Description for Investment Principles

1. Our overarching goal is to contribute to the stability of the national pension system by securing the investment returns that it requires with minimal risk and from a long-term perspective, to the sole benefit of pension recipients.

- Japan's public pension system (Employees' Pension Insurance and National Pension) is fundamentally managed as a pay-as-you-go system incorporating the concept of intergenerational dependency, whereby contributions paid by working generations support older generations.

- In the light of the country's declining birthrate and aging population, however, future working generations would be substantially burdened if pension benefits were funded by these contributions alone. The government has therefore created a fiscal plan in which reserve assets (GPIF) are used to fund benefits and fiscal equilibrium in the pension system is maintained over a span of about 100 years. After this period, the fund is projected to hold reserve assets equivalent to around one year of benefits, which will be used to pay for subsequent generations.

- GPIF's core mission is to contribute to the stability of the pension system by achieving the investment returns this system requires within the framework of the fiscal plan outlined above. In other words, the most significant risk for GPIF is a failure to achieve such returns.

- However, GPIF shall not unnecessarily pursue high returns above all else. To reiterate, our goal is solely to secure the necessary returns required by the pension system from a long-term perspective.

- GPIF is the largest pension fund in the world, with assets under management of 159 trillion yen (as of March 2019). Securing pension recipient benefits is GPIF's highest priority, and we will invest to maintain the value of reserve assets while taking market size into account.

- We will never use reserve assets to influence equity markets or to implement economic policies. We pledge to invest solely for the benefit of pension recipients.

2. Our primary investment strategy is diversification by asset class, region, and timeframe. While market prices may fluctuate in the short term, GPIF will take full advantage of our long-term investment horizon to achieve investment returns in a more stable and efficient manner, while simultaneously ensuring sufficient liquidity to pay pension benefits.

<< Diversified Investments>>

- As the proverb "don't put all your eggs into one basket" suggests, safe, efficient management of investment funds requires investing in a diversified set of assets with different attributes – not just for pension reserve assets, but in general. This has been shown theoretically and heuristically, both in Japan and abroad.

- For example, appropriately diversifying across multiple assets with different risk/return profiles – for example, investing in both bonds and equities – can produce the same expected returns with less volatility over the long term .

- Diversification is thus our primary investment strategy.

<< Characteristics of each asset class>>

- Bond investors can generally expect to receive principal payments at full maturity. In particular, domestic bonds play an important role in pension reserve fund management, as these are highly liquid instruments that yield yen-based cash required for pension payments to recipients.

  However, while public bonds are generally considered to be safer than equities, losses can arise whenever interest rates increase. Furthermore, continuously investing in bonds with interest rates lower than the rate of inflation of goods and wages would result in a decline in reserve asset value in real terms.

- With respect to equity assets, on the other hand, broad market indices such as TOPIX generally move in line with economic growth and are expected to result in high, stable returns over the long run. The basic principle of equity investment is to invest in stocks whose values are expected to rise in the long run, but in the short run, market prices can often diverge significantly from intrinsic values for a variety of reasons.

- Additionally, while investing overseas enables us to benefit from global economic growth, market prices can be affected by fluctuations in foreign exchange rates and changes in the invested country's political environment.

- While acknowledging the market fluctuations mentioned above, we believe that investing in a variety of different asset classes will contribute to achieving the investment returns required by the pension system because: (1) market prices are expected to converge to their fundamental values over the long run, and (2) holding a variety of asset classes brings the benefits of diversification.

<<Long-term investment horizon>>

- Similar to how long term time deposits earn higher interest rates than ordinary deposits which can be withdrawn at any time, longer investment horizons generally result in higher returns.

- With a long-term investment horizon, we can avoid being forced to sell assets at disadvantageous prices and wait until market prices recover.

- Financial projections for the public pension system do not forecast the need for significant reserve asset drawdowns in the foreseeable future (see the Note below), which enables us invest over a relatively long term. We aim to take advantage of this feature to achieve investment returns in a stable and efficient manner.

Note: The long term nature of the reserve fund

- The government is required to assess the current status of pension finances ("Actuarial Valuations"), make projections, and verify its robustness every five years.

- According to the latest Actuarial Valuations released in August 2019, depending on the economic scenario used, reserve assets are expected to trend upward for several decades then continuously decline after the peak.

- Our view is that, to the extent it does not affect our cash-out plan, we can invest long-term both during the period when reserve assets are high as well as after drawdowns begin.

<<Securing liquidity for pension benefits payments>>

- The pension reserve managed by GPIF has the important role of providing immediate liquidity to the government's Pension Special Account ("Account") if the amount of funds kept in the Account faces a cash shortage and is unable to meet pension benefit payments.

- As such, we think it is imperative to pool proceeds from domestic bond coupons and redemptions in advance in accordance with fiscal projections, and hold an adequate level of highly liquid assets should the Account unexpectedly require an immediate liquidity injection.

3. We formulate our overall policy asset mix and manage risks at the portfolio, asset class, and investment manager level. We utilize both passive and active management in order to achieve benchmark returns (i.e., average market returns) and seek untapped profitable investment opportunities.

<< Formulating the policy asset mix>>

- When investing over the long term, rather than frequently changing the portfolio asset allocation in response to short-term market movements, determining a policy asset mix and maintaining it over a long period is more effective and yields better results.

- In this sense, formulating the policy asset mix is the most important decision GPIF has to make. Hence, a rigorous procedure is established whenever the medium-term plan, including the policy asset mix, is created or changed. When GPIF creates or changes its medium-term management plan, which includes the policy asset mix, we first obtain approval from the Board of Governors, then submit the plan to the Minister of Health, Labor and Welfare for final approval.

- GPIF formulates an policy asset mix that seeks to achieve the investment returns required for the pension system from a long-term perspective with minimal risks.

<< Risk control>>

- The most significant risk for GPIF is a failure to achieve the investment returns required for the pension system. Meanwhile, there are a variety of risks to be controlled in day-to-day investment operations.

- Such risks include not only the market risk, liquidity risk, credit risk, and country risk associated with invested assets, but also investment and monitoring process-related risks such as asset manager/custodian risk, GPIF operational risk, and other risks.

- We identify those risks associated with overall assets, each asset class, and each investment manager in advance, and monitor and manage them both at regular intervals and ad hoc as necessary.

- Furthermore, as a long-term investor, we stay vigilant to the emergence of new risks that need to be controlled in accordance with changes in the economic environment or advances in investment diversification and sophistication, and we address such risks in a flexible and prompt manner.

<< Securing benchmark returns (i.e., average market returns)>>

- Investors trade assets in financial markets based on their own motives using a wide variety of information. Assuming a horizon long enough for information to become widely available and for many investors to conduct a massive number of transactions, market prices are expected to eventually converge to their intrinsic values and become neither undervalued nor overvalued. In this regard, markets are generally considered to be more or less efficient.

- This view is compatible with passive management (i.e., investing based on indices that reflect overall market price movements), and is useful for large long-term investors such as GPIF.

- On the other hand, the market can undervalue or overvalue security prices when public information is not sufficiently widespread amongst all investors, when markets overreact to uncertain information, or if the number of investors is limited.

- This view is compatible with active management (i.e., investment strategies that deliberately deviate from indices reflecting overall market price movements in pursuit of excess returns) and investment in alternative assets.

- GPIF utilizes both passive and active management in order to achieve benchmark returns (i.e., average market returns) while seeking untapped profitable investment opportunities based upon a thorough examination of the fundamental sources of such investment returns.

4. We believe that sustainable growth of investee companies and the capital market as a whole are vital in enhancing long-term investment returns. In order to secure such returns for pension beneficiaries, therefore, we promote the incorporation of non-financial environmental, social, and governance (ESG) factors into the investment process in addition to financial factors.

- GPIF promotes ESG investment in order to reduce negative externalities arising from environmental and social issues and thereby improve the long-term return of the overall portfolio. GPIF is particularly active in ESG initiatives due to our position as a "universal owner" and "cross-generational investor." "Universal owner" is a term used often within the pension and ESG investment industry, and refers to an investor whose portfolio spans the entire world capital market. With a broadly diversified portfolio comprised of the equities and bonds of the majority of Japanese listed companies and major foreign companies, GPIF is a typical "universal owner".

- Even if some portfolio companies are able to boost their share price by pursuing temporary profits at the expense of the environment and society, this could potentially have a devastating effect on the overall portfolio of a universal owner if other companies, the overall economy and society as a whole are negatively impacted. In other words, capital market and social sustainability is a prerequisite for the sustainability of universal owners' portfolios.

- The concept of "universal ownership" – that is, proactively taking steps to manage and limit negative externalities – lies at the core of GPIF's ESG investment activities. In addition, the longer into the future the ESG risk exists, the more likely it is that the risk will materialize. Since GPIF is a "super long-term investor" with responsibility for managing pension finances over a span of 100 years, there is enormous benefit to integrating ESG factors into our investment process. In other words, engaging in ESG activities is consistent with the objective stated in the Employees' Pension Insurance Act and the National Pension Act of "manag[ing] the pension reserve safely and efficiently from a long term perspective solely for pension beneficiaries."

- GPIF conducts ESG activities not only for equities but also for other asset classes, including bonds and alternative assets, with the aim of maximizing medium- to long-term investment returns for pension beneficiaries.

5. In order to enhance long-term investment returns and fulfill our stewardship responsibilities, we shall advance various initiatives (including the consideration of ESG factors) that promote long-termism and the sustainable growth of investee companies and the capital market as a whole.

- The "Council of Experts Concerning the Japanese Version of the Stewardship Code" assembled by the Financial Services Agency released the "Principles for Responsible Institutional Investors <Japan's Stewardship Code>" in February, 2014. Stewardship responsibility is defined as "the responsibility of institutional investors to aim to increase medium- to long-term investment returns for clients or beneficiaries by enhancing the corporate value and sustainable growth of invested companies through constructive, purposeful dialogue ("engagement"), based on a deep understanding of those companies and their operational environments."

- GPIF promotes constructive dialogue ("engagement") between our asset managers and the companies they invest in. If engagement improves medium to long term corporate value and leads to overall market growth, we benefit from higher returns. We will therefore fulfill our stewardship responsibilities by aiming to build a virtuous circle in the investment chain.

- GPIF also fulfills its stewardship responsibilities by engaging in initiatives that we are permitted to implement ourselves, by understanding and monitoring the work performed by our asset managers, by proactively engaging with these asset managers, and by disclosing an annual summary of the activities we undertake.

- GPIF will strive to fulfill our mission of enhancing medium to long term returns for beneficiaries and contribute to the stability of the pension system by engaging in a variety of stewardship activities while also considering ESG (Environmental, Social, and Governance) issues. We anticipate this to lead to a reduction in risk, with higher risk-adjusted returns being realized as investment horizons increase.

In implementing the above investment principles, GPIF is committed to further bolstering the strength of our organization and earning the trust of the public.

- Establishing an investment policy closely aligning with the Investment Principles above means nothing if we do not have the organizational capacity to effectively implement it.

- We consider it crucial to utilize deep professional expertise in fulfilling our mission. GPIF is therefore committed to bringing in sufficient talent and creating an environment that encourages continuous self-improvement and where each person can utilize his or her unique capabilities while preserving a spirit of unity.