

THE

Japanese

RETIREMENT SYSTEM

Contents

- 1** Background Statistics
- 2** Overview of the Retirement System
- 3** Safety Net
- 4** Mandatory Public Pension
- 6** Employer-Sponsored Retirement Plans
- 9** Individual Retirement Accounts
- 12** Additional Investment Opportunity: NISA
- 13** Building Wealth with Investment Funds
- 16** Resources

The Japanese Retirement System

Background Statistics

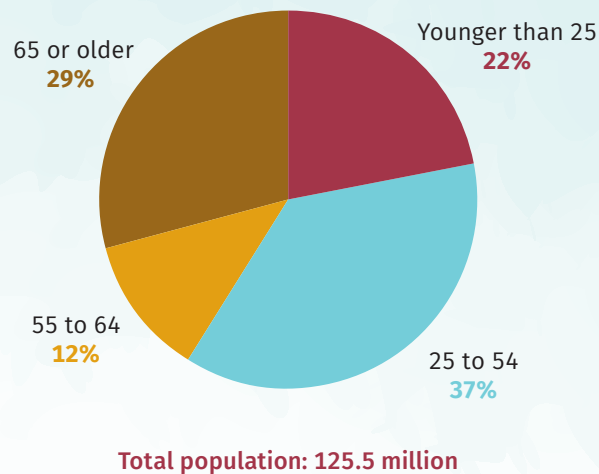
Demographics

Forty-one percent of Japan's 125.5 million people are approaching or past retirement age, and another 37 percent are in their prime working years (Figure 1). The Japanese retirement system relies on complementary components to help these individuals accumulate resources for retirement. This document lays out the design and magnitude of the components of the Japanese retirement system.

FIGURE 1

Japan's Aging Population

Percentage of population, 2020



Source: US Central Intelligence Agency, *The World Factbook*

Financial Statistics

In 2020, Japan's workforce was about 66.7 million individuals and the average annual cash wage was ¥3,820,860 (US\$35,780); Japan's gross domestic product (GDP) was ¥537.1 trillion (US\$5.1 trillion). At year-end 2020, Japan's stock market capitalization was ¥717.5 trillion (US\$6.7 trillion), and fund assets totaled ¥247.1 trillion (US\$2.4 trillion). With more than 13,800 investment trusts offered in the Japanese fund market, Japanese investors use these cost-effective, professionally managed diversified portfolios to access market securities ranging from Japanese government bonds, to domestic and foreign stocks, to investment real estate.

Overview of the Retirement System

System Design

Workers rely on a combination of resources in retirement, and the role each type of resource plays has changed over time and varies across households. Some describe the components of retirement security as pillars, others refer to tiers, and others organize the components of retirement security as a pyramid. Retirement resources can be thought of as having five key components, which draw from government programs, compensation deferred until retirement, and other savings. These five components are public/government-provided pensions, housing, employer-sponsored retirement plans, individual retirement accounts, and other assets. This document focuses on the components of the Japanese retirement system, which are complementary, having both defined benefit (DB) and defined contribution (DC) design elements, including individual retirement account saving (Figure 2). In addition, Japan, like other jurisdictions, has poverty alleviation programs in place.

FIGURE 2
Design of the Japanese Retirement System

	PAYGO	Pre-funded
Defined benefit (DB)	<ul style="list-style-type: none">» National Pension (and partial funding in GPIF)» Employees' Pension Insurance (and partial funding in GPIF)» Government employees' pension	<ul style="list-style-type: none">» Mutual aid associations» National Pension Fund» Corporate DB plans
Defined contribution (DC)		<ul style="list-style-type: none">» Corporate-type DC plans» Individual-type DC plan (iDeCo)

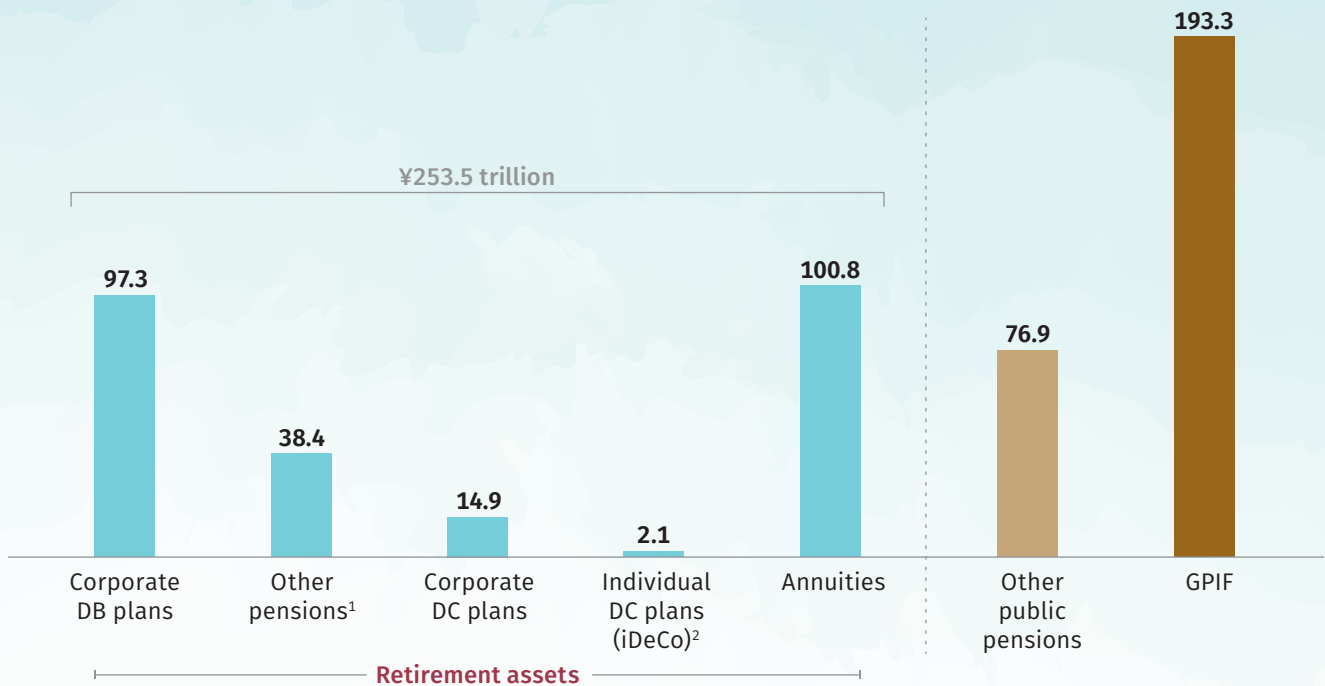
Source: Investment Company Institute

Assets Earmarked for Retirement

Japan has ¥253.5 trillion (US\$2.3 trillion) earmarked to support retirement, with an additional ¥193.3 trillion (US\$1.7 trillion) in the Government Pension Investment Fund (GPIF)—which supports Japan’s mandatory public pension system—and ¥76.9 trillion (US\$0.7 trillion) in other public pensions (Figure 3). Retirement assets represented about 45 percent of GDP. The largest component of Japanese retirement market assets is annuity reserves, followed closely by corporate DB plan assets. The DC plan component of the Japanese retirement system was introduced with the Defined Contribution Pension Act of 2001, which created corporate-type DC plans and individual-type DC plans (the latter is called iDeCo).

FIGURE 3
Assets in the Japanese Retirement System

Trillions of Japanese yen, end of June 2021



¹ Other pensions are pension funds for self-employed individuals and small businesses and include the National Pension Fund and mutual aid accounts.

² The iDeCo data are for 2020:Q1.

Sources: Bank of Japan, Government Pension Investment Fund, Pension Fund Association, and National Pension Fund Association

Safety Net

In Japan, poverty alleviation for people of all ages is provided through municipal public assistance. Elements of the Japanese public assistance system likely to be used by retirees include livelihood assistance, housing assistance, medical assistance, long-term care assistance, and funeral assistance. More than four in 10 households receiving public assistance are elderly households.

Mandatory Public Pension

Public Pension Design

The Japanese public pension is DB in design and primarily pay as you go (PAYGO) (Figure 2). It has two components, the National Pension, which provides basic pension benefits to self-employed individuals, employees, and employees' dependent spouses, and Employees' Pension Insurance, which provides pension benefits to employees. The National Pension covers three broad categories of "insured" individuals (population count in 2019):

Category 1 insured: Self-employed (14.5 million)

Category 2 insured: Private-sector (company) employees and public-sector employees (44.9 million)

Category 3 insured: Spouses of company employees or public-sector employees (8.2 million)

The category 2 insured under the National Pension also are insured under Employees' Pension Insurance (population count in 2019):

Private-sector insured (40.4 million)

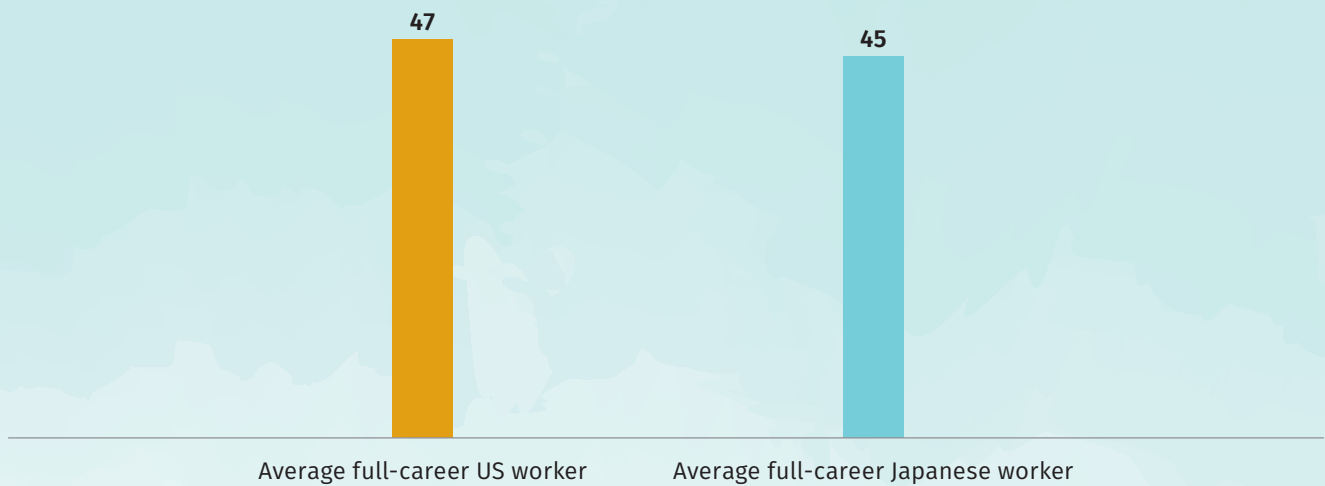
Public-sector insured (4.5 million)

For an average full-time, 40-year career worker, Japan's mandatory public pension provides similar benefit levels as US Social Security. Japan's current 18.3 percent contribution rate is higher than US Social Security's 12.4 percent, but both countries split the contributions equally between the employee and employer. Also, similarly, the benefits are not means-tested. For an average, full-time, full-career worker retiring at age 65, the first-year benefit replacement rate is 47 percent in the United States and 45 percent in Japan (Figure 4). Self-employed individuals (category 1) only participate in the National Pension (Figure 8), at a flat contribution and flat benefit level (not related to their earnings). Nonworking spouses (category 3) are covered by the National Pension. Other components of the retirement system are designed to complement these amounts.

FIGURE 4

Full-Career Worker's Replacement Rate

First-year benefits as a percentage of average inflation-indexed earnings from age 25 to 64



Note: These estimates assume that the workers were born in 1955; work from age 25 through age 64; have earnings at each age that are the same percentage of average earnings in their country as the US Social Security Administration's "medium" scaled earner; and claim benefits at age 65. If the US worker claimed benefits at their full benefit age of 66 years and 2 months, the replacement rate would be 51 percent.

Source: Investment Company Institute calculations

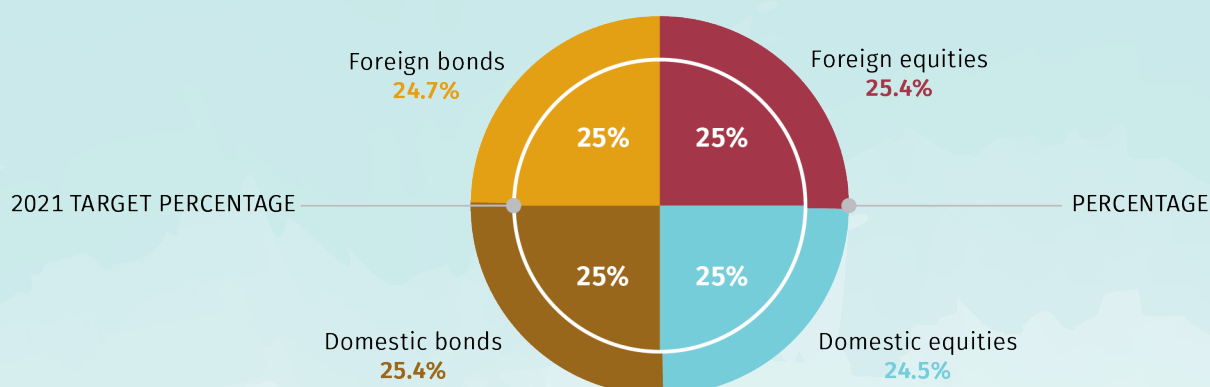
Government Pension Investment Fund

To help support the long-term sustainability of these PAYGO public pension programs, the Japanese government created GPIF. At the end of June 2021, GPIF had ¥193.3 trillion (US\$1.7 trillion) in investments, which included investments in domestic bonds (25.4 percent), domestic equities (24.5 percent), foreign equities (25.4 percent), and foreign bonds (24.7 percent) (Figure 5). These allocations align very closely to GPIF's target asset allocation, which changed in April 2020 to equally weight domestic equity (25 percent), foreign equity (25 percent), domestic bonds (25 percent), and foreign bonds (25 percent).

FIGURE 5

GPIF Takes a Long-Term View with Investing

Percentage of assets under management, end of June 2021



Source: Government Pension Investment Fund, *Investment Results for 1Q of Fiscal 2021 (Update Report)*

Employer-Sponsored Retirement Plans

Private-sector and public-sector workers (category 2 insured), in addition to paying into the National Pension and Employees' Pension Insurance programs, also may be offered retirement plan coverage at work. Public-sector workers have DB plan coverage. Historically, if offered any pension coverage, private-sector workers were enrolled in corporate DB plans. Corporate DB plans are funded by the employer, and like other jurisdictions, Japan's DB plans have unfunded liabilities. In Japan, corporate DB plans had total assets of ¥97.3 trillion (US\$875.5 billion), which covered 86 percent of their liabilities, and unfunded liabilities of ¥16.1 trillion (US\$145.2 billion) or 14 percent of their liabilities (Figure 6).

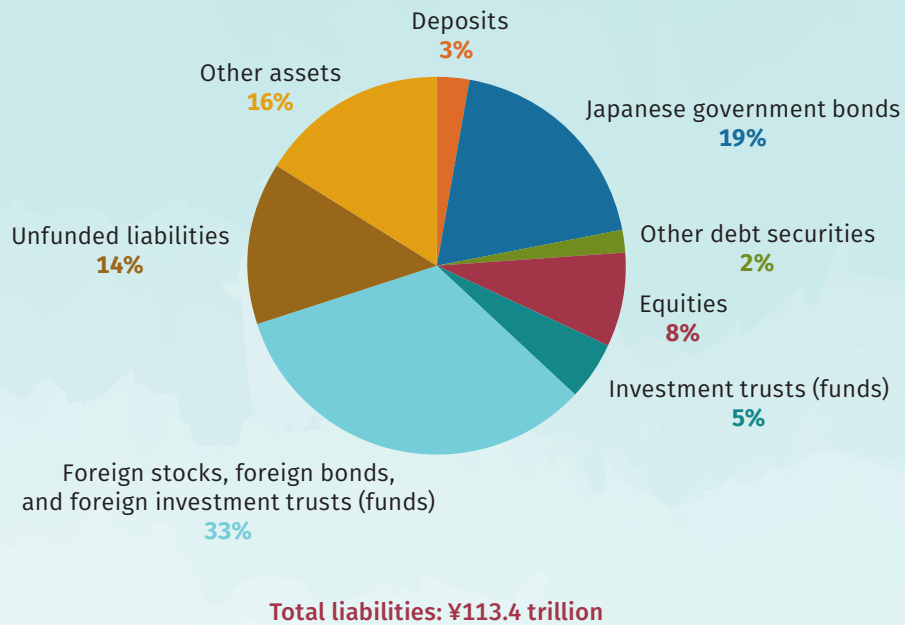
The Defined Contribution Pension Act of 2001 created corporate-type DC plans and individual-type DC plans (in the same year, DB reforms also were passed). But it was not until 2011 that the Amendments to Pension Laws to Support Securing Pension Benefits allowed participant contributions to corporate DC plans. Participant contributions may not exceed the employer's contribution, and the participant contribution amount was carved out of the existing limit. This contribution limit design means that an individual with low corporate employer contributions is at a disadvantage, being unable to make up for that shortfall with their own contributions within the plan. In addition, a higher total contribution limit would allow for more robust preparation for retirement. Allowing older workers higher contribution amounts (catch-up contributions) can also promote improved retirement security.

Corporate DC plan participants have access to a variety of investment options. At the end of 2020:Q1, nearly half (48 percent) of corporate DC plan assets were in investment funds, 36 percent were in deposits, and 16 percent were in insurance products (Figure 7).

FIGURE 6

Corporate DB Plan Investments and Unfunded Liabilities

Funding against liabilities, percentage of total, end of June 2021

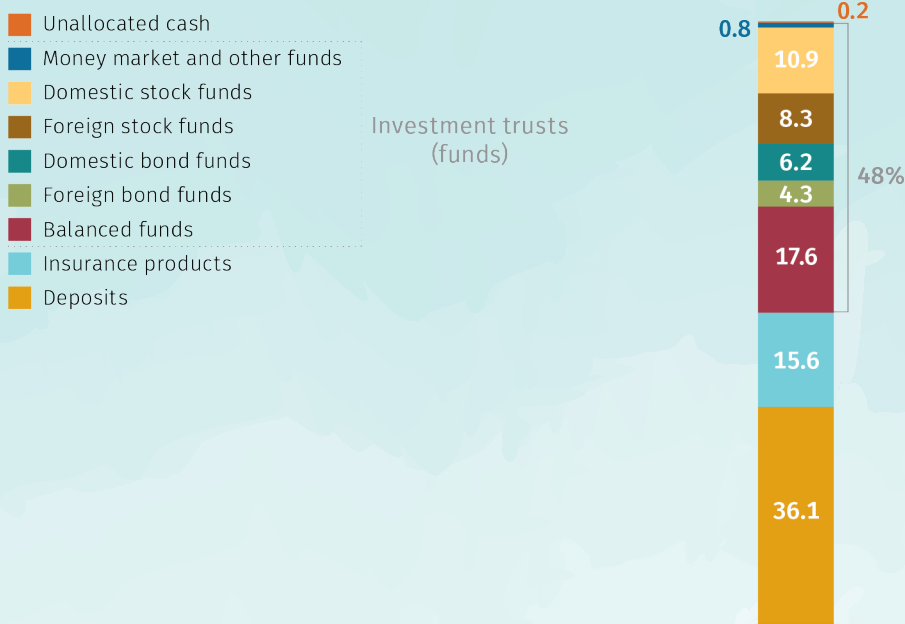


Source: Bank of Japan, Flow of Funds Accounts

FIGURE 7

Corporate DC Investors Hold a Variety of Investments

Percentage of total corporate-type DC plan assets, 2020:Q1



Total assets in corporate-type DC plans: ¥13.5 trillion

Source: National Pension Fund Association

Individual Retirement Accounts

The individual-type defined contribution pension plan (iDeCo) is a voluntary private-pension plan governed by the Defined Contribution Pension Act of 2001. Since January 2017, the plan has been available to virtually any individual between the ages of 20 and 59 who is not already participating in a corporate DC plan (some corporate DC plan participants also may be eligible). The iDeCo offers preferential tax treatment on contributions, investment returns within the account, and distributions in retirement. It also offers a full range of investment options, with providers including banks, securities and investment trust companies, and insurance companies.

Designed to complement the rest of the Japanese retirement system, iDeCo contribution limits vary depending on other retirement system coverage. For example, company employees with no retirement plan at work may contribute ¥276,000 per year to an iDeCo, as can full-time homemakers (Figure 8). Company employees with only a corporate-type DC plan have an annual iDeCo contribution limit of ¥240,000, if their DC plan limit is ¥420,000. If their DC plan limit is ¥660,000, then they may not make contributions to an iDeCo. Similarly, if the company has both a DB and DC plan, the ability to contribute to an iDeCo is limited not only by the presence of the DB plan but also by the generosity of the DC plan. Company employees with DB plans and lower-contribution DC plans are limited to an annual iDeCo contribution of ¥144,000; the same limit applies to public-sector workers. The amount that self-employed individuals may contribute to an iDeCo depends on their National Pension Fund or additional insurance premiums—the total is limited to ¥816,000 per year. This complexity, regarding both eligibility and variation in contribution amounts, may be discouraging individuals from opening an iDeCo. In addition, the contribution limits do not offer a robust savings rate. A simpler design with expanded eligibility and a uniform—and higher—contribution limit could boost participation in these accounts.

The majority (51 percent) of iDeCo participants were private-sector company employees who do not have pension plans at work (Figure 9). Another 22 percent were public-sector workers and 11 percent were self-employed. Only 12 percent were private-sector workers at companies with pension plans, perhaps reflecting the complications of determining iDeCo eligibility and coordinating limits.

Like corporate DC plan investors, iDeCo investors have access to and hold a variety of investments. At the end of 2020:Q1, 46 percent of iDeCo assets were in investment funds, 36 percent were in deposits, and 18 percent were in insurance products (Figure 10).

FIGURE 8

Japanese Retirement System Contribution Limits

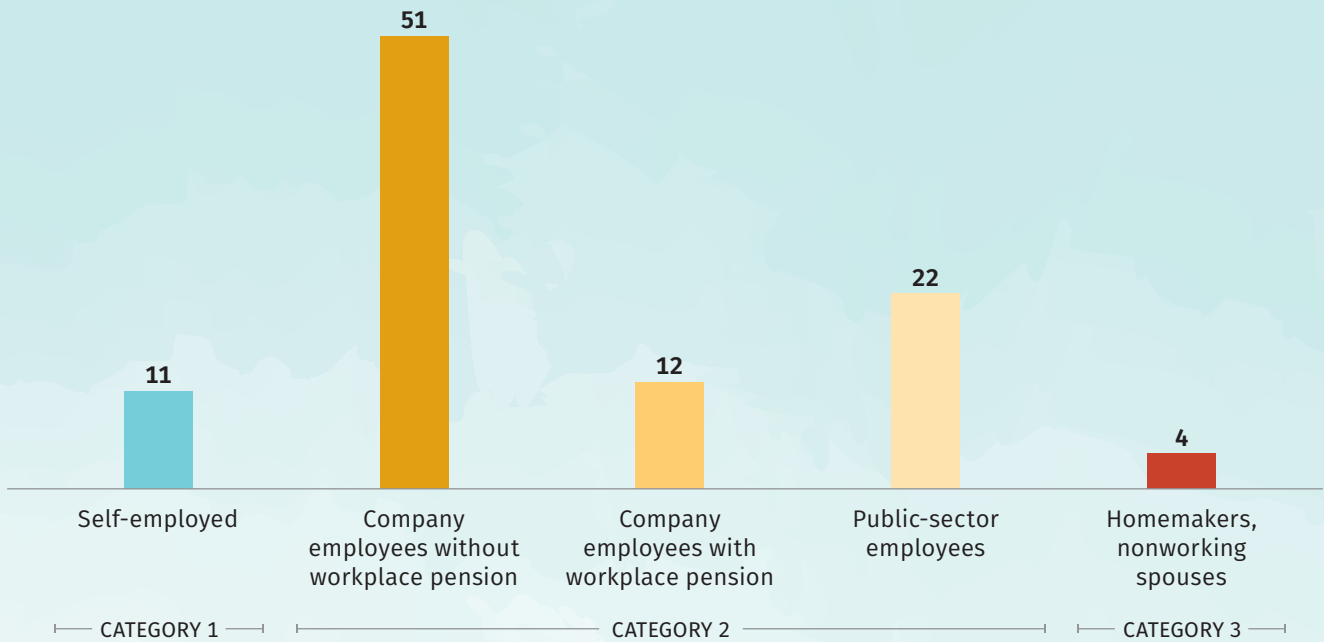
		Public pension (mandatory)		Voluntary retirement plans	
		National Pension (basic pension benefits)	Employees' Pension Insurance	Maximum annual contribution allowed to company or employer-provided pension	Maximum annual contribution allowed to iDeCo
National Pension category 1 insured persons: self-employed individuals	Self-employed individuals, freelance workers, students			National Pension Fund	¥816,000 (total for iDeCo and National Pension Fund)
	Company employees whose company does not have a corporate pension plan				¥276,000
National Pension category 2 insured persons: private-sector (company) employees, public-sector workers	Company employees enrolled only in a corporate-type DC plan			Corporate-type DC plan limit is ¥420,000	¥240,000
				Corporate-type DC plan limit is ¥660,000	¥0
	Company employees enrolled in both a DB plan and a corporate-type DC plan			Corporate-type DC plan limit is ¥186,000, when also have DB plan (no limits on DB)	¥144,000
				Corporate-type DC plan limit is ¥330,000, when also have DB plan (no limits on DB)	¥0
	Company employees enrolled only in a DB plan			No limits on DB plan contributions	¥144,000
	Public-sector workers			Retirement benefits paid as annuity	¥144,000
National Pension category 3 insured persons: full-time homemakers (male or female)	Dependent spouses of category 2 workers				¥276,000

Source: Investment Company Institute summary of information from National Pension Fund Association (iDeCo) and Japanese Ministry of Health, Labour, and Welfare

FIGURE 9

Majority of iDeCo Participants Do Not Have Retirement Plans at Work

Percentage of iDeCo participants, September 2021

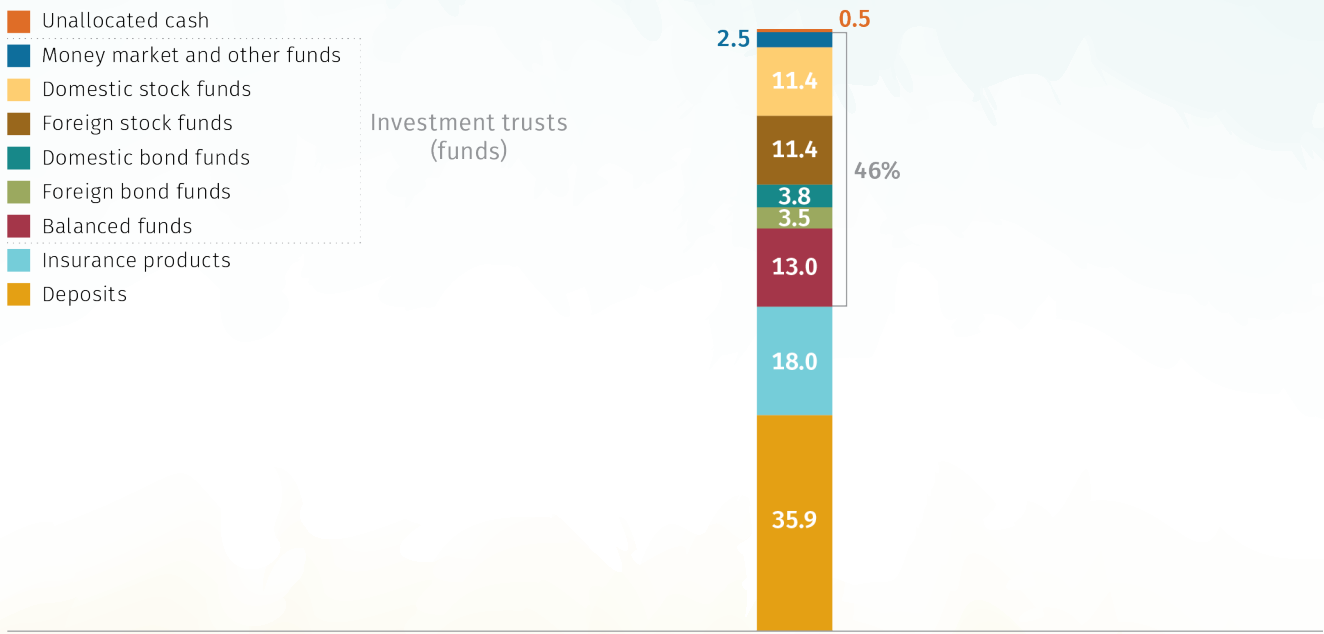


Source: National Pension Fund Association

FIGURE 10

iDeCo Investors Hold a Variety of Investments

Percentage of total iDeCo assets, 2020:Q1



Total assets in iDeCo: ¥2.1 trillion

Source: National Pension Fund Association

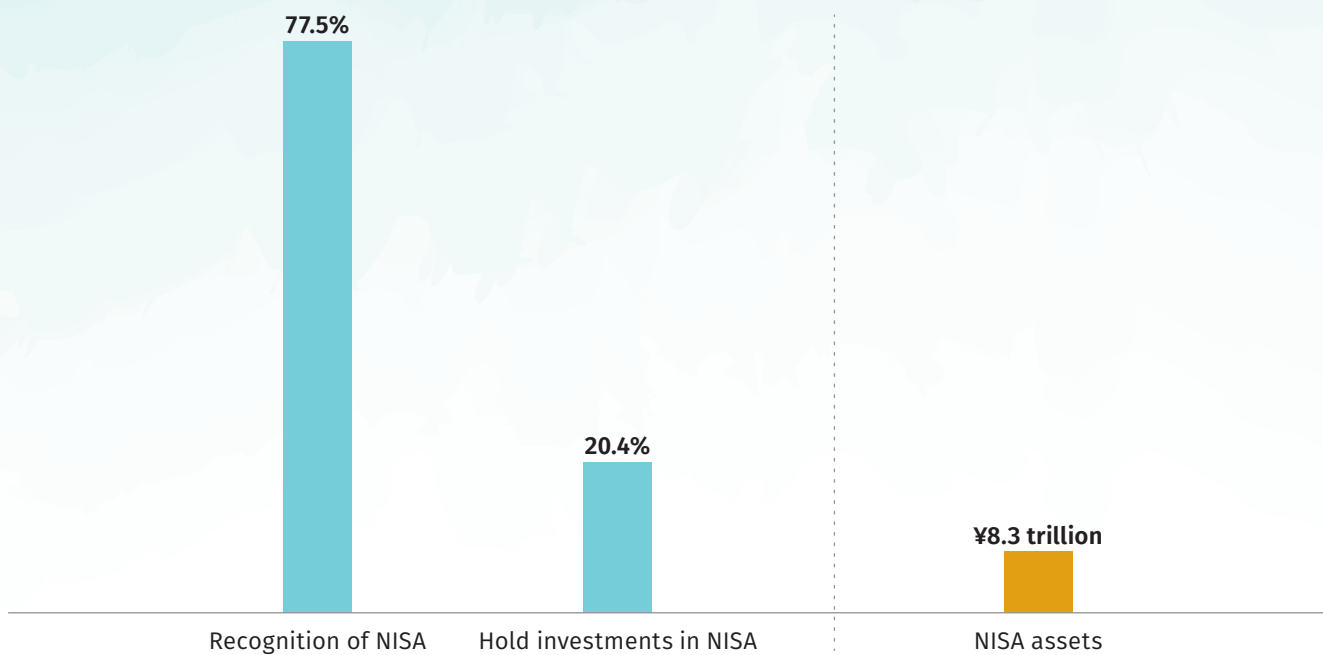
Additional Investment Opportunity: NISA

Although technically not a component of the Japanese retirement system, the Nippon Individual Savings Account (NISA), launched in January 2014, is designed to promote investment and could be used for long-term savings goals such as retirement. A NISA may be opened by Japanese residents aged 20 or older, with an annual contribution limit of ¥1.2 million (about US\$12,000) up to ¥6 million total over five years, and offers exemption from capital gains and dividends taxes. Investments through a NISA are limited to listed stocks or publicly offered stock investment funds. An installment-type NISA, available starting in 2018, also offers a tax-advantaged investment opportunity.

Survey results find that a majority of Japanese people recognize NISAs (78 percent of individuals) (Figure 11), with 30 percent knowing both the name and the details of the program and 48 percent only knowing the name. Twenty percent of Japanese individuals indicated they had a NISA. Thirty-eight percent of NISA owners opened their accounts through securities firms, 37 percent through online securities firms, and 15 percent through banks. Assets in NISAs were ¥8.3 trillion (US\$80.3 billion), and were primarily invested in investment trusts (funds) (Figure 12). Installment (also called Tsumitate) NISAs, which have lower investment limits, had an additional ¥0.72 trillion in assets (US\$7.0 billion).

FIGURE 11
NISA Recognition Has Increased but Uptake Is Low

Percentage of individuals, December 2020

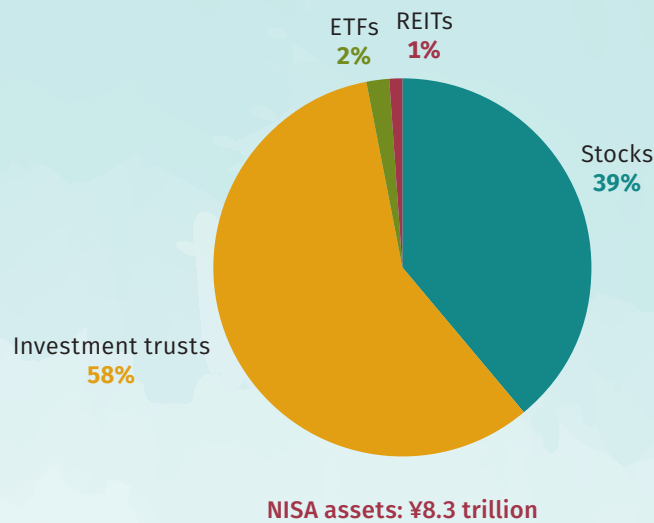


Sources: Investment Trusts Association, Japan (JITA) and Japan Financial Services Agency, *NISA Account Usage Survey* (as of December 2020)

FIGURE 12

Majority of NISA Assets Are in Investment Trusts

Percentage of NISA assets, year-end 2020



Source: Japan Financial Services Agency, *NISA Account Usage Survey (as of December 2020)*

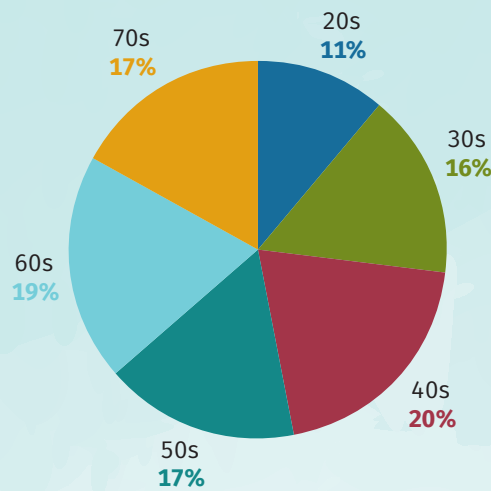
Building Wealth with Investment Funds

Investment trusts (funds) in Japan help millions of investors over their lifecycle. Investment trusts provide cost-effective, professionally managed, diversified investment. Falling under the Financial Instruments and Exchange Act (FIEA), investment trusts provide initial and continuous disclosure to investors through prospectuses and investment reports. Investment trust management companies owe a duty of sincerity to customers (conducting their business activities in a sincere and fair manner), a duty of loyalty, and a duty to exercise reasonable care. More than 22 million Japanese investors aged 20 to 79 owned investment trusts in 2020 (Figure 13).

FIGURE 13

Japanese Fund Investors Hail from All Age Groups

Percentage of investment trust investors aged 20 to 79, 2020



Total investment trust investors (aged 20 to 79): 22.1 million

Source: Investment Trusts Association, Japan (JITA), 2020 *Questionnaire on Investment Trusts, Summary of Survey Results*

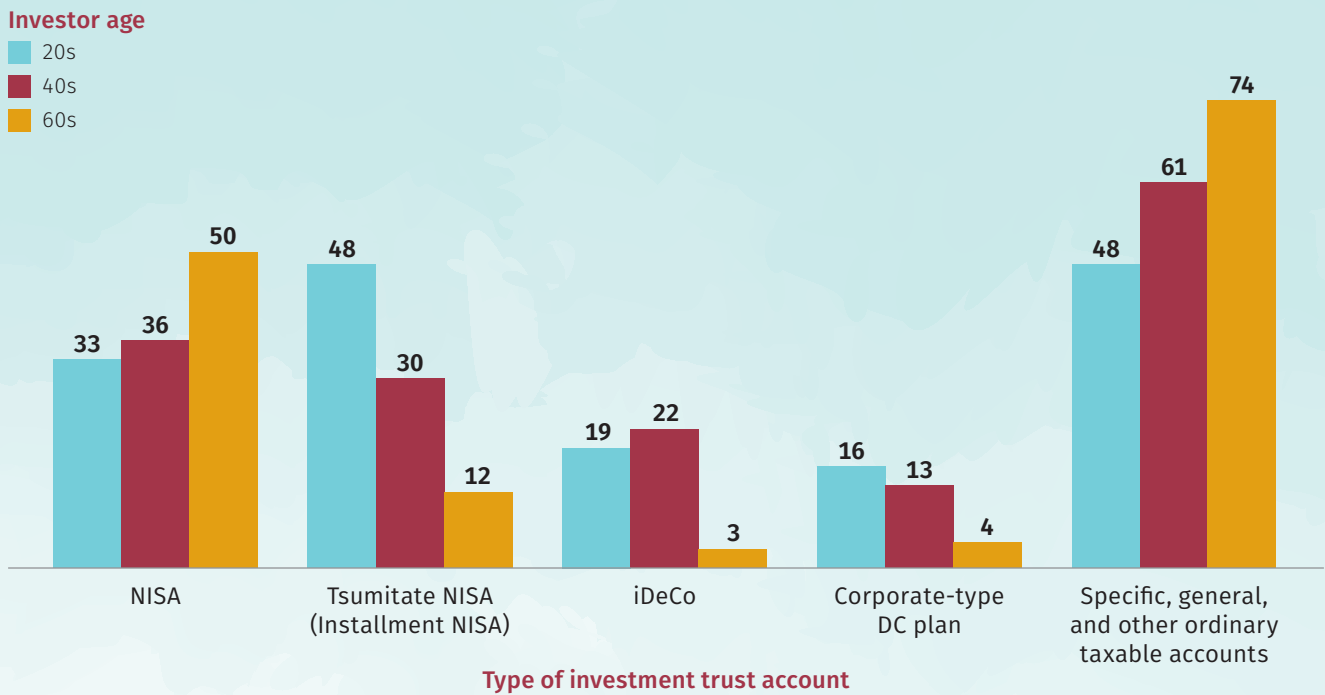
Japanese investors may own funds through a variety of accounts. It is interesting to note that younger Japanese investors are more likely to be saving and investing for retirement, while older investors are more likely to have NISA or taxable accounts. About one-fifth of young investment trust investors held funds through iDeCo and 16 percent held funds in corporate-type DC plan accounts (Figure 14).

Additionally, younger Japanese investors are more likely to be investing through installments: nearly half held funds through Installment NISAs. Investing through Installment NISAs is up dramatically from the prior year. For example, among fund investors in their twenties, the percentage of those holding an Installment NISA increased 8.8 percentage points compared with the 2019 survey (there were similarly large increases for investors in their thirties and forties).

FIGURE 14

Younger Japanese Fund Investors Are Embracing Retirement Saving and Installment Investing

Percentage of individuals owning investment trusts, selected age groups, 2020



Note: Japanese investment trust investors may hold more than one type of account.

Source: Investment Trusts Association, Japan (JITA), 2020 Questionnaire on Investment Trusts, Summary of Survey Results

Resources

- Bank of Japan, Flow of Funds Accounts
www.boj.or.jp/en/statistics/sj/index.htm
- iDeCo (National Pension Fund Association)
www.ideco-koushiki.jp/
- IIFA Worldwide Regulated Open-End Fund Assets and Flows
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- Investment Company Institute (ICI)
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 - ICI Global Retirement Resource Center
https://www.ici.org/global_retirement
- Government Pension Investment Fund, Japan (GPIF)
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- Japan's Financial Services Agency
www.fsa.go.jp/en/index.html
- Japan's Ministry of Finance
www.mof.go.jp/english/
- Japan's Ministry of Health, Labour, and Welfare
www.mhlw.go.jp/english/
 - The Point of the Pension Plan
www.mhlw.go.jp/english/org/policy/dl/p36-37_1.pdf
 - What's New
www.mhlw.go.jp/english/new-info/
- Japan National Pension System
www.nenkin.go.jp/international/japanese-system/nationalpension/nationalpension.html
- Statistics Dashboard, Statistics Bureau, Ministry of Internal Affairs and Communications
<https://dashboard.e-stat.go.jp/en/>



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