit to pay contributions.

**Contact Information**

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