

**Bureau of Labor Funds, Ministry of Labor**

# **Investment Policy Statement of National Pension Insurance Fund**

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# CONTENTS

<b>PREFACE .....</b>	<b>1</b>
<b>I. PURPOSE.....</b>	<b>1</b>
<b>II. ANNUAL REVIEW .....</b>	<b>2</b>
<b>INVESTMENT GUIDELINES.....</b>	<b>3</b>
<b>I. PURPOSE AND OBJECTIVE .....</b>	<b>3</b>
<b>II. BELIEFS .....</b>	<b>3</b>
(I) Long-term Investment.....	3
(II) Manage and assume reasonable risk .....	3
(III) Effective monitoring and management.....	4
(IV) Clear investment objectives and target returns .....	4
(V) Asset allocation is a decisive factor for risk and return.....	4
(VI) Reasonable management and operation cost.....	4
<b>III. INVESTMENT DECISION PROCEDURE .....</b>	<b>5</b>
(I) Establish investment policies and regulations.....	5
(II) Draft annual investment plan .....	5
(III) Compose investment plans .....	5
<b>IV. ASSET ALLOCATION POLICIES .....</b>	<b>5</b>
(I) Set up target proportions and ranges .....	5
(II) Assess multi-faceted factors.....	6
(III) Implement asset allocation policies and plans .....	6
(IV) Risk tolerance level of the Fund.....	6
<b>V. RISK MANAGEMENT .....</b>	<b>7</b>
(I) Risk management is not risk elimination.....	7
(II) Establish management mechanisms and procedures by risk sources .....	8
(III) Set up risk limits and budgets.....	8
(IV) Stress tests.....	8
(V) Establish procedures for ultra vires transactions.....	8
(VI) Establish regulations for derivatives .....	9
(VII) Establish comprehensive risk awareness and control.....	9
<b>VI. INVESTMENT EXECUTION POLICIES.....</b>	<b>9</b>
(I) Counterparties and intermediaries selection policies required .....	9
(II) Sustainable development shall be considered.....	9
(III) Best execution is a principle .....	10
(IV) Assessable and reasonable benchmark .....	10

(V)	Independent institution for investment and custodian service .....	10
(VI)	Regulations for security lending to deliver certain income .....	10
(VII)	Regulations for management of investment managers and custodians .	10
(VIII)	Regulations and criteria for external consultants selection and evaluation .....	11
(IX)	Regulations to process ultra vires transactions.....	11
(X)	Regulations for portfolio accounting and assets appraisal to be followed .....	11
<b>VII.</b>	<b>SUSTAINABLE INVESTMENT POLICIES .....</b>	<b>11</b>
<b>VIII.</b>	<b>INFORMATION DISCLOSURE .....</b>	<b>13</b>
<b>IX.</b>	<b>ETHICS .....</b>	<b>13</b>
(I)	Code of ethics for internal staff .....	13
(II)	Code of ethics for investment managers and their staff .....	13
<b>X.</b>	<b>ASSETS AND BENCHMARK .....</b>	<b>13</b>
(I)	Domestic deposit .....	14
(II)	Domestic debt security .....	14
(III)	Domestic equity security.....	15
(IV)	Domestic alternative investment.....	15
(V)	Overseas debt security.....	15
(VI)	Overseas equity security .....	16
(VII)	Overseas alternative investment.....	16
<b>INVESTMENT POLICY .....</b>	<b>17</b>	
(I)	Introduction.....	17
(II)	Mission and objectives .....	17
(III)	Target return.....	18
(IV)	Strategies .....	18

# **PREFACE**

The National Pension Insurance Fund (hereinafter referred to as “the Fund”) is superintended by the Ministry of Health and Welfare (MOHW). The Ministry of Health and Welfare then entrusted the utilization of the Fund to the Bureau of Labor Funds (BLF).

BLF institutes 5 Divisions and 4 administrative offices for operations, and an Investment Strategy Task Force, in charge of significant investment matters to collect different opinions for best solution; and a Risk Management Task Force to identify solutions for major risk control items and assessing effectiveness of each solution at all times.

## **I. PURPOSE**

This Investment Policy Statement (IPS) is drafted to define the mission, asset allocation, investment guideline, investment objective, and risk management. The IPS serves as guideline for investment process and all related matters, including regulations, rules, notices, and internal policies, aiming to announce the Fund’s investment philosophy, to establish performance assessment and risk management. The core belief is that the fund with different investments and risk tolerance should set up guidelines and restrictions respectively to fine-tune the process. This would provide reasonable, consistent, and comprehensive investment process and guideline that can be implemented with sustainability.

Investment practices shall follow basic principles described in the IPS and relevant regulations. It is expected that the investment can achieve the goals by affirming purposes and beliefs, instituting basic policies, establishing regulatory principles, external regulations, and internal rules.

## **II. ANNUAL REVIEW**

The IPS covers basic investment principles and shall be reviewed annually. Should modification required due to adjustment of the investment purpose and beliefs, market fluctuation over a mid-to-long-term time horizon, significant variation to cash flow pattern, it shall submit written proposal to MOHW.

# **INVESTMENT GUILDLINES**

## **I. PURPOSE AND OBJECTIVE**

To protect beneficiaries' interests, achieve sustainable operations, and adhere to relevant regulations through short- and mid-to-long-term planning.

## **II. BELIEFS**

To achieve investment objectives and goals, BLF shall prudently invest with following beliefs when the market is full of uncertainties:

### **(I) Long-term Investment**

1. Effects on far-future-generation beneficiaries' interests shall be considered.
2. Maintaining the soundness and sustainability of the Fund is an objective.
3. Reducing impacts from short-term fluctuations through diversifying investment.
4. Integrating Sustainable Investment (SI) in fund utilization.

### **(II) Manage and assume reasonable risk**

1. Consider multi-faceted risks and institute relevant policies, regulations, management, and control rules to manage risks.
2. Establish applicable restrictions or regulations for assets of different risks and the Fund's risk-tolerant level.
3. Utilize strategies, techniques, and proper collaboration of both active and passive investment to enhance long-term value of the Fund.
4. Political, economic situation, and demand-supply uncertainties of natural resources shall be considered so the shift of the market trends will not lead to excessive impact on portfolio return in the long-term.

(III) Effective monitoring and management

1. Implementing effective monitoring and management to secure the long-term rights and interests of BLF, fund beneficiaries, invested entities, investment managers, and custodians.
2. Adopting sustainable and effective performance measurement and risk control.
3. Setting up protocols to conduct due diligence, risk management and staff management of investment managers, plus keeping the protocols consistent.

(IV) Clear investment objectives and target returns

1. Setting up annual and mid-to-long-term performance reference targets.
2. Considering equilibrium between returns and risks.
3. Adopting clear reference benchmarks to measure investment managers' performance for Fund's long-term interests.

(V) Asset allocation is a decisive factor for risk and return

1. Relations between risk factors and returns shall be considered. Investment shall be diversified.
2. Attributes, cash flow pattern, and capital scale of the Fund shall be considered to enhance return.
3. Long-term allocations shall be reassessed when significant investment factor affecting portfolio risk and return occurs.

(VI) Reasonable management and operation cost

1. Relations between risk premiums and operation costs shall be considered.
2. Appropriate incentives to encourage investment managers shall be

provided to enhance long-term performance of the Fund.

3. Scale of investment shall be appropriately leveraged to increase return, reduce cost, and simplify operations.

### **III. INVESTMENT DECISION PROCEDURE**

- (I) Establish investment policies and regulations

Investment policies and regulations shall be enacted and modified when there are significant changes to investment strategies, beliefs, and organization.

- (II) Draft annual investment plan

Annual asset allocation and investment plans of the Fund shall be drafted and modified accordingly and timely prior to the beginning of each year. The plans shall be discussed in the Investment Strategy Task Force and submitted to the National Pension Supervisory Committee for ratification.

- (III) Compose investment plans

Besides liquid asset and special purpose loans, investment plans of every asset should be reviewed individually based on their characteristics and submit to Investment Strategy Task Force for approval. For fully fiduciary discretionary investments, managers shall invest according to their proposal and research. Investment managers shall also follow their investment process in place.

### **IV. ASSET ALLOCATION POLICIES**

- (I) Set up target proportions and ranges

1. Target proportions and ranges of assets shall be determined based on



characteristics, positions, attributes, and regulations of the Fund.

2. Restrictions based on risk tolerance of assets bearing higher market risk shall be established.

(II) Assess multi-faceted factors

1. Outlooks and forecast of long-term capital markets, equity market, fixed income markets, and macroeconomic situations shall be considered during asset allocation process.
2. Costs, expected returns, volatilities, and correlations shall be considered.
3. The Fund's attributes, net cash flow status, and risk tolerance level shall be considered.

(III) Implement asset allocation policies and plans

1. Market conditions of investments shall be considered to avoid discrepancy between positions and ranges set up in standing allocation policies and plans. When the Fund is trying to revert back to allocation ranges while enduring strong market volatilities, transaction costs and liquidity conditions shall be considered.
2. Central and ranges of the Fund's allocations of assets shall be treated as foundation and buffer. Rebalance strategies shall also be considered.

(IV) Risk tolerance level of the Fund

Risk tolerance level of the Fund, which is determined based on cash flow status and attributes, shall be considered. Risk budget shall be set up and controlled.

1. Net cash flow of a certain time frame should be considered. The net cash flow over net Fund assets ratio can define the development stage

of the Fund. If the ratio is far greater than zero, then the fund is at growing stage. If close to zero, then the fund is at mature stage. If far less than zero, then the fund is at declining stage. During the growing stage, the Fund may assume higher market and liquidity risks. During mature stage, the Fund may assume medium risk; while declining stage, the lower risk.

2. Fund's attributes shall be considered when determining risk tolerance levels. When establishing annual plans, relative risk cap should be proposed to provide the Fund sufficient allowance to achieve target returns while not over-assuming risks.

## **V. RISK MANAGEMENT**

The Risk Management Division of BLF is designed to monitor risks effectively and to establish control mechanisms. Risk Management Task Force was set up to propose solutions for major risk control items and monitor the effectiveness of these solutions. The main objective of fund level risk management is to reach a consensus among divisions in BLF. By establishing risk management mechanisms, investments into innovative tools can be fostered while sustainable growth of the Fund can be achieved. All divisions can make decisions based on proper risk management information to strike a balance between risks and returns. Risk management policies of BLF are deployed with following principles or methodologies while incorporating information systems into the process. Relevant internal rules and regulations shall be updated to ensure smooth operation of risk management systems. Fundamental policies are as follows:

- (I) Risk management is not risk elimination

Return is the outcome of assuming risk. Instead of eliminating risks, the purpose of risk management is to seek equilibrium between risks and returns, and to ensure that extra risks assumed can translate into

commensurate extra returns.

(II) Establish management mechanisms and procedures by risk sources

Risks of pricing, interest rate, exchange rate, credit, liquidity, counterparty, concentration, operation, legal, and climate change aspects shall be considered. Limitations and documentations shall be established based on relevant regulations. Information systems shall be utilized to generate VaR reports regularly and to adopt appropriate risk control and establish risk management mechanism.

(III) Set up risk limits and budgets

The Fund shall have sufficient flexibility to achieve target returns without over-assuming risks. Designated indexes and analyses of economy and financial markets can be utilized to estimate returns and future trends. Through computation and simulation capacities of informational systems, optimal asset allocations and risk budgets can be determined. Risk exposure statuses shall be reported periodically in the meetings.

(IV) Stress tests

Risk Management Division shall conduct stress tests based on major economic or financial events periodically to assess the Fund's current exposure and risk tolerance in extreme market condition as reference for asset utilization and investment management.

(V) Establish procedures for ultra vires transactions

When ultra vires transaction occurs, subsequent actions shall be adopted in accordance with relevant regulations and investment management guideline, including issuing notice, confirming ultra vires

transaction, processing the incident, and reporting the case.

(VI) Establish regulations for derivatives

When investing derivatives, investment divisions should abide to the principles of safety, liquidity, profitability, and risk management. The total contract value of the derivatives positions for hedging purposes shall not exceed that of underlying assets. For non-hedging purposes, the positions shall not increase the Fund's overall leverage.

(VII) Establish comprehensive risk awareness and control

Risk management is a task for all as every element of investment processes involves risks. The Risk Management Task Force and Risk Management Division shall establish fundamental principles and regulations and help other divisions building risk awareness, establishing investment processes, internal control mechanisms, and relevant risk management regulations to keep the risk management structure intact.

## **VI. INVESTMENT EXECUTION POLICIES**

(I) Counterparties and intermediaries selection policies required

Selection of counterparties of corporations or financial institutions that can directly or indirectly provide financial products; and intermediaries, e.g., brokers and traders, shall follow related policies including criteria like credit ratings and capital adequacy ratios.

(II) Sustainable development be considered

Investment should consider sustainable development. More details will be covered in a later paragraph.

(III) Best execution is a principle

Fees, taxes, basket/scattered trading cost, and trading efficiency shall be considered to achieve best execution.

(IV) Assessable and reasonable benchmark

All investment should have either market price available in public market, or from third-party appraisal, or from in-house appraisal. Investments with appropriate benchmarks to measure their performances.

(V) Independent institution for investment and custodian service

Custody of assets by in-house investment team or fully fiduciary discretionary investment managers shall be administered by qualified independent institutions.

(VI) Regulations for security lending to deliver certain income

Security lending shall be regulated. For domestic securities, regulations established by TWSE (Taiwan Stock Exchange) and GTSM (GreTai Security Market) shall be followed. For overseas securities, relevant regulations regarding qualifications for intermediary and forms and maintenance ratio of collaterals shall be documented in contracts while intermediaries shall provide reporting regularly on lending revenues, quantities, market values, margin ratios, and expenses.

(VII) Regulations for management of investment managers and custodians

BLF may designate fully fiduciary discretionary investment within the limits set in the annual plans. Selection and evaluation of investment managers or custodians shall be public. Regulations should be established to review their management regularly.

(VIII) Regulations and criteria for external consultants selection and evaluation

Criteria for selection of investment and legal consultants shall be established. Commissioned investment consultant shall provide recommendation detailing prospect or existing investment managers' staff and their investment processes in accordance with the contract. Commissioned legal consultant shall provide legal recommendations or opinion statements in accordance with the contract.

(IX) Regulations to process ultra vires transactions

In principle, ultra vires transactions caused due to market fluctuations shall be properly mended within a given timeframe. When an extension is warranted or when the situation cannot be mended, a written consent issued by authorized managers is required. In principle, ultra vires transactions caused due to negligence shall be mended immediately. A complete report detailing improvement and prevention measures shall be submitted. When an extension is warranted, a written consent issued by authorized managers is required.

(X) Regulations for portfolio accounting and assets appraisal to be followed

The Fund's assets appraisal shall follow government accounting regulations and Enterprise Accounting Standards, and shall be updated regularly based on the asset types.

## **VII. SUSTAINABLE INVESTMENT POLICIES**

Sustainable Investment (SI) refers to investment that may be beneficial for return as well as the whole society, environment, and economy when aspects of society, employee rights and interests, human rights, and environment are considered within the investment processes. Under the prerequisite of portfolio return, we hereby set up SI policy and started adopting relevant strategies

progressively, based on the development of SI. By doing so, rights of the insured can be promoted while corporations will be encouraged to implement sustainable development, thus attaining a win-win situation.

Domestic investments shall consider sustainable development regarding the environment, society, corporate governance, and information disclosure. Besides, investable and representative indices shall be adopted as benchmarks for fully fiduciary discretionary investments. Also, BLF requires entrusted investment institutions to incorporate sustainable development into their Request Proposal as a selection reference. Without undermining the Fund's rights and interests, BLF will not invest or increase investment in corporations that commit severe violations of sustainable development.

When a domestic investee has major social concerns involving employee rights, environmental protection, corporate governance, etc., BLF will take shareholder actions via dialogue, correspondence/ attendance of shareholder general meetings, or exercise of voting rights to draw the corporate's attention to related issues, track investees' sustainable development strategies. In addition, BLF would initiate communications and engagement with domestic corporates in due course. If a proposal in a shareholders meeting undermines governance, significantly impacts the company's financial stability and business development, or damages interests of shareholders, BLF will not support the proposal after case evaluations. BLF will also disclose relevant information about sustainable investment on the website, while periodically disclosing Stewardship Principles execution status and voting information, as well as investment percentages in companies that meet related sustainable standards.

For overseas investments, BLF holistically considers strategies and profit prospects as well as sustainable management, while continuing to integrate and deploy theme investments covering environmental protection, social responsibility, corporate governance, etc. For fully fiduciary discretionary

investments, BLF forbids investment managers from investing in funds that violate sustainable development. During the process of investment manager selection, BLF reviews and tracks their resource committed to sustainability and how sustainability is integrated into their investment process.

## **VIII. INFORMATION DISCLOSURE**

Given that utilization of the Fund concerns the beneficiaries' rights, relevant information shall be made public. BLF follows Legislative Yuan's resolution of December 14, 2012, which was issued after consultation among political parties during general budget deliberation. The resolution dictates that public pension and insurance funds shall disclose information including size, performance, asset association, and performance tabulations of in-house and fully fiduciary discretionary investments of domestic and overseas markets.

## **IX. ETHICS**

### **(I) Code of ethics for internal staff**

Regulations on conflict of interest regulations shall be established to control investment processes by staff including but not limited to banning insider trading, canvassing or lobbying, hospitality, and entertainment.

### **(II) Code of ethics for investment managers and their staff**

Investment managers and their staff shall observe ethics regulations issued by competent authorities, professional associations, and their own companies. Liabilities shall be assumed by investment managers when violations of codes of ethics result in detriment of the Fund's interests.

## **X. ASSETS AND BENCHMARK**

Assets shall be classified based on sufficient distinctions in aspects



including but not limited to return, risk, correlation, size, and liquidity.

Benchmarks shall be determined to serve as long-term objectives of investment, and to help investment professionals generate optimal results for the beneficiaries while following relevant beliefs and policies. Benchmarks shall be investible, measurable, representative, and clear. And evaluation standard shall be calculated based on the average data over number of years. Definitions and reference benchmarks of assets are as follows:

(I) Domestic deposit

1. Definition: New Taiwan Dollar (TWD) deposit savings in local banks.
2. Benchmark: One year large-amount average deposit interest rate from large banks.

(II) Domestic debt security

1. Definition: TWD-denominated debt securities including:
  - (1) Short-term commercial paper.
  - (2) Money market fund.
  - (3) Bond: Including government bonds, financial institution bonds, corporate bonds, other bonds, and their lending transactions and derivatives.
2. Benchmarks:
  - (1) Short-term commercial paper: average interest rate of 30-day domestic commercial paper.
  - (2) Money market fund: average interest rate of 30-day domestic commercial paper.
  - (3) Bond:
    - ① Government bond: Yield of 10-year domestic government bonds.
    - ② Financial institution bond: Yield of 7-year A-credit-rating financial institution bonds.
    - ③ Corporate bond: Yield of 5-year A-credit-rating corporate bonds.

④Other bond: Appropriate benchmark(s).

(III) Domestic equity security

1. Definition: TWD-denominated securities with traits of directly or indirectly possessing shareholders equity, including their lending transactions and derivatives.
2. Benchmarks: In-house positions adopt capitalization-weighted stock price index/ total return index compiled by major domestic stock exchanges or other appropriate indices as benchmark(s), while mandated positions take the same index or other appropriate benchmark(s) detailed in the contracts.

(IV) Domestic alternative investment

1. Definition: TWD-denominated investments that are not deposit, debt security, or equity security.
  - (1) Loan: Including loan for government or government-owned enterprises, or loan for the central government policy.
  - (2) Others: other domestic investments that are not in the aforementioned categories.
2. Benchmarks: Appropriate benchmark(s) based on actual conditions.
  - (1) Loan for government or government-owned enterprises: Long-term funding rate determined by National Development Council, the rate determined by the meeting of National Pension Supervisory Committee, or other appropriate benchmark(s).
  - (2) Others: Appropriate benchmark(s) based on actual conditions.

(V) Overseas debt security

1. Definition: Non-TWD-denominated securities with traits of debt, foreign currencies deposits, including their lending transactions and derivatives.

2. Benchmarks: Major global bond index or other appropriate indices, such as Bloomberg Global Aggregate Index.

(VI) Overseas equity security

1. Definition: Non-TWD-denominated securities with traits of directly or indirectly possessing shareholders equity, including their lending transactions and derivatives.
2. Benchmarks: Major global index or other appropriate indices, such as MSCI AC World Index.

(VII) Overseas alternative investment

1. Definition: Non-TWD-denominated investments that are not deposit, debt security, or equity security.
  - (1) Property and land: Including overseas real estates, infrastructures, real estate trust investments, property trust beneficiary certificates, and other securitized products and derivatives.
  - (2) Commodity: Including overseas precious metals, energy resources, natural resources, and securitized products and derivatives.
  - (3) Others: other overseas investments that are not in the aforementioned categories.
2. Benchmarks: Major global index, or other appropriate indices, such as FTSE EPRA/NAREIT Index, Dow Jones Brookfield Global Infrastructure Index.

# **INVESTMENT POLICY**

Based on a fund's attributes and cash flow pattern, risk tolerance levels can be divided into five segments: high, medium-high, medium, medium-low, and low. Investment targets and strategic limitations are set according to risk tolerance level and liquidity requirement. Generally, a defined contribution fund can tolerate high or medium-high levels of risks, while a defined benefit fund can tolerate lower than medium levels of risk based on its cash flow. As the Fund being relatively young with net cash inflow while belonging to defined benefit arrangement, the risk tolerance level is set at medium.

## **(I) Introduction**

National Pension Program was launched on October 1, 2008, which covers eligible nationals who are not participating in other major social insurance programs. The Program offers old age pension, maternity, mentally/physically disability pension, death and surviving family pension payments.

BLF proceeds with investing according to related regulations including Regulations for Management, Utilization and Supervision of the National Pension Insurance Fund, and Operation Directions for Management and Utilization of the National Pension Insurance Fund.

## **(II) Mission and objectives**

1. Fundamental mission: Perform fiduciary duties with prudence to ensure maximal long-term economic benefit for the insured.
2. Risk tolerance target: Pursuing maximum return under tolerable medium risks.
3. Liquidity target: Maintaining sufficient medium liquidity for payment needs.

(III) Target return

1. The annual return target is the expected rate of return in the Fund's annual asset allocation and investment plans.
2. The mid- and long-term return target of the Fund is set at 5-year-average real return rate exceeding corresponding period of 2-year-deposit-interest-rate of Bank of Taiwan, plus annual growth rate of consumer price index of corresponding period. The Fund's size and actuarial reports shall also be considered.

(IV) Strategies

Following the abovementioned asset allocation and risk management policies, specific investment strategies for the Fund are:

1. Asset allocation: Diversification of investments and risks is a principle for asset allocation. The Fund shall construct an efficient portfolio in accordance with factors including but not limited to global economy situation, market outlook, investment target, and cash flow status.
2. In-house and fully fiduciary discretionary investments: Investments can be executed by in-house teams and fully fiduciary discretionary investment managers. Domestic equity investments are mainly conducted by investment managers.
3. Active and passive investment: Investments shall partake in both active and passive terms.