

Basic Policy for Grant Fund Management (Tentative)

Pursuant to the provisions of Article 29, paragraph (1) of the Act on Japan Science and Technology Agency, National Research and Development Agency (Act No. 158 of 2002; hereinafter, the Agency Act), in order to ensure the safe and efficient management of funds in the grant account prescribed in Article 27 of the Agency Act (hereinafter, grant fund management) from a long-term perspective, the following Basic Policy for Grant Fund Management was established, based on the Basic Guidelines for Grant Fund Management (hereinafter, the Basic Guidelines), which was provided by the Minister of Education, Culture, Sports, Science and Technology (hereinafter, the Minister) in accordance with the provisions of Article 28, paragraph (1) of the Agency Act.

I. Purpose of Grant Fund Management

The purpose of the grant fund management is to secure financial resources in accordance with Article 27 of the Agency Act to provide long-term and stable support for the construction of research infrastructures necessary to realize world-class research universities through the grant operations (the operations set forth in Article 23, paragraph (1) (vi) of the Agency Act and those incidental thereto and the operations set forth in Article 23, paragraph (2)).

Furthermore, with the aim that each university will eventually manage its own fund, we strive, through appropriate grant fund management, to present an investment model that can serve as a guideline for university fund management in the future.

II. Investment Objectives, Approach, Risk Management, and Other Investment Policies

1. Investment Objectives (including target return)

The investment target for grant fund management is to achieve an annual investment return, net of expenses, at or above the sum of the target payout rate of 3% and the inflation rate (Note 1), calculated on the total assets under management at the beginning of each fiscal year. However, this does not apply during the ramp-up period (the period from the start of investment to the realization of the asset allocation in line with the policy portfolio set forth in III-1).

Note 1: The inflation rate is the 25-year forward average inflation rate, reflecting data published by the end of the previous fiscal year. For FY2023, the rate is 1.49%, based on consumer price inflation rate for each fiscal year adjusted to the calendar year in the Economic Growth Achieved Case of the "Economic and Fiscal Projections for Medium to Long Term Analysis" (Council on Economic and Fiscal Policy, January 14, 2023) by Cabinet Office for the first 10

years, and the long-term inflation assumption in Case III of the "2019 Financial Projection of Pension" (Pension Subcommittee of the 9th Social Security Council, August 27, 2019) by the Ministry of Health, Labour and Welfare for the following 15 years.

2. Investment Approach

(1) Basic Principles

Grant fund management is conducted based on the policy portfolio specified in III-1, with adherence to investment discipline and the appropriate rebalancing (purchase and sale of assets conducted so that the actual asset allocation becomes as intended in the asset allocation plan) within the allowable deviation range specified in III-2. By leveraging long-term diversification effects (across asset types, geographies, sectors, and diversified funds), we actively pursue global investments to capture economic growth both domestically and internationally in a stable, long-term manner.

Both passive management (aiming to track benchmark returns) and active management (aiming to generate excess returns relative to benchmarks) are utilized in principle.

Alternative investments (assets and strategies outside traditional asset classes) are promoted strategically for risk diversification and medium- to long-term profit generation.

Effective internal controls and operational processes are established alongside the use of external investment managers. Risk management and performance monitoring are systemically implemented.

(2) Forms of Investment

In accordance with Article 27 of the Agency Act, grant fund management is carried out through a combination of outsourced and in-house investment set forth in Article 26 of the Agency Act, specifically:

- (a) Separately-managed discretionary trust and separately-managed discretionary comprehensive trust with a trust company (including a bank that operates trust business; the same applies hereinafter);
- (b) Non-discretionary trust with a trust company, limited to those managed under a discretionary investment agreement with a financial instruments business operator;
- (c) In-house investment (including asset managed through non-discretionary trust with trust companies).

The investment form is determined based on asset characteristics and operational efficiency. Since in-house investment (c) involves greater discretion than outsourced investment (a) and (b), guidelines for in-house investment are established in advance after deliberation by the JST Investment Advisory Committee in accordance with Article 20, Paragraph (3) of the Agency Act. Due diligence is conducted on cost-effectiveness, medium- to long-term profitability, liquidity, and resilience in case of sudden market fluctuations, before implementation with care for market impact.

3. Risk Management

(1) Risk Management Policy

Risk management is conducted based on reports from investment managers and is governed by a basic risk management policy formulated after deliberation by the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act. Various risks such as market risks, credit risks, liquidity risks and operational risks (including risks related to clerical work, systems, information leaks, and reputation) are monitored in a multi-layered manner based on asset types and investment methods, with timely reporting to the Investment Risk Management Committee described in VIII-1-(1) and to the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act regularly and when necessary.

The standard deviation of the policy portfolio specified in III-1 and actual investment assets is checked monthly to ensure it is within risk tolerance. If exceeded, reports are made to the Investment Committee and the Investment Risk Management Committee specified in VIII-1-(1). The Investment Committee considers response measures promptly and reports to the Investment Risk Management Committee and the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act. The Investment Committee also takes actions including reviews of asset allocation plan if necessary.

(2) Risk Management Methods

Short-term fluctuations in asset valuations are not directly managed; however, standard deviation is monitored monthly by the Investment Risk Management Committee as a key risk indicator. By periodic stress tests conducted during the formulation, review and modification of the policy portfolio and asset allocation plan, the risk of not being able to achieve the investment purpose is appropriately managed, taking account of recovery periods from market downturns. Results are confirmed by the Investment Risk Management Committee and reported to the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act.

If asset valuation declines reach the standard deviation of the policy portfolio, the Investment Risk Management Committee reviews the market environment, reports to the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act, and subsequently to the Minister. If losses reach twice the standard deviation, the Investment Risk Management Committee checks the market environment and the necessity of reviewing the asset allocation plan. When necessary, the action is promptly taken and reported to the Minister after deliberation by the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act.

If net realized loss due to asset sales, impairment, etc. exceeds capital at fiscal year end, the Investment Risk Management Committee reviews the situation and countermeasures, implement them promptly if necessary, and report to the Minister after deliberation by the JST Investment Advisory Committee

in accordance with Article 20, paragraph (3) of the Agency Act. If this persists for three consecutive fiscal years, this is also reported to the Minister.

4. Other Investment Policies

Grant fund management is solely for securing resources for grant operations and may not be conducted for other policy objectives.

Investments are made from a long-term perspective, aiming to benefit from economic growth in and outside Japan such as in the form of interests and dividends through disciplined long-term holdings and diversification, not being overly reactive to short-term market fluctuations.

As a large-scale institutional investor with public nature, whose investment behavior has a significant impact on the market, sufficient care is taken to avoid distorting market prices or private-sector investment behavior.

III. Asset Allocation in Grant Fund Management

1. Policy Portfolio-Based Management

Grant fund management aims to maximize returns within the risk tolerance (standard deviation) derived from a reference portfolio of 65% global equities and 35% global bonds (Note 2), which is specified in the Basic Guidelines, and is managed according to the basic asset allocation (policy portfolio).

Note 2: Risk tolerance is calculated using 25 years of monthly market data, with the MSCI All-Country World Index (including dividends) for equities and the FTSE World Government Bond Index for bonds.

The policy portfolio is designed from a long-term perspective, incorporating sound asset management expertise and economic/market trends, with risk analysis based on reasonable forecasts. Compliance with risk tolerance is verified using assumed risk factors.

2. Policy Portfolio and Allowable Deviation

(1) Asset Allocation and Allowable Deviation

The policy portfolio's asset classes, asset allocation, and allowable deviations are determined after deliberation by the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act, aiming to maximize returns within risk tolerance and ensure liquidity as required in III and IV. During the ramp-up period, the policy portfolio is not disclosed due to portfolio construction considerations; only asset allocation at fiscal year-end is disclosed in the annual report.

(2) Concept of Allowable Deviation

The grant fund management is based on the policy portfolio, and allowable deviations are set to enable flexible yet disciplined investment. Rebalancing and other measures are implemented as appropriate within these ranges, considering the current rapid economic and market changes.

Codes of conduct in the events of rapid market changes are established before the commencement of grant fund management after deliberation by the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act.

(3) Review of the Policy Portfolio

The policy portfolio is verified annually. If risk analysis reveals that assumed conditions have diverged from reality in light of changes in the reference portfolio, risk tolerance, or economic/market trends, a review is considered after deliberation by the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act. If the policy portfolio is changed, an appropriate transition period is set as needed.

3. Evaluation of Grant Fund Management

Annual evaluations are conducted regarding the safety and efficiency of grant fund management from a long-term perspective and reported to the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act. The achievement of investment objective is evaluated over certain periods (3, 5 or 10 years) rather than on a single fiscal year basis.

Evaluation considers not only actual results such as investment gains and portfolio returns but includes comparison to the composite benchmarks (the weighted average of benchmark returns for equities and bonds, reflecting the reference portfolio's allocation).

In the comparison, liquidity needs, taxes, execution costs, and asset characteristics, especially for alternative investments are fully considered.

IV. Accumulation and Drawdown of Assets

Investment gains from grant fund management are used to secure annual payouts to universities, up to a maximum of JPY 300 billion per fiscal year (real terms, adjusted by the consumer price index since FY2021).

A buffer of up to JPY 600 billion (equivalent to two years' payouts) is maintained from surplus gains after payouts to ensure financial resources with liquidity for payouts in years when investment gains are insufficient (Note 3, 4).

Note 3: In order to ensure the certainty of redemption as described in V as well as to realize stable and continuous grant operations while ensuring the financial soundness of the grant

account, the buffer may only be drawn down if losses (including unrealized losses) do not exceed the sum of capital, capital surplus (excluding the buffer), and retained earnings.

Note 4: The buffer may not be used to cover deficits. Sufficient liquid assets (cash or readily marketable assets) are secured. Market impact is considered when selling assets.

V. Procurement and Redemption of Funds

Funds required for grant fund management are initially procured from government contributions and fiscal loan funds, considering the balance between equity (net assets) and debt (external obligations). Subsequently, funds are raised and expanded through the bonds issued by the Agency in accordance with Article 33 of the Agency Act and contributions from universities designated as Universities for International Research Excellence set forth in Article 7 of the Act on Strengthening Systems for Leveraging Research and Research Results of Universities for International Research Excellence (Act No. 51 of 2022) (excluding operational surplus entrusted by national university corporations).

A plan for redemption of fiscal loan funds commencing from FY2041 onward is formulated every fiscal year. To ensure certainty of redemption, a stable financial base robust to withstand historic market fluctuations (Note 5) is aimed to be built. Once such a stable financial base is built, out of the government capital contributions, the amounts that are no longer deemed necessary to implement grant operations will be treated in accordance with Article 46-2 of the Act on General Rules for Incorporated Administrative Agencies (Act No. 103 of 1999), supporting a shift from government financed funds to university-managed funds with their own funds as per government policy (“Economic Measures for Overcoming COVID-19 and Opening Up a New Era (Cabinet decision on November 19, 2021)”).

The market value of total assets is checked monthly to ensure that it does not fall below the balance of fiscal loan funds. If it does, the Investment Risk Management Committee checks market environment and necessity to change asset allocation plan and reports are made to the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act, and then to the Minister. Furthermore, if II-3-(2) applies, reports are made to the Minister.

Note 5: Specifically, equity capital (excluding buffers) relative to total managed assets must be at least 2.33 times the risk tolerance.

VI. Selection and Evaluation of Counterparties for Trust and Discretionary Investment Contracts

Recognizing the critical importance of selecting outstanding investment managers, we collect information globally and conduct thorough due diligence to select managers who understand and can implement the objectives of grant fund management. Selection criteria are set after deliberation by the

JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act. For alternative investments, given their unique schemes, costs, and disclosure practices and the fact that the application period for investment is limited with outstanding investment managers, personnel with high expertise are hired and external advisors are utilized to enhance manager selection and to make prompt and flexible decisions with careful risk management.

We actively build relationships with overseas investment institutions to select outstanding investment managers. After commencing outsourced investment, we regularly evaluate their compliance with the agreement, any service changes, and performance, taking appropriate measures such as entrusted amount review as needed.

VII. Matters to be Observed by Investment Managers

1. Basic Matters

Investment managers are required to report monthly on fund management and operation, or submit materials as necessary. Regular meetings are held with each manager, and instructions are provided as needed.

2. Investment Guidelines

For the forms of management described in II-2-(2)-(a) and (b), the investment guidelines as stipulated in Article 35 of the Ministerial Ordinance regarding Japan Science and Technology Agency, National Research and Development Agency (Ordinance No. 47 of 2003) are prepared after deliberation by the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act, and delivered to the investment managers.

VIII. Other Matters for Appropriate Grant Fund Management

1. Matters to be Observed for Grant Fund Management

(1) Strengthening Governance and Operations

The three lines of defense governance structure is established: investment department (first line) and risk management department (second line) keeping checks and balances, with independent internal audit department (third line) auditing them. Independent auditors ensure the appropriateness of internal controls and operations.

The Investment Committee (comprising the Vice President/Chief Investment Officer and others) makes day-to-day investment decisions, while the Investment Risk Management Committee (comprising directors responsible for risk management) provides checks on the investment department and manages risks. Necessary matters are deliberated in these Committees and reported to the JST Investment Advisory Committee in accordance with Article 20, paragraph (3) of the Agency Act.

(2) Securing and Developing Highly Professional Human Resources

To secure and develop highly qualified personnel necessary to achieve investment objectives, measures to establish appropriate employment and remuneration systems are implemented. Given the long-term perspective, human resource development includes OJT programs, strategic rotation, and acceptance of staff from universities, with a view to contributing to university fund management in the future.

(3) Activities to Fulfill Stewardship Responsibility and ESG-based (Environmental, Social, and Governance) Initiatives

To achieve target returns while appropriately managing risks from a long-term perspective, activities to fulfill the stewardship responsibility (for example, management of conflicts of interest, constructive engagement, exercise of voting rights) (Note 6) are promoted and ESG-based initiatives are appropriately advanced.

These initiatives are basically carried out through external investment managers, whose stewardship activities and ESG considerations are evaluated accordingly.

Note 6: Institutional investors have a responsibility to enhance medium-to long-term returns for their clients and beneficiaries (including ultimate beneficiaries) by encouraging investee companies to improve corporate value and achieve sustainable growth.

(4) Information Disclosure, Public Relations, and Transparency

We strategically plan and continuously implement information disclosure and public relations activities, and try to analyze their effects. Performance, investment methods, stewardship activities, and ESG-based initiatives are disclosed and explained in an accessible manner through annual reports and other materials.

Nevertheless, care is taken to minimize market impact. Especially during the ramp-up period, disclosure may be limited to performance and other essential information, while ensuring transparency.

(5) Sophistication of Investment and Related Research

To improve investment efficiency while appropriately managing risks, we actively conduct research on new investment products and methods, and continuously promote investment sophistication within the scope permitted by Article 27 of the Agency Act.

2. Considerations During the Ramp-Up Period

We aim to achieve investment gains equal to the maximum payout specified in IV as early as possible, by the end of the fiscal year five years after investment commencement.

We also seek to achieve the asset allocation of the policy portfolio as early as possible, by the end of the fiscal year ten years after investment commencement, appropriately taking risks within risk tolerance and taking account of asset characteristics that require time to invest. To realize this, planned transition of asset allocation is made, while securing buffers.

During the ramp-up period, evaluation is based not only on achievement of investment targets but also on the status of planned transition of asset allocation. Grant operation (support) is targeted to begin in FY2024 or later.

Supplementary Provision

This Basic Policy applies from January 19, 2022.

Supplementary Provision (Revised on March 29, 2023)

This Basic Policy applies from March 29, 2023.

Supplementary Provision (Revised on August 22, 2024)

This Basic Policy applies from August 22, 2024.