Japan Update
Reduced Interest on General Account

May 31, 2021

Reduction of expected interest rate of Dai-Ichi Life Insurance

Last year, Dai-Ichi Life Insurance (Dai-Ichi) announced that it will reduce the expected return (guaranteed return) on its general account product from 1.25% to 0.25%, effective as of October 2021. To summarize:

- Interest rate of the general account product provided by Dai-ichi, including existing products, will be reduced to 0.25% from October 1, 2021.
- The previous reduction dates back to 2002, so this will be the first interest reduction in about 20 years.
- Underwriting of new general accounts, which is currently suspended, will resume after interest reduction
- Commission rate after the interest reduction will be 0.15%
- Offering of “Floor Set Plans” (estimated yield of 1.25%) as alternative products will start

Background and impact on corporate DB pensions

General account products provided by each life insurance company maintained a uniform interest rate of 1.25%. As bond yields continued to decline in recent years, it became more and more difficult to maintain the same level of guaranteed interest on general account products. Since each life insurance company has practically stopped underwriting new general accounts, it can be seen that it is becoming difficult to maintain general accounts at the current guaranteed interest rate. Reflecting this is also the fact that life insurance companies stopped underwriting new general account products.

From the perspective of the Defined Benefit (DB) Corporate Pensions, these products with a yield of 1.25% and virtually no risk were indispensable for constructing a portfolio of pension assets to secure stable returns while limiting risk. With the reduced interest however, companies that used to utilize these products may need to look at their pension asset portfolio and make changes to their allocation.

Correspondence of DB corporate pension

Currently (as of the end of May 2021), insurance companies other than Dai-ichi Life have not announced similar interest rate cuts, there is no immediate impact for companies that have introduced general account products from life insurers other than Dai-ichi Life. It is important to note however that other insurers may follow Dai-ichi Life’s example.

The DB pension plans, that introduced general account products of Dai-ichi Life in their asset portfolio need to consider the following measures by October 2021.

If the asset structure is not changed, the lower interest rate of the general account products will lower the expected return of the entire portfolio, therefore lowering the interest rate set for the DB plan. A reduction is this rate will lead to an increase in the DB contributions payable to the pension assets. In addition, it will lead to a decrease in the expected rate of return on used for the accounting valuation of the plan, which may increase retirement benefit costs the company needs to book.

If the company intend to maintain the current expected interest rate, asset structure should be reviewed and changed. It should also be noted that it will take a considerable amount of time and cost to restructure pension asset mixes after implementing ALM or a similar approach.

Alternative product

Dai-ichi Life announced the launch a new product called "Floor Set Plans" in parallel with the reduction in interest rates on general accounts. The Floor Set Plans has the same expected yield of 1.25% as general account and has the characteristic of suppressing downside risk.

Due to this characteristic, the risk of loss of principal is quite limited, but it's important to note that, unlike for general accounts, there is a risk of price fluctuation. The product itself is a complex design that combines general accounts and options, making it difficult for corporate pension managers and other stakeholders to understand.

Simply replacing the general account with a Floor Set Plan seems to be the easiest approach when reviewing the pension asset portfolio. In this case, the expected return on investment can be maintained, but the risk of the portfolio will be higher.

In addition, it may be necessary for companies to consider re-establishing a new, optimal pension asset portfolio after considering the reduced interest general account and the floor set plan as options.

Pension asset Portfolio review

While the reduction in interest rate on Dai-ichi Life's general accounts can be thought of as a direct change to a single product, we believe the background is that bond interest rates have continued to decline worldwide in recent years.

It is quite possible that insurance companies other than Dai-ichi Life will follow this initiative. We also believe that from a broader perspective, it is time to optimize the pension asset portfolios, given that bond interest rates themselves are declining.

Japanese domestic bonds have been stable and very low for the past few years, and foreign bonds have also fallen sharply since last year, resulting in declining the expected returns.

It should be noted that based on the variables used to achieve the expected return by DB corporate pensions, there is a possibility that the new optimal portfolio will differ significantly from the current portfolio.

Services offered by Aon

When reviewing the pension asset portfolio, an often-used approach is to implement pension ALM and create policy asset mixes. The review of policy asset mix involves the review of investment policy. The process of obtaining approval for changes to DB corporate pensions from parent company is often complicated and time-consuming. In relation to the above, Aon can provide the following services.

- Implementing pension ALM
- Reviewing investment principle
- Pension committee management support

Contact Information

Kaiei Kin
Senior Consultant
Aon
+81 (3) 4589 4320
kaiei.kin@aon.com

Denes Nagy-Varga
Consultant
Aon
+81 (3) 4589 4331
denes.nagy-varga@aon.com

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