

**Fiscal Year 2016**

**Employees' Pension Insurance Benefit Fund  
Review of Operations**

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**(Local Public Service Mutual Aid Associations)**



**地方公務員共済組合連合会**

Pension Fund Association for Local Government Officials

## Table of Contents

▪ Fiscal Year 2016 Investment Results (Overview).....	P 4
【 Section 1 Administration and Investment of Funds in FY2016 】	
▪ Fiscal Year 2016 Market Environment.....	P 6
▪ Fiscal Year 2016 Asset Mix.....	P11
▪ Fiscal Year 2016 Investment Return.....	P12
▪ Contribution Analysis of the Excess Return by Asset Class.....	P13
▪ Fiscal Year 2016 Investment Income.....	P15
▪ Fiscal Year 2016 Value of Assets.....	P16
▪ Status of Risk Management (Overall Assets).....	P17
▪ Fiscal Year 2016 Fees.....	P18
【 Section 2 Systems and Activities Concerning Administration and Investment of Funds 】	
▪ Basic Approach to Investment.....	P20
▪ Stewardship Responsibilities.....	P21
▪ Diversification of eligible investment instruments (investment in alternative assets).....	P27
▪ Review of Manager Structure.....	P29
▪ Administration and Evaluation of Entrusted Investment Management Institutions and Asset Administration Institutions.....	P30
▪ Measures taken to respond to low and negative interest rates.....	P31
▪ Governance.....	P32

## Table of Contents

### 【 Section 3 Reference Data 】

▪ Pension Fund System for Local Government Officials .....	P39
▪ Changes in the value of investment assets and the asset mix (since the integration of employee pension plans) .....	P40
▪ Changes in the number of passive and active funds (entrusted investment) by asset class .....	P41
▪ Issues Held .....	P42
▪ Integration of Employee Pension Plans .....	P43
▪ Investment of funds after the integration of employee pension plans .....	P44
▪ Comparison of Characteristics of Benefits after Integration of Employee Pension Plans .....	P47
▪ Glossary .....	P48

\* Review of Operation is an overview of management and investment of the Local Public Service Mutual Aid Associations.

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

## Fiscal Year 2016 Investment Results (Overview)

Investment return: +4.75% \*Return (market value basis)  
(FY2016) (+2.24% \*Realized return (book value basis))

Investment income: +¥910.2 billion  
(FY2016) \*Investment income (market value basis)  
(+¥394.5 billion \*Realized income (book value basis))

Value of investment assets: ¥20,047.8 billion  
(End of FY2016)

As pension investment funds are intended for long-term investment, the investment status must be judged from the long-term perspective.

As investment income is based on the market value as of the end of each term, it should be kept in mind that it includes valuation gains/losses, which means it may change depending on market movements.

(Note 1) Unless otherwise specified, the return (market value basis) refers to the modified total return. (The same shall apply hereinafter.)

(Note 2) The return and income represent figures after the deduction of fees, etc. settled within the relevant period.

(Note 3) Realized income represents the sum of trading profits/losses and interest and dividend income, etc.

## Section 1 Administration and Investment of Funds in FY2016

## Fiscal Year 2016 Market Environment ① (Domestic Bonds)

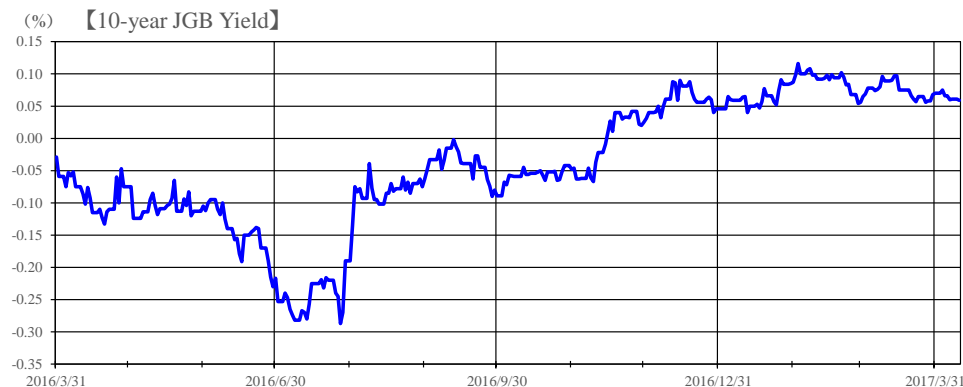
### ① Domestic Bond Market

The yield on the 10-year government bond stayed at around -0.10% from the beginning of fiscal year 2016 because of the effects of the Quantitative and Qualitative Monetary Easing with a Negative Interest Rate, which was announced by the Bank of Japan (BOJ) on January 29, 2016 (applied from February 16 of the year), but it declined to around -0.30% in July amid expectations for additional monetary easing by the BOJ. However, following the BOJ's announcement of a plan to conduct a comprehensive assessment of the economic conditions in late July, the yield rose as uncertainty grew over the future course of the monetary policy, and afterwards, it mostly stayed range-bound between -0.10% and 0.00%.

In September, the yield rose before falling back as various speculations over the possibility of additional monetary easing circulated ahead of a Monetary Policy Meeting. After a new framework of monetary policy (Quantitative and Qualitative Monetary Easing with Yield Curve Control) was announced, the yield rose temporarily but stayed at around -0.05% thereafter as the effects of the BOJ's policy change filtered through the market.

After the U.S. presidential election in November, the Japanese yield went up in line with a rise in U.S. interest rates and stayed close to 0.05% around the turn of the year. After the beginning of 2017, the yield declined at times due to concerns over European political risks related to the announcement of the United Kingdom's decision to go ahead with withdrawal from the EU (Brexit) and the French presidential election. However, the yield remained range-bound as the yield decline was moderated by concerns about possible reduction of government bond purchases by the BOJ.

On a fiscal year basis, the yield on the 10-year government bond rose (the bond price dropped) from -0.03% at the end of the previous fiscal year to 0.07% at the end of the current fiscal year.



## Fiscal Year 2016 Market Environment ② (Domestic Equities)

### ② Domestic Equity Market

Domestic equity prices rose early in the fiscal year amid expectations for additional monetary easing by the BOJ but dropped steeply after the BOJ decided in late April to keep its policy unchanged. The domestic equity market stayed weak in May and later as the yen appreciated, and it declined steeply in response to the outcome of the U.K. referendum on Brexit in June, sending the TOPIX equity index (TOPIX without dividends) down to around 1,200 points at one time. Afterwards, domestic equity prices rebounded and remained mostly range-bound in the summer and later. Although equity prices plunged temporarily after Donald Trump was elected in the U.S. presidential election in November, the market staged a sharp rebound as the yen depreciated rapidly against the dollar.

After the beginning of 2017, domestic equity prices rose at times due to such factors as expectations for the economic policies promoted by the Trump administration, the strong performance of U.S. and European economic indicators and equity price rises in the United States and Europe. However, toward the end of the fiscal year, domestic equity prices declined slightly as expectations for the Trump administration's economic policies receded and concerns over European political risks grew.

On a fiscal year basis, the TOPIX equity index (TOPIX without dividends) went up from 1,347.20 points at the end of the previous fiscal year to 1,512.60 points at the end of the current fiscal year.

(Point) 【TOPIX (no dividends)】



(JPY) 【Nikkei Stock Average】



## Fiscal Year 2016 Market Environment ③ (Foreign Bonds)

### ③ Foreign Bond Market

The yield on the 10-year U.S. Treasury bond mostly stayed flat from the beginning of the fiscal year, but in response to the outcome of the U.K. referendum on Brexit in June, it declined steeply, falling to as low as 1.4% temporarily, as risk aversion grew. Later, the yield rose moderately in response to the strong performance of U.S. economic indicators. After the election of Donald Trump in the U.S. presidential election in November, the yield surpassed 2.6% in mid-December as the view prevailed that inflation would accelerate. After the beginning of 2017, the yield stayed directionless due to a mix of various factors, including expectations for the economic policies promoted by the Trump administration, expectations for an early interest rate hike by the Federal Reserve Board and uncertainty over the political situation in Europe.

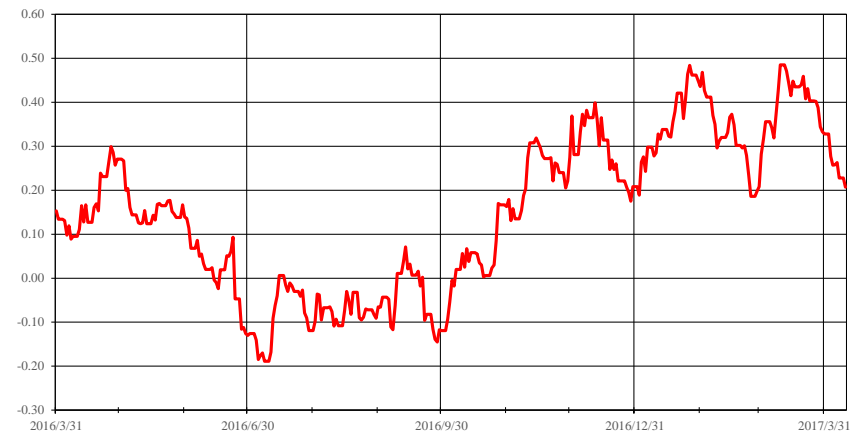
As for European bonds (German government bonds) as well, the yield declined (bond price rose) as risk aversion grew in relation to the U.K. referendum on Brexit in June. The yield temporarily rebounded in July and then remained directionless due to such factors as uncertainty over the political situation in Europe and speculation over the possible rollback of the European Central Bank's (ECB's) quantitative monetary easing.

On a fiscal year basis, the yield on the 10-year U.S. Treasury bond rose (bond price dropped) from 1.77% at the end of the previous year to 2.39% at the end of the current year. The yield on the 10-year German government bond increased (the bond price dropped) from 0.15% at the end of the previous fiscal year to 0.33% at the end of the current fiscal year.

(%) 【10-year US Treasury Bond Yield】



(%) 【10-year German Government Bond Yield】





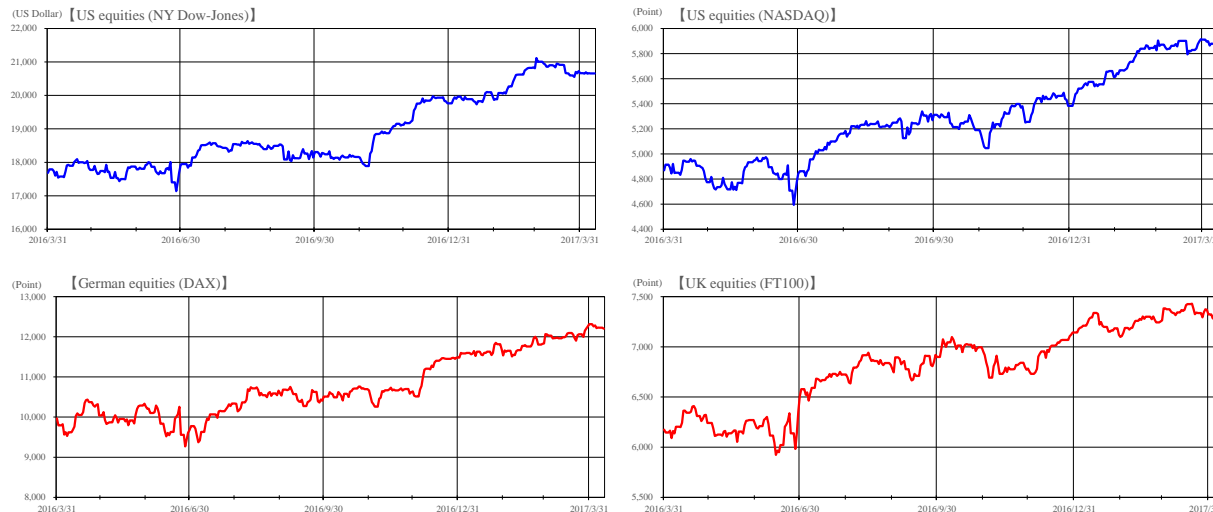
## Fiscal Year 2016 Market Environment ④ (Foreign Equities)

### ④ Foreign Equity Market

The U.S. equity market mostly stayed flat from the beginning of the fiscal year, but in response to the outcome of the U.K. referendum on Brexit in June, it fell steeply. Later, New York's Dow average (the Dow Jones industrial average) soon rebounded as the market welcomed an improvement in the employment situation, but it mostly stayed range-bound between 18,000 and 18,500. After the U.S. presidential election in November, equity prices surged amid expectations for the incoming administration's economic policies, including tax reduction and infrastructure investment. Afterwards, the equity price upsurge subsided, with the Dow average remaining mixed at around 20,000. After the beginning of 2017, equity prices got back on an uptrend due to the strong performance of U.S. economic indicators and expectations for the economic policies promoted by the Trump administration, among other factors.

The German DAX index fell below 9,300 points as uncertainty over the political situation in Europe grew in response to the outcome of the U.K. referendum on Brexit in June. After temporarily rebounding, the DAX index remained directionless for a while. However, after the U.S. presidential election in November, it rose amid expectations for the incoming U.S. administration's economic policies. After the beginning of 2017, the DAX index went up in tandem with a rise in U.S. equity prices as the extreme uncertainty over the political situation in Europe receded because of a victory won by the ruling party in the Dutch election to the lower house of parliament.

On a fiscal year basis, New York's Dow average rose from 17,685.09 at the end of the previous fiscal year to 20,663.22 at the end of the current fiscal year. The German DAX index increased from 9,965.51 points at the end of the previous fiscal year to 12,312.87 points at the end of the current fiscal year.



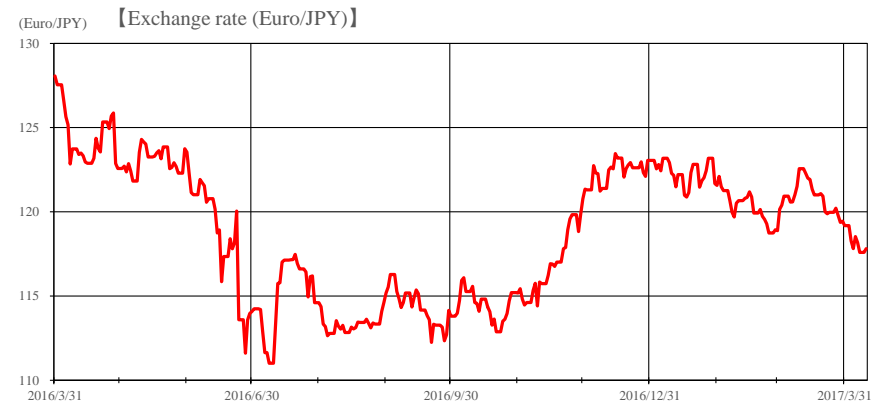
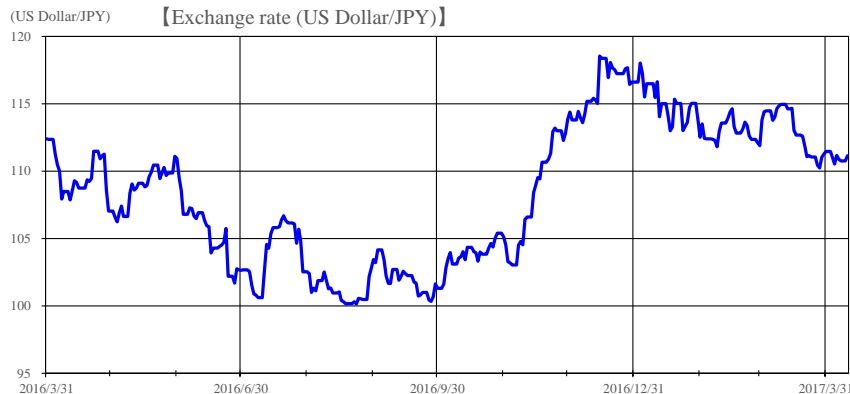
## Fiscal Year 2016 Market Environment ⑤ (Foreign Exchange)

### ⑤ Foreign Exchange Market

In dollar/yen exchange trading, the yen stayed strong against the dollar due to disappointment at the BOJ's decision in late April not to introduce an additional monetary easing measure, among other factors. The yen appreciated further in response to the outcome of the U.K. referendum on Brexit in June. Later, the yen depreciated temporarily as speculation over the possibility of an additional interest rate hike in the United States grew, but the exchange rate mostly stayed range-bound between 100 yen and 105 yen per dollar. After the long-term U.S. interest rate rose steeply following the U.S. presidential election in November, the yen depreciated rapidly against the dollar, with the dollar rising to the 118-yen range toward the end of the year. After the beginning of 2017, the yen appreciated against the dollar through the end of the current fiscal year against the backdrop of a protectionist stance indicated by President Trump, warnings issued by him against a strong dollar, and uncertainty over the political situation in Europe related to the French presidential election.

As for the euro/yen exchange rate, the yen stayed strong against the euro from the beginning of the fiscal year due to the BOJ's decision in late April not to introduce an additional monetary easing measure and uncertainty over Brexit. In response to the outcome of the U.K. referendum on Brexit in June, the yen significantly appreciated against the euro. Afterwards, the exchange rate remained mixed at around 115 yen per euro. However, after the U.S. presidential election in November, the yen depreciated against the euro as interest rates rose more moderately in Japan than in Europe. After the beginning of 2017, the yen appreciated against the euro due to increased uncertainty over the political situation in Europe related to the French presidential election and speculation over the possible rollback of the ECB's quantitative monetary easing.

On a fiscal year basis, the dollar-yen exchange rate came to 111.46 yen per dollar at the end of the current fiscal year compared with 112.39 yen per dollar at the end of the previous fiscal year. The euro-yen exchange rate stood at 119.18 yen per euro at the end of the current fiscal year compared with 128.07 yen per euro at the end of the previous fiscal year.

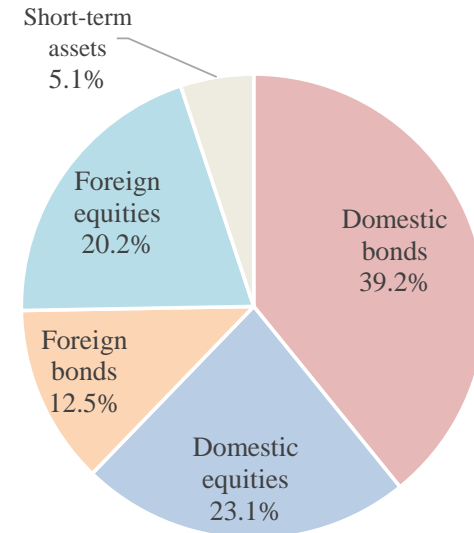


## Fiscal Year 2016 Asset Mix

(Unit: %)

	FY2015	FY2016			
	End of FY	End of Q1	End of Q2	End of Q3	End of FY
Domestic bonds	45.2	46.8	44.0	40.4	39.2
Domestic equities	19.2	20.4	21.1	23.0	23.1
Foreign bonds	11.9	12.1	11.7	12.6	12.5
Foreign equities	16.4	17.1	17.3	19.5	20.2
Short-term assets	7.3	3.7	6.0	4.4	5.1
Total	100.0	100.0	100.0	100.0	100.0

Composition by Investment Asset Class (as of end of FY2016)



(Note 1) Due to rounding, the total sum of individual figures may not necessarily add up to 100%.

(Note 2) Starting in fiscal year 2016, short-term assets held by each fund were classified into relevant asset classes in principle.

(Note 3) The ratio of alternative assets to the total amount of pension funds is 0.1% (the upper limit for the benchmark portfolio is 5%).

(Note 4) Group pure endowment insurance is included in domestic bonds.

### ○ Asset mix

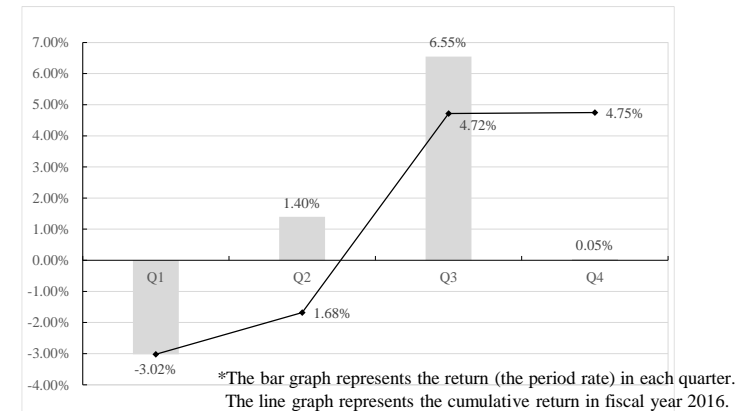
	Domestic bonds	Domestic equities	Foreign bonds	Foreign equities
Asset mix	35%	25%	15%	25%
Deviation tolerance	± 15%	± 14%	± 6%	± 12%

## Fiscal Year 2016 Investment Return

- The return (market value basis) in fiscal year 2016 came to 4.75% due to such factors as a rise in domestic and foreign equity prices. The realized return (book value basis) was 2.24%.
- By asset class, the return (market value basis) was -0.67% for domestic bonds, 14.79% for domestic equities, -5.29% for foreign bonds and 14.66% for foreign equities.

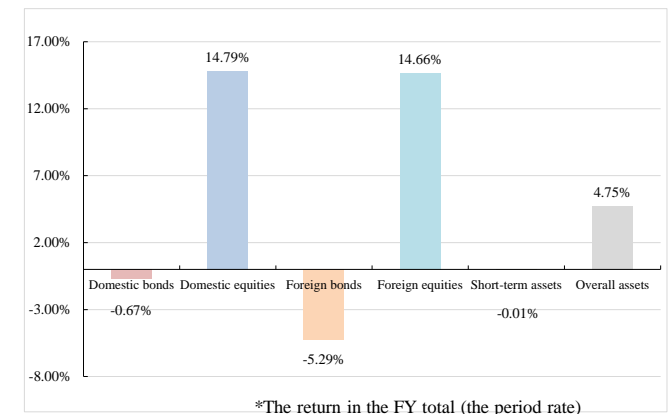
(Unit: %)

	FY2016				
	Q1	Q2	Q3	Q4	FY total
Return (market value basis)	-3.02	1.40	6.55	0.05	4.75
Domestic bonds	1.61	-1.16	-0.93	-0.32	-0.67
Domestic equities	-7.01	6.70	14.63	0.67	14.79
Foreign bonds	-8.21	-0.51	7.50	-3.59	-5.29
Foreign equities	-7.71	3.79	16.60	2.42	14.66
Short-term assets	-0.02	0.00	0.00	0.00	-0.01



(Unit: %)

	FY2016				
	Q1	Q2	Q3	Q4	FY total
Realized return (book value basis)	0.62	0.28	0.62	0.72	2.24



(Note 1) The return in each quarter is the period rate.

(Note 2) The return represent figures after the deduction of fees, etc. settled within the relevant period.

## Contribution Analysis of the Excess Return by Asset Class ①

○ The return (market value basis) for overall assets was 4.75%, while the excess return was -1.39%.

The excess return due to the asset allocation factor was negative (-1.43%) against the backdrop of a fall in domestic bond prices and a rise in equity prices because the actual portfolio was overweight in domestic bonds and underweight in domestic and foreign equities compared with the benchmark portfolio.

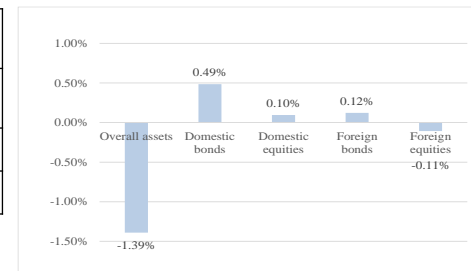
The excess return due to the individual asset factor was positive (0.19%) mainly because the return on domestic bonds exceeded the benchmark return.

FY2016 (April 2016 through March 2017)

	Overall assets	Domestic bonds	Domestic equities	Foreign bonds	Foreign equities
Return (market value basis)	4.75%	-0.67%	14.79%	-5.29%	14.66%
Benchmark return*	6.14%	-1.15%	14.69%	-5.41%	14.77%
Excess return	-1.39%	0.49%	0.10%	0.12%	-0.11%

\* The benchmark return for overall assets is calculated by weight-averaging the benchmark returns for individual asset classes based on the shares in the asset mix of the benchmark portfolio.

Excess return



	Asset allocation factor ①	Individual asset factor ②	Other factor (including errors) ③	①+②+③
Domestic bonds	-0.62%	0.17%	-0.04%	-0.49%
Domestic equities	-0.28%	0.02%	-0.04%	-0.30%
Foreign bonds	0.34%	0.02%	-0.03%	0.33%
Foreign equities	-0.59%	-0.03%	-0.03%	-0.64%
Short-term assets	-0.28%	0.00%	-0.01%	-0.28%
Total	-1.43%	0.19%	-0.14%	-1.39%

(Reference) Deviation of the actual portfolio from the benchmark portfolio in terms of the asset mix (as of the end of FY2016)

	Local Public Service Mutual Aid Associations	Benchmark Portfolio	Deviation
Domestic bonds	39.2%	35.0%	4.2%
Domestic equities	23.1%	25.0%	-1.9%
Foreign bonds	12.5%	15.0%	-2.5%
Foreign equities	20.2%	25.0%	-4.8%
Short-term assets	5.1%		5.1%
Total	100.0%	100.0%	0.0%

(i) Asset allocation factor: A factor that is attributable to the difference in terms of the asset mix between the benchmark portfolio, which is the standard for the calculation of the composite benchmark, and the actual portfolio.

(ii) Individual asset factor: A factor that is attributable to the difference between the actual and benchmark returns concerning each asset class, which may arise depending on the level of investment expertise.

(iii) Other factor (including errors): A factor combining elements of the asset allocation and individual asset factors and calculation errors.

## Contribution Analysis of the Excess Return by Asset Class ②

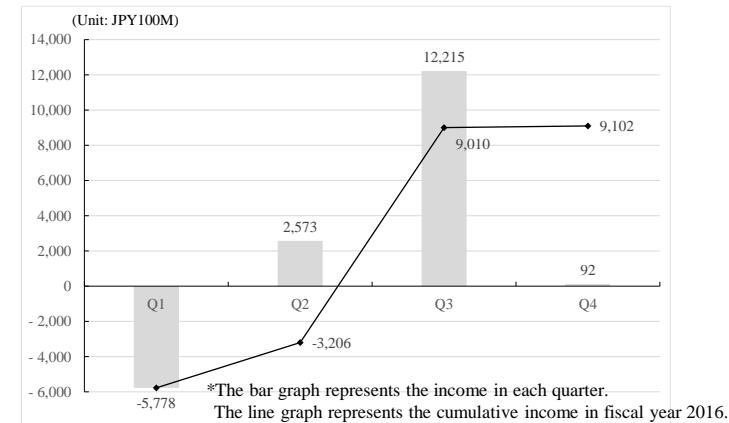
- Overall assets: The return (market value basis) for overall assets was 4.75%, while the excess return was -1.39%.  
The excess return due to the individual asset factor was positive mainly because the excess return on domestic bonds exceeded the benchmark return. Meanwhile, the actual portfolio was overweight in domestic bonds and underweight in domestic and foreign equities compared with the benchmark portfolio although the deviation of the actual portfolio from the benchmark portfolio was reduced compared to the end of FY2015. Against the backdrop of a rise in U.S. interest rates after the U.S. presidential election in the second half of the year, domestic bond prices declined and equity prices rose, and as a result, the excess return was negative mainly because of the negative contributions from the asset allocation factor.
- Domestic bonds: The return (market value basis) was -0.67%, while the excess return was 0.49%.  
The excess return was positive because the duration of domestic bonds held as part of the mandatory investment was shorter than the duration for the benchmark, which kept the rate of price drop due to an interest rate rise lower compared with the benchmark, and also because of the overweight in municipal bonds for which a percentage change exceeded the benchmark and the performance of products comprising corporate bonds and currency-hedged foreign bonds was robust.
- Domestic equities: The return (market value basis) was 14.79%, while the excess return was 0.10%.  
The sector selection effect was negative as the overweighting in domestic demand-related sectors and underweighting in the banking and electric appliance sectors made negative contributions after Donald Trump was elected in the U.S. presidential election, while the issue selection effect was positive. Meanwhile, the performance of value-oriented products was robust. As a result of all these factors, the excess return was positive.
- Foreign bonds: The return (market value basis) was -5.29%, while the excess return was 0.12%.  
The bond type selection effect was positive because of the overweighting in corporate bonds, among other factors, and the interest rate selection factor was also positive because of a successful duration strategy adapted to an interest rate change in the relevant period. In addition, general type products comprising relatively large proportions of corporate bonds performed strongly. As a result of all these factors, the excess return was positive.
- Foreign equities: The return (market value basis) was 14.66%, while the excess return was -0.11%.  
The country selection effect was negative due to the underweighting in resource-producing countries whose equities rose steeply due to a recovery of commodities markets, such as Brazil and Russia. Meanwhile, value-oriented and judgmental products performed poorly. As a result of all these factors, the excess return was negative.

## Fiscal Year 2016 Investment Income

- Investment income (market value basis) in fiscal year 2016 was ¥910.2 billion. Realized income (book value basis) was ¥394.5 billion.
- By asset class, investment income (market value) was -¥56.6 billion for domestic bonds, ¥591.1 billion for domestic equities, -¥128 billion for foreign bonds and ¥503.8 billion for foreign equities.

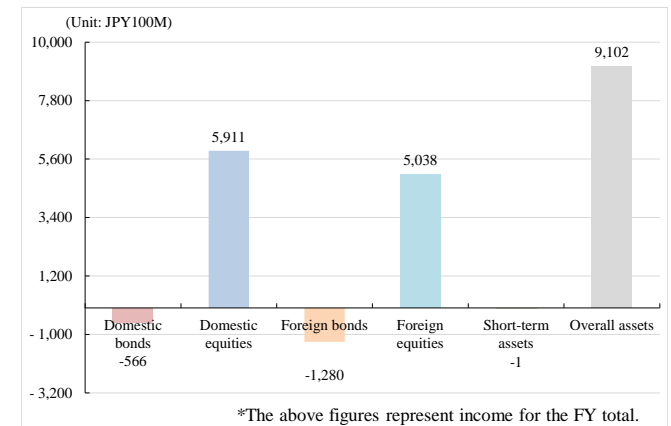
(Unit: JPY100M)

	FY2016				
	Q1	Q2	Q3	Q4	FY total
Investment income (market value basis)	-5,778	2,573	12,215	92	9,102
Domestic bonds	1,431	-982	-761	-254	-566
Domestic equities	-2,724	2,484	5,843	308	5,911
Foreign bonds	-1,932	-111	1,676	-914	-1,280
Foreign equities	-2,552	1,182	5,456	952	5,038
Short-term assets	-1	0	0	0	-1



(Unit: JPY100M)

	FY2016				
	Q1	Q2	Q3	Q4	FY total
Realized income (book value basis)	1,093	498	1,081	1,273	3,945



(Note 1) The income represent figures after the deduction of fees, etc. settled within the relevant period.

(Note 2) The investment income (market value basis) represents the realized income (book value basis) adjusted for the effects of changes in valuation gains/losses based on market value.

(Note 3) Realized income (book value basis) represents the sum of trading profits/losses and interest and dividend income, etc.

(Note 4) Due to rounding, the total sum of individual figures may not necessarily add up to the FY total.

## Fiscal Year 2016 Value of Assets

(Unit: JPY100M)

	FY2016											
	End of Q1			End of Q2			End of Q3			End of FY		
	Book value	Market value	Valuation gains/losses	Book value	Market value	Valuation gains/losses	Book value	Market value	Valuation gains/losses	Book value	Market value	Valuation gains/losses
Domestic bonds	78,652	85,069	6,417	77,898	82,862	4,964	76,140	80,136	3,996	75,066	78,505	3,440
Domestic equities	36,617	36,987	370	36,808	39,673	2,865	37,538	45,587	8,048	38,532	46,244	7,712
Foreign bonds	23,234	21,988	-1,246	23,150	21,998	-1,152	24,493	24,984	490	25,660	25,049	-611
Foreign equities	27,679	31,005	3,326	28,159	32,530	4,371	29,189	38,731	9,543	30,347	40,467	10,120
Short-term assets	6,697	6,696	-1	11,352	11,352	-0	8,689	8,689	0	10,212	10,212	-0
Total	172,878	181,744	8,866	177,367	188,414	11,048	176,049	198,127	22,078	179,817	200,478	20,661

(Note 1) Due to rounding, the total sum of individual figures may not necessarily add up to the Total.

(Note 2) Starting in fiscal year 2016, short-term assets held by each fund were classified into relevant asset classes in principle.

(Note 3) Group pure endowment insurance is included in domestic bonds.

### The amount of funds allocated and withdrawn by asset class (for FY2016)

(Unit: JPY100M)

	Domestic bonds	Domestic equities	Foreign bonds	Foreign equities
Amount of funds allocated and withdrawn	-14,897	2,600	2,865	3,078

(Note 1) The above figures represent the total amount of fund flows related to the allocation and withdrawal of funds (rebalancing) conducted for the purpose of changing the asset mix, and cashing out.

(Note 2) As a result of the final classification of funds related to the integration of employee pension plans, funds totaling ¥261.4 billion (total for the Local Public Service Mutual Aid Associations) were transferred from the Transitional Long-term Benefit Fund in December 2016.

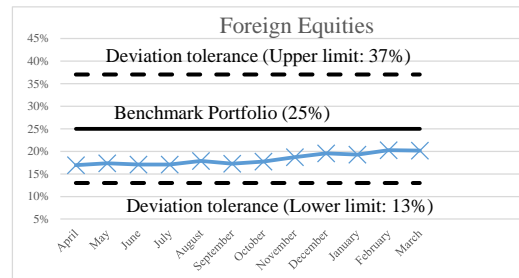
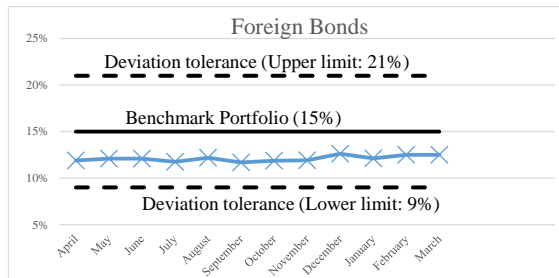
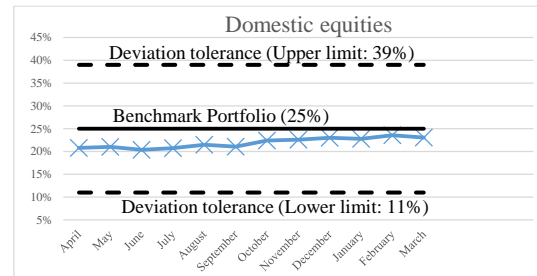
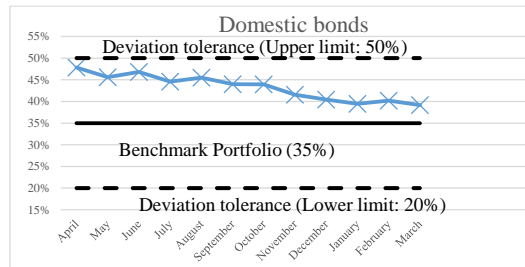


## Status of Risk Management (Overall Assets)

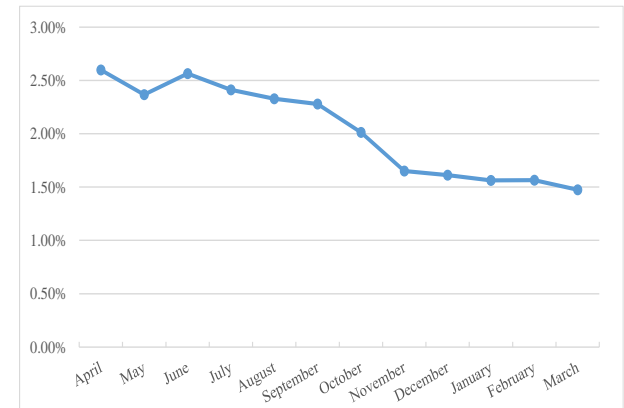
In fiscal year 2016, the shares in the asset mix concerning all asset classes—domestic bonds, domestic equities, foreign bonds and foreign equities—stayed within the deviation tolerance.

The estimated tracking error concerning overall assets is on the decline because of a reduction of the deviation concerning domestic and foreign equities and other factors.

### 【Changes in the asset mix】



### 【Changes in the estimated tracking error】



(Note) The estimated tracking error concerning overall assets represents the tracking error concerning the benchmark portfolio.

## Fiscal Year 2016 Fees

- The amount of fees totaled ¥10.2 billion in fiscal year 2016.  
The fee rate relative to the value of investment assets came to 0.05%.

(Unit: JPY100M, %)

	FY2016	
	Fee	Fee rate
Domestic bonds	17	0.02
Domestic equities	32	0.08
Foreign bonds	17	0.07
Foreign equities	35	0.10
Overall assets	102	0.05

(Note 1) Fees include management fees and custodian fees related to entrusted investment.

(Note 2) Fee rate = fee amount/month-end market value average balance

(Note 3) The month-end market value average balance includes short-term assets.

## Section 2 Systems and Activities Concerning Administration and Investment of Funds

## Basic Approach to Investment

- As a basic policy, investment shall be made for the purpose of contributing to the stable management of the Employees' Pension Insurance operations into the future by investing safely and efficiently from a long-term perspective for the benefits of individuals covered by Employees' Pension Insurance.
- In the management of funds, investments shall be made in a way that ensures appropriate diversification across multiple assets with different risk/return profiles and other characteristics.
- To ensure the required real return on investments of the funds (meaning the investment return less the nominal wage increase) at the minimum risk, a benchmark portfolio shall be established and appropriately managed and efforts shall be made to secure the benchmark return for each asset class, including over the long term.

### Administration and Investment Policy for Managed Fund of Employees' Pension Insurance Schemes (Extract)

#### 1. Basic policy concerning the Managed Reserve Fund

##### (1) Basic Policy

Especially keeping in mind that the Managed Reserve Fund is part of insurance premiums collected from insured persons of the Employees' Pension Insurance ("EPI") and valuable resources for funding future pension benefits, the Association shall invest the Managed Reserve Fund with the objective of contributing to the stable operation of EPI schemes in the future by investing it safely and efficiently "solely for" ("for" in the case of investing in line with the objectives of the Mutual Aid Association Act under Article 79-3, Paragraph (3), of the Act) the interests of insured persons of the EPI from the long-term perspective.

In addition, the Association administers and manages the Managed Reserve Fund in accordance with the Basic Guidelines for the Safe and Efficient Administration and Investment of the Reserve Funds from the Long-Term Perspective (July 2014 Notification No. 1 of Ministry of Internal Affairs and Communications (MIC), Ministry of Finance (MOF), Ministry of Education, Culture, Sports, Science and Technology (MEXT) and Ministry of Health, Labour and Welfare (MHLW); the "Fund Basic Guidelines").

Accordingly, on the basis of diversifying investments in multiple assets that differ in risk/return and other characteristics ("Diversified Investment"), the Administration and Investment Organizations (meaning the Government Pension Investment Fund (GPIF), the Federation of National Public Service Personnel Mutual Aid Associations, the Association, and the Promotion and Mutual Aid Corporation for Private Schools of Japan; the same applies hereinafter) jointly establish the Model Portfolio, and, in reference to the Model Portfolio, the Association administers and invests the Managed Reserve Fund by establishing an asset mix from the long-term perspective (the "Benchmark Portfolio").

##### (2) Investment target, risk management, etc.

###### ① Investment target

In consideration of the current status and outlook of public finances stipulated in Article 2-4, Paragraph (1), of the Act and Article 4-3, Paragraph (1), of the National Pension Act (Act No. 141 of 1959), the Association shall manage the investment of reserve funds appropriately by establishing the Benchmark Portfolio in order to generate necessary real investment returns for reserve funds (meaning investment returns less nominal wage increases) with the lowest risk, while maintaining necessary liquidity for providing insurance benefits, etc.

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

In addition, the Association strives to earn the benchmark returns for each asset class for each fiscal year, as well as generating benchmark returns for each asset class over the long term.

Appropriate market indicators shall be used for benchmarks, considering, among other factors, whether their structure reflects the market; whether they consist of investable securities, and whether details of the indicators are disclosed.

# Stewardship Responsibilities ①

## Stewardship Responsibilities

### ○ Stewardship Responsibilities

Stewardship responsibilities refers to the responsibilities of institutional investors to increase medium to long-term investment returns for their clients and beneficiaries by encouraging improvements in enterprise value and sustainable growth of investee companies through means such as constructive "purposeful dialogue" (engagement) based on a deep understanding concerning the companies, their business environment, and other factors. Activities conducted by institutional investors to fulfill their stewardship responsibilities include engagement, the exercise of shareholders' voting rights, and ESG investment.

### ○ Efforts of Local Public Service Mutual Aid Associations

Based on the idea that they must conduct stewardship activities proactively in order to fulfill its "fiduciary responsibilities for the Associations' memberships" and the "social responsibilities as a public pension fund," the Local Public Service Mutual Aid Associations independently established the Guidelines for Exercising Shareholders' Voting Rights. Through entrusted investment management institutions, the Local Public Service Mutual Aid Associations have exercised shareholder voting rights.

The Local Public Service Mutual Aid Associations agree with the purpose of the Principles for Responsible Institutional Investors <<Japan's Stewardship Code>> established by the Financial Services Agency, and announced the acceptance of the Code in February 2014.

In addition, in order to enhance transparency over the stewardship activities, the Local Public Service Mutual Aid Associations have published the Annual Stewardship Activity Report, which describes the Associations' stewardship activities, including engagement and the exercise of voting rights conducted through investment management institutions.

## Stewardship Responsibilities ②

### Exercise of Voting Rights

#### ○ Exercise of voting rights of Local Public Service Mutual Aid Associations

With regard to the exercise of shareholders' voting rights, the Local Public Service Mutual Aid Associations instruct investment management institutions entrusted with domestic equity investment to exercise voting rights after making appropriate judgment suited to the conditions of the investee companies because it is difficult for the Local Public Service Mutual Aid Associations to make judgment concerning the details of companies' management decisions. In addition, for the exercise of voting rights concerning foreign equities, some associations, etc. have already exercised such voting rights through entrusted investment management institutions, and other associations, etc. have started discussion toward future exercise of voting rights.

Local Public Service Mutual Aid Associations have formulated their respective guidelines for exercising voting rights in order to clarify their thinking concerning the exercise of shareholders' voting rights, and also require entrusted investment management institutions to exercise voting rights in accordance with these guidelines. In addition, the Local Public Service Mutual Aid Associations check the status of the exercise of voting rights by entrusted investment management institutions and the status of engagement and other activities through periodic hearings.

#### ○ Results of the exercise of voting rights concerning domestic equities

The Local Public Service Mutual Aid Associations exercised voting rights with respect to a total of 36,173 companies which settled accounts between April 2015 and March 2016 (for 141,418 proposals in total). For the details, see the following page.

## Stewardship Responsibilities ③

### ○The results of the exercise of voting rights

Between July 2015 and June 2016, regarding the Employees' Pension Insurance Benefit Fund, the Local Public Service Mutual Aid Associations exercised voting rights, through the 28 investment management institutions entrusted with domestic equity investment, with respect to a total of 36,173 companies which settled accounts between April 2015 and March 2016. The number of proposals concerning which voting rights were exercised was 141,418.

The Local Public Service Mutual Aid Associations voted against 29,624 of the 141,418 proposals (among which 3,698 were shareholder proposals), which translates into a vote-against rate of 20.9% (down 3.0 points from the previous year).

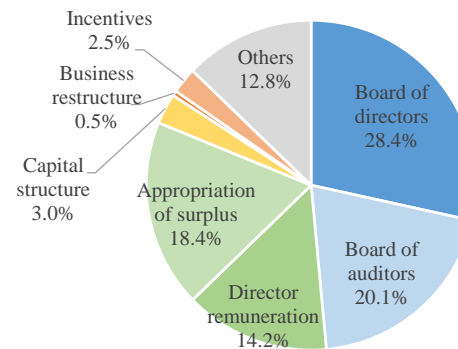
The vote-against rate came to 37.4% (down 10.9 points from the previous year) concerning proposals related to the board of directors/directors, 18.1% (up 0.0 points) concerning proposals related to the board of auditors/auditors, 10.9% (down 5.8 points) concerning proposals related to director remuneration, etc. and 4.2% (down 0.4 points) concerning proposals related to appropriation of surplus.

### Voting activity (Employees' Pension Insurance Benefit Fund)

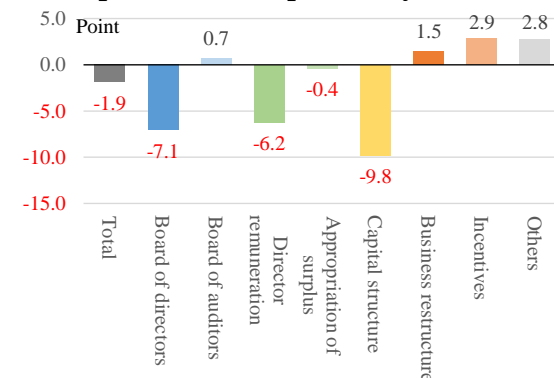
#### Companies with accounting settlement between April 2015 and March 2016

Proposal	Total	Composition	Vote for		Vote against		Vote-against rate in the previous year
			Rate		Rate		
Total	141,418	100%	111,794	79.1%	29,624	20.9%	22.8%
Shareholder proposal	3,819	2.7%	121	3.2%	3,698	96.8%	71.1%
By subject	141,418	100%	111,794	79.1%	29,624	20.9%	22.8%
Board of directors/directors	40,223	28.4%	25,165	62.6%	15,058	37.4%	44.5%
Board of auditors/auditors	28,391	20.1%	23,242	81.9%	5,149	18.1%	17.4%
Director remuneration, etc.	20,144	14.2%	17,955	89.1%	2,189	10.9%	17.1%
Appropriation of Surplus	26,056	18.4%	24,963	95.8%	1,093	4.2%	4.6%
Agenda concerning capital structure	4,241	3.0%	2,847	67.1%	1,394	32.9%	42.7%
Takeover Defense Measures	2,181	1.5%	866	39.7%	1,315	60.3%	60.0%
Capital increase or reduction	164	0.1%	156	95.1%	8	4.9%	2.4%
Third Party Allotment of Shares	55	0.0%	43	78.2%	12	21.8%	0.0%
Acquisition of Own Shares	118	0.1%	68	57.6%	50	42.4%	45.7%
Business Restructure	688	0.5%	677	98.4%	11	1.6%	0.1%
Incentives Improvement for Executives and Employees	3,603	2.5%	2,609	72.4%	994	27.6%	24.7%
Other	18,072	12.8%	14,336	79.3%	3,736	20.7%	17.9%

### Share by proposal subject



### Changes in the vote-against rate (compared with the previous year)



\* The above figures include the results of the exercise of voting rights before October 2015, when the pension plans were integrated into the Employees' Pension Insurance plan.

## Stewardship Responsibilities ④

### Engagement

#### ○ Engagement efforts

Local Public Service Mutual Aid Associations require entrusted investment management institutions to conduct engagement and hold interviews concerning the status of engagement in order to increase pension assets in the medium to long term by promoting improvements in enterprise value and sustainable growth through constructive, purposeful dialogue (engagement) based on deep understanding of investee companies, their business environment and other factors. In fiscal year 2015, they conducted engagement with a total of 11,952 companies through 28 investment management institutions entrusted with domestic stock investment. For the details, please see the next page.

#### ○ Results of engagement

As an engagement result, the Local Public Service Mutual Aid Associations seek to fulfill their stewardship responsibilities while obtaining medium- to long-term returns. However, as share prices of investee companies may fluctuate due to various factors such as global economic and monetary policy trends, it is difficult to quantitatively measure the contribution of engagement to the return. Therefore, the associations require entrusted investment management institutions to review their approach to engagement activity's objectives, contents, progress management, and management procedures in order to promote an increase in enterprise value through enhancement of corporate governance and other measures.

Concerning the status of engagement activities at entrusted investment management institutions, various cases were reported as follows:

- As a result of calling for a company to restore the trust lost due to an inappropriate incident, the decision was made to introduce measures to strengthen internal control systems and prevent recurrence.
- An investment management institution pointed out to a company the possibility that its management stance of placing emphasis on social contributions and long-term perspectives was not being recognized in the market and proposed enhancement of information disclosure, and as a result, the company created a section regarding the relevant matters in its disclosure documents.
- An investment management institution pointed out a low level of independence of outside directors and an excessive number of directors at a company, and as a result, the company announced a policy of electing an outside director with a high level of independence, introduction of an executive offer system, and steep reduction of the number of directors.
- An investment management institution proposed to a company a revision of the business portfolio, and as a result, the company announced a withdrawal from unprofitable businesses and a shift of business resources to core businesses.
- An investment management institution called for a company to make active efforts to increase the shareholder return through dialogue, and as a result, the company raised the target level of the total return ratio under a new medium-term plan.



## Stewardship Responsibilities ⑤

### ○ Number of cases of engagement

In fiscal year 2015, regarding the Employees' Pension Insurance Benefits Fund, the Local Public Service Mutual Aid Associations implemented engagement with a total of 11,952 companies through the 28 investment management institutions entrusted with domestic equity investment. The number of cases of engagement was 35,041 in total. The number of cases of direct dialogue with top managers of companies was 8,459, or 24.1% of the total.

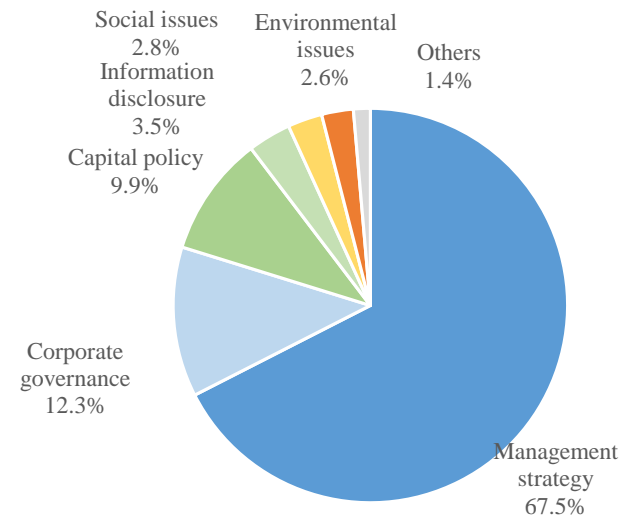
Regarding major subjects of engagement, the number of cases of dialogue concerning management strategy issues, including management challenges, came to 23,649, or 67.5% of the total, followed by dialogue concerning corporate governance issues, including the composition of the board of directors with 4,310 cases (12.3%) and capital policy issues, including the shareholder return with 3,459 cases (9.9%).

#### Number of cases of engagement in FY 2015 (including overlaps)

Dialogues	Number of cases	Composition	Dialogues with top managers	
				Rate
Total	35,040	100.0%	8,458	24.1%
Dialogues concerning management strategy	23,649	67.5%	5,730	24.2%
Dialogues concerning corporate governance	4,309	12.3%	949	22.0%
Dialogues concerning capital policy	3,459	9.9%	1,178	34.1%
Dialogues concerning information disclosure	1,238	3.5%	369	29.8%
Dialogues concerning social issues	991	2.8%	96	9.7%
Dialogues concerning environmental issues	911	2.6%	43	4.7%
Other	483	1.4%	93	19.3%

\* Including the results before October 2015, when the pension plans were integrated into the Employees' Pension Insurance plan.

#### Share by dialogue item



## Stewardship Responsibilities ⑥

### Efforts for ESG investing

Some Local Public Service Mutual Aid Associations engage in ESG investment in order to fulfill the "fiduciary duty of increasing the value of assets for the interests of members over the long term" and "the social responsibility as a public pension fund." In principle, funds managed by these associations evaluate companies from the viewpoints of environmental (E), social (S), and Governance (G) factors and make investments in companies evaluated highly in terms of the ESG factors. ESG investment seeks to ensure adequate long-term returns by paying attention not only to short-term corporate performance but also to the sustainability element as represented by the ESG factors.

As of the end of fiscal year 2016, Local Public Service Mutual Aid Associations had investment in 10 ESG-focused products with a total market value of ¥154 billion entrusted to investment management institutions. Three organizations engaging in ESG investment (the Pension Fund Association for Local Government Officials, the Japan Mutual Aid Association of Public School Teachers and the National Federation of Mutual Aid Associations for Municipal Personnel) intend to continue to do so while continuously monitoring the evaluation of companies in terms of the ESG factors and the evaluation of investment performance. Meanwhile, the Japan Police Personnel Mutual Aid Association, which adopted one ESG-focused product in fiscal year 2016, will start ESG investment, while other associations are considering making ESG investment.

### Future activities

Local Public Service Mutual Aid Associations intend to actively conduct stewardship activity, mainly the exercise of voting rights, engagement and ESG investment, in order to simultaneously fulfill the fiduciary and social responsibilities.

Local Public Service Mutual Aid Associations believe that the stewardship responsibilities can be more effectively fulfilled on the whole by continuing to appropriately develop their policy for stewardship activity, including the Guidelines for Exercising Shareholders' Voting Rights, and indicating its approach and policy and then by conducting stewardship activity through investment management institutions with in-depth knowledge concerning corporate management and appropriately monitoring their activity from the viewpoint of enhancing the activity's effectiveness.

Specifically, Local Public Service Mutual Aid Associations are considering the following efforts.

- Implementation of effective monitoring of entrusted investment management institutions

Local Public Service Mutual Aid Associations will continue to make sure that entrusted investment management institutions' stewardship activity is consistent with their policy and implement effective monitoring placing emphasis on the quality of efforts, including measures to promote effective activities by investment management institutions.

- Collaboration with other public pension funds, etc.

As part of support for appropriate decision making related to dialogue with investee companies and stewardship activity, Local Public Service Mutual Aid Associations will conduct initiatives such as exchanging opinions with other public pension funds, etc. as necessary.

- Revision of the policy for stewardship activities

Local Public Service Mutual Aid Associations revise their policy for stewardship activities as necessary in consideration of changes in laws, regulations, codes and the social situation, among other factors.

## Diversification of eligible investment instruments (investment in alternative assets) ①

To pursue diversified investment of Managed Fund for the purpose of investing Managed Fund of employees' pension insurance service safely and efficiently from a long-term perspective, alternative investment was started in fiscal year 2015 in consideration of the opinion expressed by a panel of outside experts.

In addition, some member associations have also been discussing implementing alternative investment, and the National Federation of Mutual Aid Associations for Municipal Personnel plans to introduce an asset manager registration system for alternative investment starting from fiscal year 2017.

### Investment policy pertaining to diversification of eligible investment instruments (investment in alternative assets) (Excerpt)

#### 1. Definition of diversification of eligible investment instruments

##### ① Definition of diversification of eligible investment instruments

"Diversification of eligible investment instruments" means making investments in assets whose characteristics, such as the risk/return profiles, are different from those of traditional assets such as equities and bonds ("alternative assets").

##### ② Scope of alternative assets

Alternative assets are assets such as real estate, infrastructure and private equities, and negotiable securities, trust beneficiary rights and other assets backed by those assets.

#### 2. Purpose of diversification of eligible investment instruments

Diversification is used to promote diversified investment of managed funds for the purpose of investing the funds safely and efficiently from a long-term perspective.

#### 3. Classification of alternative assets in the benchmark portfolio, etc.

##### (1) Classification of alternative assets in the benchmark portfolio

Alternative assets are classified into domestic bonds, domestic equities, foreign bonds or foreign equities according to their risk/return profiles and other characteristics.

##### (2) Share of alternative assets in the asset mix of the portfolio

The share of alternative assets in the asset mix is limited to a maximum of 5% of overall managed funds and the total assets of each implementing organization's funds.

## Diversification of eligible investment instruments (investment in alternative assets) ②

### Investment policy pertaining to diversification of eligible investment instruments (investment in alternative assets) (Excerpt)

#### 4. Matters to note when diversifying eligible investment instruments

The Pension Fund Association for Local Government Officials (hereinafter referred to as the “Association”) and implementing organizations (excluding the Association) take note of the following matters when diversifying eligible investment instruments.

- ① In principle, investment is diversified between traditional assets, such as equities and bonds, and alternative assets and across different types of alternative assets.
- ② Diversification is made after the effects of diversified investment have been recognized and sufficient evidence to support the expectation that an excess return can be obtained has been obtained.
- ③ Because alternative assets are different from traditional assets in many points, such as marketability, profitability, individuality, transaction cost, and information disclosure status, the Association and implementing organizations conduct a study with due consideration of the development of the market environment, including the steady improvement of the earning capacity of each asset and the development of the secondary market.
- ④ The Association and implementing organizations make alternative investment after developing the investment and risk management systems necessary for the investment (including hiring personnel with advanced expert skills).
- ⑤ The Association and implementing organizations use the expert knowledge of the Fund Management Committee of Local Public Service Mutual Aid Associations and the committee of specialist of implementing organizations.

#### <Specific Efforts by Association>

##### (1) Introduction of an Asset Manager Registration System

On July 31, 2015, the Association introduced an Asset Manager Registration System for Alternative Investments and started receiving entries from investment management institutions with respect to investment products using domestic and foreign real estate and infrastructure as investment instruments. Subsequently, private equities were added to the scope of eligible investment instruments on June 30, 2016.

An Asset Manager Registration System is a system whereby the Association accepts entries from investment management institutions for investment products on an ongoing basis and evaluates and selects investment products.

##### (2) Selection of investment products

From among the investment products entered, the Association carefully selected investment products that are expected to bring long-term income gains and provide the diversification investment effect. As of the end of fiscal year 2016, based on a comprehensive evaluation from both quantitative and qualitative aspects, the Association decided to adopt a total of nine alternative asset products, including three products investing in domestic real estate (diversified investment in apartments, etc. mainly in the Tokyo area), two products investing in foreign real estate (diversified investment in apartments, etc. in major U.S. markets), three products investing in foreign infrastructure (investment in infrastructure assets in developed countries), and one product investing in domestic private equities (buy-out investment in middle-sized Japanese businesses), and have started investing in six products.

In the future, to seize opportunities for investing in superior investment products likely to contribute to diversified investment of the adjustment funds, the Association will continue to evaluate the investment products entered and make selection.

## Review of Manager Structure

In fiscal year 2016, Local Public Service Mutual Aid Associations invited public applications as follows as part of efforts to improve the investment performance of the Employees' Pension Insurance Benefit Fund and the Transitional Long-term Benefit Fund by promoting the improvement of the results achieved by entrusted investment management institutions and to review its management structure. In the selection process, Local Public Service Mutual Aid Associations closely examine investment policies for products, investment processes and other factors and select investment management institutions based on a comprehensive evaluation from both quantitative and qualitative aspects while also taking into consideration opinions expressed at a meeting of outside experts.

### <Specific Efforts in Fiscal Year 2016>

#### ○Pension Fund Association for Local Government Officials

- Domestic bonds

Selected products adapted to low interest rates and started investment management in fiscal year 2017.

#### ○Japan Mutual Aid Association of Public School Teachers

- Domestic bonds

While adopting three products taking account of the low interest rate environment, reviewed existing products and terminated five of them. At the same time, selected a transition manager in order to ensure smooth transfer of assets.

- Domestic equities

While adopting one product using a non-TOPIX benchmark, reviewed existing products and terminated four of them. At the same time, selected a transition manager in order to ensure smooth transfer of assets

- Foreign equities

While adopting two products based in non-market capitalization-weighted indexes, reviewed existing products and terminated two of them.

- Foreign bonds

Reviewed existing products and terminated one of them.

#### ○Japan Police Personnel Mutual Aid Association

- Domestic equities

Selected three products and started investment management in fiscal year 2017 for the purpose of investment style diversification. At the same time, reviewed existing products and terminated one of them.

#### ○National Federation of Mutual Aid Associations for Municipal Personnel

- Domestic bonds

Terminated two existing products and adopted two products taking account of the low interest rate environment.

- Foreign bonds

Adopted seven products in order to promote risk diversification through the diversification of investment methodologies and managers.

## Administration and Evaluation of Entrusted Investment Management Institutions and Asset Administration Institutions

### (1) Entrusted investment management institutions

Entrusted investment management institutions are required to submit monthly reports on the investment status and quarterly reports on the overview of investment results, future investment policy and other matters. In addition, the Local Public Service Mutual Aid Associations conduct a detailed interview semiannually concerning the overview of investment results, future investment policy and other matters.

Furthermore, the Local Public Service Mutual Aid Associations conduct a comprehensive evaluation combining quantitative and qualitative evaluation by asset and by investment category. Comprehensive evaluation is intended to conduct evaluation from the long-term perspective and from the viewpoint of the role that each fund is expected to play. Quantitative evaluation mainly assesses the actual excess return after deduction of compensation, the information ratio (the tracking error in the case of passive investment), and the cost performance. Qualitative evaluation assesses the quality of the portfolio investment that cannot be captured by quantitative evaluation and the communications capabilities, investment process and philosophy, portfolio structuring and monitoring, execution of transactions, business management, etc. of investment management institutions. The Local Public Service Mutual Aid Associations allocate funds in a consistent manner across the entire portfolio in consideration of not only the results of comprehensive evaluation but also the balance of strategy categories in each asset class and the balance of funds in each category.

If, as a result of comprehensive evaluation, it is judged that there is no prospect for obtaining an excess return, necessary measures are taken such as termination in part.

### (2) Asset administration institutions

The Local Public Service Mutual Aid Associations provide an incentive or give a reminder for asset administration institutions as appropriate by providing feedback on the results of qualitative evaluation of their asset administration status and by transferring funds from one institution to another depending on the results in order to ensure appropriate administration by asset administration institutions.

## Measures taken to respond to low and negative interest rates

- In recent years, in order to achieve the "price stability target" of 2% at an early time, the Bank of Japan (BOJ) has introduced monetary policy measures such as the Quantitative and Qualitative Monetary Easing with a Negative Interest Rate (announced on January 29, 2016) and the Quantitative and Qualitative Monetary Easing with Yield Curve Control (announced on September 21, 2016). Consequently, investors have shifted funds from short-term assets, to which negative interest rates are applied, to Japanese government bonds (JGBs). Some investors have purchased JGBs in order to earn profits by selling them later to the BOJ, which is conducting JGBs purchase operations. As a result, the yield on JGBs declined and has stayed negative at around zero.
- In this market environment, the following points can be cited as challenges for managers.
  - Income gains may decline due to the redemption of bonds purchased when interest rates were high.
  - If investment in ultra-long-term bonds is made actively in order to avoid purchasing bonds with a negative yield, an interest rate rise in the future may cause valuation losses on bond holdings to increase and reduce the average yield due to the presence of low-coupon bonds in the portfolio.

<Measures so far taken to respond to low and negative interest rates>

- Concerning domestic bonds, the following measures have been taken.
  - Avoiding purchases of bonds with a negative yield
  - Investing in 20-year bonds as well in order to earn income gains in consideration of the risk of a future interest rate rise
  - Purchasing investment-grade corporate bonds
  - Implementation and discussion of allocation of more funds to currency-hedged foreign bonds
  - Reduction of passive investment
- Concerning other assets, the following measures have been taken.
  - Investing in real estate and infrastructure as alternative investment
  - Reducing holdings of short-term assets (surplus funds within funds) to which negative interest rates are applied
  - Opening ordinary accounts to which negative interest rates are not applied

## Governance ①

### 1. Local Public Service Mutual Aid Associations

#### (1) Organization

The Pension Fund Association for Local Government Officials is comprised of the Mutual Aid Association of Prefectural Government Personnel, the Japan Mutual Aid Association of Public School Teachers, the Japan Police Personnel Mutual Aid Association, the Mutual Benefit Association for Tokyo Metropolitan Government Employees, and the National Federation of Mutual Aid Associations for Municipal Personnel.

The Pension Fund Association for Local Government Officials provides the associations, etc. with technical and expert knowledge, and reference materials related to the administration and investment of funds. In addition, it keeps track of the activities of the associations, etc., including surveys and research, and exchanges information with and acts as a liaison and coordinator for them.

In addition, the Pension Fund Association for Local Government Officials and the associations, etc. are engaging in such cooperation activities as mutually providing necessary information concerning the implementation of activities related to investment of the implementing organizations' funds.

#### (2) Fund Management Committee of Local Public Service Personnel Mutual Aid Associations

To study expert matters pertaining to the administration and investment of funds (meaning administration and investment of the Managed Fund, administration and investment of Annuity Retirement Benefit Adjustment Fund (including administration of the investment status of Annuity Retirement Benefit Association Reserve Fund of the associations, etc.) and the administration and investment of Transitional Long-term Benefit Adjustment Fund (including administration of the investment status of Transitional Long-term Benefit Association Reserve Fund of the associations, etc.) for the Pension Fund Association for Local Government Officials established the Fund Management Committee of Local Public Service Personnel Mutual Aid Associations, which is comprised of individuals who possess academic knowledge or practical experience in areas such as economics, finance and fund management.



## Governance ②

### 2. Implementing Organizations

#### (1) Governing Council

To amend the articles of incorporation and operating rules, and study and discuss the business plans, budgets, and settlement of accounts for each business year and other important operating matters, governing councils and other committees have been established at the Pension Fund Association for Local Government Officials and the associations. These matters are to be decided through deliberations by the governing councils, etc.

The designations, etc. of the governing councils and other committees at Local Public Service Mutual Aid Associations are as follows.

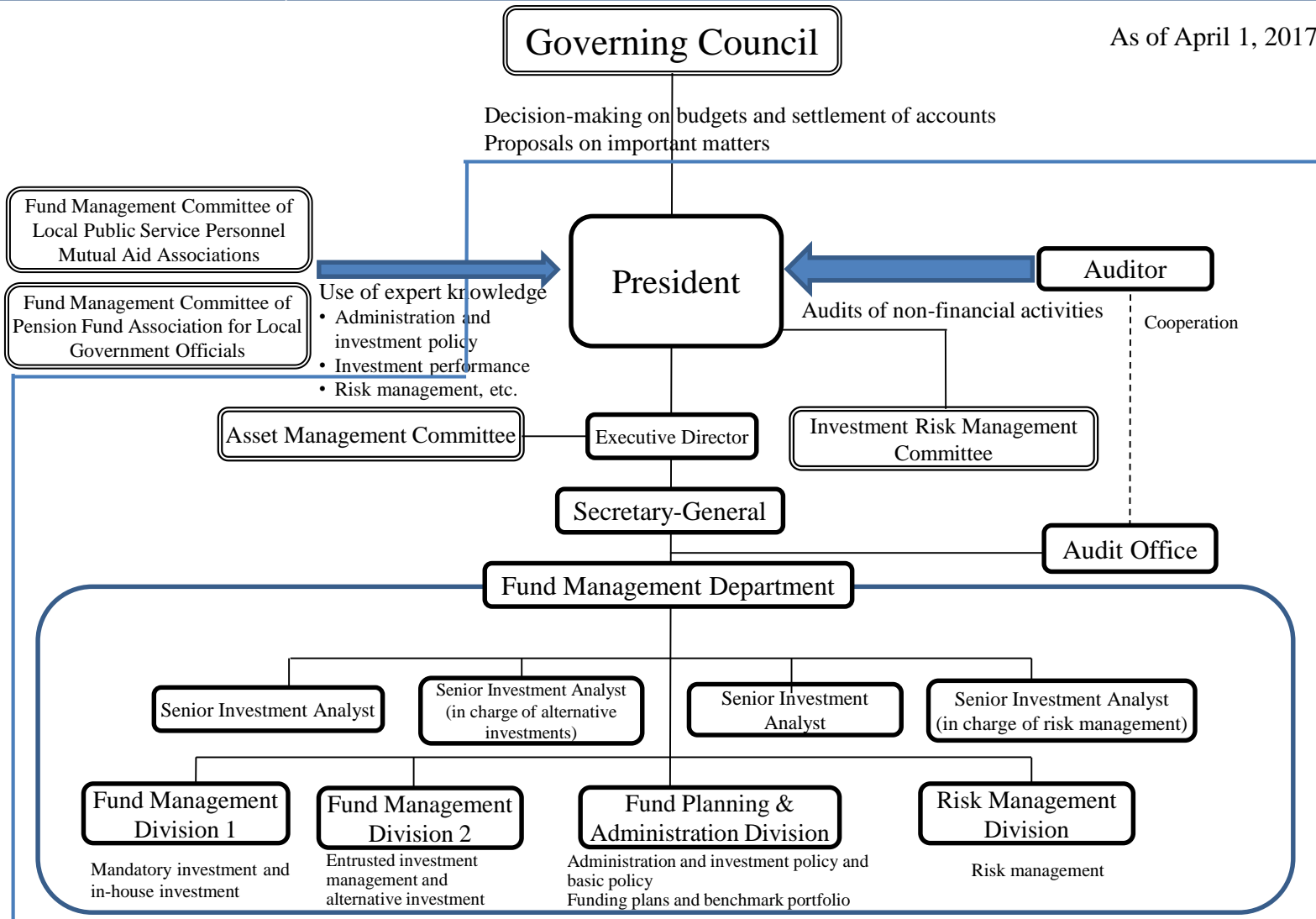
- Governing Council (Articles 38-4 and 38-5 of the Local Public Officers, etc. Mutual Aid Association Act)  
Pension Fund Association for Local Government Officials
- Governing Council (Articles 6, 7, and 8 of the Local Public Officers, etc. Mutual Aid Association Act)  
Prefectural Mutual Aid Secretary Office of the Mutual Aid Association of Prefectural Government Personnel  
Japan Mutual Aid Association of Public School Teachers  
Japan Police Personnel Mutual Aid Association
- Associations Committee (Articles 6, 9 and 10 of the Local Public Officers, etc. Mutual Aid Association Act)  
Mutual Benefit Association for Tokyo Metropolitan Government Employees, Mutual Aid Associations for Designated City Municipal Personnel, Mutual Aid Associations for Municipal Personnel (other than Tokyo and designated cities), Mutual Aid Associations for City Municipal Personnel
- General Committee (Articles 30, 31 and 32 of the Local Public Officers, etc. Mutual Aid Association Act)  
National Federation of Mutual Aid Associations for Municipal Personnel
- Management Board of Trustees (Articles 144-5, 144-6 and Article 144-7 of the Local Public Officers, etc. Mutual Aid Association Act)  
Group Mutual Aid Department of Prefectural Mutual Aid Association

#### (2) Utilization of a committee of specialists

For expert matters pertaining to the administration and investment of implementing organization funds, including the formulation and revision of basic policy, Local Public Service Mutual Aid Associations utilize committees of experts comprised of individuals who possess academic knowledge or practical experience in areas such as economics, finance and fund investments.

## Governance ③ (Reference: Governance Structure for Pension Fund Association for Local Government Officials)

As of April 1, 2017



## Governance ④ (Fund Management Committee of Local Public Service Personnel Mutual Aid Associations)

### ○ Fund Management Committee of Local Public Service Personnel Mutual Aid Associations

To study expert matters pertaining to the administration and investment of each fund (meaning the administration and investment of managed fund, the administration and investment of the Annuity Retirement Benefit Adjustment Fund (including administration of investment status of Annuity Retirement Benefit Association Reserve Fund of the Mutual Aid Association of Prefectural Government Personnel, the Japan Mutual Aid Association of Public School Teachers, the Japan Police Personnel Mutual Aid Association, Mutual Benefit Association for Tokyo Metropolitan Government Employees, and National Federation of Mutual Aid Associations for Municipal Personnel) and administration and investment of the Transitional Long-term Benefit Adjustment Fund (including administration of the investment status of Transitional Long-term Benefit Association Reserve Fund of the associations, etc.)), based on the Administration and Investment Policy for the Managed Fund for Employees ' Pension Insurance Schemes (established on October 1, 2015), the Administration and Investment Policy for the Annuity Retirement Benefit Adjustment Fund (established on October 1, 2015) and the Administration and Investment Policy for Transitional Long-Term Benefit Adjustment Fund (established on October 1, 2015), the Fund Management Committee of Local Public Service Personnel Mutual Aid Associations has been established, which is comprised of individuals who possess academic knowledge or practical experience in areas such as economics, finance, and fund management.

#### List of Committee Members (As of April 2017)

##### Chairperson

Takaaki Wakasugi	Executive Director, Michigan University-Mitsui Life Financial Research Center
Eisaku Ide	Professor, Keio University Faculty of Economics
Hidetaka Kawakita	Kyoto University, Professor Emeritus
Konosuke Kita	Russell Investments Japan Co., Ltd. Executive Consultant/Director, Consulting
Yoshiko Takayama	J-Eurus IR Co., Ltd. Managing Director
Hitoshi Takehara	Professor, Waseda Business School (Graduate School of Business and Finance)
Katsuyuki Tokushima	NLI Research Institute Pension Research Center, Financial Research Department, Chief Fixed Income Analyst
Toshino Masashi	Professor, Seikei University, Faculty of Economics
Kazuyo Hachisuka	Managing Director, Japan Economic Research Institute Inc.
Kumi Fujisawa	President, Think Tank SophiaBank
Masahiro Morimoto	All-Japan Prefectural and Municipal Workers Union General Manager, Central Executive Committee Bureau of Labor

##### • Deliberation Matters

- ① Matters concerning formulation and revision of the model portfolio
- ② Matters concerning formulation and revision of administration and investment policy
- ③ Matters concerning formulation and revision of risk management implementation policy
- ④ Matters concerning formulation and revision of investment policy for new investment instruments
- ⑤ Other expert matters concerning the administration and investment of each fund

##### • Reporting matters

- ① Investment performance
- ② Status of risk management
- ③ Investment status of new investment instruments
- ④ Status of training and nurturing of expert personnel
- ⑤ Other matters required by the committee concerning the administration and investment of each fund

- The committee can express its opinions on important matters upon request from the President concerning expert matters related to the administration and investment of each fund.

## Governance ⑤ (Approach to Risk Management)

- Generally speaking, "risk" refers to the possibility of an incident that could have a negative impact on an organization's goals and objectives. In the field of asset investment, interest rate risk, price fluctuation risk, credit risk, liquidity risk and other factors are viewed as "risks" in some cases, while the possibility that the required yield cannot be ensured may be viewed as a "risk" in other cases. Therefore, for asset investment, it is important to consider various risks commensurate with investment from a long-term perspective.
- The Pension Fund Association for Local Government Officials, in accordance with the implementation policy for risk management concerning investment of managed fund as an administration and investment organization, and the Local Public Service Mutual Aid Associations, in accordance with the implementation policy for risk management concerning investment of Transitional Long-term Benefit Fund as an implementing organization, appropriately implement risk management concerning investment in consideration of the following points: that investment of funds should be made safely and efficiently from a long-term perspective; that diversified investments should be maintained in principle; and that the relationship between all Local Public Service Personnel Mutual Aid Associations' liabilities and the funds in the future should be taken into consideration.

### Implementation policy for risk management concerning investment of the fund (excerpt)

#### 1. Basic approach concerning risk management

The Mutual Aid Association of Prefectural Government Personnel, the Japan Mutual Aid Association of Public School Teachers, the Japan Police Personnel Mutual Aid Association, Mutual Benefit Association for Tokyo Metropolitan Government Employees, the National Federation of Mutual Aid Associations for Municipal Personnel, and the Pension Fund Association for Local Government Officials appropriately conduct risk management related to the investment of their funds in light of the following matters.

- ① Investment of funds should be made safely and efficiently from a long-term point of perspective.
- ② A benchmark portfolio should be developed and investment of funds should be made on the principle of managing funds through appropriate diversification across multiple asset classes with different risk/return profiles and other characteristics (hereinafter referred to as "diversified investment") and manage the funds based thereon.

#### 2. Risk management implementing entities and subjects of management

##### (1) Employees' Pension Insurance Scheme Managed Fund

- ① The Pension Fund Association for Local Government Officials conducts risk management for investment of the Managed Fund as the administrative and investment entity.
- ② As implementing organizations, associations, etc. (meaning the Mutual Aid Association of Prefectural Government Personnel, the Japan Mutual Aid Association of Public School Teachers, the Japan Police Personnel Mutual Aid Association, the Mutual Benefit Association for Tokyo Metropolitan Government Employees, the National Federation of Mutual Aid Associations for Municipal Personnel, and the Pension Fund Association for Local Government Officials; the same shall apply hereinafter) conduct risk management for investments of the implementing organizations' funds.

## Governance ⑥ (Approach to Risk Management)

### Management of the deviation of the asset mix

- Investment based on the benchmark portfolio requires the management of various risk factors. Therefore, in order to secure profits in line with the benchmark portfolio from the long-term perspective, it is important, in particular, to manage the degree of deviation of the asset mix of the actual portfolio from that of the benchmark portfolio.
- as the asset mix constantly changes due to asset price fluctuations, the Local Public Service Mutual Aid Associations keep track of the status of the deviation of the asset mix of its actual portfolio from that of the benchmark portfolio and manages the actual portfolio so as to keep the degree of deviation within a certain range (deviation tolerance). In this way, the Local Public Service Mutual Aid Associations check whether or not there are problems such as a deviation from the benchmark portfolio in excess of the deviation tolerance.

### Monitoring of market risk, etc.

- The Local Public Service Mutual Aid Associations curb downside risks by using the value at risk approach, which measures the maximum foreseeable amount of losses, and using stress tests, which conduct simulations assuming the application of certain shocks to market indicators such as the value at risk, which measures the maximum foreseeable amount of losses, and to markets. As it also uses active investment in its investment of funds, the Local Public Service Mutual Aid Associations seek to earn an excess rate of return over the benchmark by diversifying investment strategies and investment issues within each asset class.
- Therefore, the Local Public Service Mutual Aid Associations monitor the status of market risk (price volatility risk, etc. in each asset market), credit risk (default risk), etc. with respect to each asset class, mainly from the viewpoint of difference from the benchmark for each asset class.

### Management of entrusted investment institutions, etc.

- The the Local Public Service Mutual Aid Associations manage liquidity risk (risk that purchasing and selling assets will become difficult due to a decline in trading volume) from the viewpoint of revising asset allocations (rebalancing) and smooth conversion of assets into cash. In addition, as the associations entrust the operation of some investment-related activities to external institutions under its asset investment system, the Local Public Service Mutual Aid Associations manage the status of management (status of risk management and asset administration) of the institutions to which it entrusts asset management or asset administration (entrusted investment institutions and asset administration institutions), from the viewpoint of smooth operation by individual institutions.

### Verification of the benchmark portfolio

- It is necessary to periodically verify the benchmark portfolio, which is formulated in consideration of long-term economic forecasts, by checking its assumptions, for example. In the verification, the the Local Public Service Mutual Aid Associations also check whether the existing benchmark portfolio is appropriate from the viewpoint of ensuring safe and efficient investment over the long term, so it gives consideration to the viewpoint of comparison between the target investment return and the return that would be achieved if all funds were invested in domestic bonds.

### Reporting on the status of risk management and improvement measures implemented

- The status of risk management and improvement measures implemented are reported to the committee of specialists and the Governing Council.

## Section 3 Reference Data

## Pension Fund System for Local Government Officials

### ○ Pension Fund System for Local Government Officials

The pension fund system for local government officials was established in December 1962 as a system to comprehensively manage the long-term benefits program, short-term benefits program and welfare services program for local government employees and their families, for the purpose of providing mutual aid for local government employees.

#### • Article 43 of the Local Public Service Act

"A mutual aid system shall be implemented in order to provide appropriate benefits in cases of employees' illness, injury, childbirth, involuntary leave, calamity, retirement, disability or death, or their dependents' illness, injury, child birth, death or calamity."

#### • Article 1 of the Local Public Officers, etc. Mutual Aid Association Act

"This act is intended to contribute to the improvement of the stability of lives and welfare of local public officers and bereaved families and also to efficient management of the performance of public duties by establishing a mutual aid system to provide appropriate benefits in cases of illness, injury, childbirth, involuntary leave, calamity, retirement, disability or death of local public officers, or illness, injury, childbirth, death or calamity of their dependents and by prescribing necessary matters concerning these benefits and welfare services to be provided under the system. In addition, the act prescribes matters concerning the pension system etc. for employees of local government-related entities."

### ○ Establishment of the Pension Fund Association for Local Government Officials

The Pension Fund Association for Local Government Officials was established on April 1, 1984, in order to stabilize the foundation of pension finance by integrating the pension funding units and to ensure appropriate and smooth management of operations related to long-term benefits of mutual aid associations so that sound management of the pension system can be maintained. It is a federation comprising all local public service mutual aid associations (64 associations and the National Federation of Mutual Aid Associations for Municipal Personnel as of March 31, 2016).

## Changes in the value of investment assets and the asset mix (since the integration of employee pension plans)

Changes in the value of investment assets and the asset mix of the Employees' Pension Insurance Benefit Fund (since the integration of employee pension plans)

		FY2015		FY2016	
		Total market value	Share	Total market value	Share
Domestic bonds	Total	88,456	45.20%	78,505	39.16%
	Passive	45,073	23.03%	35,763	17.84%
	Active	40,961	20.93%	38,996	19.45%
	Others	2,422	1.24%	3,746	1.87%
Domestic equities	Total	37,538	19.18%	46,244	23.07%
	Passive	23,814	12.17%	28,590	14.26%
	Active	13,724	7.01%	17,655	8.81%
Foreign bonds	Total	23,330	11.92%	25,049	12.49%
	Passive	16,085	8.22%	16,609	8.28%
	Active	7,245	3.70%	8,440	4.21%
Foreign equities	Total	32,176	16.44%	40,467	20.19%
	Passive	24,866	12.71%	32,077	16.00%
	Active	7,310	3.74%	8,390	4.18%
Short-term assets		14,197	7.25%	10,212	5.09%
Total		195,697	100.00%	200,478	100.00%

(Note 1) The value of passive investment assets includes enhanced investments, while the value of active investment assets includes alternative investments.

(Note 2) "Others" related to domestic bonds include in-house investment funds, etc. as classified according to the classification of each fund.



## Changes in the number of passive and active funds (entrusted investment) by asset class

Changes in the number of passive and active funds (entrusted investment) by asset class

		FY2015 (After integration)			FY2016		
		Cancellation	New	End of FY	Cancellation	New	End of FY
Domestic bonds	Passive	0	0	13	7	2	8
	Active	0	14	33	1	3	35
	Others	0	0	2	0	0	2
Domestic equities	Passive	1	0	18	1	0	17
	Active	1	26	75	1	1	75
Foreign bonds	Passive	1	2	14	1	0	13
	Active	1	13	26	0	7	33
Foreign equities	Passive	3	1	13	1	0	12
	Active	1	8	37	1	1	37
Alternative		0	1	1	0	5	6
Total		8	65	232	13	19	238
Asset administration institutions		0	0	19	1	0	18

(Note 1) Funds which are effectively managed in the same way as other accounts (e.g. funds temporarily established for the purpose of smooth transfer of assets) are not included.

(Note 2) Newly adopted funds are classified by fiscal year to which the date of effective start of investment belongs.

## Issues Held

The tables below show the top 10 bond issues held through mandatory and in-house investment and the top 10 bond and equity issues indirectly held through entrusted investment as of the end of March 2017, with bond issues classified by issuer name and equity issues by issue name (For information concerning bond and equity issues ranked 11th or lower, see the website of the Pension Fund Association for Local Government Officials.)

Meanwhile, some associations of the Local Public Service Mutual Aid Associations manage investment and makes investment decisions concerning domestic bonds, while entrusted investment management institutions manage investment and make investment decisions concerning some domestic bonds, domestic equities, foreign bonds and foreign equities.

### ○Domestic bond issues held (by issuer, in order of total market value)

No.	Names of issuer	Total market value (Unit: JPY100M)
1	Government of Japan	34,943
2	Japan Finance Organization for Municipalities	16,975
3	Japan Expressway Holding and Debt Repayment Agency	1,427
4	Osaka Prefectural Government	987
5	Joint LGB	978
6	Tokyo Metropolitan Government	722
7	International Finance Corporation	602
8	East Japan Railway Company	460
9	Aichi Prefectural Government	443
10	Japan Housing Finance Agency	436
Total	452 issuers	75,577

### ○Foreign bond issues held (by issuer, in order of total market value)

No.	Names of issuer	Aggregate market value (Unit: JPY100M)
1	UNITED STATES OF AMERICA	10,136
2	REPUBLIC OF ITALY	2,470
3	FRENCH REPUBLIC	2,121
4	UNITED KINGDOM	1,702
5	FEDERAL REPUBLIC OF GERMANY	1,608
6	KINGDOM OF SPAIN	1,430
7	KINGDOM OF BELGIUM	561
8	COMMONWEALTH OF AUSTRALIA	540
9	CANADA	499
10	KINGDOM OF THE NETHERLANDS	426
Total	678 issuers	25,721

### ○Domestic equity issues held (in order of total market value)

No.	Names of issuer	No. of shares	Aggregate market value (Unit: JPY100M)
1	Toyota Motor Corporation	20,827,700	1,279
2	Mitsubishi UFJ Financial Group	160,096,900	1,135
3	Nippon Telegraph and Telephone Corporation	16,253,100	782
4	SoftBank Group	9,527,100	751
5	Sumitomo Mitsui Financial Group	17,429,300	718
6	Honda Motor Co., Ltd.	18,272,700	617
7	KDDI Corporation	18,869,200	560
8	Mizuho Financial Group	265,955,000	553
9	Sony Corporation	13,351,300	504
10	Mitsubishi Corporation	18,248,700	446
Total	2,151 issues		46,007

### ○Foreign equity issues held (in order of total market value)

No.	Names of issuer	No. of shares	Aggregate market value (Unit: JPY100M)
1	APPLE INC	4,691,191	751
2	MICROSOFT CORPORATION	6,893,252	506
3	AMAZON.COM INC	406,788	402
4	FACEBOOK INC	2,292,834	363
5	JOHNSON & JOHNSON	2,416,424	335
6	JPMORGAN CHASE & CO	3,233,202	316
7	EXXON MOBIL CORPORATION	3,453,512	316
8	ALPHABET INC-CL C	321,761	297
9	ALPHABET INC-CL A	311,333	294
10	WELLS FARGO & CO	4,741,118	294
Total	2,995 issues		40,165

(Note 1) The names of bond issuers and equity issues are those provided by the T-STAR/GX system of the Nomura Research Institute and the BARRA ONE system of MSCI and by Bloomberg as of May 2017.

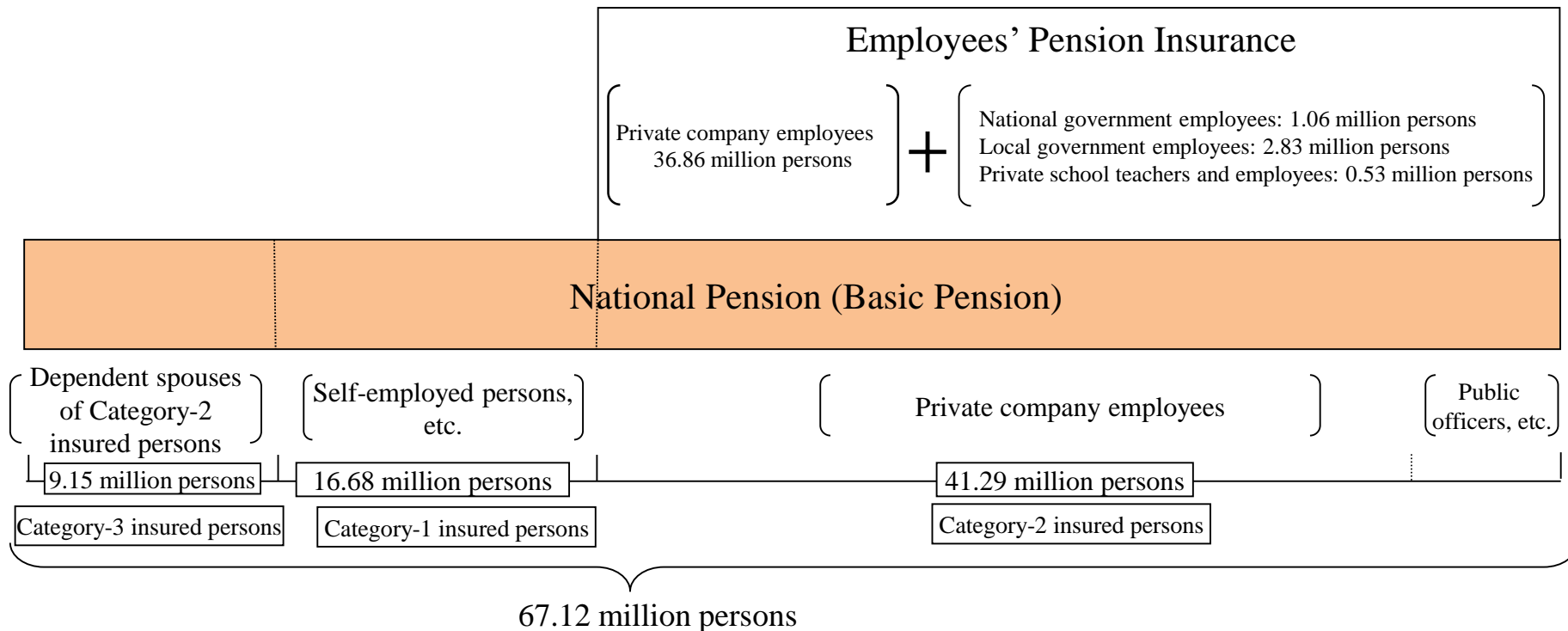
(Note 2) The total market value of bonds is an aggregated figure calculated for each issuer by the Association based on data registered in the T-STAR/GX system of the Nomura Research Institute.

## Integration of Employee Pension Plans

As a result of the integration of employee pension plans, mutual aid pensions were abolished and integrated into the Employees' Pension Insurance plan.

Local government officials and private school teachers and employees joined the Employees' Pension Insurance plan, resulting in the realization of universal insurance premiums and benefits (elimination of differences across different systems).

(The figures are as of the end of March 2016).



(Note) The number of people who are members of corporate pension plans among those who are members of the Employees' Pension Insurance plan is 15.97 million.

(Breakdown: Employees' Pension Fund: 2.54 million people; defined-benefit corporate pension plans: 7.95 million people; defined-contribution pension plans (corporate type): 5.48 million people)

Meanwhile, the number of members of defined-contribution pension plans (individual-type) is 260,000 people and the number of members of the National Pension Fund is 430,000 people.

## Investment of Funds after the Integration of Employee Pension Plans ①

### ○ Investment of funds after the integration of employee pension plans

In order to ensure efficient administrative processing after the integration of employee pension plans, mutual aid associations continue to be responsible for management of pension records of association members, determination and revision of standard compensation, collection of insurance premiums, determination of pension benefits and provision of pension benefits.

Mutual aid associations also continue to be responsible for administration and investment of funds.

As a result of the integration of employee pension plans, the Long-term Benefit Fund, which has until now been the only funding source for long-term benefits, has been replaced by the following three funds: the Employees' Pension Insurance Benefit Adjustment Fund, the Annuity Retirement Benefit Adjustment Fund, and the Transitional Long-term Benefit Adjustment Fund, since October 2015.

### ○ Decisions concerning Funds Basic Guidelines, target asset mix (model portfolio) and the benchmark portfolio

- ① The chief Ministers (Minister of Health, Labour and Welfare, Minister of Finance, Minister for Internal Affairs and Communications, and Minister of Education, Culture, Sports, Science and Technology) jointly formulate the Funds Basic Guidelines (Article 79-4 of the Employees' Pension Insurance Act).
- ② The four administration and investment entities (the Government Pension Investment Fund, the Federation of National Public Service Personnel Mutual Aid Associations, the Pension Fund Association for Local Government Officials, and the Promotion and Mutual Aid Corporation for Private Schools of Japan) jointly formulate the target asset mix of funds (model portfolio) based on the Funds Basic Guidelines (Article 79-5 of the Employees' Pension Insurance Act Article 79-5).
- ③ The Association formulates the administration and investment policy (including the portfolio at local public service mutual aid associations), which serves as the common policy for organizations such as local public service personnel mutual aid associations (the implementing organizations) in accordance with the target asset mix (model portfolio) (Article 79-6 of the Employees' Pension Insurance Act).
- ④ A basic policy (including the benchmark portfolio) concerning fund administration and investment is formulated by local public service personnel mutual aid associations and other organization so as to conform to the administration and investment policy set by the Association (Article 112-4 of the Local Public Officers, etc. Mutual Aid Association Act).

# Investment of Funds after the Integration of Employee Pension Plans ②

## Mechanism of Fund Investment after Integration of Employee Pension Plans

Chief Ministers

Central government

Minister of Health,  
Labour and Welfare

Minister of  
Finance

Minister for Internal  
Affairs and  
Communications

Minister of Education,  
Culture, Sports, Science and  
Technology

① Funds Basic Guidelines (Article 79-4 of the Employees' Pension Insurance Act)

Announced on  
July 3, 2014

② "Target asset mix of funds (model portfolio)" (Article 79-5 of the Employees' Pension Insurance Act)

Announced on  
March 20, 2015

Government Pension  
Investment Fund  
(GPIF)

Administration  
and investment  
policy

Federation of National  
Public Service  
Personnel Mutual Aid  
Associations (KKR)

Administration  
and investment  
policy

Pension Fund Association for Local Government Officials

③ Administration and investment policy  
(Article 79-6 of the Employees' Pension Insurance Act)

Approved by the  
Minister for Internal  
Affairs and  
Communications on  
September 30, 2015

Promotion and Mutual  
Aid Corporation for  
Private Schools of  
Japan (PMAC)

Administration  
and investment  
policy

④ Basic Policy  
(Article 112-4 of the  
Local Public  
Officers, etc. Mutual  
Aid Association Act)

Mutual Aid Association  
of Prefectural  
Government Personnel  
Basic Policy

Japan Mutual Aid  
Association of Public  
School Teachers  
Basic Policy

Japan Police  
Personnel Mutual Aid  
Association  
Basic Policy

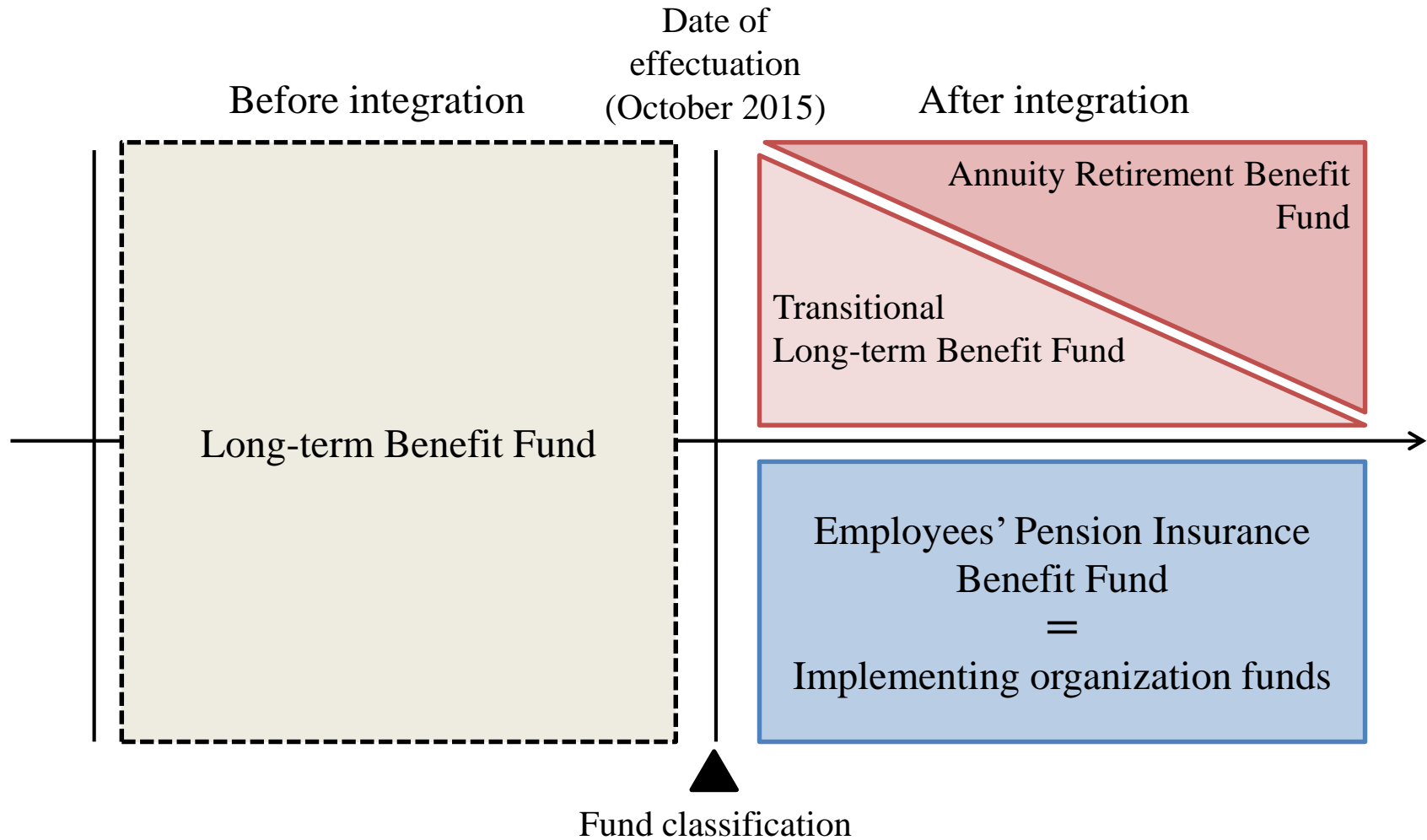
Mutual Benefit  
Association for Tokyo  
Metropolitan Government  
Employees  
Basic Policy

National Federation of  
Mutual Aid Associations  
for Municipal Personnel  
Basic Policy

Approved by the  
Chief Ministers  
on September 30,  
2015

Implementing  
organizations

## Investment of Funds after the Integration of Employee Pension Plans ③



## Comparison of Characteristics of Benefits after Integration of Employee Pension Plans

	Employees' Pension Insurance Benefits	Transitional Long-term Benefits	Annuity Retirement Benefits
Pension characteristics	Employee Pension Insurance as public pension insurance [Part of the social security system]	Benefits retained against the backdrop of expected rights concerning parts of mutual aid pensions as public pensions	Part of retirement benefits [Corresponds to private-sector corporate pensions]
	Benefit amount linked to inflation		Benefit amount not linked to inflation
	Macroeconomic adjustment applied		—
	Actuarial valuation every 5 years	Preparation of the current funding status and forecast every 5 years	Actuarial valuation every 5 years
Funding system	Pay-as-you-go system	Closed pension plan	Advanced funding method
Benefits design	Defined benefit type (scheme that sets the benefit level as a percentage of the compensation during the active service period)		Cash balance-type (scheme that links the benefit level to the government bond yield, among other factors)
Premium rate	Has been increased in stages. Will remain fixed at 18.3% for public officials from 2018 onwards. (Will remain fixed at 18.3% for the Employee Pension Insurance from 2017 onwards.)	No new contributions will be made because this is a closed pension plan.	To be set in consideration of factors such as the entitlement rate, with the maximum insurance premium rate set at 1.5%.

## Glossary

### ○ Administration and investment organizations

The four management and investment entities are the Government Pension Investment Fund, the Federation of National Public Service Personnel Mutual Aid Associations, the Pension Fund Association for Local Government Officials, and the Promotion and Mutual Aid Corporation for Private Schools of Japan.

### ○ Transitional Long-term Benefit Fund

Fund comprising the following funds: (i) the Transitional Long-term Benefit Association Reserve Fund administered and invested by individual mutual aid associations and the National Federation of Mutual Aid Associations for Municipal Personnel (hereinafter referred to as "Associations, etc.") after the integration of employee pension plans for the payment of benefit pertaining to the former occupational portion of the plans (transitional long-term benefit), and (ii) the Transitional Long-term Benefit Adjustment Fund set aside by the Pension Fund Association for Local Government Officials for the payment of the necessary amount in case of a shortage of fund for transitional long-term benefit of individual Associations, etc.

### ○ Employees' Pension Insurance Benefit Fund

Fund comprising the following funds: (i) the Employees' Pension Insurance Benefit Association Reserve Fund administered and invested by individual Associations, etc. after the integration of employee pension plans for the payment of employee's pension insurance benefit, and (ii) the Employees' Pension Insurance Benefit Adjustment Fund set aside by the Pension Fund Association for Local Government Officials for the payment of the necessary amount in case of a shortage of fund for employees' pension insurance benefit of individual Associations, etc.

### ○ Annuity Retirement Benefit Fund

Fund comprising the following funds: (i) the Annuity Retirement Benefit Association Reserve Fund set aside, administered and invested by individual mutual aid associations and the National Federation of Mutual Aid Associations for Municipal Personnel (hereinafter referred to as "Associations, etc.") for the payment of retirement pension benefit (after the integration of employee pension plans, and (ii) the Annuity Retirement Benefit Adjustment Fund which is to be set aside by the Pension Fund Association for Local Government Officials for the payment of the necessary amount in case of a shortage of fund for pension benefit of individual Associations, etc.

### ○ Long-term Benefit Fund

This is a pension fund which was administered and managed by the Pension Fund Association for Local Government Officials before the integration of employee pension plans. Through it, funds were set aside to prepare for possible shortage of funds to cover pension benefit payments by mutual aid associations.