

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

(Established on October 1, 2015)

(Revised on July 19, 2018)

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

## I Basic policy for the administration and investment of the ARB adjustment fund

### 1 Basic policy

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

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

### 2 Utilization of the Fund Management Committee of Pension Fund Association for Local Government Officials

The Association shall establish a Fund Management Committee of Pension Fund Association for Local Government Officials consisting of individuals with academic knowledge and practical experience in fields such as economics, finance, and fund management (the “Committee”).

The Association shall leverage the expert knowledge of the Committee when examining technical matters concerning the administration and investment of the ARB adjustment fund including the development and revision of the Basic Policy.

### 3 Initiatives to strengthen investment capabilities

In order to fulfill the required role regarding fiduciary responsibilities and the development of markets, etc., while responding to changes in the socioeconomic environment, the Association must continuously strive to strengthen its investment capabilities and enhance its investment structure.

Therefore, based on the contents of the “Asset Owner Principles” (formulated by the Cabinet Secretariat on August 28, 2024), the Association will develop and implement a “Policy for Strengthening Investment Capabilities” regarding initiatives to enhance its investment capabilities, etc.

The implementation status of this policy will be periodically reviewed and disclosed to the public, and its contents will be revised as appropriate. Any particularly important changes will be subject to deliberation by the Committee.

### 4 Fund management plan

#### (1) Annual fund management plan

An annual fund management plan for the management of the ARB adjustment fund shall be created before the beginning of every fiscal year.

The annual fund management plan shall include the following:

##### A Outlook for cash flows

##### (A) Closing balance

##### (B) Expected revenues

##### a Paid-in money from associations

##### b Bond principal and interest

- c Financial adjustment contributions received
- d Other revenues
- (C) Expected expenditures
  - a Financial adjustment contributions
  - b Grants to associations
  - c Money transferred to the administration accounting
  - d Mandatory investment
  - e In-house investment
  - f Other expenditures

(D) Balance brought forward or closing balance

B Investment plan

(A) Mandatory investment

Acquisition of municipal bonds or bonds issued by the Japan Finance Organization for Municipalities

(B) In-house investment

(2) Quarterly fund management plan

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

The quarterly fund management plan shall include a specific outlook for cash flows based on the annual fund management plan.

5 Pooled investment

Part of the ARB adjustment fund may be invested together with respective ARB association reserve funds deposited with the Association by the local public service mutual aid associations (Local Public Service Personnel Mutual Aid Associations stipulated in Article 3, paragraph (1) of the Act, excluding constituent associations stipulated in Article 27, paragraph (2) of the Act (“Mutual Aid Associations”)) or the National Federation of Mutual Aid Associations for Municipal Personnel.

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

1 Ensuring fiduciary responsibility

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

2 Consideration of the impact on market and private sector activities

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

3 ESG-conscious investment

With respect to the investment of the ARB adjustment fund, the necessary initiatives shall be implemented, based on a case-by-case analysis, with a view to promoting investment that takes into consideration ESG factors (Environmental, Social, and Governance), a non-financial factor in addition to financial factors based on the concept that the sustainable growth of investee companies and the entire market is necessary for the increase of returns on investment assets over the long term so as to secure long-term returns for the benefit of members.

4 Impact-conscious investment

From the perspective of securing long-term returns for the benefit of members, the necessary initiatives shall be implemented, based on a case-by-case analysis, with a view to promoting investments considering the social and environmental effects (impacts) generated by the business activities of investee companies as a non-financial factor.

5 Coordination and cooperation with other administration and investment institutions

The Association shall provide other administration and investment institutions with technical and expert knowledge and materials on the administration and investment of reserve funds, gain an understanding of research and study activities, etc. made by other administration and investment institutions, and exchange information and communicate/coordinate with other administration and investment institutions by, for example, providing said information.

In addition, the Association and other administration and investment institutions shall cooperate and work together by sharing the necessary information, etc. in relation to the management of ARB Association Reserve Funds.

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

1 Investment targets

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

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

2 Basic approach to the Benchmark Portfolio

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

The Association shall report on the establishment of the Benchmark Portfolio to the Governing Council (meaning the Governing Council stipulated in Article 38-4, Paragraph (1) of the Act; the same shall apply hereinafter) upon deliberation by the Committee.

3 Asset class and asset mix of the Benchmark Portfolio

The asset mix of the Benchmark Portfolio shall be as follows.

Assets	Domestic bonds
Asset mix	100%

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

Short-term assets are classified into domestic bonds.

4 Review of the Benchmark Portfolio

The Association shall appropriately manage risks, etc. based on market trends, and annually verify the Benchmark Portfolio by, for example, confirming that the most recent investment returns meet the target benchmark interest rate (meaning the benchmark interest rate stipulated in Article 77, Paragraph (3) of the Act; if there is an addition rate to be added pursuant to a fiscal recalculation (meaning the recalculation stipulated in the latter part of Article 113, Paragraph (1) of the Act), the ben

benchmark interest rate before adding said addition rate; and if there is a deduction rate to be deducted pursuant to a fiscal recalculation, the benchmark interest rate before deducting said deduction rate).

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

## 5 Securing liquidity for expenditures

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

## 6 Risk management

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

### (1) Overall assets

In order to appropriately manage the portfolio, check the asset mix of the ARB adjustment fund for any deviations from the Benchmark Portfolio at least once a month, and take the necessary measures.

In addition, the Association shall enhance necessary functions, such as for understanding and analyzing market trends.

Furthermore, the Association shall confirm risks associated with overall assets, analyze and assess the level of risk exposure, and conduct, among other things, analysis of factors for deviations from the return needed for the reserve fund.

### (2) Asset class

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

### (3) Mandatory and in-house investments

Establish guidelines for investment (the “In-house Investment Guidelines”), and manage risks appropriately by, for example, checking investment performance and level of risk exposure.

### (4) Asset management institutions

Present guidelines for asset management to each asset management institution (the “Asset Management Guidelines”), understand the asset management status and changes to asset management structures of each institution, and manage the credit risk, etc. of each institution appropriately.

In addition, administration and investment institutions shall continue to monitor the stable operational status of asset management institutions.



## 7 Investment methods

### (1) Basic approach

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

### (2) Specific investment methods

#### A Mandatory investment

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

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

- a Strictly administer and take custody of the Association's assets, separating them from other trust assets.
- b Pay careful attention to the delivery and settlement of securities.
- c Give sufficient consideration to credit risk, administrative capability and costs, etc. when re-entrusting custody services.
- d Submit data regarding the status of asset administration at the end of every month and, on an as-needed basis, provide necessary data and explanations.
- e Observe laws, regulations and contracts, etc. and establish the necessary framework to ensure compliance.

(B) In the event an asset management institution has engaged in any act that violates laws and regulations, contracts, and the Asset Management Guidelines, etc. prompt reporting shall be requested and instructions shall be given as necessary.

#### B In-house investment

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

#### (A) Types

##### a Long-term investment

##### (a) Basic approach

The acquisition of domestic bonds shall take into account interest outlooks, etc. and efforts shall be made to make favorable investments over the long term.

##### (b) Investment assets

Investment assets shall consist of the following yen-denominated securities.

##### (i) Government bonds

##### (ii) Municipal bonds

##### (iii) Bonds issued by the Japan Finance Organization for Municipalities

##### (iv) Bonds guaranteed by the government or a local government

##### b Short-term investment

##### (a) Basic approach

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

(b) Investment assets

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

c Lending to other accounts

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

(B) Financial institutions

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

(C) Entrustment of asset management

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

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

(3) Selection and evaluation of asset management institutions

A Selection of asset management institutions

Asset management institutions shall be selected from financial institutions that are engaged in trust services and meet the following criteria. If there are sub-trustees and co-trustees ("Sub-trustees, etc." in B), the following items, etc. shall be confirmed in the same manner.

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

(B) Asset management status is favorable.

(C) The framework for compliance with laws and regulations is in place.

B Evaluation of asset management institutions

Asset management institutions shall be evaluated in a timely manner through qualitative assessment with respect to their business management status, asset administration status and framework for compliance with laws and regulations, and their suitability shall be determined accordingly. If there are Sub-trustees, etc., confirmation shall be made from the same perspective.

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

1 Enhancing transparency

Regarding the administration and investment of the ARB adjustment fund, the Association shall promptly publish the status of administration and investment performance, etc., such as investment returns and risks for each fiscal year on its website, etc. on an annual basis.

In addition, the Association shall promptly publish the quarterly status of administration and investment performance, etc. such as investment returns on a quarterly basis on its website, etc.

The Association shall strive to enhance publicly disclosed materials by devising ways to make them easier to understand, etc.

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

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

2 Enhancing operational framework, including the retention of highly skilled and specialized personnel

In order to strengthen the function of making agile decisions in the execution of investment management that respond to changes in the economic and market environment while comprehensively managing the overall assets through specialized expertise, the Association shall appoint a Chief Investment Officer (CIO). In addition, the Association shall, if necessary, examine in detail operations that require advanced and specialized skills as well as the expertise required for such operations, and strive to retain highly skilled and specialized personnel who possess such expertise.

In addition to providing staff with support to obtain fund management qualifications, the Association shall aim to enhance the performance of its staff by, for example, leveraging highly skilled and specialized personnel and promoting the acquisition of knowledge and skills through practical experience and training.

Regarding personnel development, the Association shall clarify the competencies and career paths required of staff involved in the management of funds for public pensions, formulate a personnel development policy to retain and develop the necessary personnel, and implement it systematically.

The enhancement and development of specialized personnel shall be actively promoted by reporting on the status of such activities to the Committee as necessary and taking their opinions into consideration.

Furthermore, in order to conduct efficient and effective business operations, the Association shall work to improve the processes and systems for data processing related to fund management.

### 3 Strengthening risk management

In addition to enhancing investment capabilities, the Association shall also strengthen risk management under a risk management officer who is independent of the investment division, so that an appropriate check function can be exercised over the investment division.

Therefore, in addition to establishing risk management systems, the Association shall strive to enhance risk management by, for example, strengthening forward-looking risk analysis functions, establishing risk management analysis tools, and enhancing information collection and investigation functions.

### 4 Enhancing research and study activities

When conducting research and study activities, in addition to commissioning such work to think tanks and other similar institutions, engaging staff including highly skilled and specialized personnel in the work shall be considered so that know-how on the administration and investment of the ARB adjustment fund will be accumulated within the Association. If highly skilled and specialized personnel are employed, establishing the framework necessary to expand internal research and study activities by leveraging said personnel shall be considered to accumulate know-how obtained from the research and to ensure the safe and efficient administration and investment of the ARB adjustment fund in the future.

In the event research is outsourced, thorough measures shall be taken to prevent information leaks.

#### (Appended Table) Rating Agencies

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

#### Supplementary Provisions

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

#### Supplementary Provisions



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

Supplementary Provisions

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

Supplementary Provisions

This Basic Policy comes into force from April 1, 2025.