

Matching contributions a potential boost to DC in Japan

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Japan's defined contribution system has just received a substantial birthday present as it reaches its 10th year in Japan: approval of matching contributions.

Only corporations were allowed to make contributions on the assumption that corporate DC was a kind of retirement benefit system, and contributions from workers themselves were not permitted. A change starting in January will allow subscribers who want to make personal contributions within a set limit and below the corporate contribution.

It is an open question how far matching contributions will spread, but they could transform DC as a whole and change the perceived value of the retirement benefit system.

The retirement benefit system is funded by employee contributions. An employee's efforts is reflected in the retirement system premiums as a part of the compensation system, including wages and bonuses, with reference to the worker's evaluation and benefits by the company. In other words, a company's premiums are in actuality a labor cost tied to the employee's abilities.

Putting it more flatly, the wages and retirement premiums paid for a worker differ only in how they are taxed or booked. Of course, tax and premium assessment considerations are important, but the reality is that company premiums are being squeezed out of nowhere.

The borderline between company and employee contributions is already quite vague. For example, income that should be an employee's wage is simply renamed a corporate premium in a pseudo-matching or selective DC.

This is a corporate-style DC. By reducing its compensation and defining that reduced portion as a premium, a company can pay premiums under the DC system with no burden to itself.

The employee's taxable income goes down by the premium portion and wages, which form the basis for calculating social security payments, decline for both the employee and company (in other words, the social security burden is eased). Under this system, funds for the retirement benefit system are nothing more than labour fees.

Since the DC system was introduced in 2001, the nation's retirement payout system has come under question.

The DC system does not allow a cut in retirement benefits if a worker has been at a company for at least three years, and wages cannot be cut post facto either. In contrast, pensions under defined benefit (DB) systems have been frequently adjusted downward.

Moreover, portability has been enhanced under DC systems so that early retirees can receive assets that they accumulated in their previous jobs, which is not necessarily the case under DB corporate pensions.

DC systems are also strong against the risk of liquidation of a pension plan, with all assets protected and simply transferred to a personal DC. Corporate DB pensions are not always protected.

Furthermore, it is true that retirement systems no longer work to prevent misconduct and employee turnover. Leaving old-age asset planning to the company has also eroded faith in pensions as a tool to encourage greater diligence.

The set belief in retirement systems by which companies simply pay out the money is being reconsidered with the advent of DC as a pension scheme offshoot. Matching contributions were introduced in a virtual passage of the baton with the demise of qualified pension plans.

Matching contributions should transform workers' perception of pensions from "money supplied by the company" to "money accumulated and managed by one's own efforts". The integrated management and operation of corporate and employee contributions should further abet this process.

Matching contributions are said to raise the consciousness of subscribers, but the effects are not limited to DC. Workers will undoubtedly look more closely at corporate DB schemes as well. DC targets a new relationship between employer and employee, and matching contributions should help create a framework along those lines.

Looking at matching contributions as another man's problem or comparing DB premiums with previous subscriber premiums shows insufficient understanding of the issue. Matching contributions should be seen as the first step in big changes in the retirement system over the next 10 years.