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Retirement Plan Consulting Challenges in the Pacific Rim

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Summary: The economic, political, and social environment for retirement plans in the Pacific Rim differs from that in North America. This has led to different approaches to the problem of providing for a secure retirement. However, North American companies are branching out into the Pacific Rim and, similarly, Pacific Rim companies are moving into North America. North American actuaries are being asked more often to value, design, and otherwise comment on retirement plans in the Pacific Rim.

Mr. Yuan Chang: Asia is very big. The list of countries that actually belong to Asia includes Cyprus, Israel, Pakistan, Sri Lanka, and the United Arab Emirates. But today we're only talking about the Pacific Rim countries, which include China, Hong Kong, Indonesia, Japan, South Korea, Macao, Malaysia, the Philippines, Singapore, Taiwan, and Thailand. These, by the way, are not necessarily countries, to avoid any political problems, I'm going to speak of them as "regional entities."

There's a major crisis raging in these countries at the moment. I won't be saying much about the crisis, but there are two things I would like you to remember. One is that there is a distinct difference between a real economic crisis and a financial crisis. Bear in mind, though, that financial crisis can lead into a real economic crisis. Asia's major financial crisis has led every country into an economic problem in one way or another.

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I say this because all Asian countries are different. They're not one big glob, as we see in America. Asia is a large group of countries, and each one has a different structure. The reasons for their crises also are different, and, as a result, recovery will possibly take different routes and different amounts of time. I'm not prone to predictions, but we think in one year's time you're not going to see the bottom. You're probably going to see a very slow recovery in several countries, and perhaps the worst will be in Japan and Indonesia. Watch those two and you might develop a better feel for the entire Pacific Rim.

Throughout Asia, there are a number of countries that have fairly well-developed pension schemes in the public and private domain. We'll be focusing on Hong Kong, Indonesia, and Japan.

Before I go straight into the retirement plans, I should mention that the SOA now has an Asia Committee headquartered in Hong Kong. It is supposed to cover the Pacific Rim, although the initial concentration right now is in the greater China area—China, Hong Kong, and Taiwan—where the Society does have a large number of members. Hong Kong, for example, with about 185 members, has the most Fellows outside of the United States. Taiwan has the greatest number of members (207)—including all ASAs—outside of the United States. So the two comprise about two-thirds of SOA members in Asia. And we have a permanent staff member in Hong Kong. The function of that office is to support Society members in Asia and create influence for the SOA in the area, not so much in competition, but at least in cooperation with other international organizations or country-specific actuarial institutes and societies.

Our panelists for this session work in the location they're going to be speaking about, so they have a great deal of expertise. Jeff Newnam is the chief actuary and financial director for The Principal Financial Group Life and Pension Company in Jakarta, Indonesia. Before moving to the international department in 1994, he worked in pension, corporate tax, and individual.

The next speaker will be Tom Jaros, who is the chief actuary at Principal's International Asia, Ltd. in Hong Kong. For the last three-and-a-half years, Tom has been responsible for coordinating actuarial activities not only in Hong Kong but throughout the Southeastern Asia region for member companies of The Principal Financial Group. He is a member of the Actuarial Society of Hong Kong, where he's active on the Retirement Schemes Committee, and the Actuarial Society of India. Prior to moving to Hong Kong, Tom worked in various financial and valuation-related roles at Principal Mutual in Des Moines, Iowa.

Our third speaker, Les Lohmann of Lohmann International Associates, is the only fully qualified North American pension actuary in Japan. He has been providing retirement plan accounting, funding, and design advice in Tokyo since 1990. A frequent speaker at actuarial meetings, his monthly newsletter, *LIA Facts*, has been on the Internet for over a year. He's also a regular contributor to *Contingencies* magazine. His most recent article, "Far and Away: Consulting in Japan," will appear this summer.

I'd like to briefly mention what's going on in China because, in the next century, this will probably be the biggest market in the whole world. The trick, of course, is how to make it happen. It's just a matter of when, though, not of whether it will happen. The number of people are there; it's just a matter of making people into markets. China does not currently have a unified or any other kind of retirement scheme because, for the last 40 or 50 years, the state took care of everybody. The system is employer-based, but most employers, if not all, were state-owned, which meant that people were in the habit of being taken care of from cradle to grave. But that's changing, and it's changing very fast. State-owned employers no longer have the wherewithal to deal with retirement and, recognizing this, China's trying to unify its pension scheme.

Last year a new set of regulations came out on a unified pension law. Right now employees are required to contribute 4% and employer 20%. That sounds a bit strange, but most of that will probably be going to pay for those who are already in retirement or expected to be in retirement and have no time to accumulate. A portion of the employer contribution, I think it's 7% of the 20%, will be going into the individual's account along with the employee's 4%. And those numbers will start to shift annually upwards for the employee and downwards for the employer. Even though 24% may sound high for a basic package, it is estimated to be around a 55–60% replacement, but there has been no work that makes the actuarial linkage sound. In fact, I'm not sure that any actuarial linkage has been attempted. There are some efforts right now, particularly with Asia Development Bank's funding, to test out whether this whole scheme is going to work.

While it's called unified pension law, it allows a great deal of discretion on the part of the local government, the provincial municipalities, and certain companies, so they are very busy right now restructuring whatever they have into something that looks vaguely like the law. Normally, I would say that's a great area for a lot of consulting, but that isn't exactly being done either. First, a consultant represents a very high cost relative to what it is they're really dealing with. And, second, the Chinese are, for many different reasons, somewhat used to getting free consulting. Therefore, anyone who is interested in China may have to provide some consulting free before claiming that market. Let's move into Indonesia with Jeff Newnam.

Mr. Jeffrey Newnam: Indonesia's a relatively young pension market, with pension laws just being written within the last five years. A lot of work has gone into these laws and the results are mixed. I'm going to discuss what happened prior to the pension laws, the impact of the labor laws on benefit designs, the pension legislation, and the challenging aspect of selecting assumptions when you have no data.

Pension benefits are not a desired benefit in Indonesia at this time. People are more concerned about their income levels, and they would rather have cash as opposed to a pension benefit—a promise, as they see it, that may have little value in the future. Desired benefits for an employee might be a housing loan, medical benefits, or a company car.

The media used to establish pension plans are foundations. Foundations can be set up for a number of different purposes, one of which is to provide retirement benefits. They also are set up for religious purposes, educational plans, or any number of things, similar to what we use foundations for in the United States. These foundations were set up because there is no trust law in Indonesia. Because you cannot put assets in a trust, they set up a separate entity from an employer, a foundation, or, under the new pension law, a separate company to hold assets in trust. Group endowment plans, sold by insurance companies to cover all the employees, also are available.

Let me backtrack here for a minute. A lot of these plans were just promises to pay benefits. Funding was optional. They could be contributory, so, a company could withhold money from employees but not necessarily contribute it to the foundation. They might have just used it as a payroll holiday.

This was a dubious setup. The foundations were nontransparent in the accounting and recordkeeping areas. Even if money had been contributed, there may or may not be assets in these funds. The money could be used to pay people's salaries, to fund the business as working capital, or to line corrupt employees' pockets.

The group endowments were a step up, but these products had a lot of problems as well. Their defined benefit base, once again, may have been contributory, but the product lacked defined cash and surrender values. They had extremely high commission levels to the people selling the products, similar to individual products. Possibly 50% of the first-year contribution could be a commission. These lacked transparency as well. The insurers would not disclose plan assets or plan liabilities to the companies that bought them. If a plan was sold in the mid-1980s, today the company might not know the asset value. And, furthermore, there might not be any way to get the money. The money might not exist. If you're a third party who wants to provide a legitimate pension plan for these people, it's also very difficult to try to recover any of that cash.

Another item is informal plans. Each company is required to have an employment regulation outlining the terms and conditions of employment at that company. These cover working hours, working conditions, pay, and, if applicable, pension benefits. So it's also possible for a company to have a plan under its labor agreement, yet have no set up, organized plan. There are no independent unions in Indonesia to promote pension and welfare benefits for workers.

There is a social security setup in Indonesia, and quite a bit of money is being collected, but there's not a lot of confidence that this will provide any benefits for people in the future. It's used for a lot of political purposes, and, until recently, was controlled directly by President Suharto, who personally directed how some of the funds were going to be invested and used. This also was not a good situation.

The labor laws are quite interesting because that's really what defines pensions for a lot of people in Indonesia. These are primarily termination indemnities based on length of service. They're final salary plans—not a final *average* salary, but final salary. It is possible under the labor laws to force people to retire when they reached pension age, and, if this occurs, the employer has to pay a severance amount under the law. Most employees consider this to be their pension plan. It's a lump sum benefit, and typical retirement ages are 55–60, with 55 being most common.

However, the law, to a large extent, is ignored by employers. Anybody who is terminated for cause or without cause should receive this termination benefit, but a lot of employers don't pay it. Employees can go to the government and the Minister of Manpower to enforce the law. Unfortunately, when they do that, they involve a government official, and chances are, that government official is going to be holding out his hand. So part of what the company pays the employee will end up going to the official. Also, there's no protection for the workers if the employer becomes bankrupt. So it's a less-than-ideal situation.

If there's a qualified retirement plan offered by the employer, some of these benefits are reduced. A typical benefit design would be one month's salary for each year of service paid out as a lump sum defined benefit. This affects qualified designs in several ways. First, employees expect a lump sum upon retirement. But it also affects the way companies pay salaries. It's typical for a company to pay a base salary, plus several layers of allowances: a transportation allowance, a meal allowance, a lodging allowance, etc. It's typical to see these allowances exceed the base salary, which ultimately affects the pension benefit that's provided.

Also, in a lot of the legislation you see, laws are not coordinated. There are four different areas that deal with the pension laws: the manpower regulations, the tax regulations on pension distributions, and various insurance and pension laws. And there's a lot of conflict between all four of these areas, so you need to have a good understanding of all areas of the law. Fortunately, the laws, when you compare them to IRS regulations, are quite simple and straightforward.

The law is formed in three parts. You have the basic law established by the president. He presents the basic law to the House of Representatives. They cannot change the law, but they can interpret it, fill in some of the voids and details to give it a little more shape, and dictate areas where the appropriate minister can add further regulations. So you have law being the top level. You have regulations below that. These two pieces cannot change. But then down below that, you have the detail in the ministerial decrees dictated by the Finance Minister. Below the Finance Minister you have the heads of taxation, insurance, pensions, and banking. Those are the real areas that do the most detailed analysis of the laws and provide the most guidance in what needs to be done. So it's important to know that level when you're looking at the laws in Indonesia.

The pension funds are divided into two different types of funds: (1) employer pension funds, which are established by an individual employer and (2) financial institution pension funds, which are pooled instruments established by insurance companies and banks.

The employer funds can be defined benefit (DB) or defined contribution (DC). Primarily they're final salary plans. A typical formula might be one or two months' salary for each year of service, and employers are free to discriminate between different classes of employees. In Indonesia, you don't see top-heavy rules like 401(m) testing of benefits. So the benefits can be discriminatory based usually on service but sometimes on salary as well. Maximum benefits also are defined by the law. For DB plans, funding is done quite quickly compared with the United States. The initial unfunded plan can be funded over a 10-year period, and subsequent plan amendments can be made over a five-year period. I'm not sure what cost methods are acceptable.

Under the old methods, contributions to the plans were not tax deductible, except when the benefits were actually paid out. So employees could be contributing to a plan for a long time without realizing any tax benefits. With the new law, you get deductions every year based on the amount you contribute.

The old plans generally provided lump sum benefits, whereas the new law requires annuitization. There is a grandfathering of prior plans that will allow lump sums to be paid at certain points in time. For those of you who don't like dealing with *Financial Accounting Standard (FAS) No. 87* and *FAS No. 88*, the accounting standards in Indonesia are very basic. I don't think they even deal with pension plans, funded status, and all those lovely things. So from that standpoint, it's very easy on the sponsor.

I'm most familiar with the financial institution pension funds. We established one three years ago, and it was an interesting process getting everything approved through the government, which tends to move very slowly. The founding institution establishes the rules based on provisions in the law. These provide only DC benefits. Discrimination, once again, is allowed, and there's no testing to make sure that you're treating all the different employees fairly.

The maximum contributions are 20% of salary, or 12 million rupiah per year, which used to be quite a bit of money. Now it's not very much at all. No loans are allowed from these plans, but you can withdraw your contributions, and most of the different insurance companies and banks that have set this up have various limitations on how you can take the money out, such as a certain percentage of the contributions after a certain period of time. Generally, they don't allow you to take all of your money out.

There's very little flexibility allowed in setting up these plans because the regulations have been written tightly by the government. The government doesn't have the manpower necessary to do strict audits of the plans, so they wanted them to run on autopilot with a little bit of reporting. One of the interesting items is that you cannot differentiate on fees. You have to charge the same fee to an individual that you would charge to a group of 5,000 or 10,000 people, which makes it very interesting to be price competitive in certain markets.

The last item I'd like to talk about is the selection of actuarial assumptions. I find this a particularly difficult area, and basically use the "swag" method—<u>s</u>ome <u>w</u>ild <u>a</u>ctuarial <u>g</u>uess. There are very little data available. Most people do not use computer systems because computerization of the industry is just beginning. So we don't have any experience data to work with. In setting interest-rate assumptions, the longest term instrument you can find on a fixed income side is one year. In determining the pension interest rate, you're looking 30 or 40 years to the future, and it's interesting to see what people use. In published reports, I've seen anything from 5–15% being used. As a plan participant, I think I'd like to be in the plan that uses 5% to reassure myself that the funding levels are there.

Mortality's also a difficult assumption because group insurance mortality tables do not exist and you have to guess what the mortality levels will be. There is an individual table produced by the insurance industry, but it's flawed. It has data from, roughly, ages 20–55. The rest of the mortality experience is Japanese experience from the 1930s that they figured fit the 20–55 band. I've seen people using the 1949 annuity table, the 1951 group annuity table, and also the 1971 table. Lack of computerization will hinder developing a table in the future, and there's not enough experience.

Turnover varies by the type of employee that you're doing a valuation on. For unskilled employees, you might not have any turnover at all, but for the key management people, you'll see very high turnover because there are very few of these people and they're eagerly sought after by many companies.

Similar to interest rates, salary scale is also a difficult one to set because salary is tied to the economic growth rate and inflation. Inflation can be quite high; this year, the year-on-year inflation rate is about 50%. Over time, you know that salaries are going to catch up to that inflation rate, so it's difficult to set a long-term assumption for that. Also, an interesting cultural fact is that the concept of pay for performance does not exist there. So every employee of a company receives the same raise regardless of performance. This past year, a typical pay increase was 15%, which is low when you consider that the currency has devalued 80–90%.

Mr. Thomas A. Jaros: I'm going to give you some general information about Hong Kong, talk about the current situation and changes, and outline some specific challenges and opportunities for consulting actuaries. With 6 million people, Hong Kong is an extremely crowded place. Even though it is about 400 square miles, 80% of the land is too mountainous to live on, so it's very crowded, noisy, and everything that goes along with that. It's a very dynamic community. People love to make money and want to work hard. Because people are working all the time, you don't see too many outside hobbies in Hong Kong. Work, horse racing, and eating are the prime activities.

Hong Kong has a very high living standard. The salaries are similar to what you would find in the United States. People straight out of school don't make quite as much, but the professionals are making just as much as they do in the United States, if not more. It's nice to know because it allows you to make comparable assumptions, with some variations, and work with the comparable numbers.

Communications in Hong Kong is very informal, and there are few rules. You can read the insurance law in Hong Kong probably in four or five hours. The pension law's a little longer, but you could probably get up to speed on all the rules and regulations in a few weeks. However, it's not good enough just to look at the rules and regulations. Because they are so few and far between, a lot of them derive from informal communication. If you want to know the practice for doing something, you often have to ask actuaries in other companies or call the government. In Hong Kong, much of your information is gleaned through the grapevine.

Hong Kong is a special administrative region of the People's Republic of China. The rules are different for mainland China. Hong Kong is part of China now, but if you read the insurance law for China, it specifically excludes Hong Kong, Taiwan, and Macao.

English and Chinese are the official languages in Hong Kong, and both are used very heavily. There tends to be a preference for written English and spoken Cantonese. English is preferred for written documents because sounding out a Chinese character is essential to understanding the meaning, so technical language becomes very hard to work with in Chinese.

A qualified actuary in Hong Kong is a Fellow. If you are just an EA or an ASA, you're not qualified. You must have that fellowship status. However, you can be a Fellow of the SOA, the British Institute, or the Australian Institute. All three are acceptable in Hong Kong.

The "50% salary rule" applies in Hong Kong. If you're a fresh graduate from the university, your salary will be about 50% lower than you would earn in the United States. But if you're a Fellow with a few years' experience, your salary will be about 50% higher than you would earn in the United States. So they have a very steep salary scale and Fellows are very much sought after.

I'll try to stay away from too many statistics. General information can be found on two very good Web sites. The Hong Kong government is very good about publishing general population statistics, census statistics, and life tables on its site *www.info.gov.hk/*. And the Office of the Commissioner of the Insurance *www.oci.gov.hk/* has a lot of information on pension and insurance rules and regulations that you can download quickly and easily.

Hong Kong has 16,000 DC retirement plans with 600,000 scheme members and 500 DB plans with 300,000 scheme members. It's probably a very similar ratio here in the United States. Most of the plans are DC, but the big plans for the large companies have a lot of members, which accounts for two-thirds/one-third split. Pension schemes are voluntary at present but will become mandatory in about a year or so. And they're going to be private, so there's going to be a real opportunity.

Right now retirement plans are governed by the Occupational Retirement Schemes Ordinance (ORSO), which is detailed on the Web site. ORSO is part of the Insurance Authority in Hong Kong. We also have the Securities and Futures Commission, which is similar to the SEC in the United States. The Securities and Futures Commission looks at DC plans and, in particular, retirement schemes where you're using a pooling mechanism similar to a 401(k) plan. They look at all the advertising materials, complete plan descriptions, and anything that you send out to a customer. There's a lot more disclosure required in Hong Kong than in the United States for these sort of things, and it's spelled out with the Securities and Futures Commission's materials.

With respect to DB plans, the first thing that might strike you if you were to go to Hong Kong is that they're working with lump sum benefits, which are usually expressed as a multiple of monthly earnings. Lump sums are very popular because the benefit is tax free. If employees take it as an annuity, it's considered regular income and, therefore, taxable. But there are other reasons for their popularity, too. People like lump sums when the economy is uncertain. The ups and downs here in the United States are nothing compared with what's happened in Hong Kong. I did some background checks, and there have been four or five times since 1970 where the stock market has lost 80% of its value, though over that period, the average return has been higher for Hong Kong. But if you have a very volatile economy and high inflation at times, annuities might not be the best thing to have.

Valuations are required once every three years. That's been making a lot of the actuaries very nervous in Hong Kong because, if you're signing off on a three-year statement and have a heavy investment in equities, you're not sure that the assets will be sufficient to cover the liabilities.

Many funding methods are used, and they don't vary very much from country to country in Asia. The fact that the invested accrued benefit must be fully funded has caused a lot of problems recently, and I'll talk more about this later.

Hong Kong's investment philosophy sometimes appears to be shortsighted, but there might be reasons for that. One of the reasons is that you are working with lump sums at retirement, which gives you a shorter investment horizon. Another thing that comes into play is high turnover because employees get the lump sum benefit when they quit the job. So there's some logic to having a short-term strategy. Then again, you'll see some plans that are invested 80–90% in equities because salary inflation has been running at 10–12% in the last five to ten years. At the same time, you have interest rates very similar to those in the United States because the Hong Kong dollar's been pegged to the U.S. dollar. As a result, you have problems that happened last year.

The fully funded status rule poses problems for some people. Three years ago, Hong Kong instituted a rule that all plans had to be fully funded within three years. The government thought that meant you had to be fully funded, by Oct. 15, 1998, and stay fully funded. However, many of the actuaries thought it meant that whenever you had a deficiency, you had three years to fund it. Right now, the Actuarial Society of Hong Kong is talking with government officials trying to get some clarification on this, but there is a fear that the plans will have to stay fully funded at all times.

DC plans in Hong Kong are very similar to U.S. 401(k) plans, where you have employee and employer contributions. Typically, contributions are about 5% of salary, and the employer benefit generally increases with service. It's OK to discriminate in a lot of cases. The executives certainly have much bigger benefits than the lower-level employees, but you can't discriminate within a particular employee class. It's OK to give the janitors nothing and the senior executives 25% of salary. Vesting is common and, once again, related to the tax law; if you don't have vesting fast enough, then you won't get the tax deduction.

You generally have multiple fund options with DC plans. Some plans only have one, but that's changing. Guarantee products are very popular. The people in Hong Kong tend to be very conservative with their retirement savings and want a very hard guarantee. It's contrary to what you might have heard about Hong Kong people, but when it comes to saving for the future, they tend to be very safe. A hard 5% guarantee means that the account is credited with 5% interest per year, and possibly more, and that the account balance gets carried forward to the next year. I don't expect to see these plans last much longer because of the current interest rate environment, which is similar to that in the United States. A lot of companies lost money last year selling these types of plans.

Lump sum benefits are very common at termination, and there are very few investment restrictions right now. You can set up a United States equity fund or an Asia equity fund. With respect to tax rules, the marginal rate is 15%. If you want to avoid taxes, Hong Kong's a good place to be living. Investment income and capital gains aren't taxable. Employer contributions are tax deductible, but employee contributions are not. But there are real tax advantages for the employee in that the benefit, taken as a lump sum at retirement, is tax free.

Currently, there is no social security program. What's coming up is the Mandatory Provident Fund (MPF) law that requires everybody to set up a DC plan. You can set up an equivalent DB plan or, if you have a DB plan and it provides a certain minimum benefit, you're OK, too. The timetable for implementation has not been set yet, but my sources tell me it will probably be August or September. All the laws have been passed. It's just a matter of the authority sitting down and saying this is the date it's going to be.

A lot of new business is coming up in Hong Kong. It's estimated 250,000 new DC schemes will be set up with 2 million new members. That's about eight people per plan. Hong Kong is a country of small employers. My guess is that, on an annual basis, there will be $3 billion (and that's U.S. dollars) in new contributions—plus or minus 50%. I've heard estimates anywhere from $1.5 billion to $5 billion in contributions. We will find out in a year and a half.

The basic rules of the MPF is that the DC plan have a minimum 5% contribution from both the employee and employer, and it must be 100% vested and portable. Employees will be able to take their benefits from one employer to another. Preservation of benefits is a very important issue in Hong Kong. It used to be that when you quit your job, you got your benefit with no penalty whatsoever, but the MPF changes that. Employees won't get their benefits until age 60 for early retirement or 65 for normal retirement. Finally, companies will have to offer one or more fund choices.

For investments, the MPF stipulates a 30% effective Hong Kong currency content. The government wants people to invest in Hong Kong, but realizes that people might want to do otherwise. You can get away with a currency hedge. If you invest 100% of your money in U.S. equities, but purchase a currency hedge on 30% of it, that's good enough. The government feels that's all that's necessary to keep the Hong Kong dollar from becoming devalued.

There's a requirement for one type of guarantee fund. A provider has to offer a capital preservation fund that guarantees a payout at least equal to the savings account rate, which, in the last few years has been about 3.5–4%.

Designing guarantee products will be a big opportunity for the next few years. Right now, when employers start up their MPF plan, employees must be given a choice of whether to go into the MPF plan or stay in their current plan, so advising employers is going to be tricky from a consulting standpoint.

MPF plans pose some specific challenges and opportunities. One is going to be the integration of existing plans with MPF plans. How do you work with employers who want to keep their DB plans? At the same time, if one employee wants to go into a new DC plan, the employer has to let them. The fully funded status is another problem for consulting actuaries. How do you change your recommendations for contributions in funding with that type of requirement?

The use of equities after the Asian equity crisis will be a continual challenge. You certainly want to invest in equities for a DB plan, but doing so is going to raise some eyebrows. And development of guarantee products for DC plans is going to be a challenge.

The final consideration is pension education. The old joke in Hong Kong is that, contrary to popular belief, the Hong Kong investor is very long term—they often hold stocks up to six months. Getting people to look beyond just a few years at a time is going to be a continuing effort there.

Mr. Leslie John Lohmann: I do retirement plan consulting—design, funding, and accounting—and I do have the advantage of being the only person in Japan with this expertise. However, *FAS No. 87* doesn't require that expertise, and I'm not a qualified Japanese actuary, although I am a member of the Institute of Japan and a one-person shop.

I'm going to talk about Japan, in general its pay setup, and its retirement security, which I call the three-and-a-half-legged stool. I'm also going to talk about current issues and consulting generally.

Like Hong Kong, Japan is very crowded. Unlike Hong Kong, English is not an official language, but it is used for all international business. Transportation is terrible in Japan; 60 kilometers is about a two- or three-hour trip. And, of course, it is expensive, despite a 60% or 70% devaluation of the yen during the past three years, which is not quite as bad as Indonesia. Furthermore, Japan is in a recession right now, although a recession in Tokyo is very unlike a recession in Houston. Houston went from $3 billion of construction in 1983 to zero in 1984, but there are still a lot of construction cranes in Tokyo.

The country is very homogeneous. People have a very difficult time understanding anything which is not Japanese, and the companies are very employee-centric. They have very little regard for stockholders and very high regard for the managers and directors. Company relationships mean more than actual stockholder relationships, and this has influenced the design of pay and pension systems.

There are very few actuaries employed as independent consultants. Of those who are, most are either very old actuaries who retired from their companies and are now being used by foreign firms, or very young people who haven't finished their exams. To my knowledge, there is no Japanese independent consulting firm that is an actuarial firm. It is possible to qualify as a Fellow of the Institute of Actuaries of Japan without exams. This is not something that they publicize or mention when dealing with the SOA in trying to get cross-recognition of the statuses.

The Japanese have very different standards of practice. Within an insurance company, the actuary works for the marketers in the insurance company, not for the participants of retirement plans. This creates a great deal of trouble for an actuary's work load and his or her ability to make sure that the reserves are appropriate for the prices being charged.

A relatively new designation, the "certified pension actuary," developed in 1989 or 1990 does not require any additional examinations. It only requires some experience, and the responsibilities are quite limited. Certified pension actuaries only deal with employee pension funds (EPFs) and are the half leg in the three-and-a-half-legged stool. Private employer plans are not affected at all.

Pay in Japan is similar to that in Indonesia and Hong Kong. There is a base pay and some allowances. Japan, however, is also very big on the fixed bonus concept. Similar to the rest of Asia, very little pay is based on merit, and that's why the bonuses are generally fixed. The foreign firms working in Japan are trying to introduce the concept of merit-based bonuses, but they're not having a very big impact in that regard. The recession will probably have more influence as time goes on. Some of the allowances are taxable, and some are not. The base pay is the unit for most employee benefits, and it's typically less than two-thirds of total compensation because of the way the bonuses work.

The base pay is almost universally paid monthly and anchored to your pay when you join the firm. It is related to education and age because most people in Japan start right out of school, either high school or university or graduate school. Employees often are paid a full-time salary for going to graduate school. The more fortunate ones attend graduate school full time in the United States, receive full-time employee benefits while doing so, and then come back to the company several years later to begin working. They are hired out of university and go straight into their MBA as employees.

There can be a small service component to the base pay. Frequently that's handled through the allowance component, and especially as the foreign firms have more influence, it can be an arbitrary percentage of monthly gross. Many foreign firms are trying to bring in a nonbonus or merit-bonus system, and they need a base pay that is something less than the full compensation when the total compensation has been calculated based on the traditional bonus. At times, pension plans or the work rules define base pay differently for different classes of employees, thereby avoiding the requirement for nondiscrimination among classes of employees in Japan on retirement benefits. So the benefit will be directly related to the pay, but the pay itself is an arbitrary number.

The bonuses, usually about one-half of total base pay, are paid in two pieces, and very few benefits are related to the bonuses. Some unemployment and a bit of the health insurance may attract some premiums, but they're much lower than the base pay numbers.

Allowances attract no benefits, and they are varied and discriminatory. Those that are widely provided are transportation and some special allowances such as marriage, death situations, and catastrophic loss, such as your house burning down. These are usually not very significant amounts, however. The more discriminatory ones are the housing and cost of living adjustment (COLA) allowances. A person living and working in Tokyo for a large car company, for example, would have the same base pay as the company's head office employees in Nagoya, but would receive a very large COLA for living in Tokyo. The allowances also can be position related, with a big bias toward the upper managers.

The three-and-a-half-legged stool consists of private savings, employment-related arrangements, and government arrangements. In Japan, DC plans are not an effective vehicle for retirement savings at this time, but there are efforts under way to establish one similar to what is being used in the United States. The other is the EPF that I mentioned, a private arrangement in which companies are permitted to opt out or buy out of the pay-related portion of the government scheme. When they do that, they have to provide some additional benefits. Because they use open-group valuation techniques, the premiums tend to be lower than the government tax, but the funding is terrible. And it's not based on turnover, which, in the past, through a lifetime employment situation, had been quite reliable, but isn't any longer. We have had one EPF go insolvent in the past couple of years.

The environment that we find ourselves in is quite different from that of the United States. Retirement does not mean getting too old to work and then getting a benefit for the rest of your life. Any reason for leaving employment is considered retirement in Japan. It has to be included in the work rules established for any company with 10 employees or larger. Normal retirement age is a very different animal from the age limit. The age limit is the age at which the company can start to reduce your responsibilities and/or pay without your agreement. Very often, it's age 55, and sometimes it's age 50. The normal retirement age, which can be an imperative age, might be five or 10 years after that. Therefore, you find some strange situations in which a retirement plan will define the pay to be used as the pay at age 55, regardless of when the person leaves after that because, in all likelihood, that would be their highest pay.

Funding means all sources of funds. It is not merely external funding. So plans in Japan must be funded, and that includes balance sheet funding, which you can get a tax deduction for.

The environment is DB, and the normal form tends to be lump sum. As with Indonesia and Hong Kong, the tax benefits are significantly greater with a lump sum payment. Although it is taxed, it is taxed separately from other income. It's not taxed at your highest marginal rate, and only half of it is taxable at the present time.

The external funding rules are nonexistent. The way it works is that you buy an insurance product from an insurance company or a trust bank. They're trying to change some of the investment rules, but it tends to reflect the group annuity situation in the United States in the 1950s. The products are insurance company products that are sold for retirement plans. There is no private or individual annuity market.

Three things are more important than the funding of a plan for an employee to get their anticipated retirement benefits: the company must survive, the retirement plan must survive, and the person has to keep his or her job. If those three things don't persist, whether or not the money is there is immaterial. The way the Japanese plans have worked, especially with the internal funding, the balance sheet funding, is that they have supported those first three elements very much. As a result, there has been less apparent security of an accrued benefit, but fairly good security of anticipated benefits in the plans.

Fund management is changing. The insurance products are disappearing a bit, and we're moving toward asset diversification. The old rules are being thrown out as we speak, and there's an effort to get some genuine asset management, rather than the friends' and cohorts' approach to handling money. Japan is very much an aging society, and the accounting rules and deregulation are having an impact. We have a changing employment environment, where lifetime employment is probably going to disappear soon.

Consulting is very different in Japan. It's not understood. The typical consultant in Japan is a former executive of the company who is on a consulting contract, receives regular monthly pay, and is called on occasion as an advisor. The company sees that as free advice, and, thus, it's very hard for a fee-based consultant to be understood on all these issues. The insurance products and the cross-holding of companies is changing, and it is an area that's affecting our consulting.

Brokerages that sell products on a commission or soft dollar basis are much more readily received than are fee-based consultants. Therefore, a lot of consulting that looks like strategic or actuarial is advertised as "human resource" consulting, but you have to be careful because that has regulated prices within the statutory rules.

With respect to consulting cost effectiveness, we do have to educate our publics. As in Hong Kong, sponsor out-of-pocket can become ridiculous if we don't watch what we're doing, and we also have to help a lot in asset management.

Integrating retirement benefits with other benefits is becoming more important, and we, as outsiders, have to try to raise standards within the communities outside of North America that we're working in.

As with Indonesia and Hong Kong, our challenges are the actuarial assumptions, which are very much influenced by lower interest rates. We have a very narrow market, a different mortality to deal with, (whether or not it's better is arguable), severance and salary increases with lifetime employment (very low severance in the early years of employment, disappearing in the 40s age bracket, and not setting up again until the age limit), and socialized medical care, which influences the ability to provide companies with any products for health benefits.

We have lower interest rates and very low bond ratings. Moody's recently lowered the government's bonds. And there is no annuity market, as I mentioned earlier. Japanese mortality has improved considerably over time, and we need to recognize that going off to the future. However, in the assumptions that actuaries are using for retirement plans, we expect American workers to survive longer than Japanese workers.

In the early stages of employment, employees are given high raises because the plan is to underpay them until a certain age, then start paying them more when they get older, and eventually decrease their pay later on. You might consider this as being an employee equity curve. As employees are underpaid in the early years, they're making contributions to the equity of the company and then eventually leave the company. And they usually leave some money on the table.

We need to understand the age limit and what a tax-qualified pension plan is. A tax-qualified pension plan in Japan does not have any tax benefits. An EPF is a government-type plan run by companies. Book reserve plans are balance sheet plans that are tax qualified and preferred. The payments are paid out for a plan simply on the benefits, based on the employee's age. It's a static population, and the payments jump when people get older. Companies can actually make money for the first 10 years because of the tax benefits involved, and they get to keep the money. And that does not take into account the additional earnings on their own money.

Bankruptcy is a problem. In Japan, as in other countries, a book reserve plan does not provide much security in the event of company insolvency. However, the tax benefits are quite useful, and investments right now are quite torrid. We need to share our good ideas abroad, and we need to be aware of the good ideas that we find abroad. Americans tend to push their ideas onto others and miss out on the good ideas that are lying in the world beyond us.

We also face other challenges in Japan, such as social security totalization. These are the agreements between countries to get deductions for everyone. And we need to develop new employee benefits, such as expatriate packages, third country national packages, etc.

Mr. Chang: This overview has provided the flavor of the Pacific Rim markets with respect to culture and circumstances. Different designs and actuarial practices are in play, but one thing is sure: There is a growing market out there for North American actuaries.

From the Floor: I have a question for Jeff on Indonesia. You mentioned earlier that the pension law in Indonesia is fairly straightforward, but that there's some difficulty for conducting an actuarial valuation by selecting assumptions. What's the purpose for conducting an actuarial valuation if the regulations don't require it?

Mr. Newnam: Actuarial valuations are required every three years. I think in practice they do them every year. They do not legislate the assumptions, though, and the government publishes a nice book. They're very good with statistics and try to throw a lot of them at you. All of the DB plans have all of their assumptions listed by the government on a yearly basis. However, there needs to be more uniformity in the selection of assumptions. I don't know why one company considers a 6% interest rate reasonable and another actuary assumes 15% is reasonable. I'm not quite sure who's doing all of this work. I have some general feelings for who's doing some of it, but there's a wide range in the assumptions that are used.

From the Floor: What is the purpose of the valuation? Is it to determine the plan solvency, or the contribution limit, or what?

Mr. Newnam: The purpose is to determine funding levels.

Mr. Jaros: Let me just add a bit here. One of the things I've noticed in many companies in many countries is that the American companies and the large European firms want the valuations done. They want to know what their liability is and understand the finance information about their own companies. Then, the local firms follow suit. In Hong Kong, the people consider themselves a nation of followers in a lot of respects.

Mr. Lohmann: The United States accounting is having a very important effect in that it's influencing the international rules. Many companies want to be listed, so they're using *FAS No. 87*. *FAS No. 87* does not yet require the annual valuations, but I recommend them because things vary too much, and I'm not going to sign something that has not been done annually. If the client wants to use my report to develop its own interval numbers, that's fine. It doesn't have my name on it. But then the gain/loss is rather tough that third year.

Mr. Chang: We need to remember that actuaries are going to be doing things that may not be required by law at this moment. Perhaps they're trying to influence the different countries to see whether the certain standards are to be established. Indeed, if the standards out there are not up to par, shall we say, it puts a limit on the market for North American actuaries.

From the Floor: I have a question for Tom. Does the actuarial community think the MPF might force everybody to have a DC plan with this full funding requirement?

Mr. Jaros: Some people have hypothesized that that's the government's way of saying it just wants DC plans. The government has denied that. I think that the largest plans will continue to have DB plans, but they're going to be more top-up plans. While you have this base defined contribution, you'll see a hybrid plan come through where companies will take the benefit employees get from the DC plan and subtract it out of your DB benefit to figure out a total defined benefit. I think you'll continue to see that with the largest employers.

From the Floor: What is the attitude of the employers in Hong Kong and in Japan who have U.S. operations? Are they funding their U.S. employees through their own home plans or do they have to fund them through U.S. plans? What is their attitude?

Mr. Jaros: I'll go first in Hong Kong. Typically the ex-patriots stay under their plan in the United States. So in Hong Kong, out of 50 employees, we have three ex-patriots. Those remain under the U.S. plan, and that's very common. The other employees generally go with a local plan that suits the local market conditions.

Mr. Lohmann: I wasn't quite sure whether your question was about Japanese companies within the United States.

From the Floor: No, Japanese companies in Japan.

Mr. Lohmann: With United States employees?

From the Floor: Yes.

Mr. Lohmann: It's very similar to Hong Kong. Typically, supported expatriates are entirely on the U.S. package. And, if you recall the discrimination rules and such, that's quite important because often the Japanese subsidiary will fall into the control group and, thus, those employees need to be included. It can be an advantage in some ways because the expatriate's total compensation, counting their COLA and housing, can be quite high. If they weren't very highly paid in the United States, this can push down their percentages relative to the other highly paid employees, so it can produce a benefit.

However, Americans who are in Japan on their own who are hired as locals are not being tracked. The firms are probably breaking U.S. rules because they're not being included in any way in any of the calculations. However, it's a real challenge for anyone to find these people and show that anything was done incorrectly because they are showing up as Japanese employees paying Japanese taxes.

Mr. Chang: I think the question is about local companies that have U.S. employees and how the companies treat them, which is just the reverse of the answers.

Mr. Newnam: In Indonesia, there are quite a number of ex-patriot workers who are independent contractors. They're hired locally for a two- or three-year stint, and then they change companies, maybe even countries. They call themselves "investment advisors," and sell unit-linked products out of places such as the Isle of Man or Bermuda. These people usually have a very high net income, and their private money is going into these insured plans. A lot of it's being done informally on an individual basis.