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Lump-sum retirement benefits still constitute an important market

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With the number of new retirees set to decrease sharply going forward, financial institutions have ceased to show much interest in the lump-sum retirement benefit market. However, there are many regions in which total retirement benefit payouts will not decline much. It is still important for financial institutions to offer asset management services targeted at such retirement benefits. Financial institutions need to take a fresh look at retirees' asset management needs and develop new services to meet them.

Sharp falloff in new retirees

The postwar baby boomers' mass retirement from the labor force is fading into history. The number of new retirees is projected to decrease going forward. Exhibit 1 plots the number of Japanese turning 60, the retirement age in Japan, by year. It shows that the annual number of newly turned 60-year-olds will decline from its 2009 peak of 2.3 million to below 1.5 million in 2017 before leveling through 2025 at 1.4–1.5 million, a decrease of one-third from the years of the baby-boomer retirement wave.

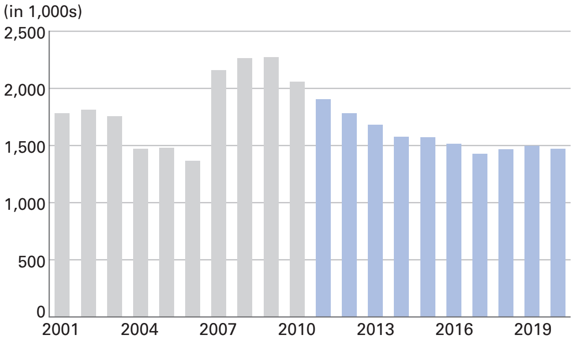
In addition to facing a sharp falloff in new retirees in coming years, investment trust companies, brokerages, banks, and other financial institutions have passively watched as new retirees deposited most of their retirement benefits into savings accounts, even during the baby boomers' mass exodus from the workforce. They were largely unsuccessful at inducing new retirees to invest their retirement benefits in investment trusts and other such investment products. They consequently have ceased to exhibit much interest in the lump-sum retirement benefit market.

Total retirement benefit payouts will not decrease sharply

The projected decrease in new retirees suggests that total retirement benefit payouts will likewise decrease, but the reality is a bit more complicated. The complicating factor is a divergence between the overall number of retiring employees and the number of retiring public employees, which is a disproportionate determinant of the total annual payout of retirement benefits.

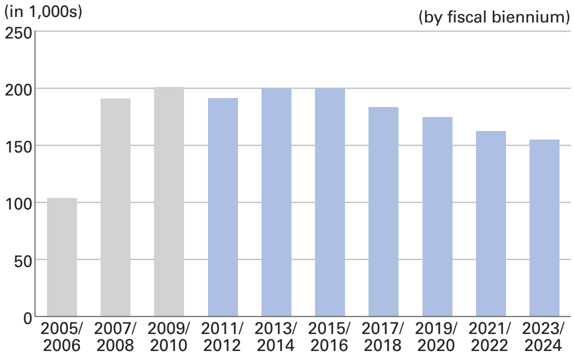
Exhibit 2 plots numbers of municipal public employees, which account for three-quarters of all public employees, turning age 60 on a biennial basis. It shows that retiring

Exhibit 1. Number of Japanese turning age 60 by year



Source: Population Projection for Japan: 2006 – 2055
(National Institute of Population and Social Security Research, December 2006)

Exhibit 2. Number of municipal public employees turning age 60



Source: NRI, based on mortality tables,
Municipal Public Employee Compensation Survey results dated April 1, 2005, etc.

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municipal public employees increased sharply from 2007 like their private-sector counterparts, but will not immediately decrease from 2010 onward. The number of retiring municipal public employees will remain for a while at about the same level as during the baby boomers' peak retirement years. This projected trend reflects that municipal governments heavily hired workers in post-baby-boom birth cohorts also. The total annual payout of retirement benefits to public employees is consequently unlikely to decline until around 2016.

Although public employees account for only 6.4% of Japan's employed labor force of 62.5 million, their retirement benefits account for about 30% of total annual retirement benefit payouts. According to statistics[1)], public employees' lump-sum retirement benefits account for ¥3.2 trillion of total retirement benefit income of approximately ¥11 trillion. Public employees' high level of total retirement benefits reflects several factors. First, their retirement benefits per worker are higher than private-sector employees'. Second, unlike private-sector employees, public employees received nearly all of their retirement benefits in the form of lump-sum payouts. Third, job turnover tends to be lower in public sector than in the private sector. Public employees therefore presumably accumulate more years of service on average than their private-sector counterparts.

Bolstered by public employees' retirement benefits, the annual nationwide total of retirement benefit payouts should stay at roughly 80% of its current level through fiscal 2016.

No decline in total retirement benefits in non-urban areas

Needless to add, the number of newly retiring workers will not decrease uniformly throughout Japan. The rate of decline will generally be lower in non-urban areas than in urban areas. Over the five years through 2015, the number of retiring workers will decline relative to the preceding 5-year period by some 20% in the Greater Tokyo, Greater Nagoya, and Kinki (Osaka-Kobe-Kyoto) regions but only 10% elsewhere[2)]. The rate of decline is particularly low in the Kyushu and Tohoku regions while the number of workers reaching retirement age will even increase in certain areas, including Kagoshima and Okinawa.

While the number of retiring municipal employees will not decline for a while as explained above, its trend also will vary by region. The number of retiring municipal employees will hold steady or even increase modestly in certain areas, not only in non-urban regions but within the three major metropolitan areas also. Namely, in Tokyo, Aichi, and their neighboring prefectures, retiring elementary and middle school teachers in particular will steadily increase over the next few years. This trend reflects that these prefectures' elementary and middle schools hired many teachers in the wake of the echo baby boom and mass migration to urban regions.

In sum, while the lump-sum retirement benefit market will shrink in Tokyo, Aichi, Osaka, and other urban areas, it will not contract much in many other regions relative to its size during years in which the baby boomers retired.

Rethink of asset management services for retirees is needed

What should banks, brokerages, and other financial institutions do in terms of asset management services to capture inflows from retirement benefit payouts that will remain at a high level for a number of years?

Since 2000, financial institutions have not rolled out any notable services targeted at pensioners' cash flow needs, other than investment trusts that periodically distribute income. If they candidly take a fresh look at retirees' asset management needs, they should be able to develop other new products and services that would gain widespread popularity. For example, one idea is to address the elderly's universal anxiety about outliving their savings. Although it is sensible for the elderly to invest as much as possible in life annuities to hedge against so-called longevity risk, life annuities are in fact unpopular. To overcome resistance to annuities, financial institutions could offer a product that combines a life annuity with a long deferment period and an investment trust with an automatic liquidation feature. The long deferment period would reduce annuity premiums. If the investment trust's

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assets are drawn down as they accrue investment returns, the product could be offered at a low price, provided that it does not offer a guaranteed rate of return. Another advantage is that the investment trust's target rate of return would be clearly defined, obviating any need to take excessive risks.

Since the baby boomers began to retire en masse, financial institutions have not been very successful at capturing inflows from lump-sum retirement benefits with their asset management services. While their lack of success is partly attributable to exogenous factors in the form of serial financial crises, another contributing factor is financial institutions' failure to seriously attempt to meet retirees' needs. In Japan, where societal aging is now in full swing, expectations placed on financial institutions' asset management services will only increase. Financial institution should rethink their asset management services for retirees.

Note

1) National Tax Agency statistics on income tax withholdings. –2009–

2) Population Projection by Prefecture (May 2007, National Institute of Population and Social Security Research).

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