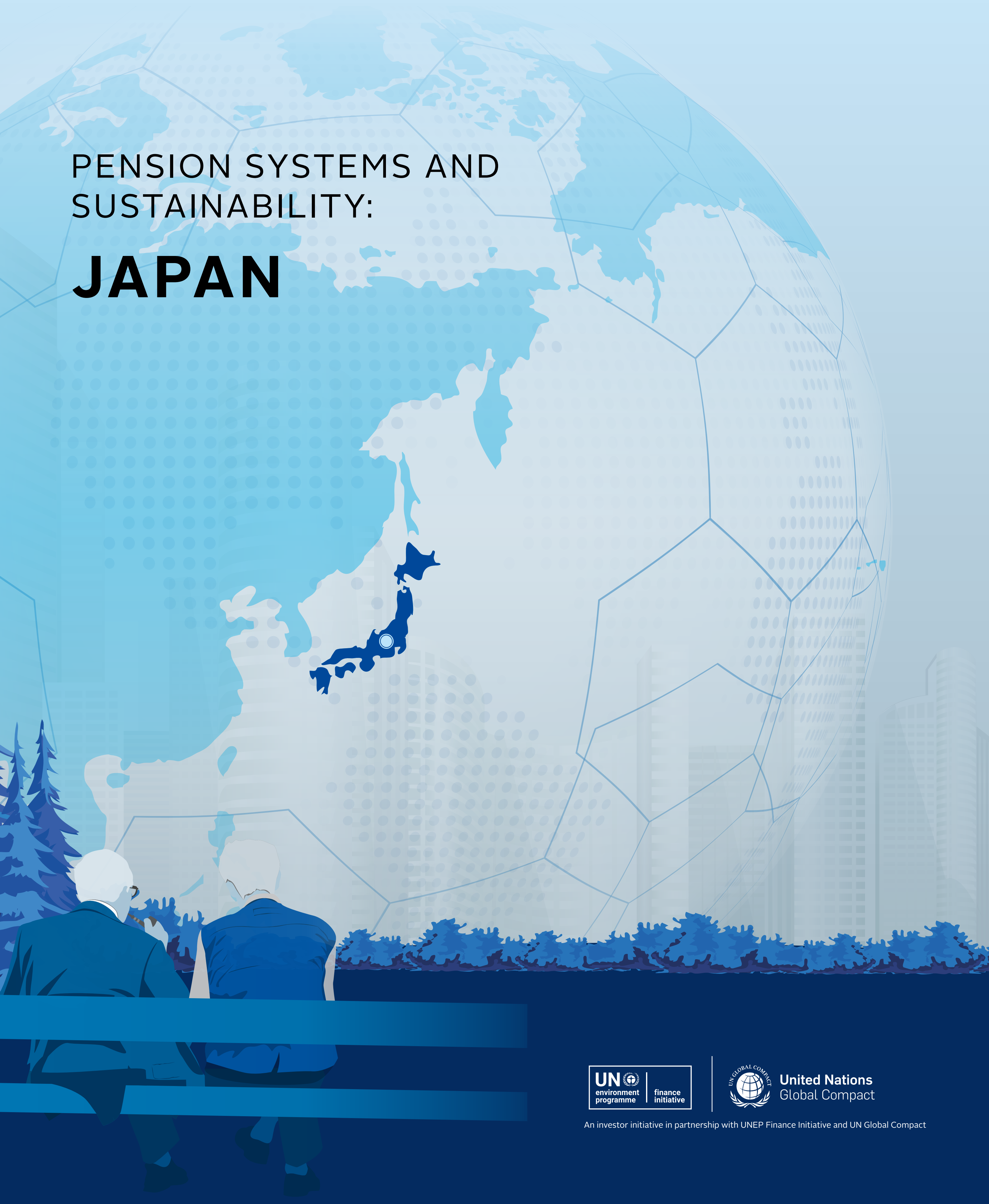
PRI Principles for Responsible Investment

PENSION SYSTEMS AND SUSTAINABILITY:

JAPAN



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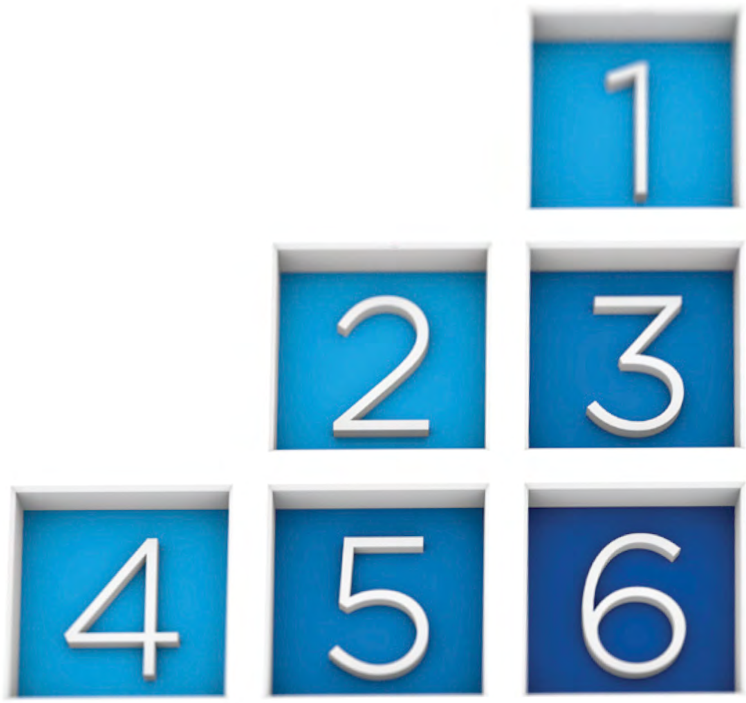
THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.



PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

CONTENTS

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- BlackRock Japan Co. Ltd.
- Nissay Asset Management Corporation, Investment Division
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- Keidanren (Japan Business Federation), Social Communication Bureau
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INTRODUCTION

With 297 trillion yen ($2,854 billion) in assets, the Japanese pension system is the third largest in the world.[1] Between public and private providers, some 54% of assets are managed by PRI asset owner signatories, a higher proportion than in Australia, the US and the UK. This report builds on ideas set out in the PRI briefing 'Sustainable Finance Policy in Japan', published in October 2020, providing an overview of the Japanese system and its key sustainability challenges. It concludes by making a series of recommendations to policymakers and industry participants.

While Japan's pension system has many advanced features, it has not yet been able to comprehensively reflect sustainability issues throughout the system. In this paper, we highlight three key challenges:

1. The public pensions segment benefits from high asset concentration and strong governance arrangements, and the recently updated Basic Policy for Reserves (BPR) requires funds to take necessary steps to integrate ESG factors into investment activities. Still, how to incorporate these factors is left to the discretion of each fund.
2. Private pensions markets are relatively fragmented in terms of assets – although the number of DB plans is falling significantly. Investment chains are complex, especially for corporate DC plans. Consideration of ESG factors is generally seen as desirable but is not explicitly and systematically required. Financial service providers play an important role and there are governance risks - for example relating to costs borne by members caused by insufficient communication between employers and Pension Management Institutions.
3. While in recent years the leadership of the Government Pension Investment Fund (GPIF) has encouraged asset managers to focus on ESG issues, their approaches often lag those of leading international firms.

Japan's pension system assets and PRI coverage. Sources: various sources including MHLW, GPIF, PFA, Council of Pension Management Institution, Japan Investment Advisers Association.

Total pension assets ($bn)	2,854
Workplace pension assets ($bn)	2,718
Personal pension assets ($bn)	136
Approximate total PRI signatory coverage	54%
DB as % of total workplace pension assets	95%
DC as % of total workplace pension assets	5%

Exchange rates used: $1=JPY104, all data (rounded) is from March 2020.

This report should be read in the context of similar reports focusing on Australia, the US and the UK, which the PRI published in 2020. The collective aim of the four reports is to discuss the policy and structural features of pension systems and to understand how these impact the sustainability of those systems. Sustainability in this context is defined as the ability of plan boards and managers to be responsible investors, active stewards and allocators of capital to economic activities with desirable social and environmental outcomes. We have identified a range of challenges across the countries in question. One of the most important, when designing private pension systems, is that policymakers often ignore the connection between policy, structure and sustainability. To realign pension systems with sustainable, equitable economies, this gap needs to be closed.

1 In the PRI research series we previously used the term retirement system, but to reflect terminology in Japan we use the term 'pension system' synonymously throughout this paper

PART I: OVERVIEW OF JAPAN'S PENSION SYSTEM

A significant feature of the Japanese pension system is "Universal Pension Coverage", which applies to every Japanese resident aged over 20. Coverage consists of a National Pension (first tier) and Employees' Pension (second tier) for paid workers. Also, some paid workers are members of a Defined Benefit (DB) plan and / or Defined Contribution (DC) plan (third tier).

The third tier is implemented at the discretion of employers. Once implemented, it is a principle that employees are enrolled on a mandatory basis. Lastly, iDeCo, which is an individual type of DC pension, is open to every Japanese resident under 60 on a voluntary basis (Table 1). This age requirement will be slightly relaxed to include employees under 65 from 2022.

Table 1: Overview of Japan's pension system. Source: Created by RIPPA based on various information such as MHLW, GPIF, PFA, Council of Pension Management Institution, Japan Investment Advisers Association, R&I "Pension Newsletter"

	PUBLIC PENSION	PRIVATE PENSION				
Employed or not	Employed (National pension covers all citizens)				All citizens	Self Employed
System Type	Employee's Pension Insurance / National Pension System	Defined Benefit (DB)		Defined Contribution (DC)		National Pension Fund
Investment Vehicle	GPIF/ Mutual Aid Association	Rule Type DB	Fund Type DB	Corporate Type DC	Individual Type DC "iDeCo"	NPFA
Total Assets (JPY Trillions)	202.7	74.5		13.6	2.2	3.9
PRI Signatories as % total assets	74%	14%		NA	NA	0
Sector Concentration	GPIF accounts for 74% out of all public pensions	PFA accounts for 14% out of total DB assets		Fragmented	NA	4 NPFs have 100% of assets
Service provider concentration	Top 10 asset managers hold 2/3 of assets	Top 10 asset managers hold ~70% of assets*		Top 10 Pension Management Institutions hold 90% of DC assets		4 trust banks and 15 investment management companies hold 100% of assets
Regulator	MHLW, MOF, MIC, MEXT	MHLW		MHLW, FSA		MHLW
Governance Structure	GPIF's Board of Governors supervises Executive Office and is audited by Audit Committee.	Employer is the plan sponsor.	Employer is the plan sponsor. Pension plan directors are responsible for execution	Employer is the plan sponsor. DC Pension Management Institutions manage the plan as fiduciaries.	NPFA is the implementing body. Pension Management Institutions act as fiduciaries.	The board of council makes decisions and the board is responsible for execution.

	PUBLIC PENSION	PRIVATE PENSION			
Asset Allocation	Long Term Policy Portfolio: Domestic Bond 25% Domestic Equity 25% Overseas Bond 25% Overseas Equity 25%	Actual asset allocation: Domestic Bond 23.3% Domestic Equity 9.0% Overseas Bond 17.3% Overseas Equity 12.2% General Account 17.9% Others (including Hedge Fund) 15.1% Cash 5.3%	Actual asset allocation: Domestic Bond 6.2% Domestic Equity 10.9% Overseas Bond 4.3% Overseas Equity 8.3% Balanced Type 17.6% Bank Deposit 36.1% Life Insurance G/A 15.6% Others 1.0%	Actual asset allocation: Domestic Bond 3.8% Domestic Equity 11.4% Overseas Bond 3.5% Overseas Equity 11.4% Balanced Type 13.0% Bank Deposit 35.9% Life Insurance G/A 18.0% Others 3.0%	Policy Portfolio: Global Bond 52% Global Equity 48%
Key barriers to responsible investment		Shortage of staff such as human resources with appropriate investment skills.	Limited responsible investment product options. Administrative burden to replace products. Limited understanding of responsible investment by employers and employees.	Limited responsible investment product options. Limited understanding of responsible investment by citizens.	

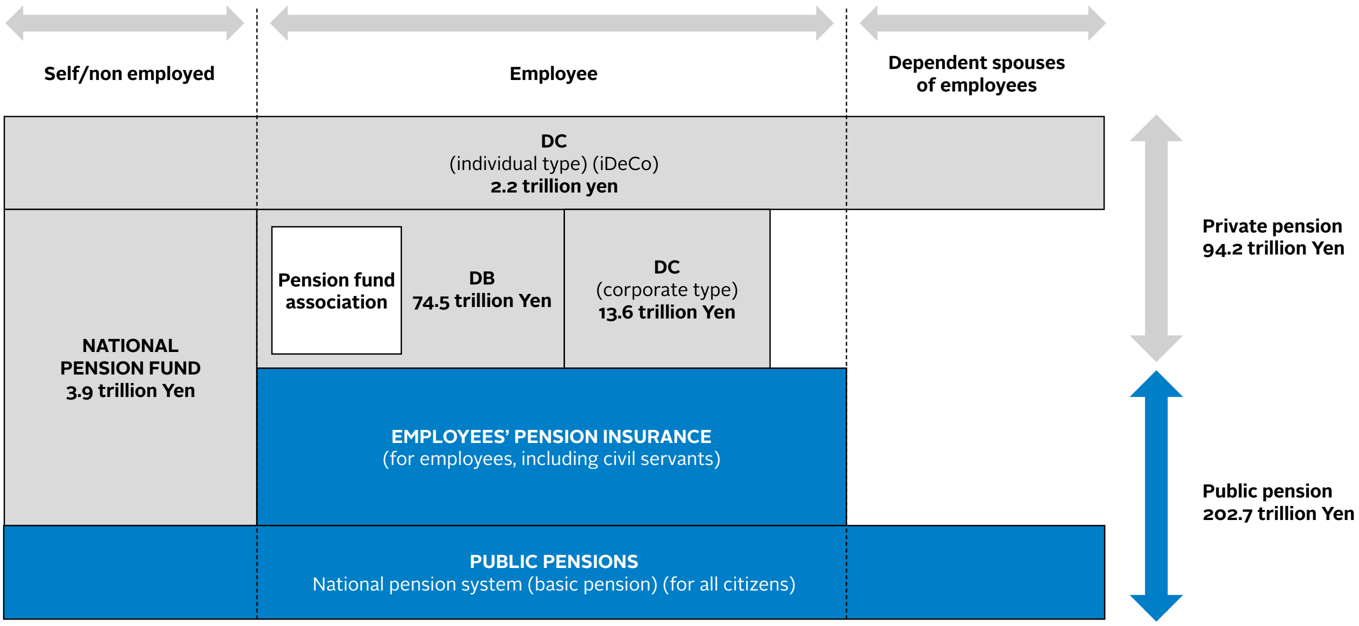
* Only this ratio is calculated as of the end of March 2019.

Abbreviations: GPIF (Government Pension Investment Fund), NPFA (National Pension Fund Association), MHLW (Ministry of Health, Labour & Welfare), MOF (Ministry of Finance), MIC (Ministry of Internal Affairs and Communications), MEXT (Ministry of Education, Culture, Sports, Science and Technology), FSA (Financial Services Agency), PFA (Pension Fund Association)

The classification of the Japanese system is different to the European three-pillar system. Generally, in the three-pillar system, the first pillar is public, the second is corporate, consisting of DB and / or DC plans, and the third is personal.

In Japan, corporate pension plans and individual DC plans (iDeCo) are classified as the third "tier". Another feature of the Japanese system is that the value of assets managed by public pension funds (203 trillion yen) is more than double the value of private pension funds (94 trillion yen) (Figure 1).

Figure 1: Overview of Japanese pension system.



* Employees younger than 70 (including civil servants) must join the Employee's Pension Insurance.

** Self-employed persons can voluntarily join the National Pension Fund.

*** DB and DC are the pension benefit systems that set the rules based on the laws. While DB and DC may be implemented at the same time, there are many companies that do not have such an offer.

**** PFA plays a major role in terms of the portability of corporate pensions by providing benefits to the mid-career withdrawals.

Since March 2010, the value of public pension assets has increased by 18% and the value of private pension assets has risen by 14%. Particularly remarkable is the increase in DC assets. Corporate type DC assets have tripled, while individual assets grew 5.5 times, driven by the expansion of coverage in 2016. The Ministry of Health, Labour and Welfare (MHLW) conducts financial verification for public pensions every five years, calculating the financial position for the next 100 years. According to the latest verification, conducted in 2019, the amount of the pension reserve in 2030 will vary from 273.5 trillion yen to 212.3 trillion yen depending on demographic and economic assumptions. It is likely that private pension assets will grow relative to public pension assets, and that the existing trend of migration from DB to DC will persist. Discussions on the expansion of individual retirement asset formation are underway, and individual assets are expected to continue to grow more rapidly than corporate DC assets.

The public pension system is in principle pay-as-you-go, with the current generation paying for current retirees.[2] However, due to a declining birth rate and aging population, this could lead to the burden on future generations increasing significantly. Therefore, a portion of pension contributions have been accumulated as a pension reserve fund and are invested for the longer term.

Another feature of the Japanese system is the "macro-economic slide mechanism" in public pensions. These pensions were initially indexed to take-home wages and then to consumer price inflation. However, the macro-economic slide mechanism, introduced in 2004, means that indexation rates will be reduced based on the decline in the working-age population and increased longevity. This will lead to lower pensions in aggregate.

2 Under this system, funds are basically not accumulated.

PART II: PUBLIC PENSIONS

The public pension system in Japan consists of first and second tiers. The first tier is called the National Pension System and covers everyone aged 20 or over. Entitled claimants receive basic pension benefits. The second tier is mandatory for private companies and public sector employees. It is called the Employee's Pension System and is an earnings-related benefit, which means that the recipient receives benefits proportional to his or her pensionable remuneration, on top of basic pension benefits.

Japan's public pension reserve was 203 trillion yen at the end of March 2020, equal to two thirds of total pension assets. The public pension sector in Japan is the most consolidated segment of any of the four countries examined in this series. The Government Pension Investment Fund (GPIF) accounts for 74% of the balance and three other Mutual Aid Associations manage the rest. Only GPIF is a PRI signatory (Table 2).

Table 2: Assets and Participants of Public Pension Funds. Source: Annual Report of each plan and MHLW.

RANK	NAME OF ENTITY	ASSETS (JPY BILLIONS, MARCH 2020)	SYSTEM NAME	ACTIVE PARTICIPANTS (1,000, MARCH 2019)	PRI SIGNATORY YES/NO
1	GPIF	150,633.2	National Pension*	67,460	Yes
			Employees' Pension	39,806	
2	Local Governments**	41,112.3	Employees' Pension and additional pension	2,850	No
3	National Government	7,402.1		1,070	No
4	Private Schools	3,505.7		560	No

* Active Participants of National Pension include those of Employees' Pension.

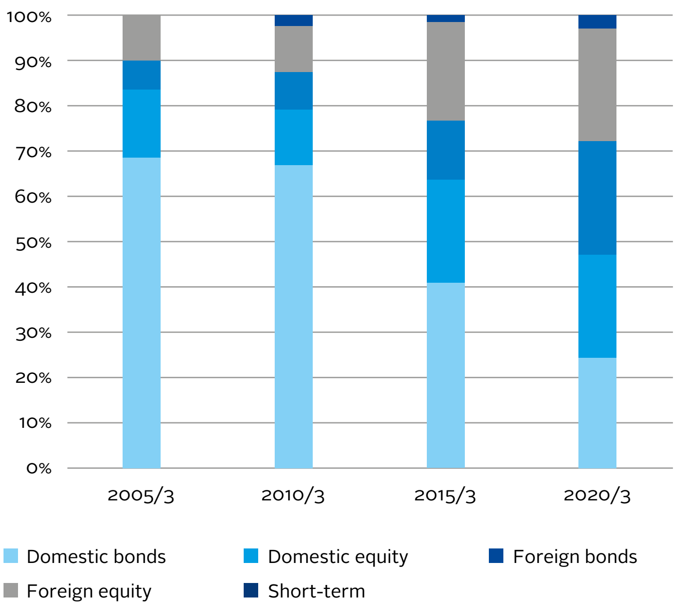
** Local Governments include; Mutual Aid Associations for Local Government Officials, Japan Mutual Aid Associations of Public School Teachers, Police Mutual Aid Associations, Metropolitan Employee Mutual-Aid Association, National Federation of Mutual Aid Associations for Municipal Personnel, Pension Fund Association for Local Government Officials.

1. GOVERNMENT PENSION INVESTMENT FUND

GPIF is an executing agency under the supervision of the Ministry of Health Labour and Welfare (MHLW). MHLW appoints GPIF's President and members of the Board of Governors and formulates, with other ministries, the Basic Policy for Reserves (BPR), which governs the operation of GPIF and mutual aid associations. BPR was revised in 2020 to promote ESG investment. Any material changes to GPIF's investment strategy and process relating to BPR requires the consent of MHLW.

GPIF manages the pension reserve fund for both the National Pension (tier 1) and Employees' Pensions (tier 2). GPIF revised its policy portfolio in October 2014, shifting towards Japanese equity (25%) and overseas equity (25%) from Japanese fixed income. The total allocation of 50% to equities is considerably higher than in Japan's corporate pension plans, giving GPIF more exposure to an asset class in which responsible investment, historically, has seen more traction (Figure 2). The basic portfolio for the five years from April 2020 is set to be 25% domestic bonds, 25% domestic equities, 25% foreign bonds and 25% foreign equities.

Figure 2. Allocations of GPIF by asset class. Source: Annual reports of GPIF



GPIF believes that "improving the governance of the companies that GPIF invests in while minimising negative environmental and social externalities – that is, ESG (environment, social and governance) – is vital in ensuring the profitability of the portfolio over the long term".[3] In addition, in line with the investment principle that "expansion of long-term investment returns requires sustainable growth of investees and the market as a whole", GPIF has promoted ESG integration throughout the investment process, including in domestic and foreign bonds, alternatives and infrastructure investment. Allocations to these asset classes have risen in recent years, as they have to domestic and foreign equities.

According to GPIF, passive investment based on indices that integrate ESG factors will not only improve the risk/return profile of the portfolio over the long term, but also enhance the Japanese equity market through secondary effects such as the improvement of ESG ratings.[4] GPIF began to request proposals for domestic market ESG indices in 2017 and selected three Japanese ESG equity indices, after which it began passively investing in funds based on these benchmarks. In 2018, GPIF selected two other indices for domestic and foreign equities that focus on targeting corporate greenhouse gas emissions.

GPIF first published an ESG report in 2018, aiming to highlight the long-term benefits of its ESG activities. In 2019, GPIF disclosed climate change-related financial information for the first time, in line with Task Force on Climate-related Financial Disclosures (TCFD) recommendations. In 2020, it expanded its scope of analysis to include a comprehensive assessment of climate change-related risks and opportunities across all major asset classes in the fund's portfolio.[5]

GPIF requires its asset managers to engage with investee companies, even in passive management of equity. For investments in bonds, it has conducted joint research with the World Bank: "GPIF provides external asset managers with an opportunity to both integrate ESG into their fixed income investments and gain excess returns over government bonds by building platforms in which they can invest in green bonds and other securities issued by multilateral development banks and government finance agencies".[6]

According to a RIPPA survey on awareness around ESG investing, conducted in 2017, 5% of ordinary Japanese citizens are "very aware" or "somewhat aware". If including the response "have heard the term before", the total rises to 14%.[7] The implication is that 86% of respondents knew nothing about ESG investing. Promoting understanding among Japanese citizens, as beneficiaries and the ultimate owners of capital, will therefore be an important task in the years ahead.

In the pay-as-you-go system, the funding ratio concept is not used as an indicator of financial soundness. The long-term investment target is "wage increase rate +1.7%". Performance has averaged +2.39% in the 19 years since inception, contributing to enhanced fiscal consolidation of public pensions.[8]

A major reform of GPIF's governance structure was undertaken in October 2017, before which it was based on an autonomous system whereby the President was responsible for both decision making and execution. This has been revised so that important organisational policies are now determined by a council system of a board of governors, composed entirely of external experts, except for the President. Business is executed under the authority of the executive office, and monitored by the board of governors. Furthermore, an audit committee works with the board of governors to conduct risk audits, while ensuring compliance with business procedures.

Given its size, GPIF's focus on ESG issues, including joining PRI in 2015, has had a ripple effect across the Japanese asset management industry. Major asset management companies contracted by GPIF have both incorporated ESG factors into their investment processes and signed the PRI. Furthermore, as these asset management companies also manage corporate pension assets, ESG investment in Japan's pension management industry has expanded significantly. Japan's ESG investment balance in 2016 was approximately 56 trillion yen.[9] By 2019 it had increased sixfold to 336 trillion yen.[10]

3 GPIF "ESG REPORT 2019" p1 https://www.gpif.go.jp/en/investment/GPIF_ESGREPORT_FY2019.pdf

4 GPIF "ESG REPORT 2019" p17 https://www.gpif.go.jp/en/investment/GPIF_ESGREPORT_FY2019.pdf

5 GPIF "Analysis of Climate Change-Related Risks and Opportunities in the GPIF Portfolio" https://www.gpif.go.jp/en/investment/GPIF_CLIMATE_REPORT_FY2019_2.pdf

6 GPIF "ESG REPORT 2019" p20 https://www.gpif.go.jp/en/investment/GPIF_ESGREPORT_FY2019.pdf

7 RIPPA, "Research on the Public's Awareness of ESG Investing of Pension Funds" https://www.nensoken.or.jp/english/wp-content/uploads/sites/2/rr_30_10.pdf

8 GPIF Annual Report 2019, p17 https://www.gpif.go.jp/en/performance/annual_report_fiscal_year_2019.pdf

9 Response from MOE in Nov. 2020

10 MOE's High Level Meeting on ESG Finance, reference material (p5) made up from GSIA (2017) 2016 Global Sustainable Investment Review and from The Japan Sustainable Investment Forum (JSIF) http://www.env.go.jp/policy/02ESG.pdf (in Japanese)

GPIF's in-house investment is solely focussed on fixed income, as public pension funds are not permitted to hold individual equities directly (Table 3).

Table 3: In-house investment of GPIF. Source: Annual Report of GPIF, fiscal year 2019.

ASSET CLASS	ASSETS (JPY BILLIONS), MARCH 2020
Passive Funds of Domestic Bonds	10,698.1
Fund of Inflation-Linked Government Bonds	2,953.5
Funds of Japanese Yen-Denominated Short-Term Assets	12,961.0
Fund of Fiscal Investment and Loan Program Bonds	896.2
Fund of Foreign Currency-Denominated Short-Term Assets	90.4
Total	**27,599.2**

2. MUTUAL AID ASSOCIATIONS

Though other mutual aid associations are much smaller than GPIF, both the Pension Fund Association for Local Government Officials (PFALG) and The National Federation of Mutual Aid Associations for Municipal Personnel (NFMAA) began implementing sustainable/ ESG investments prior to GPIF. PFALG aims to improve long-term investment returns through sustainable growth of investee companies. At the same time, it aims to support its beneficiaries in addressing sustainability topics, such as relating to the environment and human rights: "PFALG believes that they can fulfil their fiduciary responsibility to increase shared value for the policyholders over the long-term as well as fulfilling their social responsibility as a public pension fund. Thus, they have been actively pursuing 'Sustainable Investments (ESG investment)".[11]

11 PFALG Investment Report for 2019 (in Japanese) p37 https://www.chikyoren.or.jp/Portals/0/2_sikinunyo/joukyo/r1chikyoren/joukyo_r1_kounen_pal20200703rbzi6.pdf

PART III: PRIVATE PENSIONS

Private pensions in Japan are composed of DB and DC plans (Table 4). They are further divided into corporate pension plans implemented by business owners and personal pensions voluntarily enrolled into by individuals. Though there is a clear trend from DB to DC in Japan, private pensions are still predominantly DB, with 83% of assets falling into this category.

However, corporate type DC coverage has increased from 3.4 million to 7.2 million members over the past ten years, now accounting for 39% of private pension members. The number of DB members, meanwhile, has fallen from 13.6 million to 9.6 million over the past ten years (Table 4).

Table 4: Growth of DC plans. Source: MHLW, Pension Fund Association

	DATE	DB TOTAL	DC-CORPORATE TYPE	DC-INDIVIDUAL TYPE	DC TOTAL	DB+DC TOTAL
Number of plans	March 2010	25,197	3,301	1	3,302	28,499
	March 2015	14,328	4,635	1	4,636	18,964
	March 2020	12,587	6,435	1	6,436	19,023
Number of active participants ('000')	March 2010	13,570	3,400	110	3,520	17,090
	March 2015	11,450	5,060	210	5,280	16,730
	March 2020	9,550	7,230	1,560	8,790	18,340
Assets (JPY trillions)	March 2010	74.4	4.5	0.4	4.9	79.3
	March 2015	89.8	9.1	1.1	10.2	100.0
	March 2020	74.5	13.6	2.2	15.7	90.2

* Defined benefit type plans include qualified pension plans, employees' pension funds, and defined benefit corporate pension plans.

Legislative changes for employees' pension funds in 2013[12] led to a significant drop in DB assets, and a wider fall in private pension assets in the latter half of the past decade. As a result, the ten-year growth rate of private pension assets (14%) is less than that of public pension assets (18%).

Corporate DC assets have more than doubled over the same period, while personal pension assets, termed iDeCo in Japan, have increased by 450%. It is important to note, however, that iDeCo assets constitute less than 1% of total pension assets in Japan. This is a fraction of the personal pension segments in other countries, such as Independent Retirement Accounts in the US (36.7%), self-managed super funds in Australia (26.5%) and UK personal pensions (17.0%).

Similar to the UK and the US, the structure of private pension investment in Japan involves multiple decision-makers. In order to eliminate conflicts of interest and establish bankruptcy remote structures – especially in DC – there is regulatory focus on the separation of functions. The unfortunate result is a complex value chain and a private pension system that is difficult for participants and beneficiaries to understand. This, in turn, leads to communication challenges between business owners, members, and third-party service providers. In addition, while consideration of ESG factors is widely interpreted as the norm, regulation does not explicitly require the incorporation of ESG factors.

12 Employees' pension funds are corporate pensions partially substituting Employees' Pension. Although they used to be central to Japan's corporate pension system, the creation of new funds is now prohibited and the dissolution of existing funds has been promoted since the law was amended in 2013.

1. CORPORATE PENSIONS

(1) PENSION FUND ASSOCIATION

The Pension Fund Association (PFA) plays a central role in the portability of DB corporate pension funds, for example through managing assets of DB pension funds for mid-career withdrawals.[13] The board of trustees of the PFA is composed of representatives from members – Japanese corporate pension funds - and is the highest decision-making body. The board of directors, appointed by the board of trustees, is responsible for executing PFA's activities

PFA also provides services including publishing (on corporate pensions), and advice and training for members. The body is active in policy matters, such as system improvement and tax reform, and shares information on stewardship responsibilities with corporate pension funds. It has set up a working party with MHLW to tackle stewardship issues.

PFA has been a front runner in improving Japanese corporate governance. Efforts to bolster governance in domestic stock management started around 20 years ago. Since 2016, PFA has outsourced its engagement activities, and in 2017 it joined the Institutional Investors Collective Engagement Program, along with several major Japanese asset management companies, to explore the possibility of collective engagement.

In May 2016, PFA adopted the Japanese Stewardship Code and signed the PRI. The body now integrates ESG factors into all of its active investments – both domestic and overseas equities – with an emphasis on engagement in passive investment. In addition to investing in green bonds domestically and overseas, PFA now also invests in renewable energy and microfinance. Its investment style is mainly active. Based on its research, PFA outsources asset management to overseas investment management companies, through which it aims to earn excess returns on its policy asset mix, taking into account pension liabilities. It started investing in private equity from an early stage and is active in private assets such as infrastructure, real estate, and debt investments, as well as hedge funds.

(2) PRIVATE SECTOR DB

Historically, many Japanese DB pension plans originate in the severance payment system.[14] Business owners who operate DB pension plans tend to regard it as a corporate benefit in their HR systems, and do not see themselves as asset owners. In addition, all DB assets are outsourced to asset management companies.

Until recently, private sector DB plans have been reluctant to undertake responsible investment activities. This is evidenced by the fact that only relatively few private sector DB plans have signed the PRI. However, following revision of the DB Guidelines[15] in 2017, which referred to ESG, consideration of medium- to long-term sustainability, including ESG factors, is now included in the Stewardship Code revised edition of March 2020. Acceptance of the Stewardship Code is growing among DB plans, while asset owner recognition of responsible investment is steadily increasing.

According to a survey undertaken by PFA, "approximately 30-40% of the 269 corporate pension plans surveyed received reports and explanations from their asset managers about their voting rights execution status, the status of their portfolio companies, engagement policies and actual implementation, as well as policies for managing conflicts of interest and self-assessments of stewardship activities, among other matters.

This seems to indicate that pension funds that have yet to adopt the Stewardship Code are engaging in some stewardship activities."[16]

In a questionnaire conducted by Nissay Asset Management, approximately one third of the 224 major DB funds surveyed had either adopted ESG-related funds already or were planning to do so – a ratio that has been increasing since 2017.[17] An article published by industry magazine Pension Newsletter reported that 40% of DB pension plans are interested in ESG-specialised investment, and interest among asset owners has risen sharply.[18]

13 Mid-career withdrawals are persons who have lost membership rights of DB corporate pension plans due to their resignation whether voluntarily or not. Although mid-career withdrawals are ineligible to receive pension benefits from corporate pension plans to which they belonged to, if the requirements stipulated in the agreement are met, they may receive lump sum withdrawal payments. For mid-career withdrawals to receive pension benefit in the future, resource equivalent to withdrawal payment must be transferred either to PFA or to a newly joined corporate pension plan. PFA takes over pension benefits for mid-career withdrawals and serves as the aggregation center for mid-career withdrawals of multiple corporate pension plans.

14 In Japan, workers at a prescribed age, mostly 60, used to receive some amount of lump sum severance payment at the time of leaving the company. Source of the payment is often prepared as a book reserve within the company. While such payment practices still exist today, workers tend to remain working in the company even after receiving the payments up to age 65 or more.

15 "Guidelines on the roles and responsibilities of those who engage in asset management tasks for Defined Benefit corporate pensions"

16 Response from Private Pension Division, Pension Bureau, MHLW in Nov. 2020

17 Response from NAM in Nov. 2020

18 Pension Newsletter R&I, December 7, 2020 "Momentum for Full-scale ESG Investment"

In terms of asset allocation of private sector DB plans, the PFA survey finds that ownership of Japanese and overseas equities are on a downward trend, with PFA member company pension plans holding 9.1% and 12.1% respectively as a proportion of total investment at the end of March 2020 (Figure 3).

The largest corporate retirement plan managed just over 3 trillion yen in assets. However, this figure, quoted from the annual securities report, may include amounts allocated to lump-sum severance benefits (Table 5). None of the largest plans are PRI signatories, but in the case of corporate pensions of major financial institutions, the parent financial institution is the signatory.

Figure 3: Change in asset allocation over time. Source: Pension Fund Association "Corporate Pension Survey" (FY 2019 overview)

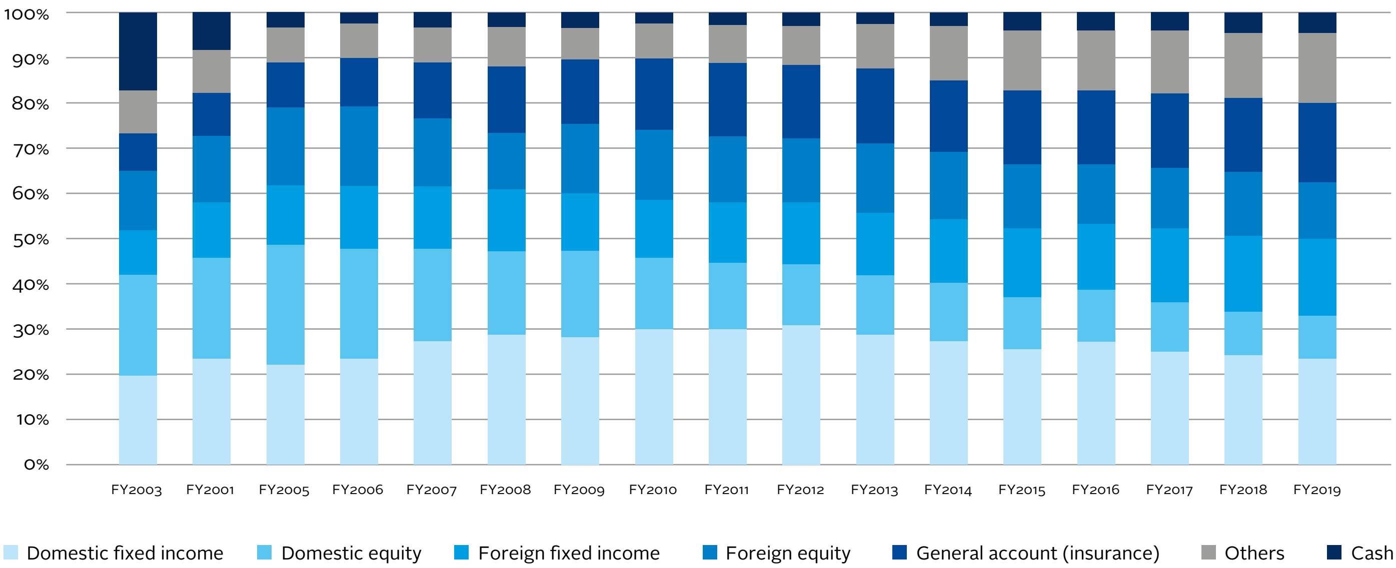


Table 5: Top 10 retirement benefit assets of Japanese companies. Source: Annual reports of listed companies.

SPONSOR	ASSETS JPY BILLIONS*	SPONSOR	ASSETS JPY BILLIONS
Mitsubishi UFJ Financial Group	3,043	**Fujitsu**	1,391
Toyota Motor	2,382	**Hitachi**	1,368
Mizuho Financial Group	2,225	**Panasonic**	1,364
Honda Motor	2,036	**Sumitomo Mitsui Financial Group**	1,319
NTT	1,886	**Mitsubishi Electric**	1,042

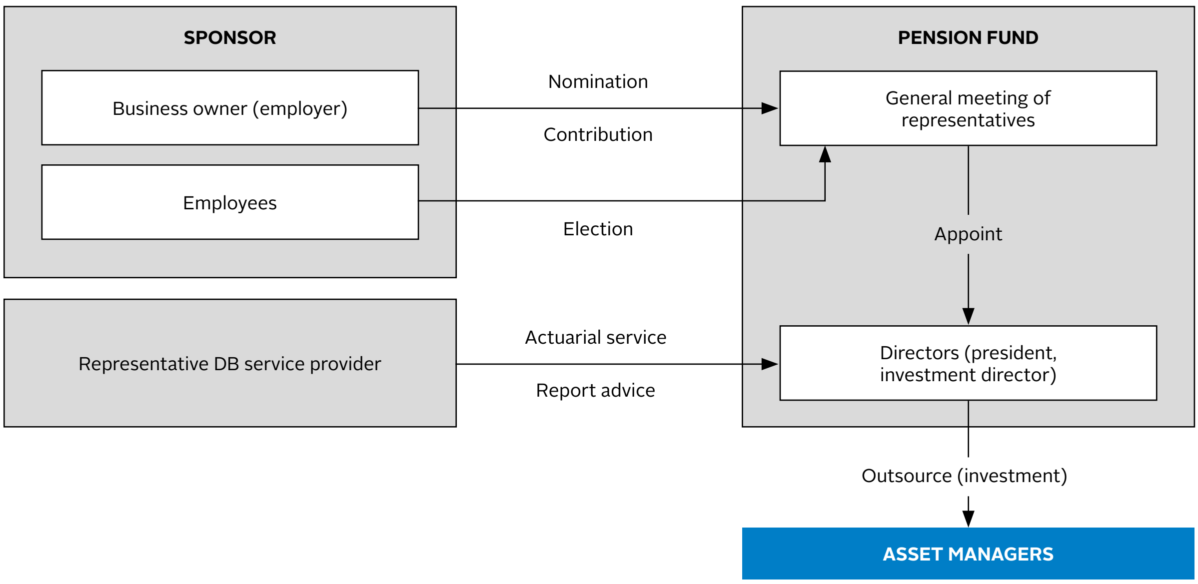
* The amount of retirement benefit assets in each company's securities report is stated. They include not only the balance of the defined benefit corporate pension (DB) but also the amount of retirement benefit assets of domestic and overseas consolidated companies and may include the amount to be used for lump-sum severance benefit.

(3) DB VALUE CHAIN

Within corporate DB plans, the employer is ultimately responsible for pension asset management and benefit payments. Although the assets are held in a trust fund, independent of the sponsor, plan fiduciaries are always business owners. There are two types: 1) a fund type in which the corporate pension fund established by the business owner and the member representative is the implementing body, and 2) a rule type in which the business owner implements with the consent of the member representative.

In the case of the fund type, the business owner and employees select the same number of representatives. The representatives nominated by the business owner appoint half of the directors, including the president, and the representatives elected by employees appoint the other half. The general meeting of representatives is the decision-making body, while the directors are responsible for management of the fund. The value chain showing governance and decision making is illustrated in Figure 4.

Figure 4: DB value chain (fund type)



The "Representative DB Service Provider" (RDBSP) model plays an important role in relation to actuarial and other pension services of corporate pension plans, providing small to medium-sized DB plans with a one-stop service solution. Smaller-sized sponsors, in particular, tend to use RDBSPs as investment and employee benefits advisors. On the other hand, relatively large DB plans use more diversified service providers, such as investment consultants and/or specialised operations management companies for their investment consulting or actuarial work. The RDBSP is either a trust bank or a life insurance company.

Along with trust banks and life insurance companies, investment management companies play a significant role in offering various investment products. The market share of the investment management companies tends to be higher, especially for the larger DB plans.

(4) CORPORATE DC PLANS

Established in 2001, the DC system enables business owners to sponsor corporate DC pension plans. While it is the business owner that contributes to the corporate DC plan in principle, it may prescribe that employees contribute a matching contribution within half of the contribution limit and within the employer's contribution amount. Employees select investment products for themselves and bear the investment risk, while business owners have a "duty of effort" to provide investment education as far as possible to the employees.

The average premium is about 160,000 yen, or the equivalent of a little less than 5% of the average salary.[19]

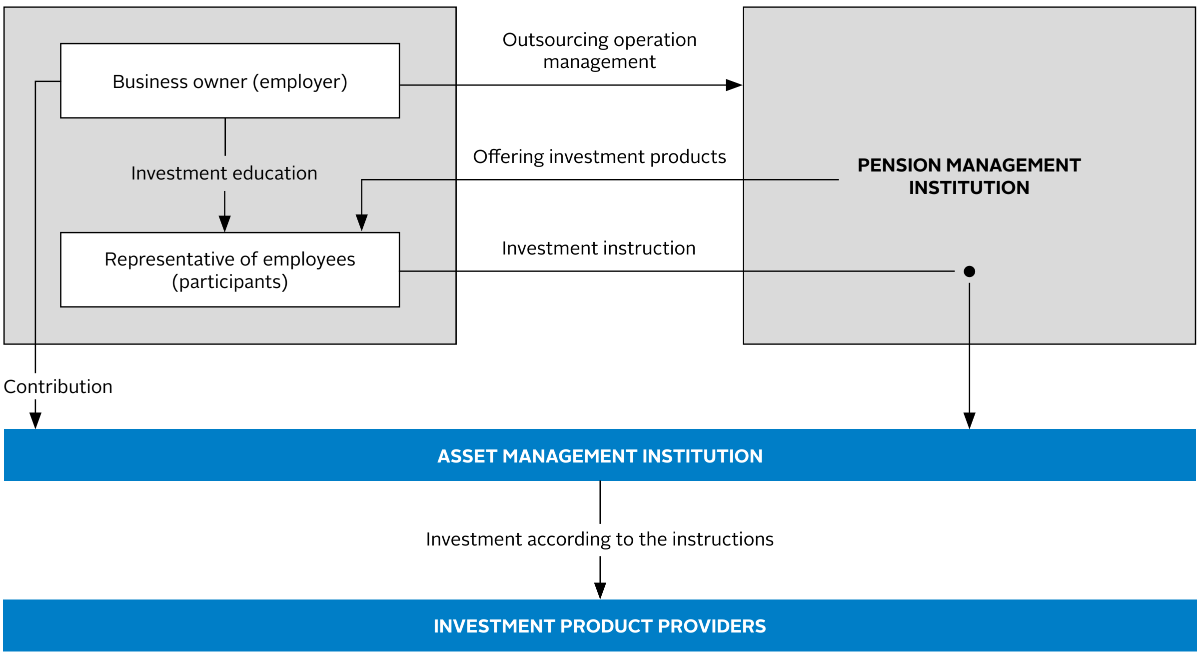
19 Council of Pension Management Institution "DC Pension Statistics (end of March 2020)" p9, MHLW "Annual Wage Structure Basic Statistical Survey" Men and women total 307.7 thousand yen (2019)

(5) DC VALUE CHAIN

Under the DC system, the business owner appoints a Pension Management Institution, such as a bank, trust bank, life insurer, or securities company, and an Asset Management Institution, such as a trust bank. The Pension Management Institution and the Asset Management Institution play important roles in plan design and helping employees make investment decisions. In Japan, each specialised organisation is required to perform defined functions, such as operation management, asset management or product provision (sales). This structure aims to eliminate conflicts of interest by prohibiting Pension Management Institutions from recommending specific investment products in their distribution.

It is also designed so that products can be selected exclusively in the interests of plan members. In addition, by assigning the asset management function to an independent institution such as a trust bank, the bankruptcy remote structure of paid premiums and assets invested by plan members is guaranteed. Such functional separation aims to make the system reliable for plan members. On the other hand, the system might be overly complex or lead to governance issues, such as insufficient communication between business owners, service providers and DC plan members, due to the existence of multiple specialised organisations (Figure 5).

Figure 5: DC value chain (corporate type)



It is important for plan members to be aware of responsible investment issues. The role of the Pension Management Institution, which proposes investment products, is critical in this respect. In recent years, it has been claimed that business owners lack good governance in the operation of DC systems.

Because cross-selling might impact DC governance, MHLW now requires Pension Management Institutions to disclose investment products on their websites. For this reason, the 2016 revision of the DC Law requires business owners to re-evaluate their Pension Management Institution every five years. MHLW is working to further strengthen DC governance.

Some employees who have automatically joined a DC plan are allocated to the default fund -selected for savers who do not make an active fund choice. It has been just two years since the default fund was legally added as an option.

Though the number of DC plans that set default funds is increasing, there is currently no DC plan offering ESG-labelled mutual funds as the default fund. Corporate type and individual DC plans have similar allocations to both Japanese equities (10.9% and 11.4% respectively) and overseas equities (8.3% and 11.4%) (Table 6).

Table 6: DC asset class breakdown (of total assets). Source: Council of Pension Management Institutions, March 2020

	EQUITY FUNDS		BALANCED FUNDS	BOND FUNDS		MONEY FUNDS	INSURANCE	OTHER
	Domestic	International		Domestic	International			
Corporate type	10.9%	8.3%	17.6%	6.2%	4.3%	36.1%	15.6%	1.0%
Individual type	11.4%	11.4%	13.0%	3.8%	3.5%	35.9%	18.0%	3.0%

As many as 29 investment trusts, with a total balance of about 690 billion yen, are labelled 'ESG', and 11 have been set up since the beginning of 2020.The most popular investment trust is the Mammoth ESG investment trust, which has 660 billion yen under management as of October 2020 – highlighting fast-growing interest in responsible investment.[20] In the DC system, however, the replacement of investment products incurs a considerable administrative burden. This is one of the barriers to replacing traditional investment products with ESG investment trusts.

(6) Industry and trade unions

The Japan Business Federation (Keidanren) is one of the most important and influential business groups in the country. Keidanren has set up "Society 5.0 for SDGs"[21], which works to solve social issues and achieve the SDGs through digital innovation. In March 2020, it published a joint research paper with Tokyo University and GPIF, highlighting that the evolution of ESG investment is key to achieving SDG goals. It encourages member companies to promote information disclosure required by the Corporate Governance Code, and to participate in constructive dialogue with investors. Furthermore, the report recommends the enhancement of corporate pension plan stewardship activities.

In 2010, the Japanese Trade Union Confederation (RENGO) formulated the "Workers Capital Responsible Investment Guidelines". The Confederation reaffirmed its responsibilities and rights in relation to workers' capital, for example corporate pension plans, and clarified its policy to actively engage in responsible investment. Under this policy, RENGO also called on GPIF to invest responsibly. In addition, since its first enactment in February 2014, RENGO has argued that pension funds should comply with the Japanese Stewardship Code. It is expected that these efforts - both by the Keidanren management organisation and the Confederation - will further support responsible investment by pension funds in Japan.

20 Morningstar "ESG/SDGs funds have excellent compatibility with DC, and new settings are trending one after another" 20 October 2020 https://ideco.morningstar.co.jp/column/029899.html

21 A concept that means a sustainable, human-centred future society realized through digital innovation" (Keidanren Answer 2020.10)

2. PERSONAL PENSIONS

(1) NATIONAL PENSION FUND ASSOCIATION

With AUM of 3.9 trillion yen and 349,000 members as of March 2020, the National Pension Fund[22] is an individual pension system (DB type) that can be voluntarily joined by individuals, such as the self-employed, who cannot join Employees' Pension schemes. The National Pension Fund Association (NPFA) is a quasi-governmental organisation that manages the assets of this system. It has adopted the Japanese Stewardship Code, and considers ESG factors in selecting and evaluating investment management companies. However, it is not a PRI signatory. NPFA believes that "it has significant meaning to consider ESG factors in the investment process because due consideration of ESG factors in investee companies contributes to the increase and sustainable growth of company values, which is the foundation to expand the rate of return after adjusting for medium to long-term risk".[23] It requires asset managers "to show clearly how issues concerning sustainability (medium to long-term sustainability including ESG) suitable to the investment strategy are considered."[24]

The board of councillors, composed of representatives of members and other external experts, is the most powerful decision-making body. The board of directors, appointed by the board of councillors, is responsible for executing NPFA's activities. All NPFA fund investment is outsourced.

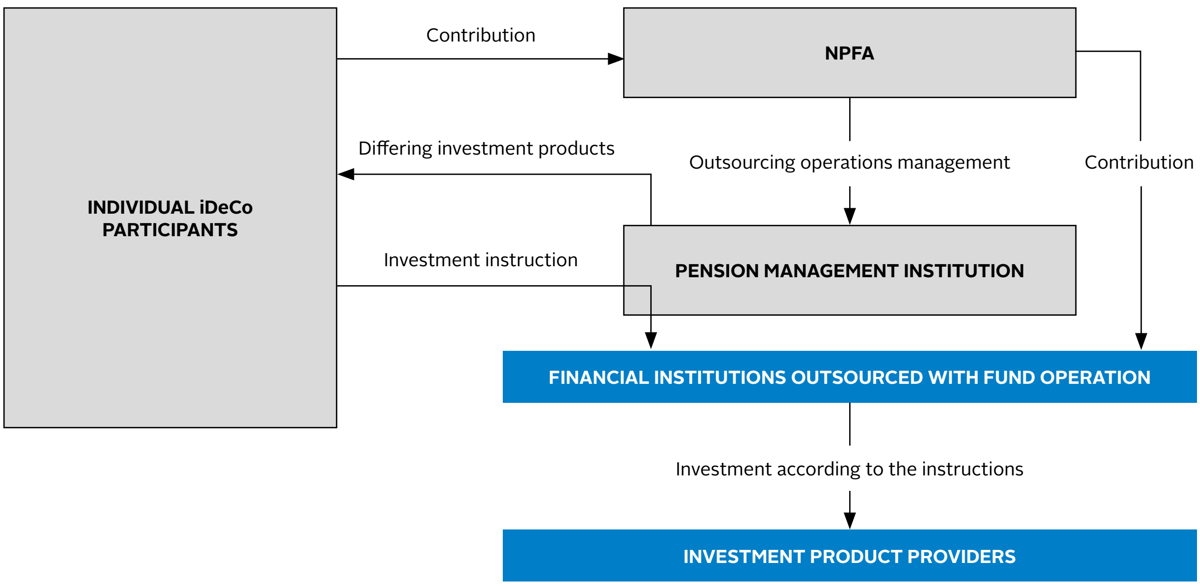
(2) INDIVIDUAL TYPE DC

With membership limited to the self-employed and employees without corporate pension plans, the number of individual type DC participants only increased slightly from inception in 2001 until 2016. However, since it was nicknamed "iDeCo" in 2016, membership numbers have risen sharply, following a successful marketing campaign and expansion of the scope of participation.

Those who wish to participate in iDeCo must apply to NPFA. Participants can select their own Pension Management Institution among the institutions contracted by NPFA. When a worker leaves a company with a corporate DC plan, the assets of that person are automatically transferred to the NPFA, except in cases where the assets are transferred to the corporate pension plan of a new employer. Assets transferred to NPFA are not invested until the saver starts iDeCo. Although there is a tendency for funds to flow into ESG-related investment trusts, as referred to above in "Corporate type DC plans", ESG-related products are still limited in iDeCo's investment product options.

iDeCo lets participants choose how to invest contributions for the purposes of asset formation. Members pay contributions until they turn 60, after which they can receive their benefits (Figure 6).[25]

Figure 6: iDeCo value chain



22 NPFA "Annual Report" in Japanese

23 NPFA "Principles for Stewardship activities"

24 https://www.npfa.or.jp/org/pdf/stewardship_activity2020.pdf in Japanese

25 NPFA official Web-Site "What is iDeCo?" https://www.ideco-koushiki.jp/english/#:~:text=How%20iDeCo%20works,can%20receive%20old%2Dage%20benefits.

PART IV. SERVICE PROVIDERS

Service providers play an important role in the Japanese pension system. Indeed, the investment management of most pension assets - both public and private - is outsourced to external asset managers. Some pension funds also use investment consultants to evaluate asset managers.

1 ASSET MANAGERS

Outsourced pension assets are managed by a relatively small group of asset managers. The top 10 Japanese asset managers for both public and private DB are responsible for 80% of outsourced assets (Table 7.1), although institutions differ for each segment. Taking only the discretionary investment of private DB pensions into account, the ratio of assets held by the top 10 companies is about 20% (Table 7.2).[26] For DC, 90% of assets are entrusted to the top 10 Pension Management Institutions, and there is a trend towards further concentration (Figure 7.3).

By comparison, the top 10 funds managers in Australia manage 50% of externally managed pension assets. In the US, the top 10 asset managers for DB funds account for 20% of externally managed assets. For DC funds the number is 50%. The only country with a significantly higher degree of concentration is the UK, where the top three asset managers hold more than 70% of externally managed pension assets.

Table 7.1: Top 10 Financial Service Firms. Source: R&I Pension Newsletter, Oct 5, 2020 Aug 3, 2020; Aug 5, 2019; July 1, 2019.

RANK	INVESTMENT MANAGEMENT COMPANY OF PUBLIC DB PENSIONS	ASSETS (JPY BILLIONS), MARCH 2020	INVESTMENT MANAGEMENT COMPANY OF PRIVATE DB PENSIONS*	ASSETS (JPY BILLIONS), MARCH 2019	PENSION MANAGEMENT INSTITUTION OF DC	ASSETS (JPY BILLIONS), MARCH 2020
1	State Street Global Advisors (SSGA)	24,605.2	Sumitomo Mitsui Trust Bank, Limited	14,499.4	Sumitomo Mitsui Trust Bank, Limited	3,391.6
2	Sumitomo Mitsui Trust Asset Management	18,739.3	Mitsubishi UFJ Trust and Banking Corporation	13,196.4	Mizuho Bank, Ltd.	2,353.0
3	Asset Management One Co. Ltd.	18,462.0	Nippon Life Insurance Company	6,929.2	Mitsubishi UFJ Trust and Banking Corporation	2,151.9
4	BlackRock Japan Co. Ltd.	16,177.2	Mizuho Trust & Banking Co., Ltd.	6,246.6	Nippon Life Insurance Company	1,729.3
5	Mitsubishi UFJ Trust and Banking Corporation	14,990.6	The Dai-ichi Life Insurance Company, Limited	3,681.1	Nomura Securities Co., Ltd.	1,222.6
6	Resona Asset Management Co. Ltd.	11,419.1	Meiji Yasuda Life Insurance Company	3,432.2	Japan Pension Navigator Co., Ltd.	941.5
7	Sumitomo Mitsui Trust Bank, Limited	9,937.3	Resona Bank, Ltd.	3,338.8	The Dai-ichi Life Insurance Company, Limited	727.0
8	Nomura Asset Management Co., Ltd.	7,125.0	Nissay Asset Management Corporation	2,041.4	Tokio Marine & Nichido Fire Insurance Co., Ltd.	637.4
9	Resona Bank, Ltd.	4,867.1	Asset Management One Co. Ltd.	1,623.8	Sompo Japan DC Securities Inc.	581.2
10	Legal & General Investment Management Japan KK	4,647.8	Sumitomo Life Insurance Company	1,617.9	Resona Bank, Ltd.	423.1

* Because the data for trusts and life insurers other than the discretionary investment account as of the end of March 2020 was not available this is the data as of March 2019. For reference, Table 7.2 shows the value of the discretionary investment account as of the end of March 2020.

26 A discretionary investment account is a contract in which a business operator engaged in the investment management business is entrusted with the authority necessary for investment decisions and investment on behalf of the customer.

Table 7.2: Top 10 Discretionary Investment Account. Source: Japan Investment Advisers Association

RANK	DISCRETIONARY INVESTMENT ACCOUNT	ASSETS (JPY BILLIONS), MARCH 2019
1	Nissay Asset Management Corporation	1,939.3
2	Sumitomo Mitsui Trust Bank, Limited	1,927.8
3	Mitsubishi UFJ Trust and Banking Corporation	1,643.7
4	Tokio Marine Asset Management Co. Ltd. Japan	1,588.1
5	Sumitomo Mitsui DS Asset Management Company Ltd.	1,565.7
6	Asset Management One Co. Ltd.	1,484.3
7	Hitachi Investment Management, Ltd.	1,364.4
8	Nomura Asset Management Co., Ltd.	1,353.5
9	BlackRock Japan Co. Ltd.	1,268.6
10	Russell Investments Japan Co. Ltd.	1,252.3

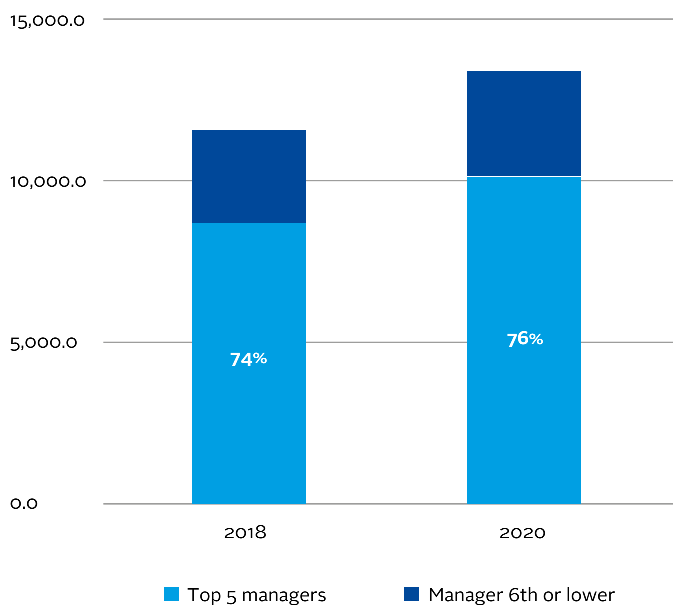
Large Pension Management Institutions play a major role in the implementation of responsible investment in the Japanese pension system. Nine of the top 10 Pension Management Institutions are PRI signatories.

All major investment management companies are currently managing GPIF assets. As such, they are in the process of integrating ESG factors into their investments - not only for equities, but also for other asset classes such as bonds and infrastructure investment. GPIF has said that ESG integration is expected in line with the Stewardship Principles and that it will assess levels of compliance going forward.[27]

The Japan Stewardship Initiative advocates a voluntary approach in the asset management industry to resolving practical issues, such as unifying reporting formats to enhance communication between asset owners and asset manager organisations regarding stewardship activities. It is expected that such actions will encourage responsible investment, including stewardship-related activities.

Asset managers headquartered in Japan have substantially increased their focus on responsible investment over recent years. Despite this trend, a 2020 study by UK-based NGO, ShareAction suggests that Japanese asset managers lag leading international firms in terms of ESG implementation.[28]

Figure 7.3: Corporate-type DC Pension Management Institution Entrusted Assets (¥billion). Source: R&I Newsletter on Pensions & Investment September 17, 2018 & October 5, 2020



27 GPIF Annual Report 2019 p64 https://www.gpif.go.jp/en/performance/annual_report_fiscal_year_2019.pdf

28 ShareAction report 2020: https://shareaction.org/wp-content/uploads/2020/03/Point-of-no-Returns.pdf

2 INVESTMENT CONSULTANTS

As pension management in Japan is generally outsourced, the selection and evaluation of investment institutions is an important decision for pension plans. It is common to use investment consultants to support this process, mainly for major corporate pension plans. A recent PFA survey estimates that 30% of corporate pension plans are using investment consultants (Table 8).[29] This is a similar proportion to superannuation funds in Australia. In the UK, where pension funds are legally bound to take "proper advice", the use of investment consultants is more widespread. Similarly, in the US, the majority of institutional assets are subject to investment consultant input.

Investment consultants in Japan are more frequently used among larger pension plans. The consultants can be divided into three groups: the Japanese subsidiaries of global firms, affiliated companies of financial institutions, and independent companies.

The Stewardship Code, revised in March 2020, requires service providers of institutional investors, including investment consultants, to develop and disclose any conflicts of interest. According to MHLW's DB guideline, the consultant must be an entity that has registered as an investment advisory business under the Financial Instruments and Exchange Act.

Table 8: Corporate pension plans contracting with consultants. Source: PFA "Corporate Pension Survey" (FY 2019 Summary Version December 24, 2020) Reprinted from P18

CORPORATE PENSION PLAN SEGMENT BY AUM	SHARE OF CORPORATE PENSION PLAN CONTRACTING (%)
Less than 3 billion yen	3.60%
3~5 billion yen	9.10%
5~10 billion yen	19.80%
10~20 billion yen	28.00%
20~30 billion yen	45.10%
30~50 billion yen	51.50%
50~100 billion yen	65.30%
More than 100 billion yen	67.50%

* Number of respondents: 929, Average rate of contracting: 30.5%

29 Survey of corporate pension funds by PFA (FY2019 summary version, 24 December, 2020)

PART V: REGULATORY FRAMEWORK

There are several laws established for public and private pension plans in Japan. In order to implement these laws, government orders are laid down by the cabinet, and implementing regulations by MHLW. Circular notices from the competent authorities are often used to complement or interpret these as administrative guidelines. Principle-based and soft-law approaches using comply or explain instruments were officially adopted with the Stewardship Code in 2014 and with the Corporate Governance Code in 2015.

The Ministry of the Environment (MOE) has led sustainability policy making for more than 10 years. MOE played a major role in creating the "21st Century Financial Action Principles"[30], formulated in October 2011, which set out guidelines for financial institutions wanting to fulfil the roles and responsibilities necessary for the formation of a sustainable society. As of December 2020, 285 institutions, including trust banks and insurance companies that manage the assets of pension funds, had signed the principles. In this way, MOE is attempting to change the flow of capital in pursuit of a sustainable system.

MOE attaches great importance to "ESG" as a driving force for enhancing the flow of funds, including pension assets, to sustainable projects Since climate risk is increasingly seen as a systemic risk internationally, MOE has called for the expansion of "ESG investment" to include the use of green bonds by public and corporate pension plans and other institutional investors.

In late 2020, Prime Minister Yoshihide Suga announced Japan's aim to be carbon neutral by 2050. Part of this aim is to make "green investment more common through the full mobilization of regulatory reforms and other policy measures".[31] The high level of asset concentration in the public pension sector, and direct government control, may uniquely enable the Japan pension system to attain such objectives, compared to more fragmented, market-driven systems, where financial service providers play a more decisive role.

1. PUBLIC PENSION LAWS

It is stipulated in public pension laws (National Pension Law and Employees' Pension Insurance Law) that an investment must be conducted "for the exclusive benefit of the insured". This has been confirmed by MHLW to mean that it is prohibited to manage the pension reserve fund apart from exclusively for the benefit of the insured. Whether ESG factors were for other policy purposes was previously one of the main challenges for public pension plans looking to undertake responsible investment activities. The relevant rule for public pension plans with respect to responsible investment is the basic policy for reserves (BPR), laid down in 2014 by MHLW and three other Ministries[32] in charge of mutual aid associations. BPR is the framework for the investment of public pension assets, and as such has legitimised consideration of ESG factors as a means to secure investment profit. Furthermore, it is legally enforceable, not only for GPIF but also for the other mutual aid associations.

BPR was revised in February 2020, and now says that, "the reserve funds shall implement necessary initiatives by individually examining the promotion of investments that consider ESG (environmental, social and governance) as non-financial factors in addition to financial factors, from the viewpoint of securing long-term returns in the interest of beneficiaries."[33] The provision of "the exclusive benefit of the insured" expresses a duty of loyalty. The revised BPR requires GPIF and mutual aid associations take necessary actions to integrate ESG factors into investment processes. The means to incorporate these factors, however, is left to the discretion of each fund. GPIF's investment principles are exactly the same as the basic reserve fund guidelines for ESG investment.

30 https://pfa21.jp/aboutus

31 https://japan.kantei.go.jp/99_suga/statement/202010/_00006.html

32 MOF (Ministry of Finance), MIC (Ministry of Internal Affairs and Communications), MEXT (Ministry of Education, Culture, Sports, Science and Technology)

33 BPR Article 32, GPIF Investment Principles, Article 4

2. PRIVATE PENSION REGULATION

In the past, there was no legal provision to refer to "ESG" for private pension investment. Instead, responsibilities such as loyalty obligations were stipulated for employers and fund-type directors, with the predominant view that ESG investment would be contrary to fiduciary responsibility. The situation, however, has changed in recent years, with DB guidelines revised in 2017 to clarify that it is desirable to consider the Stewardship Code and think about ESG factors as qualitative evaluation criteria when selecting asset management institutions. While this is now widely interpreted as the norm, and more corporate pension plans are starting to consider it, the guidelines do not explicitly require the incorporation of ESG factors. MHLW expects each corporate pension plan to fully consider how to incorporate ESG factors when selecting asset managers and/or choosing investment products, and more and more pensions are doing so.

3. STEWARDSHIP AND CORPORATE GOVERNANCE

The Stewardship and Corporate Governance Codes in Japan are normative standards that are not legally binding. Companies that have signed the codes are asked to implement them on a "comply or explain" basis. Both codes mention activities expected of pension plans and their service providers and they are set to have a significant impact on the promotion of ESG investment in the Japanese pension system. It is said that "the codes work as 'two wheels of a cart', as the sustainable growth of companies is promoted by both investors and companies".[34] The Stewardship Code was most recently revised in 2020, while the Corporate Governance Code was revised in 2018. The description of ESG became more explicit in these revisions.

FSA believes that "it is important to encourage asset owners such as corporate pension plans, which are located closest to the ultimate beneficiaries, to carry out effective stewardship activities for the entire investment chain to function. Regarding the consideration of sustainability, asset owners play a key role in encouraging investment managers to consider sustainability".[35] MHLW also encourages corporate pension plans to accept the Stewardship Code.[36] They state that "it is significantly meaningful for corporate pension plans through stewardship activities to aim to expand medium to long-term investment return, which fits with the basic role of corporate pension plans to secure retirement income and meet expectations of beneficiaries".

34 PRI "Briefing on sustainable finance policy in Japan" https://dwtyzx6upklss.cloudfront.net/Uploads/k/y/y/policybriefingjapan20201014en_387326.pdf

35 Response from FSA in Dec. 2020

36 Response from Private Pension Division, Pension Bureau, MHLW in Nov. 2020

PART VI – RECOMMENDATIONS FOR POLICYMAKERS AND THE INDUSTRY

Pension plan boards and managers should be equipped, structurally and in terms of governance, to be responsible investors, active stewards and allocators of capital to economic activities with desirable social and environmental outcomes. However, too often, existing policy and structure disempower the institutional vehicles that could otherwise direct asset managers, investment consultants and other service providers to deliver good outcomes for beneficiaries. Often misaligned incentives, governance issues, and lack of leverage and direction from pension plans are barriers to sustainability.

To address the system challenges identified in this paper, the PRI proposes the following eight preliminary interventions.

MHLW and regulators should:

1. Consider further steps to align pension regulation with sustainability objectives such as the 2050 net-zero commitment. This could include the introduction of pension fund reporting, based on recommendations made by the Task Force on Climate-related Financial Disclosures.
2. Require pension plans to systematically incorporate ESG issues into investment decision making, undertake stewardship activities and disclose their approach to beneficiaries.
3. Ensure that plans are administered in members' best interests – including in relation to sustainability - through fit and proper governance arrangements.
4. Require employers of corporate type DC plans to work with trade unions to fulfil their governance responsibilities.
5. Require that all pension management institutions conduct stewardship activities and disclose information regarding investment options to clients and beneficiaries.

Industry bodies (including the PRI) should:

1. Facilitate further international and domestic coordination on systemic sustainability issues between universal asset owners.
2. Support pension plans of various types and sizes with education, tools and collaborative engagement facilities to further advance responsible investment. This could include PFA and other organisations providing technical advice and capacity-building support to corporate plans.
3. Foster engagement with asset managers and service providers to ensure that their policies, processes, products and services meet the sustainability needs of their clients and beneficiaries.

The PRI welcomes feedback from policymakers, academics and industry groups as we work to develop our solutions further.

CREDITS

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The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UN environment programme | finance initiative

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org

United Nations Global Compact