

# Pension Record-keeping Problems in Japan

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[Abstract]

There arose a serious pension record-keeping problem in Japan in May 2007. Around 50 million pension records of social security were found to be floating, not having been integrated into the unified pension numbers. Moreover, around 69,000 records of salaries were suspected of frauds by employers. The pending records are due to human errors made by enrollees, their employers and agencies. There has been no integrated collection of taxes and social security contributions in Japan, and additionally no monitoring organizations were effectively implemented in pension administration. The general public was under the illusion that government officials were able to do and did everything correctly without making any mistakes. However, human errors are inevitable anywhere. Regular and prompt examinations over possible errors are required for proper record-keeping of pensions. When a no-match is identified, an interactive notification and responding correction with confirmation should follow in due course. A trustworthy government with its competent and neat implementation is, thus, the basis for any pension system.

## 1. Introduction<sup>1</sup>

In May 2007, it was announced by the Japanese government that around 50 million records of social security pensions were floating, not having been integrated into the unified individual pension identification numbers.<sup>2</sup> This mismanagement became a national scandal,

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<sup>2</sup> Imperfections in pension records are also known in other countries such as the United States, the United Kingdom and Australia. In the United States, about 8 million social security records (around 4% of the total) need to be corrected every year, and around 5 million letters containing social security statements annually are returned to the Social Security Administration because addresses are no longer correct. Similarly, in the United Kingdom, every year, about 2 million pension contribution records (around 3.5% of the total) do not include the national insurance number. In Australia, around 6 million records were lost on members who quit their job or migrated abroad. For more information, see Bateman (2008).

ushering in the demise of Abe administration in the Upper House election in July 2007.

Moreover, in September 2008, the Japanese government also announced that around 69,000 records of salaries were changed through possible false reports from employers since April 1886.

This article will examine the current pension record-keeping problems in Japan. The second section describes what happened in keeping of pension records. The third section discusses what was wrong in implementing social security pension programmes. The fourth section explains recent commitments by the government and its current performance in correcting errors in pension records. The fifth section argues possible frauds by employers in reporting the amount of salaries. The sixth section makes some proposals for better pension programme implementation. The final section concludes the article.

## 2. What Happened in Keeping Pension Records

Japan has several schemes with regard to social security pensions among different sectors of the population. The oldest scheme dates back to 1884 and has a history of more than 120 years. The newest scheme was established in 1961. Before January 1997, pension identification numbers were issued to each participant on a regional basis independently from each pension programme. These used to be changed when the participant moved to another region, to another company or to another pension programme. They were also changed when the participant acquired a new family name after his/her marriage or divorce. This is mainly because there was no adding-up requirement of covered years among the different pension schemes.<sup>3</sup> Many Japanese, thus, were likely to have two or more pension identification numbers before retirement. It is only in January 1997 that the *unified* pension identification number was introduced for all eligible persons in Japan.

When the government implemented the unified pension identification number system, it found that there were some 300 million pension identification numbers, while the eligible persons were around 100 million in number at that time. In despatching each unified identification number to each eligible person, the Social Insurance Agency (SIA), the management and implementation organization of social insurance systems in Japan sent them postcards, asking whether they had multiple identification numbers for pensions in the past and to send back their reply cards containing a list of all pension numbers they had in the past, if any. The SIA received only 9.16 million replies (around 9 percent), at that time. The majority of Japanese people failed to recognize how important the reply cards were.

Under the prevailing provisions, the pension identification numbers are not integrated to the unified ones, unless an eligible person notifies the SIA with its confirmation. Japanese people usually notified their past pension identification numbers just before their retirement to receive their old-age benefits. The integration process was rather slow, in this sense, and there still remained around 50 million pending pension records that were not integrated into the unified identification numbers, even 10 years after its implementation. The interactive

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<sup>3</sup> Currently we have an adding-up requirement of covered years among different schemes of social security pensions in Japan.

information exchanges of pension record details between the programme participants and the SIA hardly worked out.<sup>4</sup>

### 3. What went wrong?

There are five major reasons for huge numbers of floating pension records in Japan. First, there have been careless mistakes made by the programme participants, their employers, and the agency staff in writing the application forms, in employers' reports on their employees' details, and in processing pension records. Human errors are inevitable. Furthermore, there were fraudulent or cheating activities by employees and/or their employers.

Second, generally speaking, Japanese people do not take kindly to error. Government officials in Japan used to be regarded as the best and the brightest, and thus too much reliance on bureaucracy was observed in the past. The general public was under the illusion that government officials were able to do and did everything correctly without making any mistakes. The effective check system with a feedback to correct any errors of pension records on a regular basis had never been implemented in Japan.

Third, to make matters worse, Japan has unique difficulties in pronouncing Chinese characters. Prior to the introduction of digitized records in the 1960s, all pension records were kept in the hand-written paper form. In the process of transferring these written records to computer records via punch cards, Japanese names written in Chinese characters could not be handled properly because of technological limitations at that time. As there are variations in the correct pronunciation of Japanese names consisting of the same Chinese characters, it was necessary to ask each individual to verify the correct pronunciation of their name. However, the correct pronunciations of the names were not asked in processing punch cards, mainly due to budget limitations. Card punchers were forced to mechanically assign one pronunciation of each Chinese character, whether right or wrong. Mistakes made in the process of transferring the records from the old format to the new one remained uncorrected for a long time.

Fourth, there has been no integrated collection of social security contributions and taxes in Japan. This induced possibilities of fraudulent reporting on pensions by employers: underreporting the number of qualified employees, underreporting the amount of monthly salaries and bonus payments, etc.

Fifth, no monitoring organizations have been effectively implemented in the field of pension administration in Japan. This is mainly due to reluctance against information disclosure by the SIA. It was only in May 2007 that the SIA made public the number of floating pension records after insistent inquiries by one member of the Parliament in the

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<sup>4</sup> The floating pension records were also seen in *private* pensions in Japan. In case of the contracted-out occupational pension funds, 1.24 million cases (around one-third) were unpaid in 2006 to their eligible pensioners who terminated their participation before the normal retirement age. This is mainly due to the fact that their correspondence addresses were unknown. Other DC plans of 401 (k) type, which were introduced in 2000 in Japan, have the same difficulty, since the correspondence addresses of 20,000 account-holders are unknown today.

opposite party.

In sum, the knowledge of programme participants about the pension system details was (and still is) insufficient, and quite often they lost their pension entitlements simply because of ignorance. Their employers did not always pay enough attention to providing correct information to the SIA. The SIA, in turn, behaved passively, waiting until the participants claimed their entitlements.

#### 4. Recent government's commitments and their current performance

Since May 2007, the problem of a huge number of floating pension records has become one of the most serious national challenges, which the Japanese government has been vigorously trying to overcome. It classified the 50.95 million unidentified records by the insured's age, finding that 22.15 million cases (around 43%) referred to people under the age of 60 years and 28.80 million cases (around 57%) referred to people over the age of 60 years.<sup>5</sup>

Investigations of pending pension records carried out between 1 June 2006 and 13 February 2009 led to the progress report of the following five findings. First, among the originally unidentified member records, 10.10 million (19.8%) were recently integrated. Second, 16.16 million of the unidentified records (31.7%) referred to individuals who had either passed away or did not qualify for pension entitlements. Third, for 7.74 million of the unidentified pension records (15.2%), likely matches were identified, but needed to be confirmed, and special notification letters ("blue letters") were sent to these individuals when addresses were available. In response to the special notifications sent out, replies were received in relation to 3.55 million notifications, while no reply was received in relation to 3.65 million notifications. No addresses were available for 0.54 million of the likely matches. Fourth, 5.33 million unidentified pension records (10.5%) were likely matches, but still under investigation. Fifth, 11.62 million (22.8%) required further investigation in the future.

Thus, while some progress was made in resolving the issue, almost 17 million pension records still remain unidentified.

From April 2009, the SIA began to send out social security pension statements ("orange letters") to all programme participants annually. The statement includes pension information on the unified personal identification number, the insured's name, the pronunciation of the name, gender, birth date and year, date of enrolment and/or departure from the programme, the identification of the company in which the participant worked/works, all records of monthly salaries and semi-annual bonuses he/she received, records of contributions, and expected amounts of monthly pension benefits. The SIA strongly expects that, upon receiving this statement, the participants will actively make responses, which will enable the Agency to integrate the pending pension records and to correct remaining errors in the SIA pension data base.<sup>6</sup>

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<sup>5</sup> Around 0.30 million records had no information on the insurees' birth date and year.

<sup>6</sup> The government set up a third-party committee for pension record scrutiny that allows insurees to appeal when their pension records do not reflect their actual payment histories. There are difficulties, however, as a majority

## 5. Fraud Reports by Employers

In September 2008, the Japanese government also announced that among the social security pension records since April 1996, around 69,000 records of salaries were changed through possible false reports from employers. These changes could have reduced the pension entitlements of the respective persons.

From October 2008, the staff of Social Insurance Agency (SIA) began to visit the residences of 20,000 pensioners among 69,000 persons above stated, and from April 2009, the SIA began to send the social security pensions statements to the remaining 49,000 persons who are currently paying pension contributions.

It is verified that the record changes above stated were made through the reports from around 42,000 business establishments, mainly in years from 1993 to 1995, when the Japanese economy suffered from the serious bubble burst.

### *Background for Cheating*

In Japan, the principal program of social security pensions for the private-sector employees, the KNH (Kosei-Nenkin-Hoken), used to be applied only to business establishments of five employees or more. Those of four employees or less were excluded from the KNH for a long time.

The opposite parties repeatedly insisted the KNH coverage be changed to include small businesses with one employee or more. But the government kept a cautious stance against these demands, since 1) employment conditions of these small businesses were quite unstable, 2) their handling abilities of social security documents would be poor, and 3) considerable additional administrative costs would be incurred if implemented.

After long disputes, the KNH coverage has been expanded since 1988, to include small business establishments of one employee or more.

The number of KNH-covered establishments increased sharply from 1988 by 100,000 every year, while the number of the SIA regular staff remained little changed at around 17,000, even after the radical change of the KNH coverage.

In the early 1990s, delinquency in paying the KNH contributions increased fairly in number, since many companies in Japan faced a serious financial risk due to the bubble burst.

In order to avoid bankruptcy, some business establishments were forced to send *false* reports to the SIA, stating that the amount of salaries reported in the past was found to be mistaken and that the “right” amount was substantially lower. These businesses were often small family-run businesses, and the false reports were made for the employer and his/her employees who were often family members. If these reports were accepted by the SIA, they were able to get back a refund on part of past contributions, with which they could pay their

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of people in Japan more often than not failed to keep the pay-slips or receipts of past pension contributions. Many no longer have any of the proof that is required for correcting their pension records. As of 26 April 2009, the third-party committee had received 89,380 cases, had examined 62,754 cases (70%), and had only approved 24,061 cases (38.3%).

current KNH contributions and avoid bankruptcy. Other more malicious employers sent similar *false* reports of past salaries even for their employees who were non-family members without notifying the employees themselves.

The SIA accepted these false reports without any back-up documents and made few field checks, fictitiously assuming that employers would always be honest in making their KNH reports. Furthermore, there was no cross-checking of the tax report with the tax authorities. In this sense, there was a strong incentive for employers to make false KNH reports to the SIA.

The SIA operational manual for collecting contributions and handling delinquency was drafted on the assumption that there was a very limited number of SIA staff in charge of these operations (compare the number of the SIA staff, 17,000, with that of the National Tax Agency in Japan, around 45,000). The SIA was forced to assume that the employers would be honest, which requires no substantial check system of frauds. The SIA social security statements including a change in the amount of past salaries were sent back directly to the employers and *not to their employees*. The employees had few opportunities to check their past earnings records in the SIA database until they reached the pensionable age to apply for their old-age benefits.

In sum, at the SIA there was overdependence on applications from program participants and the employers' reports. So far, all documents related to the KNH application and contribution payments, and their letters of confirmation were exchanged only between employers and the SIA. No direct accesses from the SIA to KNH *employees* had taken place before December 2007. No integrated collection of tax and social security contributions were implemented. All these induced considerable numbers of frauds.<sup>7</sup>

## 6. Some proposals for better pension implementation

So far, the Japanese government was swamped by the task of integrating floating pension records and had little time to rebuild an administration system of correct pension record-keeping.

Japan no longer suffers from corruption among the agency officials, observed in many developing countries. Rather, a huge number of floating pension records were mainly due to a series of mistakes without any prompt correction of errors. Proposals for better pension implementation are as follows.

### *Periodical feedback for correcting errors*

Given that human errors are inevitable, pension management systems should be designed in such a way that any human errors are checked promptly with a set-up of

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<sup>7</sup> Cheating is not limited to underreporting of the amount of salaries. Intentional non-applications to the KNH scheme are not uncommon among new companies and an intentional drop-out is common among business establishments under a severe financial risk. Furthermore, atypical employees are likely to be fictitiously reported as non-applicants of the KNH even among large- or medium-size companies.

periodical and interactive feedback from the system participants, their employers and the agency. When a no-match is identified, notification with responding correction and confirmation should follow in due course.<sup>8</sup>

The Japanese must be more realistic and level-headed to accept that many errors are intrinsically human. Human errors not only took place in the past, but also are and will continue taking place. The Japanese should be more accepting of human errors.<sup>9</sup> The feedback system for error correction needs more funding, more human resources and more machines.

Moreover, pension participants and their employers have to be more active in the error correction process. Unfortunately, so far, the involvement of participants has been limited in Japan. The SIA sent out 100 million letters in January 1997, asking participants to report their multiple pension numbers to be unified under one pension identification number. Only 9.16 million (9%) replies were received, as mentioned above. From December 2007 to March 2008, special notification letters were sent out to 10.27 million people because their pension records were likely to be identified if participants provided further information. Only one half of those contacted replied. The SIA sent additional letters to encourage participants that did not reply to provide information, asking them to help in the error correction process. Without their cooperation, this process could not be completed.

### *Moving towards e-Government*

Many countries are moving towards e-Government. Much information is released through the Internet and e-mails at both private and public levels. Governments also use these instruments more extensively than before. The Japanese Government has announced that governmental administration and registration procedures should use computer-cum-Internet systems more extensively in the coming years.

It is essential for the pension administration to keep valid correspondence addresses of all participants. The central government and municipal governments, in fact, collect individual and household information on various occasions and events such as the time of birth, school enrolment, changes in employment, changes in employment status, medical examinations, hospitalization, passport issue, driver's license issue, marriage, divorce, death, change of address and tax payment. If the various levels of government were able to share such information and consolidate it in the same database, it would be much easier to find and correct pension participants' valid addresses.<sup>10</sup>

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<sup>8</sup> Furthermore, the regular and interactive exchange of information on the KNH pension records between the program participants and the SIA will be most promising to diminish the number of reporting errors and frauds in pension implementation.

<sup>9</sup> The SIA in Japan had a strong incentive to hide negative information such as errors and frauds. It was apt to think that if negative information became public, public criticisms would destroy the reputation and credibility of the SIA, and that this would further increase the number of drop-outs from the social security pensions. In the long run, however, this would create irrecoverable damage to the administration of the pension system. This is exactly what happened with the SIA in Japan.

<sup>10</sup> In Sweden, for example, all government registration information is pooled and consolidated or classified into an individual information account which is administratively efficient, convenient, and cheaper than keeping separate databases.

Needless to say, governments need to pay full attention to security and privacy issues in relation to the Internet and e-mail. In so doing, they are required to send sensitive information via postal mail or ask participants to access such information on the Internet in a strictly protected manner.

Under an e-Government, pension participants will be able to access their records on past pension contributions along with past monthly wages they received through the Internet, so that errors can be quickly corrected. As the recent pension record problems in Japan reveal, individual records are not necessarily correct. In order to amend errors in the pension records, participants should keep their wage records and receipts of their public pension contributions for some years.<sup>11</sup> Under an e-Government, companies would also be required to register all the relevant information through the Internet. Various types of information on each company could be consolidated into an individual company record. Assembling data on a company in this manner would make it difficult for companies to commit fraud in relation to pension records.

### *Integrated Collection of Taxes and Social Insurance Contributions*

The SIA in Japan is to be divided into two independent organizations. One is the National Health Insurance Association, which was activated already from October 2008. The other is the Japan Pension Agency (JPA), which will be established in January 2010. According to the stipulations establishing the JPA, the agency will be responsible for collecting and handling pension contributions. However, as a matter of comparative advantage, the tax bureau has more expertise in collecting various taxes and social insurance contributions.<sup>12</sup> In fact, in many countries, collection of social security contributions is delegated to the tax bureau.<sup>13</sup> In fact, in many countries, collection of social security contributions is delegated to the tax bureau.<sup>14</sup> As the tax bureau usually has more information on companies' profits and transactions, companies would have less room to evade pension contributions. From the employers' perspective, it is cost effective (that is, compliance costs are lower) when they pay taxes and pension contributions at the same time. Thus, it would be better in Japan, also, to move to integrated collection of pension contributions by the tax bureau.

### *Giving much more importance to implementation*

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<sup>11</sup> This is already a common practice in many other countries. In France, for example, insurees are required to keep all receipts for 40 years, while in Italy, they are required to keep them for at least five years.

<sup>12</sup> The administrative costs and compliance costs incurred in implementing the KNH program to small-size businesses and those under financial risks are much more expensive. One way to save these costs is an integrated collection of tax and social security contributions through tax authorities. The Japanese National Tax Agency is a group of professionals for collecting taxes, and is exceedingly powerful and strict in executing their job.

<sup>13</sup> See Sandford (1995) and Zaglmayer et al. (2005).

<sup>14</sup> See Sandford (1995) and Zaglmayer et al. (2005).



The huge number of floating pension records very much angered the the general public and caused much distrust against Parliament members of ruling parties in Japan. The members transferred their anger and distrust to government officials in the SIA. The abolishment of the SIA was legislated in June 2007. There was a strong demand for drastic sanctions, and so far little has changed. The JPA, a special non-public entity, is to be established, instead of the SIA.

There are two objectives in setting up the JPA. The first is to reduce the size of the organization by cutting the number of staff by 40% (from 23,780 in 2005 to 14,470 in 2012) <sup>15</sup>. The second is to progressively use outside resources (that is, private companies).<sup>16</sup> Consequently, around 3,000 existing officials will be redundant at the SIA by the end of year 2009, and they will be fired. It is as if the SIA staff had become a scapegoat.

The reduced number of JPA officials, as mentioned above, was calculated on the assumption that they will be engaged in usual operations, and that no work will be required of them to manage the very serious, difficult and long-lasting integration problem of floating pension records. On 10 May 2009, the question of who would take on this problem if it were not the JPA staff still remained unsolved.

The existing SIA staff members are likely to lose their pride and sense of mission under the persistent and severe bashing against them, which will induce lower levels of motivation. Many of them are weary from overtime work having occurred in the past 2 years. Some have already quit their jobs, switching to careers outside the SIA.

The integrity of government officials in charge of pension matters ranging from the system design to field operations has not been analysed in Japan. This is all due to the mistake of having disregarded operational practice of pensions. It is becoming urgent to place more importance on implementation issues.

## 7. Concluding remarks

Japan already has more than 35 million social security pensions beneficiaries, amounting to nearly 30% of the total population. It has become normal for people to take pension benefits for granted.

There are three major issues on social security pensions: design, coverage and implementation. The implementation issue has not been really analyzed though, but its importance is growing, at least in Japan.

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<sup>15</sup>The number of regular staff is to be reduced from 13,940 in 2005 to 10,770 in 2012.

<sup>16</sup> The following items are to be outsourced: the processing of various application forms and documents; the initial screening of application forms; the use of call centers to reply to pension- and health insurance-related questions; public awareness campaigns for social security pension systems, measures to encourage the pension participants to contribute and help those who can apply for payment exemptions; and general administrative work such as the calculation of the JPA members' salaries, the provision of fringe benefits, and the maintenance of facilities.

A serious pension record-keeping problem arose in Japan in May 2007. Namely around 50 million pension records of social security were found to be floating, not having been integrated into the unified specific pension numbers. The pending records are due to human errors made by enrolees, their employers and agencies. There has been no integrated collection of taxes and social security contributions in Japan, and, additionally, no monitoring organizations have been effectively implemented in the field of pension administration. Government officials in Japan used to be regarded as the best and brightest, and thus too much reliance on bureaucracy was observed in the past. The general public was under the illusion that government officials were able to do and did everything correctly without making any mistakes. However, human errors are inevitable anywhere. Regular and prompt examinations over possible errors are required for proper record-keeping of pensions. When a no-match identified, an interactive notification and responding correction with confirmation should follow in due course. The trustworthy government with its competent and neat implementation is, thus, the basis for any pension system.

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