

Securing Lifelong Retirement Income: Global Annuity Markets and Policy

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Chapter 9

Annuity Markets in Japan

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In Japan, some retirees are fortunate enough to receive generous occupational pensions from their former employers, but the number of such people is relatively small and most must save to pay for life in retirement.¹ Financial institutions provide vehicles to facilitate them to do so, including bank saving deposits, life annuities, life insurance, equities, bonds, and others. Nevertheless, the Japanese Survey on Life Insurance conducted by the Life Insurance Culture Centre (2009) shows that more than 40 percent of people surveyed consider bank deposits as the most reliable saving vehicle, while 16 percent considered annuities as a reliable vehicle; also 30 percent of respondents believed there was no reliable vehicle. In short, annuity products are not especially popular among Japanese as a way to provide retirement income.

In this chapter, we first describe the framework for income security in retirement in Japan, including financial vehicles available to individuals. Next, we discuss attitudes toward these financial products and show that annuities are not especially popular in Japan. Finally, we explore possible causes for the unpopularity of annuity products, including tax policy that seems inequitable to those who work for enterprises without corporate pensions or with those receiving low benefit levels.

The Japanese retirement income security system

To understand the roles played by annuity products offered by life insurance companies or cooperatives in Japan, it is useful to understand the Japanese retirement income security system (see Figure 9.1). A basic level of benefit is provided by social insurance schemes. For instance, all residents are compulsorily covered by the Japanese National Pension (NP) scheme that provides flat-rate benefits called ‘basic pensions’. Those covered by the NP scheme are classified into three categories, including (a) workers aged 20–59 who are self-employed, farmers, fishermen, unemployed, or students, as well as their spouses who work with them or do not

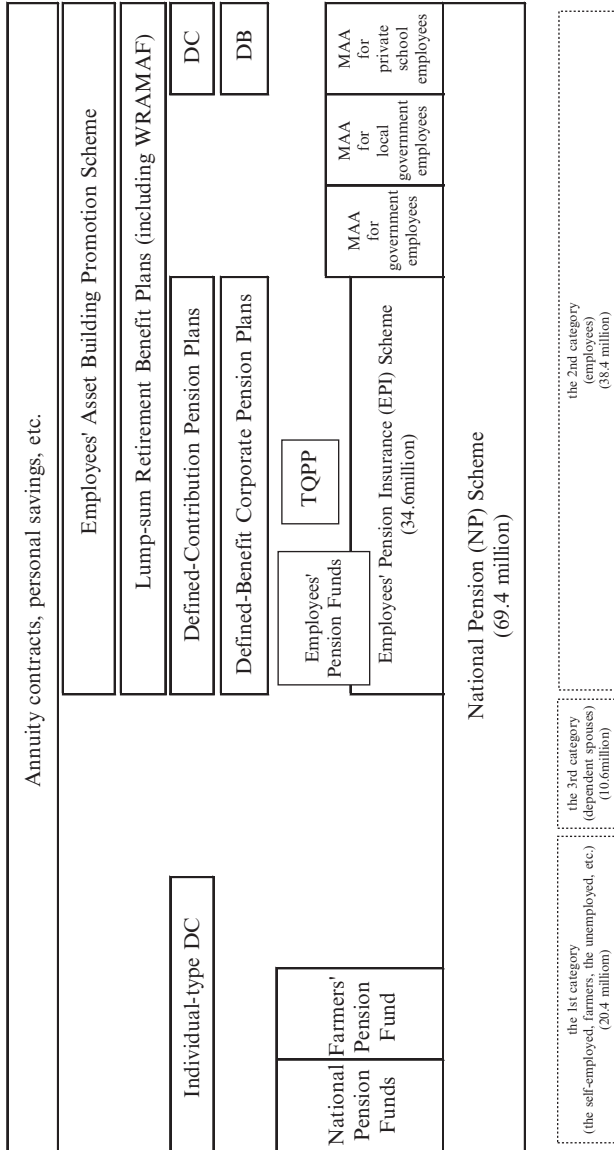


Figure 9.1 Framework of the retirement income security system in Japan *Notes:* The figures indicate the number of active participants as of the end of March 2008. MAA, Mutual Aid Association; TQPP, Tax-Qualified Pension Plans, to be abolished at the end of March 2012; WRAMAF, Workers' Retirement Allowance Mutual Aid Fund; DC, Defined Contribution Pension Plans; and DB, Defined Benefit Corporate Pension Plans. *Source:* Author's calculation; see text.

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work for pay; (b) a second category consisting of both private and public employees; and (c) a third category which includes the dependent spouses aged 20–59 of employees in the second category. This last group is mainly dependent housewives who can receive the flat-rate basic pension without paying contributions into the NP scheme.² All employees are also compulsorily covered by one of the employee pension schemes³ that provide earnings-related benefits.⁴ So, a married retiree couple can receive two basic pensions and one or two earnings-related pensions if they have careers as employees. If they have been self-employed throughout their career, they have two basic pensions. The monthly basic pension amount in the case of forty years of coverage is about JPY 66,000 (US \$730, Euro 530)⁵ in FY2010.⁶ On the other hand, the earnings-related pensions will, roughly speaking, eventually be about 20 percent⁷ of the career average of indexed (or ‘revalued’)⁸ annual pensionable remunerations in the case of forty-year coverage.

On top of this base are complementary pension plans, of two types: employment-based plans and other plans for individuals. There are four employment-based plans including the Employees’ Pension Funds (EPF), the Defined Benefit Corporate Pension Plans (DB), the Corporate-type Defined Contribution Pension Plans (DC), and the Lump-Sum Retirement Benefit (LSRB) Plans.⁹ The EPF plans are defined benefit plans but substitute a portion of the old-age EPI (Employees’ Pension Insurance) benefits; they normally cover employees satisfying a certain set of conditions prescribed in the plan statute, and there is no room for individual employees to decide whether to opt in or out. There are three types of complementary pension plans for individuals, where the first category includes four schemes established by law: the National Pension Funds (NPFs), the Farmers’ Pension Fund (FPF), the Individual-type DC, and the Employees’ Asset Building Promotion Scheme (Government of Japan 2009; we say more on these below). A second group includes annuity products offered by life insurance companies, agricultural cooperatives, and mutual cooperatives. The third group includes bank deposits and similar vehicles by securities companies.

One may argue that bank deposits are not annuities and hence not a form of complementary pension plan. Yet, it is very difficult to tell the difference from the perspective of retired persons’ economic life between drawing money regularly out of a bank account versus receiving annuities from an annuity-certain contract. Both of them make complementary income for the retired people to enrich their retirement life. Consequently, this chapter focuses on complementary pension plans offered to individuals.

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Complementary pension plans for individuals

Delving into more detail into the four statutory schemes mentioned above, the NPF system is for the people in the first category of the NP scheme. Introduced in 1991, the system is not compulsory and people may join the fund on a voluntary basis. Two kinds of NPF funds are available, the regional type and the occupational type. Each one of the forty-seven Japanese prefectures has one regional-type NPF fund. Other than these, there are also twenty-five occupational-type NPF funds such as the fund for medical practitioners, for lawyers, etc. The NPF funds offer life annuities and annuities-certain, where participants can choose one of them or combine them. It is generally argued that the first layer should be a life annuity; if a participant chooses several of them, the sum of the annuity amount from the life annuities should exceed the sum of the annuity amount of an annuity-certain payout. The upper ceiling of the total amount of premiums is JPY 68,000 per month (approximately US \$756 or EUR 548). This ceiling only applies to an individual; if a couple participates in the NPF fund, each of them can pay premiums up to JPY 68,000. However, if the participant also participates in the FPF or in the Individual-type DC, then contributions to these plans are also counted and the ceiling of the premiums for the NPF fund is lowered accordingly (Farmers' Pension Fund 2009*a*). The premiums are tax-deductible.

Although the NPF funds provide a fairly generous premium ceiling, the number of participants in these funds is limited. As of end-March 2009, the number of participants was only 610,000, or 3 percent of the people in the first NP category. The number of pensioners was about 244,000. The size of the reserve fund was about JPY 2.2 trillion, that is, about US \$24 billion or EUR 17.5 billion. The FPF is a defined contribution pension for farmers where the reserve fund is collectively invested and managed. Each participant pays contributions of no less than JPY 20,000 and no more than JPY 67,000, per month. The number of participants is also small, at end-March 2009 being only 57,000 in total, and the reserve fund stood at JPY 110 billion (Farmers' Pension Fund 2009*b*). The FPF was introduced in 1971 and started as a defined benefit plan. Yet, as the number of farmers decreased rapidly, its financial conditions worsened and eventually it changed into a defined contribution plan in 2003. It began registering its first defined-contribution participants in April 2004.

The Individual-type DC was implemented in 2002 and its implementation is delegated to the National Pension Fund Association (2009). Anyone in the first category of the NP scheme or any employee except for those covered by either an EPF plan, or a DB, a Corporate-type DC, or a Tax-Qualified Pension Plans (TQPP), can join the Individual-type DC on a voluntary basis. The participants in the first category of the NP scheme can contribute

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up to JPY 68,000 per month, while employee participants can contribute up to JPY 23,000 per month.¹⁰ If a participant in the Individual-type DC is also a participant in the NPF fund or in the FPF fund, the contribution ceiling is lowered by the contribution amount to these schemes. As of end-March 2009, there were 101,000 participants in the Individual-type DC, out of which 39,000 participants were in the first category of the NP scheme and 62,000 were employees. The number is still very small. The share of the participants in the first category of the NP scheme is about 0.2 percent and that of the employee participants in the EPI scheme is about 0.2 percent.

The Employees' Asset Building Promotion Scheme is a saving promotion program operated in cooperation with employers and the government. It tends to be introduced in enterprises at the initiative of the employer, and employees join it on a voluntary basis. There are three options in the scheme: the first is an ordinary saving course wherein employees contract with banking corporations and accumulate a fixed amount of money in the account every month. There is no tax advantage for this, but since employers deduct the fixed amount from the salary and hand it over to the bank directly, it seems a more certain way to build up. The second option involves a contract with life insurance companies or banks; the employer then deducts a fixed amount of salary and hands it over to the life insurance firm or bank. This option provides some tax advantages on the interest, but if one terminates the contract before the retirement age, one must pay some penalty (the tax advantage is explained below with the third option). If the provider is a life insurer, the worker may have a life annuity contract, but if the provider is a bank, only an annuity-certain contract is feasible. The third option is a dedicated saving account for housing, and if one terminates the contract for the purpose other than obtaining a house to live in, a penalty is then incurred. The tax advantage for the second and the third options is that interest is not taxed as long as the sum of the principal and interest does not exceed JPY 5.5 million (about US \$61,000 or EUR 44,000) when the contract is with a financial institution other than an insurer, or as long as the principal is no more than JPY 3,850,000 (about US \$42,800 or EUR 31,000) if the contract is with an insurance company.

The Employees' Asset Building Promotion Scheme was introduced in 1971, and as of March 2009, there were 6.7 million contracts for the first option, 2.2 million contracts for the second option, and 1.1 million contracts for the third option (corresponding assets were JPY 10.4 trillion, JPY 3.9 trillion, and JPY 2.7 trillion, respectively). Since annuity contracts are part of the second option,¹¹ there are not so many annuity contracts in this program, either.

A second group of complementary pension plans for individuals involves annuity products offered by life insurance companies,¹² agricultural coop-

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eratives, and mutual cooperatives. Unfortunately, there are no statistics on how many people have annuity contracts with those financial institutions or what average benefit levels are. Nevertheless, the Life Insurance Culture Centre (2009) conducted a survey on household relationships with life insurers in Spring 2009 and obtained 4,054 responses from households with at least two members. To summarize survey results related to annuity contracts, we first see that 23 percent of the households had annuity contracts with life insurance companies, agricultural cooperatives, or mutual cooperatives; there, the average annual amount of the annuities was JPY 1,119,000 (US \$12,400, EUR 9,000). These annuity contracts partly duplicate the tallies for annuity contracts under the Employees' Asset Building Promotion Scheme. But here, the majority are annuities-certain and life annuities make up only 17 percent of the whole. The distribution of how long the annuity payments last is provided in Table 9.1. Table 9.2 shows the distribution of the ages when the annuity begins to be paid.

The survey also looked into the types of financial vehicles on which people rely for retirement life, and the results appear in Table 9.3. The most popular vehicle is bank deposits and similar products, in that over 40 percent of the households surveyed relied on them. The next most popular was life insurance, with 23 percent of the households holding these. The third was annuity products, held by 16.3 percent, much less than bank deposits. Also, about 30 percent of the households stated that there is no reliable financial vehicle for retirement living.

Other statistics also show that annuity products are not popular among the Japanese. For instance, the Life Insurance Association of Japan publishes annual statistics on the number of contracts by type of insurance, and in March 2009, the forty-five life insurance companies¹³ that were members of the Association had about 17.4 million annuity contracts¹⁴ worth a total

TABLE 9.1 Duration of annuity payments in Japan

Duration of annuity payment	Household heads having such contracts as percentage of households surveyed (%)
5 years	9.6
10 years	38.6
15 years	7.6
Lifetime	16.5
Other	2.1
Unclear	29.2

Note: If a household head has two or more annuity contracts, each of his/her contracts is counted.

Source: Author's calculations based on Life Insurance Association of Japan (2009); see text.

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TABLE 9.2 Age at which annuity payments start in Japan

Age when annuity payments start	Household head having such contracts as percentage of households surveyed (%)
Younger than 60	5.6
60	30.5
61–64	5.3
65	25.8
66–69	3.0
70 or older	7.6
Unclear	26.7

Note: If a household head has two or more annuity contracts, each of his/her contracts is counted.

Source: Author’s calculations based on Life Insurance Association of Japan (2009); see text.

TABLE 9.3 Reliable financial vehicles to save for retirement

Financial vehicles	Households that answered ‘yes’ to this financial vehicle as percentage of households surveyed (%)
Deposits in banks or trusts	41.7
Life insurance	23.1
Annuity	16.3
Real estate	15.9
Securities	9.4
Employees’ Asset Building Promotion Scheme	5.2
Casualty insurance	3.1
Others	1.4
No reliable vehicle	30.3
Unclear	6.5

Note: If a household head has two or more annuity contracts, each of his/her contracts is counted.

Source: Author’s calculations based on Life Insurance Association of Japan (2009); see text.

of JPY 89.3 trillion (US \$1.0 trillion, EUR 720 billion). Here the amount of the contract refers to the present value of the annuity from its payment start date (if not yet in payment status), and the present value of remaining payments in payout. In Japan, many households have multiple annuity contracts, so the number of households with annuity contracts is much

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smaller than 17.4 million (Life Insurance Association of Japan 2009). The National Institute of Population and Social Security Research (2009) estimated that the total number of households was about 50 million, confirming that annuity contracts are not widespread in Japan.

The third group of complementary pensions for individuals consists principally of bank deposits and financial vehicles offered by securities companies. On average, people surveyed by the National Survey of Family Income and Expenditure of 2004¹⁵ had bank deposits and other financial vehicles worth JPY 13,591,000 (US \$151,000 or EUR 110,000), and securities averaging JPY 2,980,000 (US \$33,000 or EUR 24,000). This shows that bank deposits are very popular among Japanese. Relatively few rely entirely on own saving for retirement income, since only about 6 percent relied entirely on private pensions in 2005 (Government of Japan 2005).¹⁶ Instead, most people rely mainly on social security benefits; their annual income is JPY 4,139,000 (US \$46,000 or EUR 33,000) and the average social security benefit is JPY 3,120,000 (US \$35,000 or EUR 25,000) or about three-quarters. The share of the benefits from private pensions was about 6 percent.

Why annuity products are unpopular in Japan

The private annuity market is very small in most countries, with few exceptions (Mackenzie 2006), and Japan is not one of them. Nevertheless, it is difficult to identify the exact causes for their unpopularity. One reason might be that people perceive that commissions on the annuity products are expensive. While people may not know insurance mathematics, they can add up the premiums they pay and the sum of the annuity benefits they expect to receive. They may also believe that bank deposits are free of commissions, despite the fact that the interest paid is very low.

Another reason is that Japanese people tend to be disinterested in life annuities, a trait observed in pension plan designs and member behaviors in occupational pension plans as well. Many DB plans only offer term-certain annuities, and even when a plan does offer a life annuity, there is always a provision that allows members to convert it into a lump-sum benefit. In the latter case, most members choose the lump-sum. We also observe that life insurance companies and cooperatives do not seem active in promoting the sales of life annuities, perhaps seeking to avoid longevity risk.

An additional explanation for the peoples' reluctance to purchase annuities is that some may want to keep money on hand to deal with catastrophically expensive events such as hospitalization or unemployment, or home repairs. Bank deposits are more liquid for this purpose than annuity

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contracts. Also, banks in Japan are seen as more reliable than life insurance companies or cooperatives, particularly since in some instances, life insurance companies have declared bankruptcy and annuitants suffered large losses. People might also believe that the government would give bailouts to banks if they got into difficulty.

A final reason people do not favor lifetime annuities is that the tax system does not encourage them. Although individual tax advantages exist for some retirement income programs, there is no comprehensive tax treatment for such financial vehicles. For example, if a person took out an annuity contract with a life insurance company or cooperative, the annual premiums paid are only tax-deductible up to the low ceiling of JPY 50,000 (US \$556 or EUR 400), and benefits received are taxed. Another example is that there is no tax advantage for bank deposits even if one put money in them for retirement purposes. Thus, the current tax system is indifferent to individual efforts to accumulate assets for retirement security.

While these factors surely contribute to the unpopularity of annuity products in Japan, it might be the case that some defined contribution plan participants may seek to convert these assets into annuity contracts at retirement in the future. But currently, few people do so, suggesting that it is unlikely that the number of annuity contracts will grow rapidly in the future.

Taxation issues

Whether the market for annuities grows in Japan will depend on the tax system. While occupational pension plans enjoy tax advantages, these plans are prevalent. But there are no or small tax advantages for individual efforts for income security, outside the NPF, the FPF, the Individual-type DC, and the Employees' Asset Building Promotion Scheme. There is no tax incentive to encourage those people whose firms offer no occupational pension plans or have occupational pension plans which pay low benefit levels, to accumulate retirement assets for themselves. One reason this may be true is that there is no way to verify that the tax advantages are used properly. Of course, this is a big disadvantage for employees without employment-based complementary pension plans or with low levels of employment-based complementary pension plans. Accordingly, the current inequitable tax treatment deserves another look.

A more equitable opportunity to save for retirement would allow a uniform ceiling for tax-deductible contributions, including contributions by employers to the employment-based complementary pension plans, and statutory complementary pension contributions for individuals. Interest on these contributions could also be tax-deductible. In this sense, the reform would follow the logic of an Individual Retirement Account (IRA) and

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would include a comprehensive and consistent tax treatment for complementary pensions as a whole.

Some technical difficulties might result including the need to gather information on pension contributions and earnings; perhaps it would be necessary to introduce a tax-filing number to track these. Another issue would be how to treat lump-sum contributions to the complementary pension plans for individuals. Many people save most of their lump-sum retirement payments for retirement when they retire from their companies. It would be sensible to impose a similar tax treatment for such lump-sum payments as for monthly contributions.

Finally, it would be useful to review existing tax treatments for the variety of old-age schemes already in place in Japan. For example, employee contributions to the EPF and NPF are tax-deductible,¹⁷ while employee contributions to DB are not.¹⁸ This sort of irregularity can be corrected and made consistent with other tax-favored retirement programs, to make it easier to meet income needs in retirement.

Conclusion

Annuities have not been popular in Japan as a means to finance retirement. And when annuities are found, they tend not to be life payouts but rather term-certain products. Possible reasons for the unpopularity of annuity products include costs and inequitable taxation that hinders people from buying them. To date, the tax authority has not discussed reforming the tax system comprehensively and consistently to enhance people's efforts to save for retirement. Doing so would expand the annuity market as by-product.

Notes

¹ The Comprehensive Survey on Working Conditions (Government of Japan 2009) reports that retirement benefit plans are offered by 84 percent of enterprises with more than thirty employees, but benefit levels vary from one enterprise to another.

² To finance the benefit expenditures of the basic pensions, every social security pension scheme transfers the designated amount of money to the Basic Pension Sub-account that manages the revenue and expenditures for the basic pension payments. The designated amount of money is determined in the following way. The total amount of basic pension expenditures is divided among the social security pension schemes in proportion to the number of active participants aged 20–59 of the schemes plus, in the case of schemes for employees, the number of dependent spouses aged 20–59. The share is the designated amount of money for each scheme. Thus, the dependent spouses in the third category of the NP scheme are deemed to have paid contributions to the NP scheme.

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- ³ The social security pension schemes in Japan include the Employees' Pension Insurance (EPI) scheme that covers private sector employees, the Mutual Aid Association (MAA) scheme for government employees, the MAA scheme for local government employees, and the MAA scheme for private school employees.
- ⁴ Enterprises that are not legal entities with fewer than five employees are not covered by the EPI scheme. The employees therefore only have the flat-rate NP benefits. Part-time employees of any enterprises who work for fewer than three-quarters of the working hours of regular employees are not covered by the EPI scheme, either.
- ⁵ We assume that US \$1 = JPY 90, Euro 1 = JPY 124.
- ⁶ FY means fiscal year. In Japan, the fiscal year starts on 1 April and ends on 31 March.
- ⁷ Currently, it is about 26 percent of the career average of revalued annual disposable income. It is projected that it will eventually reduce to about 23 percent, after modified indexation reforms are applied.
- ⁸ 'Revalued pensionable remunerations' mean pensionable remunerations indexed to the increase of gross wages minus the accumulated difference between the increase of gross wages and the increase of disposable income since 1988. Furthermore, the 2009 actuarial valuation shows that the benefit level is projected to be reduced by about 8.6 percent through modified indexation; the ultimate benefit level would be 20 percent of the career average of revalued annual pensionable remunerations in the case of forty years of coverage.
- ⁹ There is another group of corporate pension plans called Tax-Qualified Pension Plans (TQPP), but they are to be abolished by the end of March 2012. LSRB plans of individual companies are managed on a book reserve basis, but, for small companies that cannot manage such LSRB plans for themselves, there is a fund called the Workers' Retirement Allowance Mutual Aid Fund (WRAMAF) for small companies established on a statute. Small companies can join the WRAMAF on a voluntary basis.
- ¹⁰ The fairly large difference in the contribution ceilings between the participants in the first category of the NP scheme and the employees is mainly attributable to the fact that there are no earnings-related social security pensions for the people in the first category of the NP scheme.
- ¹¹ They are the contracts with life insurance companies in the second option.
- ¹² Life insurance companies include the Japan Post Insurance Co. Ltd. that was privatized in 2007.
- ¹³ The number of the member companies was forty-six at the end of March 2009, but the Yamato Life went bankrupt in 2008, so the statistics exclude data for Yamato Life.
- ¹⁴ The statistics exclude contracts with agricultural cooperatives and mutual cooperatives, but these are few in number. According to Life Insurance Association of Japan (2009), the number of annuity contracts with agricultural cooperatives was about 3.2 million and that of annuity contracts with mutual cooperatives was 0.2 million in March 2009.

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- ¹⁵ The National Survey of Family Income and Expenditure is conducted every five years and the latest survey was carried out in 2009. Results are yet to be published as of summer 2010, so we can only refer to the 2004 survey.
- ¹⁶ They may mainly be medical practitioners or lawyers.
- ¹⁷ The bill to introduce employee contributions to DC also stipulates that employee contributions are tax-deductible; the bill is slated for discussion in the Diet in 2010.
- ¹⁸ Strictly speaking, employee contributions to DB are treated in the same way as the premiums for life insurance contracts. A tax deduction is permitted up to JPY 50,000 (US \$556 or EUR 400) per year, which is very little. The ceiling is applied to the sum of the employee contributions and other premiums for life insurance contracts. In many cases, premiums for life insurance contracts already exceed the ceiling leaving no room for employee tax-deductible contributions.

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