# Purpose and System of Public Pension Fund Management

## 1. Purpose of the management

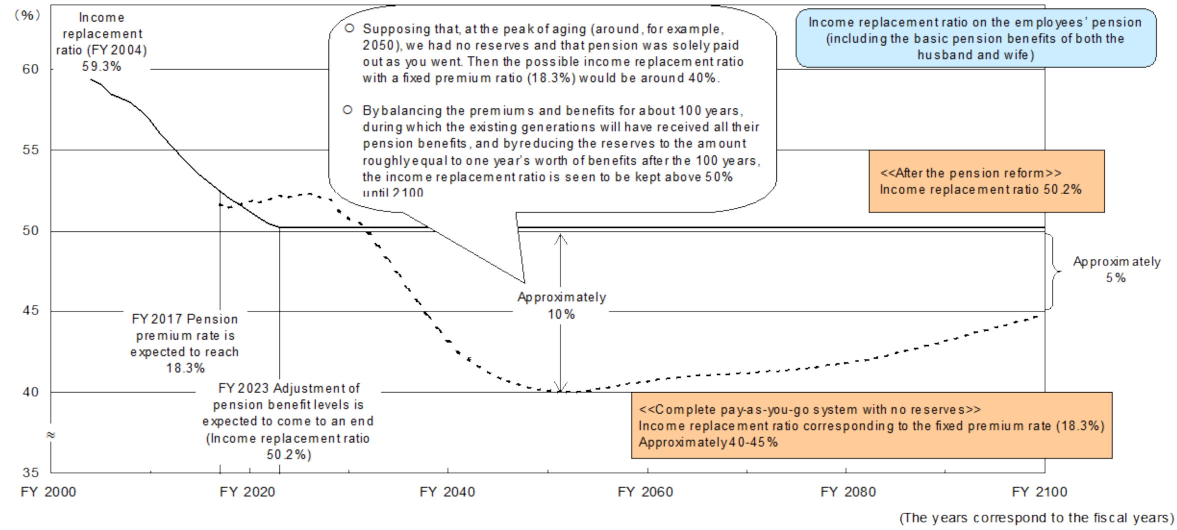
Japan's public pension system (the Employees' Pension Insurance and National Pension) is operated based on the concept that the active worker generation supports the elderly generation. Therefore, there is no intent to reserve necessary funds for pension benefit payments.

However, the Japanese population is rapidly aging with fewer children, meaning that, if the pension benefits should be only funded by the working generation's contributions, then a drastic increase in contribution payments and a drop in pension benefits would be inevitable. Therefore, the system has developed a financial plan to reserve a certain amount of fund and make good use of income from reserve fund investment.

According to the financial system before the reformation of the pension system in 2004, the whole period of the future should be taken into account and a certain amount of fund should be reserved for the future and invested for effective gains (the permanent equilibrium system). However, as a result of the reform in 2004, a new financial system was adopted so that a period of approximately 100 years should be taken into account and the amount of reserves in the final year of this period should be allocated to benefits for one year (the limited equilibrium system). The new system also requires a fund equivalent to benefits for one year or longer to be reserved over a period of approximately 100 years and income from reserve fund investment should become an important source of pension payment.

Comparing prospects for income replacement ratios between the financial system that requires reserves after the reformation of the pension system in 2004 and the complete pay-as-you-go system that does not require reserves, the former can achieve a higher ratio by use of reserves than the latter.

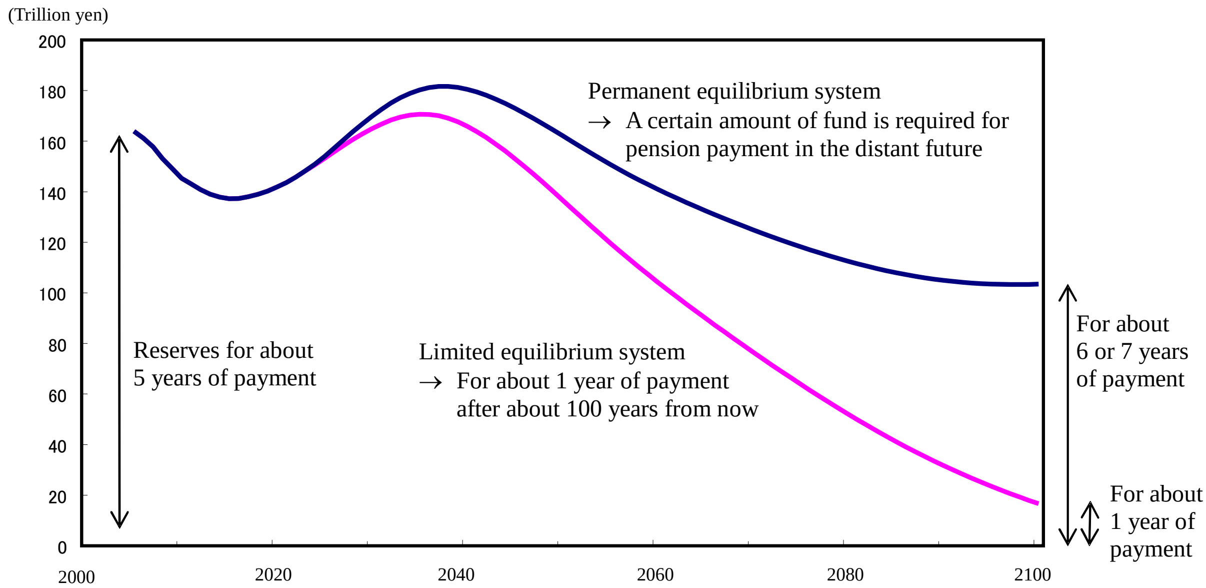
Income Replacement Ratios based on the Reformed Pension System and on the Complete Pay-As-You-Go System
- 2004 Fiscal Budget Recalculation -




Note: The income replacement ratios shown above are those on newly starting pension benefits in the respective years.

# Illustration of Prospects for Pension Reserves (Employees' Pension)

**Based on Prices in 2004**



## 2. System of the management

Until FY 2000, the management of pension reserves was totally entrusted to the former Trust Fund Bureau of the Ministry of Finance (now the Fiscal Loan Fund of the Ministry of Finance). However, the drastic reformation of the Fiscal Investment and Loan Program created a new system in which the Minister of Health, Labour and Welfare should entrust the reserves directly to the former Government Pension Investment Fund (hereinafter referred to as “the former GPIF”) whereby the reserve assets should be managed.

However, as part of the plan to reduce and rationalize corporations with special status, the pension system was reformed for the thorough specialization of organizations which manage pension reserves and the clarification of their responsibilities. In accordance with the New Government Pension Investment Fund Act enacted in June 2004, the New Government Pension Investment Fund (hereinafter referred to as “the new GPIF”) was established in April 2006, following which the former GPIF was dissolved and the reserve assets began to be managed by the new GPIF.

The fund investment services that the former Pension Welfare Service Corporation had conventionally operated by borrowing funds from the former Trust Fund Bureau were succeeded by the former GPIF. They are sustained as succeeded fund investment services from FY 2006 to FY 2010 when the new GPIF could complete repayment.

With regard to the management of pension reserves by the new GPIF, the Minister of Health, Labor and Welfare is required to set a mid-term target as a standard for evaluating the performance of the new GPIF as well as guidelines for the new GPIF to develop a mid-term plan. The Evaluation Committee under the Ministry of Health, Labor and Welfare, which is composed of external knowledgeable people, takes responsibility for evaluating the performance of the new GPIF.

On the other hand, the new GPIF has developed a mid-term plan by themselves as a specific plan to achieve the above-mentioned mid-term target in which they have determined (i) Fundamental policies for investment, (ii) Assets proportion (the basic portfolio) in a long perspective, and (iii) Items to be observed. According to this plan, they will systematically provide management and investment services specifically for the benefit of the insured in a safe and efficient manner from a long-term perspective.

The new GPIF is required to set up an investment committee composed of members appointed by the Minister of Health, Labor and Welfare from among those who are highly capable of judgment on economy and finance. The Committee will review a mid-term plan and supervise the situation of investment and the implementation of investment and management services.

In connection to this matter, the Reports on the Operation of the Pension Reserve Fund will be abolished with those related to FY 2005 (reports of this fiscal year), and after FY 2006, the Minister of Health, Labour and Welfare will annually verify the effect(s) the application of the pension reserve fund has on pension financing and report to the IACEC.

Concerning the new GPIF, the actual results of its operations during each fiscal year are evaluated by the IACEC in consideration of the results of the survey/analysis on the state of implementation of its medium-term plan during the relevant fiscal year as well as the details of the said reporting conducted by the Minister of Health, Labour and Welfare.

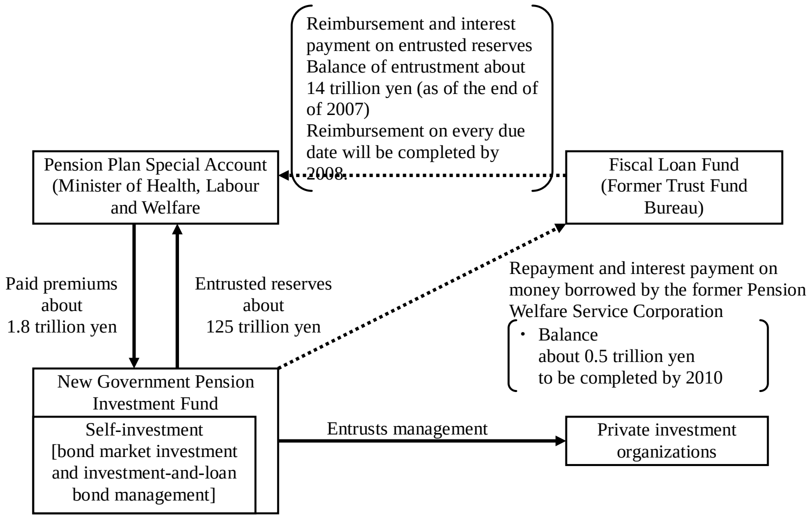
[Current system (from FY 2001)]

(Points)

- ○ Managed by the Minister of Health, Labour and Welfare
  Abolished entrustment to former Trust Fund Bureau
- ○ The Minister of Health, Labour and Welfare conducts management by entrustment to new GPIF (former GPIF till end of Mar. 06)

* Numbers in this figure are balances as of the end of FY 2008. (Paid premiums in FY 2008)

* The fund investment services operated by the former Pension Welfare Service Corporation were succeeded by the new GPIF (the former GPIF until FY 2005) and will be continuously provided as succeeded fund investment services until FY 2010.



## 3. Management Methods

As stated in Section 2, pension reserves are managed under such a system that the Minister of Health, Labor and Welfare directly entrusts them to the new GPIF (the former GPIF until FY 2005). The new GPIF invests the pension reserves as government funds entrusted by the Minister in the market through private investment institutions and also manages and invests (or holds to maturity) the investment-and-loan bonds accepted directly from the special account of the Fiscal Loan Fund from FY 2001 to FY 2007. The new GPIF is also required to manage the assets succeeded in connection with the former Pension Welfare Service Corporation.

In addition, the pension reserves are managed in the form of “interim entrustment to fiscal investment and loan funds” until the end of FY 2008 when the reserves entrusted to the former Trust Fund Bureau are to be fully reimbursed.

### (1) Management by the New GPIF

#### 1) Market Investment

Employees’ and national pension reserves entrusted by the Minister of Health, Labor and Welfare are to be systematically managed and invested by the new GPIF according to its own mid-term plan. They diversify their investment based on the basic portfolio with the focus on domestic bonds in combination with internal and external stocks to a certain extent.

Actual market investment is made through private investment institutions (trust banks and investment consultants), through which the reserves are well managed to steadily achieve the target proportion of assets in each year on the basis of assets to be invested (five types of assets, namely domestic bonds and stocks, foreign bonds and stocks and short-term assets)

#### 2) Acceptance of Investment-and-loan Bonds

The new GPIF (the former GPIF until FY 2005) manages and invests (or holds to maturity) the investment-and-loan bonds accepted directly from the special account of the Fiscal Loan Fund from FY 2001 to FY 2007, separating them from market investments.

Although the former Trust Fund Bureau lent funds procured from the entrustment of postal savings and pension reserves to corporations with special status, the fiscal investment reform has required corporations with special status to procure necessary funds by issuing investment institution bonds in the market. As for corporations with special status which have difficulty in issuing such bonds, investment-and-loan bonds as a sort of government bond will be issued from the special account of the Fiscal Loan Fund and the market-procured funds will be lent to those corporations. It is stipulated by the law that some of investment-and-loan bonds should be transitionally accepted with the pension reserves entrusted to the new GPIF (the former GPIF until FY 2005) as well as postal savings.

3) Management of Assets Succeeded from the Former Pension Welfare Service Corporation

The new GPIF (the former GPIF until FY 2005) succeeded to assets worth about 26 trillion yen for the fund investment services operated by the former Pension Welfare Service Corporation together with the debts to the former Trust Fund Bureau and has invested these assets as well as the pension reserves entrusted by the Minister of Health, Labor and Welfare for market investment as described in Subparagraph 1) above.

(2) Entrustment to the Fiscal Loan Fund

Until FY 2000, it was stipulated that the full amount of pension reserve fund should be totally entrusted to the former Trust Fund Bureau and about 147 trillion yen of fund was actually entrusted to the bureau as of the end of FY 2000. This amount of fund should be reimbursed from the Fiscal Loan Fund at a rate of about 20 trillion yen a year in the period from FY 2001 to FY 2008. Until the completion, some of pension reserves transitionally continued to be entrusted to the Fiscal Loan Fund.

On the entrusted funds, interest will be paid from the Fiscal Loan Fund at the rate fixed at the time of entrustment.