Japan Update
Extension of Retirement Age

April 30, 2023

Many companies have been increasing, or considering whether to increase, their retirement age in recent years. This is partly driven by legislation in Japan aimed at countering the continuing reduction in the working population caused by low birth rates and an aging population. This article considers the key benefit design, financial, and general points for companies to consider in relation to their retirement benefit schemes when increasing their retirement age.

Background

The “Stabilization of Employment of Elderly Persons” Act (hereafter referred to as “the Act”) is legislation that was introduced to help secure employment opportunities for elderly people, and contains various measures pertaining to a company’s retirement age. Since its original implementation, the Act has been amended several times, and the latest version stipulates that employers must take measures to offer employment until at least the age of 65. This can be achieved either by abolishing the retirement age, raising it to at least 65, or by introducing a “continuous employment system”, which offers employment from the existing retirement age until age 65. In addition, the Act stipulates that companies should “make efforts” to help secure working opportunities until age 70.

In light of the Act and the decline in the working population, more and more companies have been increasing their retirement age in recent years. According to a survey carried out by the Ministry of Health, Labour and Welfare, the proportion of companies with a fixed retirement age of 65 or above increased significantly, from 14.5% to 24.5% over the period from 2012 to 2022. Going forwards, we may see further companies looking to increase their retirement age, as a result of factors such as further declines in the working population, and the increase in the retirement age for civil servants (a phased increase taking place from 2023 to 2031).

Review of retirement benefit scheme design

When increasing a company’s retirement age, it is sensible to review the wider retirement benefit scheme. As part of this, one of the most important considerations is the level of the retirement benefit offered.

In the hypothetical case of increasing the retirement age from 60 to 65, the following three patterns show the typical approaches that could be used (further details of these are shown in the graphs later in this note):

1) Maintain the current benefit level up to age 60, and continue to grant benefits at the same rate beyond age 60.

2) Maintain the current benefit level up to age 60, but do not grant any further benefits beyond age 60.

3) Maintain the same benefit level at retirement age, by reducing the benefit level up to age 60, and then continuing to grant benefits beyond age 60.

In the case of defined contribution (DC) plans, it's not legally possible to reduce the accumulated benefit amount, so generally pattern 1 or pattern 2 would need to be used.

When reviewing the design of a retirement benefit scheme, there can be financial implications for both the employer (cost of benefits granted) and employees (level of benefits received).

Under pattern 1, continuing to grant benefits beyond age 60 can lead to higher employee motivation, as their work after age 60 will be rewarded with higher retirement benefits. However, the cost of the benefits to the employer will usually increase, especially in the case of DC schemes and schemes where benefits are paid solely as lump sums on leaving the company. Alternatively, in the case of defined benefit (DB) schemes which pay a lifetime pension, the total amount of pension benefits paid may decrease (as the pension start date is five years later), leading to a lower cost for the employer.

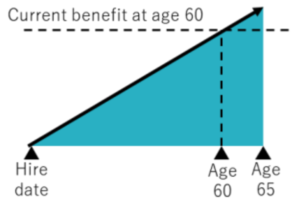
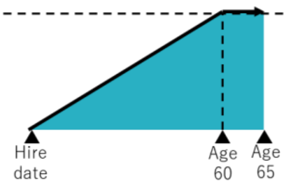
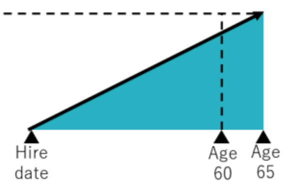
Under pattern 2, the cost to the employer is expected to be lower than pattern 1, as no further benefits are granted beyond age 60. However, there is a risk that employees' motivation could be reduced, as their work beyond age 60 would not be rewarded with higher retirement benefits. Additionally, in the case of allowing employees to be paid their retirement benefit at the original (lower) retirement age, care should be taken regarding the tax treatment (in particular, whether the beneficial retirement income tax deductible would apply or not).

Under pattern 3, the reduced benefit level can help lead to a lower expected cost, and employees will continue to accrue benefits beyond age 60. However, as the value of the benefits earned in each year will be lower, and the accumulated benefit level will be reduced at the plan change date, employee motivation could decrease. Additionally, pattern 3 is based on the premise of hiring employees until retirement age (a lifetime employment system), which may not be in line with modern careers and workstyles, which are becoming more diverse.

In addition to the benefit level, it may be necessary to review any age-related factors used in the retirement benefit scheme. A common example is the reduction factors used in the case of voluntary resignation for funded DB schemes and Retirement Allowance Plans (unfunded DB schemes). These factors often vary by age, and so companies may need to re-consider their appropriateness when extending the retirement age.

A further consideration is the consent requirements when making changes to a retirement scheme – trade unions or employee representatives must provide their approval. In particular, care should be taken for any funded DB schemes where benefits are being reduced, as consent to the reduction will be needed.

【Graph】Main patterns for reviewing benefit level when increasing retirement age from 60 to 65

	Pattern 1	Pattern 2	Pattern 3
Graphical image			
Retirement benefit	Increasing until age 65	Capped at age 60	Increasing until age 65
Level of retirement benefit at age 60	Same as current scheme	Same as current scheme	Lower than current scheme
Cost to employer ※	Generally increases	Generally unchanged or a decrease	Generally decreases
Employee motivation impact	From age 60: higher motivation Up to age 60: higher motivation	From age 60: lower motivation Up to age 60: same motivation	From age 60: higher motivation Up to age 60: lower motivation

※Depending on the design of the retirement benefit scheme, accounting standards and assumptions used, the actual cost impact can vary.

Financial impact on company

When increasing the retirement age, the financial impact on the company will depend on the type of retirement benefit scheme in place.

In the case of funded DB schemes and Retirement Allowance Plans, the change will impact the accounting costs of the scheme – in particular, the service cost (affecting the Profit and Loss) and defined benefit obligation (affecting the Balance Sheet). Increasing the retirement age can result in a lower service cost and defined benefit obligation due to the later timing of benefit payments. However, the precise impact resulting from the change in level of benefits (whether in line with pattern 1, 2 or 3) will depend on the design of the benefit scheme, accounting standards and assumptions used.

In addition, a past service cost (equivalent to the change in defined benefit obligation) may arise. The accounting treatment of any past service cost would depend on the accounting standards applied.

In the case of DC schemes, the retirement benefit cost is composed of the employer contributions to the scheme. Therefore, the impact on retirement benefit cost will depend on whether the employer chooses to continue to pay contributions beyond age 60 or not (i.e. whether pattern 1 or 2 is chosen).

Other impacts

When increasing the retirement age, the cashflow impact on the company will depend on the type of retirement benefit scheme in place. The contributions into funded DB schemes and DC schemes may change depending on the scheme design. For unfunded lump-sum Retirement Allowance Plans, increasing the retirement age may result in upcoming retirements being postponed, which may lead to a reduction in benefits paid in the years following the change.

In terms of tax, if employees accrue benefits for a longer period of time due to the extension of the retirement age (i.e. pattern 1 or 3), a higher tax deductible will result from the longer service period.

Key points

When reviewing retirement benefits as part of increasing the retirement age, it's important to balance the financial impact on the company (cost of benefits) and the employees (level of benefits received), and it's common to simulate the impact on the cost of benefits before undertaking any changes. In addition, it's advisable to consider not only the retirement benefits, but also implications for the wider working conditions and total compensation costs, including salary costs, welfare and other benefits.

Additionally, when undertaking an increase in the retirement age, communication with employees is extremely important. Providing a clear message on the background to the change and what employees can expect, rather than just stating the details, can help to improve employee engagement, retention and motivation.

Aon's services

In relation to increasing the retirement age, Aon can provide the following support:

- Review of retirement benefit scheme design
- Simulation of impact on accounting costs
- Review of wider benefit policies including welfare and protection benefits
- Employee communication support when undertaking changes in retirement benefit schemes and wider benefit policies.

Contact information

Fumichika Harasaki
Senior Consultant
Aon
+81 (3) 4589 4316
fumichika.harasaki@aon.com

Tom Ogier
Consultant
Aon
+81 (3) 4589 4329
tom.ogier@aon.com

About Aon

Aon plc (NYSE: AON) exists to shape decisions for the better — to protect and enrich the lives of people around the world. Our colleagues provide our clients in over 120 countries and sovereignties with advice and solutions that give them the clarity and confidence to make better decisions to protect and grow their business.