About GPIF
First, Some Basics…

<table>
<thead>
<tr>
<th></th>
<th>FY2018</th>
<th>FY2001 to FY2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate of Return (Quantity)</td>
<td><strong>1.52%</strong> (+¥2.4tn. ($22.6bn.))</td>
<td><strong>3.03%</strong> (annualized) (+¥65.8tn. ($621bn.))</td>
</tr>
<tr>
<td>Total Assets</td>
<td><strong>¥159.2 trillion</strong> (approx. $1.5 trillion)</td>
<td></td>
</tr>
</tbody>
</table>

*As of Apr. 1, 2019
First, Some Basics...

Inside: Policy asset mix
Outside: Actual portfolio as of March 31, 2019
(figures in parentheses indicate deviation limits)
First, Some Basics...

Japanese Pension System Overview

(All figures valid as of end-March 2015)

1st tier

National pension (Basic pension)

- 17.42M people
  - Self-employed persons (Type 1)

- 40.39M people
  - Insured persons (Type 2)

- 9.32M people
  - Spouses of insured persons (Type 3)

2nd tier

- 0.45M people
  - Individual-type DC (0.21M people)
  - Corporate-type DC (5.05M people)

- 7.62M people
  - DB Corporate pension

Employees’ pension

- 35.99M people
- 4.41M people

Civil servants

3rd tier

- 3.63M people
  - Employees’ Pension fund

Retirement annuity

*FY2014

Source: Ministry of Health, Labour and Welfare

年金積立金管理運用独立行政法人
Government Pension Investment Fund
First, Some Basics…

GPIF Governance Structure

Minister of Health, Labour and Welfare

- Design of Public Pension Schemes/Actuarial Valuation of Pension Finance
  - Setting of and giving directions on the Medium-term Objectives (investment returns, etc.)
  - Approval of the Medium-term Plan and Statement of Operation Procedures, etc., assessment of GPIF

GPIF

Board of Governors

- Comprised of experts in such fields as economics, finance, asset management and business administration, and the President.
- Chairperson and governors are appointed by the Minister of Health, Labour and Welfare from committee members other than the President.
- The Executive Managing Director (Investment and Management) is allowed to state opinions on relevant proposals.

Decision-making on important policies, including the Asset Mix Policy

Audit Committee

- Comprised of the Governors appointed by the Minister as qualified to be the Auditors

Approval of the appointment of the Executive Managing Directors

Supervision of execution

Executive Office

Execution

Social Security Council (The Committee of Pension Fund Management)
Deliberation on the Medium-term Plan, etc.

Council decision-making system

Separation of decision-making and supervision from execution

Appointment

Appointment of the President
Approval of the Executive Managing Director (Investment and Management)
First, Some Basics…

Payout Structure

Reserve Fund

approx. 10% 

Pension premiums

Government contribution

FY2015

FY2060

FY2110年度（平成122）

Note: Actuarial valuation conducted in FY2014. Assumes inflation rate of 1.2%, real wage growth of 1.3%, and real investment return of 1.7%
Promoting Long-Termism: Driving ESG Investment
Driving ESG Investment

Quick Facts

Universal Owner

- ¥159 tn ($1.5 tn) in AUM
- 5,111 stocks held
- 3,457 bond issuers held

Cross-Generational Investor

- 25 year policy asset mix
- 100 year fund life

ESG-Based Investment

- ESG integrated over ¥159tn. in assets
- ¥3.5tn. ($33bn.) linked to ESG indexes
- ¥106bn. ($1bn.) invested in green bonds

Our objective is to **make the market more sustainable**, not beat it.
Our overarching goal should be to achieve the investment returns required for the public pension system with minimal risks, solely for the benefit of pension recipients from a long-term perspective, thereby contributing to the stability of the system.

Our primary investment strategy should be diversification by asset class, region, and timeframe. While acknowledging fluctuations of market prices in the short term, we shall achieve investment returns in a more stable and efficient manner by taking full advantage of our long-term investment horizon. At the same time, we shall secure sufficient liquidity to pay pension benefits.

We formulate the policy asset mix and manage and control risks at the levels of the overall asset portfolio, each asset class, and each investment manager. We employ both passive and active investments to attain benchmark returns (i.e., average market returns) set for each asset class, while seeking untapped profitable investment opportunities.

By fulfilling our stewardship responsibilities (including the consideration of ESG (Environmental, Social, and Governance) factors), we shall continue to maximize medium- to long-term investment returns for the benefit of pension recipients.
Driving ESG Investment: Why We Do It

Investment Principle #4
Maximize long-term return for beneficiaries through ESG and other stewardship.

Proxy Voting Principles
To enhance long-term value, managers should consider ESG issues when voting.

Stewardship Principle #4
Managers should integrate ESG
Managers should proactively engage
Managers should sign on to PRI

Prevent Short-Termism to Create Long-Term Value
Driving ESG Investment

**Holistic Approach**

- PRI
- TCFD
- Thought Leadership
- Global Asset Owner Forum

**Portfolio Approach**

**Direct**
- Adoption of ESG Benchmarks
- Green Bond Investment with Intl. Institutions

**Indirect**
- ESG Integration-Based AM Evaluations
- Stewardship-Based AM Evaluations
- Engagement with Index Providers
- AI Research

Fixed Income ESG Research

30% Club/30% Coalition

Climate Action 100+

Research on ESG Disclosure

TCFD

PRI

Green Bond

30% Club/30% Coalition

Thought Leadership

Climate Action 100+

Research on ESG Disclosure

Agenda Item 3a, Attachment 2, Page 13 of 32
Promoting Long-Termism: Holistic Approach
Holistic Approach: Improving the Global Market

Signatory of:

- **PRI** (Principles for Responsible Investment)
  Signed in September 2015. Hiro Mizuno was designated MD in January 2017 and joined the Asset Owner Advisory Committee and the SDGs Advisory Committee.

- **30% Club**
  Signed in November 2016.

- **THIRTY PERCENT COALITION**
  Signed in November 2016.

- **TCFD** (Task Force on Climate-Related Financial Disclosures)
  Announced support in December 2018.

- **Climate Action 100+**
  Joined in October 2018.

- **CFI+**
  Hiro Mizuno is one of the founding members of the Climate Financial Leadership Initiative launched in January, 2019.
Holistic Approach: Fixed Income ESG Research

The GPIF and World Bank Released a Joint Study On the ESG Investment Environment for Fixed Income Investors

Results

- ESG investing is increasingly becoming mainstream.

- ESG factors pose a material credit risk for fixed income investors.

- Many issues remain in ESG definitions, data, engagement, and supply/demand balance.
GPIF Co-Created the Global Asset Owner Forum With CalPERS and CalSTRS to Discuss Common Challenges Facing Global Asset Owners

Themes
- International Initiatives
- ESG Disclosure
- AM Compensation
- ESG Research/Ratings
- etc...
GPIF’s ESG activities were featured in a Harvard Business School (HBS) case study entitled “Should a Pension Fund Try to Change the World? Inside GPIF’s Embrace of ESG”

The case, written by Profs. Rebecca Henderson, George Serafeim, Josh Lerner and Naoko Jinjo, was taught in HBS’s “Reimagining Capitalism” class.
Promoting Long-Termism: Direct Portfolio Approach
## Direct Portfolio Approach: ESG Benchmark Adoption

FTSE Blossom Japan | MSCI Japan ESG Select Leaders | MSCI Japan Empowering Women | S&P/JPX Carbon Efficient | S&P Global Ex-Japan Large Mid Carbon Efficient

### Concept | ESG | ESG | Diversity | Low Carbon | Low Carbon

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Domestic Equities</th>
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<th>Domestic Equities</th>
<th>Foreign Equities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cumulative Returns*</td>
<td>3.90%</td>
<td>5.17%</td>
<td>5.77%</td>
<td>5.10%</td>
<td>9.16%</td>
</tr>
<tr>
<td>Excess Over Benchmark*</td>
<td>-0.99%</td>
<td>0.28%</td>
<td>0.65%</td>
<td>0.21%</td>
<td>0.21%</td>
</tr>
</tbody>
</table>

- All benchmarks overweight companies with **high metrics/positively screen**
- Benchmarks **do not divest** from any specific industry

*Mar. 31, 2017 to Mar. 31 2019"
The GPIF Has Partnered with the World Bank and Other Multi-National Institutions to Mobilize Capital to Green Projects
Promoting Long-Termism: Indirect Portfolio Approach
We expect our asset managers to:

- Understand and apply GPIF’s Stewardship Principles and Proxy Voting Principles
- Implement an internal compensation scheme that promotes long-termism
- Practice good governance and work to prevent conflicts of interest
- Improve disclosure with respect to voting, ESG materiality and TCFD recommendations
- Integrate ESG in line with investment style

We promote this through:

**Passive Managers**
- Having passive managers practice active ownership
- Engaging with index providers

**Active Managers**
- Introducing performance-based fee structure and multi-year contracts
- Commission research to understand manager dynamics
We define ESG integration as the explicit and systematic inclusion of ESG issues in investment analysis and investment decisions.

GPIF requires each external asset manager to identify and engage on critical ESG issues.

Investment Policy revised to include ESG Integration

Evaluation

- Weight
  - 100% Qualitative
  - Equity passive: 30%
  - Equity Active: 10%

- Stewardship activities
  - Active managers should generate quality alpha

- Investment policy, management process, organization, human resources, etc.
Indirect Portfolio Approach: Passive Mandate

Index Provider Engagement

78% managed passively

Qualitative judgments made by index providers
Active engagement with providers necessary

What We Engage On

Index Governance
- Internal Structure
- Transparency
- Conflicts of Interest etc.

Index Consultation
- Provide input on index construction, evaluation process, etc.

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Indirect Portfolio Approach: Passive Mandate

Manager Engagement

Asset Managers

Propose Business Model

"New Passive Investment"
- Create engagement plans
- Select assessment metrics
- Measure stewardship outcomes

GPIF

Select Based on Model

Has the manager:
- Set appropriate KPIs?
- Established an appropriate engagement framework?

Assessment

Equity passive
- 30%
- 70%

GPIF checks achievement

Contract Awarded

Stewardship activities
- Investment policy, management process, organization, etc.
Indirect Portfolio Approach: Active Mandate

Performance-Based Fee Structure

**Concept**

- We should pay active managers based on alpha generated
- If no alpha is generated, active managers should receive the same fees as passive managers.
- Payment should be linked to long-term performance

**Our Expectations**

- Set appropriate alpha targets
- Maintain capacity for stable excess returns
- Aim for long-term sustainable performance

Alignment Not Reduction
Performance-Based Fee Structure

- **Base Fee Rate**: (Equal to passive fees)
- **Break-even point**: Performance-based fees start
- **New Performance-based fee**: (No upper limit)
- **Current Performance-based Fee**: (Has upper limit)
- **Fixed fee**: (Constant fee rate regardless of alpha generated)
Indirect Portfolio Approach: Active Mandate

Understand internal dynamics at asset managers

Mercer Compensation Scheme Analysis

What we wanted to test:

1) Does pay scheme contribute to long-term returns?
2) Does pay scheme result in short-termism?

How we tested it:

Questionnaires and interviews with asset manager C-level executives

Our findings:

<table>
<thead>
<tr>
<th>Positives</th>
<th>Negatives</th>
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<tbody>
<tr>
<td>Managers generally have compensation structures that avoid short-termism</td>
<td>Most managers don’t use structure strategically</td>
</tr>
<tr>
<td>Leading asset managers take context, history, etc. into account in pay structure</td>
<td>Few asset managers compensate ESG staff appropriately</td>
</tr>
</tbody>
</table>
Indirect Portfolio Approach: AI-Based Research

Understand internal dynamics at asset managers

AI-Based Research

FY2017 Commissioned Research

Analyze massive amounts of domestic equity active manager transaction data to understand:

- Actual investment style based on behavior, not self-assessment
- Changes in investment styles ("Style Drift")
- Formation of bubbles due to many managers practicing a specific investment style

FY2018-19 Commissioned Research

- Expand research to other asset classes
- Apply analysis to selection and evaluation of asset managers
Our Common Endeavor As Universal Owners
In order to overcome short-termism in our investment chain and fulfill our fiduciary duty, **Partnership With Other Asset Owners is Key**

Together we have an immense responsibility to bolster the sustainability of global capital markets.