

MEMO# 13670

July 16, 2001

JAPAN PASSES DEFINED CONTRIBUTION PENSION LEGISLATION

[13670] July 16, 2001 TO: INTERNATIONAL COMMITTEE No. 43-01 PENSION COMMITTEE No. 47-01 RE: JAPAN PASSES DEFINED CONTRIBUTION PENSION LEGISLATION On June 22, the Japanese Diet passed significant defined contribution ("DC") pension legislation. The new law allows Japanese companies to adopt DC plans ("company plans") similar to 401(k) plans in the United States. The new law also allows individuals who are either self-employed or employed but not covered by any pension plan at work to make contributions to plans ("individual plans") similar to individual retirement arrangements in the US. The legislation takes effect on October 1, 2001. The Embassy of Japan in Washington, D.C. has provided the Institute with an official summary of the legislation, a copy of which is attached. According to this summary, the legislation includes the following features:

- **Contributions - Company Plans.** Unlike US 401(k) plans, contributions to the company plans must be made entirely by the employer up to the contribution limits. The contribution limits depend on whether the employer has an existing defined benefit pension plan. If the employer has a defined benefit ("DB") plan, contributions are limited to ¥216,000 (about \$1,718) per year. If the employer does not have a DB plan, the contribution limit doubles to ¥432,000 (about \$3,436) per year.
- **Contributions - Individual Plans.** Self-employed individuals may contribute up to ¥816,000 (about \$6,491) per year to individual plans. Individuals who are not covered by either a DB or a DC plan at their company may contribute up to ¥180,000 (about \$1,432) per year to an individual plan.
- **Investments.** Plan administrators select the investment options for company plans. Plans must include at least three investment options. Although not reflected in the Embassy of Japan's summary, we understand that the new law requires one of the investment options to have a principal-guarantee feature. Investment options may include mutual funds and investment trusts, as well as savings products, government bonds, equities, and insurance products. Real property, real estate, financial futures and commodity futures are not permissible investment options.
- **2Plan administrators must provide information about the plan and investment options to participants and must permit participants to change investments at least once every three months.**
- **Distributions.** Individuals who have participated in a plan for more than ten years are eligible for distributions at age 60. The eligible age for distributions increases on a sliding scale to 65 for individuals who have participated in a plan for less than ten years. Participants who die or are severely disabled are eligible to receive distributions regardless of their age. Distributions may be made in the form of an annuity or a lump sum payment. If a participant participates in the plan for less than three years, contributions must be made in a lump sum.
- **Tax Incentives.** → **Contributions.** Contributions to plans are tax exempt. For company plans, the employer receives the deduction (as a loss) equal to the contributions that it made on behalf of its employees to their plans. For individual plans, contributions are deductible from individual income. → **Accumulation.** It is unclear whether

a tax will be imposed on pension assets during the accumulation phase. It appears that amounts accumulated in a plan will be subject to a “special corporate tax” equal to 1.173%. However, it is our understanding that this special corporate tax has been suspended until March 2003, and that it is possible that that suspension could be extended beyond that date. → Distribution. Although distributions are taxable, no tax is owed on pension distributions (all distributions from DC plans, DB plans and the national pension system) that total less than a standard amount. • Portability. For employees whose job tenure is more than three years, their company plan account is fully portable. These individuals can roll over their plan assets to their new employer’s DC plan or the national pension fund. Similarly, individual plan assets may be rolled over to an employer’s DC plan. • Fiduciary Responsibilities. The new law outlines the fiduciary responsibilities owed by the employer, trustee (i.e., custodian), plan administrator and the National Pension Fund Association (with respect to individual plans). The summary provided by the Embassy of Japan does not further describe these fiduciary duties. • Conversion of Existing DB Plans. The law allows employers to convert existing DB plans to DC plans with the agreement of employees. Conversions are subject to limitations not described by the summary provided by the Embassy of Japan. These provisions will be implemented through regulations promulgated by the Ministry of Health, Labor and Welfare later this summer. Robert C. Grohowski Associate Counsel Attachment 3Attachment (in .pdf format)