

The point of concern about the implementation of Liability-Driven Investment (LDI) in a pension plan in Japan

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Abstract

The immediate recognition on balance sheet is examined on International Financial Reporting Standards (IFRSs). If it takes place, many companies would like to reduce volatility of funding status in pension plan. Therefore there is a possibility that Liability-Driven Investment (LDI, the invested method to decrease the volatility of the difference (surplus) between the pension asset and the liability on accounting) would become one of the attractive alternatives of the pension investment strategy.

Although examples of application of LDI in frozen pension plans in the United Kingdom and the United States are reported, LDI looks uncommon in Japan. The typical reasons are that there are few frozen pension plans, the period of the liability on pension plans is too long to set the bonds corresponding to their period, the current interest rate is too low and the further bond investment does not look like a wise strategy, etc.

If we would implement LDI in an active pension plan, the future accruals might complicate it. In this paper, I discuss the asset allocation method which allows an active pension plan to carry out LDI.

In Japanese GAAP(JGAAP), a single interest rate corresponding to the average remaining benefit period of the pension plan must be used as the discount rate for measuring DBO (Defined Benefit Obligation) other than using the term structure of interest rate, so-called yield curve. The term structure of interest rate is to be considered principally in IAS19, where DBO fits for the bond much better than the single interest rate. As an adoption of IFRSs is anticipated in JGAAP, I discuss DBO measured with yield curve in this paper.