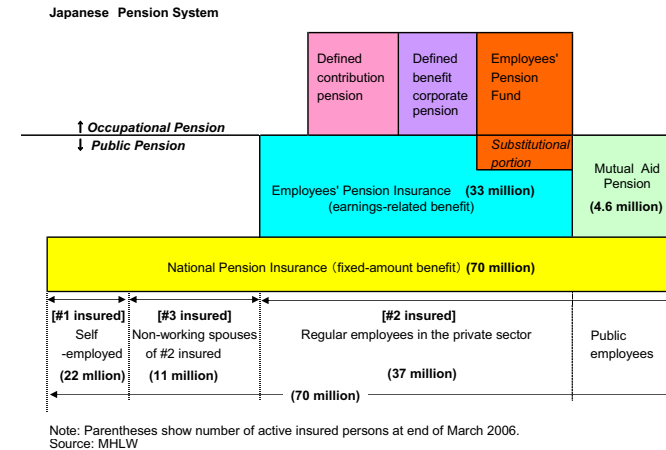


Investment Policy and Pension Governance in GPIF

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Japanese Pension Scheme Structure

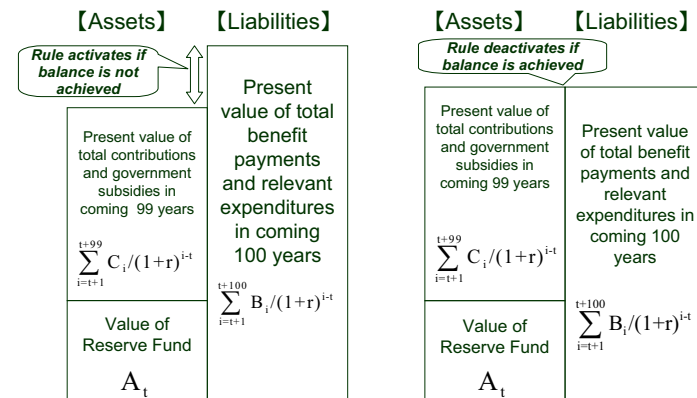


Outline of Public Pension Plan

- Universal: All persons must participate in NPI from age 20
- Finance: Pay-as-you-go scheme with 140 trillion yen reserve fund
- One-third (one-half from 2010) of basic pension is publicly funded.
- Two- tiered system: Basic pension benefit (fixed amount from NPI) and earnings-related benefit from EPI
- Benefits: Public pension used to be an average-salary-based defined benefit plan.
- 2004 reform reduces real benefit amount to reflect decrease in number of active workers and longevity growth of beneficiaries. Benefit adjustment will continue until assets and PV of future taxes equal the PV of future benefit payments.
- Contribution (Tax): EPI contribution rate will be raised gradually from 13.58% now to 18.3% in 2018. NPI monthly contribution will rise to 16,900 yen from 13,860 yen.
- Benefits: The average employee and spouse are expected to receive 50% of annual salary, or 2.8 million yen (2004 prices).

Benefit Adjustment Rule

Real benefit adjusts (decreases) to reflect the decrease in number of active insured (workers) and greater longevity of beneficiaries



Notes: A= Value of reserve fund, C= Revenue (pension insurance tax and government subsidies), B= Expenditures (benefits and relevant expenditures), r= Discount rate.

Note:
 1. Nominal value of benefit amount never decreases.
 2. Schedule of contribution rate is fixed.

Results of 2009 Actuarial Validation

Expected asset amounts in the two public pension accounts

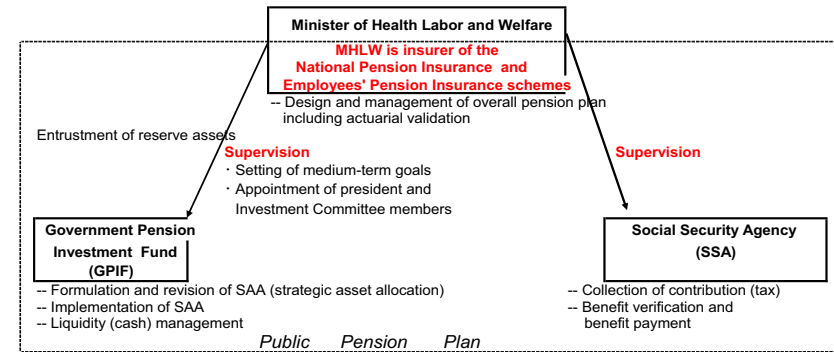
(Nominal value in trillion yen)

Fiscal year (end)	NPI			EPI			Total of two accounts		
	Annual disburse-ments	Surplus	Assets	Annual disburse-ments	Surplus	Assets	Total disburse-ments	Total assets	Total assets ÷ disbursements (multiple)
2009	4.7	0.1	10.0	35.8	-0.9	144.4	40.5	154.4	3.8
2010	4.7	0.2	10.2	36.7	-1.7	142.6	41.4	152.8	3.7
2020	6.1	0.5	13.0	46.7	6.4	168.4	52.8	181.4	3.4
2030	7.1	0.9	20.6	53.6	11.8	264.0	60.7	284.6	4.7
2040	9.4	0.6	29.0	71.3	7.1	365.8	80.7	394.8	4.9
2050	12.0	0.3	33.1	88.1	2.8	411.0	100.1	444.1	4.4
2105	27.7	-0.6	27.1	121.5	-14.6	185.6	149.2	212.7	1.4

Notes: MHLW forecast assumes 1.0% CPI inflation rate, 2.5% wage growth rate, and 4.1% annual expected return on assets. EPI assets and total of two accounts include the substitution (contracted-out) portion of EPF occupational pension.

Source: MHLW

Roles of MHLW, GPIF and SSA



- GPIF's responsibility is limited to investment management
 - GPIF is not an independent pension fund but an investment division of the public pension insurance scheme (more like a sovereign wealth fund)

Decision Making Structure

- Decision making responsibility for overall pension plan design and investment management has been reallocated as follows.
- Pension plan design is the responsibility of the Minister of Health Labor and Welfare (MHLW)
 - setting of benefit and contribution levels
 - validation of financial feasibility (actuarial validation)
- Investment management is the responsibility of GPIF
 - formulation and revision of SSA
 - implementation of SSA (including manager selection)
 - cash (liquidity) management
- Tax collection and benefit payment are the responsibility of the Social Security Agency

GPIF is an "Independent Administrative Institution"

- Established (reorganized) in April 2006 as an independent administrative institution
- Formerly a special entity under direct MHLW control
 - MHLW formulated SAA in consultation with the Social Security Council, and was responsible for investment results
- GPIF is now under indirect MHLW control, but its budget must be approved by MHLW, who is requesting all agencies to decrease direct and indirect expenditures by 12% in the medium term plan (from 2006 through 2010)
 - GPIF is not completely autonomous

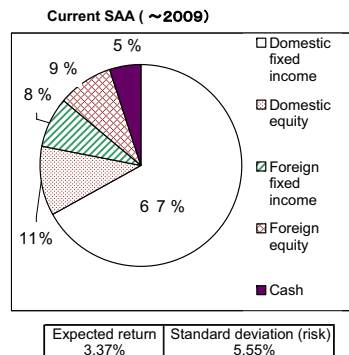
Governance of GPIF

- MHLW
 - Sets mid-term goals
 - Evaluates performance from the standpoint of pension finance (may issue improvement decrees)
 - Appoints president
 - Appoints Investment Committee members
- GPIF President
 - Responsible for all decisions and operations of GPIF, including formulation and implementation of mid-term plan and SAA
 - Under duty of prudent care and loyalty
 - Appoints and manages staff, including other executive
- Investment Committee
 - Up to 11 members: two representatives each from labor and management, and the rest are experts in finance, economics and investment
 - Function: Extends opinions on mid-term plan, SAA, and other important matters pertaining to investment operation

Medium-term goals given by MHLW (April 2006 — March 2010)

- Pursue operational efficiency and cost reduction
- Enhance expertise and fiduciary responsibility
- Conduct thorough disclosure
- Conduct sound and efficient management of reserve funds
 - Secure real return (1.1 % above wage growth) on investment
 - Exceed market return in each asset class
 - Control risks through diversification and other measures
 - Avoid exercising unnecessary influence in the market and in management of private enterprises
 - Secure liquidity sufficient for pension benefit payment
 - Formulate specific policies for reserve fund management
- Formulate SAA (and revise if necessary)
- Exercise appropriate control of investment risks
- Rely primarily on passive (index) funds

Current SAA



Assumed Value of Parameters

	Expected return (%)	Risk (%)	Correlation Matrix				
			Domestic fixed income	Domestic equity	Foreign fixed income	Foreign equity	Cash
Domestic fixed income	3.0	5.42	1				
Domestic equity	4.8	22.27	0.22	1			
Foreign fixed income	3.5	14.05	-0.05	-0.29	1		
Foreign equity	5.0	20.45	-0.01	0.25	0.55	1	
Cash	2.0	3.63	0.39	0.05	-0.03	-0.07	1

SAA Formulation Process in 2004

Process

1. Estimate parameter values
 - Expected return must be consistent with macro-economic model used in MHLW actuarial validation
 - Risk and correlation are estimated from historical data
2. Draw efficient frontier with constraints
 - Foreign fixed income < foreign equity < domestic equity
 - Cash allocation is 5%
3. Select two out of 11 portfolios with the highest Sharpe Ratio and having expected returns from 3.2% to 3.7%
4. Choose the portfolio with lowest shortfall probability in the simulation



Features of SAA formulation process

- Risk budget (risk tolerance) and expected return are set by the MHLW actuarial validation process
 - Total portfolio risk must not exceed the risk of domestic bonds
- Home country bias is affirmed
- In the 2009 SAA revision process, discretionary scope of GPIF will be closely watched on these points



Overall evaluation and future tasks

- As an independent administrative agency, GPIF now bears full responsibility for investment management, while MHLW is responsible for managing the overall pension plan as insurer.
- Investment management including SAA formulation has been separated from MHLW, who was apt to be the target of criticism.
- GPIF has made best efforts to fulfill its accountability through disclosure and explanation of its investment process and results both to MHLW and the public. As a result, it is less vulnerable to reputation risk and political criticism in the current market turmoil compared to the post-Internet bubble period of 2000 and 2001.
- On the other hand, in addition to GPIF's massive AUM, its characteristic as a "independent administrative institution" might work as a constraint and impede freedom to pursue innovative activities to improve efficiency, such as hiring investment professionals in-house, and investing in new asset classes



Reminder:

Views and opinions in these slides are Usuki's personal ones and do not necessarily reflect those of GPIF, NLI Research or any organization he is affiliated with.