

Basic Policy for the Annuity Retirement Benefits (ARB) Adjustment Fund

(Established on October 1, 2015)

(Revised on July 19, 2018)

(Last revised on March 31, 2020)

In accordance with Article 112-11, Paragraph (1), of the Local Public Service Mutual Aid Association Act (Act No. 152 of 1962; the “Act”), the basic policy for administering and investing the annuity retirement benefits (ARB) adjustment fund (the “Basic Policy”) is established for appropriate administration and investment of the ARB adjustment fund as follows.

I Basic policy on the administration and investment of the ARB adjustment fund

1 Basic policy

The Association shall manage the ARB adjustment fund with the objective of contributing to the stability of the ARB plan operations based on the characteristics of a cash-balance pension plan whose benefit level is linked to government bond yields.

Accordingly, the Association shall administer and invest the ARB adjustment fund by establishing an asset mix from the long-term perspective (the “Benchmark Portfolio”).

2 Investment target

The investment of the ARB adjustment fund, which has the characteristics of a cash-balance pension plan, shall be managed appropriately by establishing the Benchmark Portfolio so that investment returns needed for the fund (i.e., assumed return (meaning the assumed return stipulated in Article 28, Paragraph (5) of the Order for Enforcement of the Local Public Service Mutual Aid Association Act (Cabinet Order No. 352 of 1962))) will be generated with the minimum risk.

In doing so, the Association shall pay attention not to distort, among other things, price formation in the market and private sector investment activities.

3 Use of the Fund Management Committee of Pension Fund Association for Local Government Officials

The Association shall leverage the expert knowledge of the Fund Management Committee of Pension Fund Association for Local Government Officials that consists of academic experts and practical experts in such fields as economy, finance, and fund management (the “Committee”) when examining technical matters concerning the administration and investment of the ARB adjustment fund including the development and revision of the Basic Policy.

4 Fund management plan

(1) Annual fund management plan

An annual fund management plan for the management of the ARB adjustment fund

shall be created before the beginning of every fiscal year. The annual fund management plan shall include the following.

- A Outlook for profit/loss and the ARB adjustment fund
 - (A) Beginning balance of the ARB adjustment fund
 - (B) Total revenues
 - (C) Total expenditures
 - (D) Profit for the term
 - (E) Closing balance of the ARB adjustment fund
 - (F) Investment return
- B Outlook for cash flows
 - (A) Closing balance
 - (B) Expected revenues
 - a Paid-in money from associations
 - b Bond principal and interest
 - c Financial adjustment contributions received
 - d Other revenues
 - (C) Expected expenditures
 - a Financial adjustment contributions
 - b Grant to associations
 - c Money transferred to the administration accounting
 - d Mandatory investment
 - e In-house investment
 - f Other expenditures
 - (D) Balance brought forward or closing balance
- C Investment plan
 - (A) Mandatory investment
 - Acquisition of municipal bonds or bonds issued by the Japan Finance Organization for Municipalities
 - (B) In-house investment

(2) Quarterly fund management plan

A quarterly fund management plan for the management of the ARB adjustment fund shall be created before the beginning of every quarter.

Matters to be described in the quarterly fund management plan shall be the same as those of the annual investment management plan.

5 Risk management

With respect to the administration and investment of the ARB adjustment fund, risk management shall be conducted for overall assets, each asset class, each asset management institution, and mandatory and voluntary investments, by the methods below. The implementation policy of this risk management shall be reported to the Governing Council upon deliberation at the Committee, and timely reports on the risk management status shall be made to the Governing Council and the Committee.

(1) Overall asset

In order to appropriately manage the Benchmark Portfolio, check the asset mix of the ARB adjustment fund for any deviations from the Benchmark Portfolio at least monthly, and take necessary actions.

Also, enhance necessary functions for understanding and analyzing market trends.

Furthermore, check risks of overall assets and conduct the analysis and assessment of the degree of risk-taking and the analysis of factors for deviations from the return needed for the fund.

(2) Asset class

Manage risks associated with each asset class, including market risk, liquidity risk, and credit risk.

(3) Mandatory and in-house investments

Establish a guideline on investment (the “In-house Investment Guidelines”), and manage risks appropriately by checking the investment and risk-taking status.

(4) Asset management institutions

Present a guideline on asset management to each asset management institution (the “Asset Management Guidelines”), understand the asset management status of each institution, and manage it appropriately.

In addition, manage credit risk of each institution and pay attention to any changes to asset management structures.

6 Investment methods

(1) Basic approach

Administration and investment institutions shall, in principle, invest the full amount, excluding short-term assets necessary for benefit payments, in domestic bonds and hold them until maturity. In doing so, the administration and investment institutions shall strive to increase the return upon controlling risks by appropriately selecting the types and maturities of domestic bonds.

(2) Specific investment methods

A Mandatory investment

In accordance with Article 11-10-3 of the Regulation for Enforcement of the Local Public Service Mutual Aid Association Act (Order of the Ministry of Home Affairs No. 20 of 1962), the entrustment of asset management in the case of investment by acquiring municipal bonds or bonds issued by the Japan Finance Organization for Municipalities shall be conducted as follows.

(A) The management of mandatory investment assets may be entrusted to asset management institutions. The asset management institutions are required to observe the following items and the Asset Management Guidelines.

- a Strictly administer and take custody of the Association's assets, separating them from other trust assets.
 - b Pay utmost care in securities delivery and settlement.
 - c Give sufficient consideration to credit risk, administrative capability, costs and the like when re-entrusting custody services.
 - d Submit data regarding the status of asset administration at the end of every month and, on an as-needed basis, provide necessary data and explanations.
 - e Observe laws, regulations, contracts, and the like establishing structures to ensure the observance.
- (B) If an asset management institution has engaged in any act that violates laws and regulations, contracts, the Asset Management Guidelines or the like, prompt reporting shall be requested, and instructions shall be issued as necessary.

B In-house investment

In order to contribute to the safe and efficient investment management of the ARB adjustment fund, part of the fund shall be administered and invested in accordance with the following long-term and short-term investment rules as well as the In-house Investment Guidelines.

(A) Types

a Long-term investment

(a) Basic approach

For domestic bonds, strive to make favorable investments over the long term, taking into account the interest outlook and other points.

(b) Investment assets

Investment assets shall be the following yen-denominated securities.

- (i) Government bonds
- (ii) Municipal bonds
- (iii) Bonds issued by the Japan Finance Organization for Municipalities
- (iv) Bonds guaranteed by the government or a local government

b Short-term investment

(a) Basic approach

Short-term investment shall be limited to the minimum amount and made for the purpose of securing liquidity (e.g., cash) necessary for financial adjustment contributions and grants to associations of the ARB adjustment accounting. Efforts shall be made to make favorable investments in consideration of safety and liquidity, the investable period, and short-term interest trends.

(b) Investment assets

Investment assets shall include short-term government bonds, treasury discount bills, deposits, negotiable certificates of deposits, commercial papers (including repurchase agreements) rated A or above by any of the Rating Agencies stipulated in the Appended Table and the

MMF.

c Lending to other accounting

Lending to other accounting shall be made in accordance with what is provided for separately by the Association. However, no lending shall be made to the Employees' Pension Insurance benefits adjustment accounting and the transitional long-term benefits adjustment accounting.

(B) Financial institutions

The standards stipulated by the In-house Investment Guidelines shall be observed in selecting partner financial institutions.

(C) Entrustment of asset management

a The Association may entrust the management of in-house investment assets to asset management institutions.

b The provisions of A-(A) and A-(B) apply mutatis mutandis to the entrustment of in-house investment assets to asset management institutions. In such case, the provisions apply with the term "mandatory investment assets" being replaced by "in-house investment assets."

(3) Selection and evaluation of asset management institutions

A Selection of asset management institutions

Asset management institutions shall be selected from financial institutions that are engaged in trust services and meet the following criteria.

(A) Business standing (e.g., capital, financial position, number of employees, customers) is found to be stable

(B) Asset management status is favorable.

(C) A structure for complying with laws and regulations is in place.

B Evaluation of asset management institutions

Asset management institutions shall be evaluated in a timely manner through qualitative assessment with respect to their asset administration status and structures for complying with laws and regulations, and their competence shall be determined.

7 Investment considering non-financial elements

With respect to the investment of the ARB adjustment fund, the necessary initiatives shall be implemented, based on a case-by-case analysis, with a view to promoting investment considering non-financial elements including ESG (Environmental, Social, and Governance) in addition to financial elements based on the approach that the sustainable growth of investee companies and the entire market is necessary for the increase of return on investment portfolio over long time so as to secure long-term return for the benefit of members.

8 Pooled investment

Part of the ARB adjustment fund may be deposited with the annuity retirement benefits

deposit accounting for investing.

II Matters to be observed in administering and investing the ARB adjustment fund

1 Ensuring fiduciary responsibility

Thorough observance of the duty of care and loyalty of a prudent expert shall be ensured for all persons involved in the investment of the ARB adjustment fund. This shall be stipulated in contracts with respect to contracts with asset management institutions.

2 Consideration to impact on the market and private sector activities

In managing the ARB benefit adjustment fund, the Association shall, in light of the market size, strive not to be excessively impacted by the market and not to distort, among other things, price formation in the market and private sector investment activities, especially by avoiding concentration in specific time periods for investing and exiting funds.

3 Securing liquidity for pension benefits

Based on the outlook of pension financing and the profit and loss status, the Association shall secure liquidity (e.g., cash) necessary for expenditures, such as financial adjustment contributions and grants to associations, and conduct cash management efficiently.

4 Coordination with other administration and investment institutions

The Association shall provide other administration and investment institutions with technical and expert knowledge and materials on the administration and investment of reserve funds, gain understanding on research and study and other efforts made by other administration and investment institutions, and conduct information exchange and communication/coordination with other administration and investment institutions by, for example, providing information in response to the information gained.

In addition, the Association and other administration and investment institutions shall cooperate by coordinating with each other with respect to investment operations of ARB association reserve funds by, for example, providing necessary information.

III Matters concerning asset mix from the long-term perspective in administering and investing the ARB adjustment fund

1 Basic approach to the Benchmark Portfolio

The Benchmark Portfolio, which shall have an asset mix and deviation tolerance in line with the investment targets, shall be established from the long-term perspective in consideration of generally accepted expert knowledge on asset administration and investment as well as economic trends in and outside Japan, based on forward-looking risk analyses.

The Association shall report on the establishment of the Benchmark Portfolio to the Governing Council upon deliberation at the Committee.

2 Benchmark Portfolio

The asset mix of the Benchmark Portfolio shall be as follows

	Domestic bonds
Asset mix	100%

(Note) Short-term assets may be held to the extent necessary for making financial adjustment contributions.

Short-term assets are classified into domestic bonds.

3 Review of the Benchmark Portfolio

The Association shall appropriately manage risks based on market trends, annually verify the Benchmark Portfolio and, if it is considered necessary in cases, such as that the investment environment assumed at the time of establishing the Benchmark Portfolio deviates from reality, examine the Benchmark Portfolio and revise it as necessary after reviewing the Benchmark Portfolio stipulated in III-2 of the “Administration and Investment Policy for Annuity Retirement Benefits (ARB) Adjustment Fund” (established on October 1, 2015). Any change to the Benchmark Portfolio shall be reported to the Governing Council upon deliberation at the Committee. If the Association finds it necessary in consideration of market impact and other factors, it shall establish a transition portfolio (meaning a transitional asset mix up until the realization of the Benchmark Portfolio) in order to smoothly transition to the revised Benchmark Portfolio.

IV Other necessary matters concerning appropriate administration and investment of the ARB adjustment fund

1 Enhancing transparency

Regarding the administration and investment of the ARB adjustment fund, the Association shall devise ways to make disclosure documents easier to understand by promptly publishing the status of administration and investment performance, such as investment returns and risks for each fiscal year by leveraging its website on an annual basis (on a quarterly basis for the quarterly status of administration and investment performance [including the status of investment portfolio as a whole and individual portfolio assets]).

Such publication shall be reported in a timely manner to the Governing Council and the Committee.

When making such publication, attention shall be paid to market impacts.

2 Retaining and leveraging highly skilled and specialized talents

The Association shall, if necessary, examine in detail the operations that require advanced and specialized skills as well as the expertise required for such operations, and strive to retain highly skilled and specialized talents who have such expertise.

In addition, training shall be conducted by leveraging highly skilled and specialized talents with the aim of enhancing the performance of its staff.

The enhancement and development of specialized talents shall be promoted actively,

with reporting on the status made to the Committee as necessary and their opinions taken into consideration

3 Strengthening risk management

Necessary risk management systems shall be established.

In addition, in light of conducting flexible investment, the Association shall strive to enhance risk management by, for example, strengthening forward-looking risk analysis functions, establishing risk management analysis tools, and enhancing information collection and investigation functions as necessary.

4 Enhancing research and study operations

When conducting research and study operations, besides commissioning the work to think tanks and other similar institutions, engaging staff including highly skilled and specialized talents in the work shall be considered so that know-how on the administration and investment of the ARB adjustment fund will be accumulated within the Association. If highly skilled and specialized talents are employed, the establishment of a structure for expanding internal research and study activities by leveraging the talents shall be considered to accumulate know-how obtained from the research and conduct the administration and investment of the ARB adjustment fund safely and efficiently in the future.

In the case of commissioning the research, measures to prevent information leak shall be taken thoroughly.

(Appended Table) Rating Agencies

- 1 Rating and Investment Information, Inc.
- 2 Japan Credit Rating Agency, Ltd.
- 3 S&P Global Ratings
- 4 Fitch Ratings Ltd.
- 5 Moody's Investors Service, Inc.

Supplementary Provisions

This Basic Policy comes into force from October 1, 2015.

Supplementary Provisions

This Basic Policy comes into force from July 19, 2018.

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This Basic Policy comes into force from April 1, 2020.

[DISCLAIMER]

When there are any discrepancies between the original Japanese version and the English translation version, the original Japanese version shall prevail.