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Japan's individual defined contribution pension plan enrollment soon to surpass one million

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Executive Summary

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Japan's iDeCo (individual defined contribution) plan enrollment is growing rapidly in the wake of a January 2017 expansion of iDeCo eligibility. iDeCo plans differ from corporate defined contribution plans in several respects, the biggest of which is that most iDeCo participants do not open iDeCo accounts until they are in their 40s or 50s. With this tendency toward opening iDeCo accounts at a relatively late age unlikely to change, iDeCo plans should be redesigned to reflect their distinctive nature as a retirement savings vehicle dependent on self-motivation.

iDeCo enrollment is growing rapidly

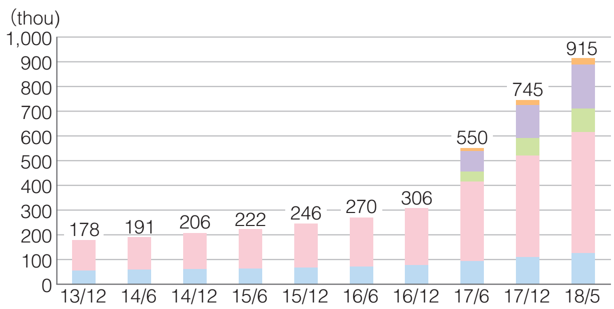
Individual defined contribution pension plans (colloquially known as iDeCo plans), hitherto vastly overshadowed in terms of enrollment by corporate defined contribution plans, continue to grow in popularity. Until a few years ago, iDeCo plans were not widely known because they were available only to the self-employed and company employees without a workplace pension plan. As of the 10th anniversary of their inception, total iDeCo plan enrollment was not even 200,000, nearly half of whom had opened their iDeCo accounts as a rollover from a corporate defined contribution plan. In 2015, iDeCo plans started to gain public attention when the government unveiled a tax reform package that expanded iDeCo eligibility to essentially anyone up to age 60. Growth in their enrollment has since accelerated (Exhibit 1). In 2017, iDeCo enrollment grew 150%. In 2018 through May, an average of over 34,000 iDeCo accounts were opened monthly. If this growth rate persists, iDeCo enrollment will surpass one million within a few months.

Among newly eligible participants who have opened iDeCo accounts as of May 2018, 176,000 are public employees, 96,000 are company employees with workplace pension plans and 26,000 are so-called Category 3 participants, mostly nonworking spouses. iDeCo accounts are rapidly gaining popularity among public employees in particular. The iDeCo enrollment rate for public employees (ratio of public-employee iDeCo plan participants to total public employees under age 60) has already reached 4.4%. Meanwhile, enrollment has been accelerating even among people who have been eligible to open iDeCo accounts from the outset. Most notably, iDeCo plan participants who are company employees without a workplace pension plan have more than doubled, increasing by 262,000, since January 2017. The expansion of iDeCo plan eligibility seems to have spurred enrollment even among previously eligible individuals. However, iDeCo enrollment growth rates vary among participant categories. Among nonworking spouses, few if any of whom earn enough income to benefit from iDeCo contributions' tax-deductibility, the enrollment rate is a mere 0.3%.

New enrollees are mostly in their 40s and 50s

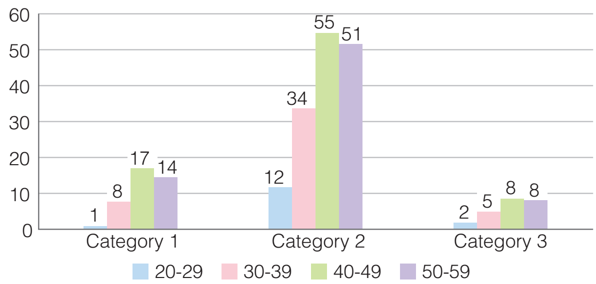
By age bracket, most of the individuals who opened iDeCo accounts in FY2016, when iDeCo enrollment started to grow sharply, were in their 40s or 50s. Exhibit 2 presents estimates of how many individuals out of every 10,000 eligible individuals in four age brackets actually opened iDeCo accounts in FY2016 based largely on National Pension Fund Association data. In Category 2, which includes company employees and public employees, the FY2016 new enrollment rate was almost as high in the 50-59 age bracket (51 per 10,000) as in the 40-49 age bracket (55 per 10,000). The same pattern was evident in Category 1 (self-employed, etc.) and Category 3 (nonworking spouses, etc.). New enrollment rates are much higher in the 40-49 and 50-59 age brackets than in the 20-29 and 30-39 age brackets across all three categories. Individuals who open iDeCo accounts in their 40s or 50s do not have much time before they reach the contribution age limit of 60 and are consequently hard-pressed to accumulate enough retirement savings. Perhaps for this reason, many people in these age brackets are making maximum or near-

Exhibit 1: iDeCo enrollment



Source: NRI, based on Ministry of Health Labor and Welfare and National Pension Fund Association data

Exhibit 2:
Estimate iDeCo new enrollment rates in FY2016 (new enrollees during year per 10,000 individuals eligible to enroll)



Note: New enrollees may include some who rolled over corporate DC plan accounts into iDeCo accounts.
Source: NRI estimates based on data from multiple sources

maximum iDeCo contributions to provide even a bit more retirement incomes for themselves. In category 2, the percentage of iDeCo participants making near-maximum monthly contributions in the ¥20,000-23,000 range is 40% in the 40-49 age bracket and 48% in the 50-59 age bracket[1]. In Category 3, the corresponding percentages are likewise high, with 82% of Category 3 participants in the 50-59 age bracket making near-maximum monthly contributions (¥20,000-23,000). These data imply that many individuals in their 40s and 50s who do not have much more time to save for retirement are flocking to iDeCo plans and hurriedly starting to contribute the maximum amount allowable.

NOTE

1) National Pension Funds Association data on iDeCo plans as of March 31, 2017.

iDeCo-specific issues that should be addressed

Corporate defined contribution plans' enrollment rate (ratio of corporate defined contribution plan participants to nationwide total number of company employees) does not differ much by age bracket because most companies uniformly enroll all of their employees. iDeCo enrollment rates, by contrast, differ substantially by age bracket. If such differences are a temporary phenomenon confined to iDeCo plans' mass-adoption phase, they need not be regarded as a problem. In actuality, however, they will likely persist because few people in their 20s and 30s have enough financial resources to commit to making iDeCo contributions. According to Japan's 2017 Family Income and Expenditure Survey data, households headed by individuals in their 30s, for example, have average financial asset holdings of ¥6.3 million but average liabilities, mainly in the form of a home mortgage, of ¥12.3 million. Large debts have been empirically proven to constrain individuals' saving behavior. Accordingly, as long as many younger adults continue to take out large home mortgages, mostly while in their 30s, iDeCo enrollment will likely remain low in younger age brackets. Educational activities to get young adults to realize the importance of opening an iDeCo account from a young age are of course important. Their effectiveness, however, is extremely limited. Therefore, a portion of participants who can actually save enough money to fund their retirements by the time they retire remains small even though iDeCo plans are designed to do so if they consistently contribute to an iDeCo account from a young age through age 60. To better enable people to avoid an underfunded retirement, iDeCo plans need to be redesigned on the assumption that most people will not open an iDeCo account until they reach their 40s or 50s to avoid an underfunded retirement. Needless to add, iDeCo plans, like their corporate counterparts, should allow participants to continue contributing beyond age 60. Additionally, the iDeCo contribution limit should be raised high enough to enable even individuals who enroll at a relatively late age to save enough money to adequately fund their retirements.

Although iDeCo plans differ entirely from corporate defined contribution plans in that participation is left to the discretion of eligible enrollees, they have hitherto been treated as subordinate to corporate plans in discussions of defined contribution pensions. However, rules that were set for corporate defined contribution plans may not be suitable for iDeCo plans. As iDeCo plans gain prominence, iDeCo-specific issues should be addressed.

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