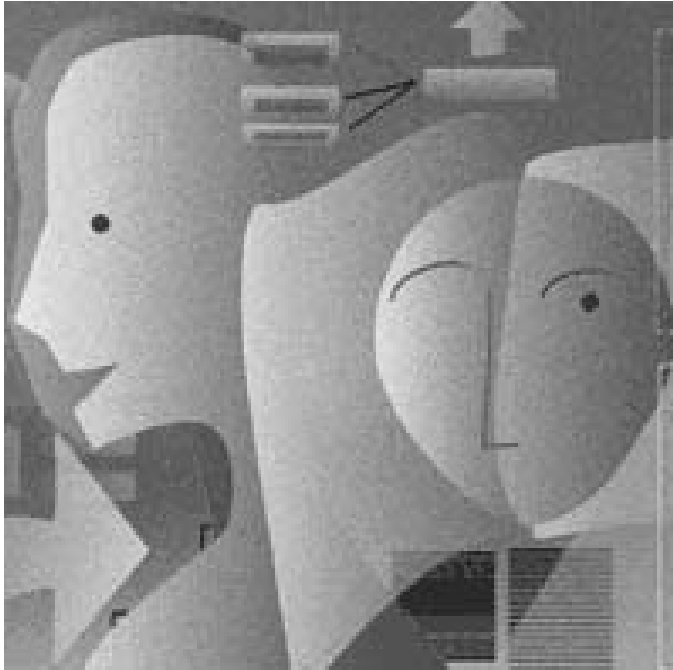


# MERCER

Human Resource Consulting



April 27, 2005

## **China Pension Update**

Prepared for OECD/IOPS Conference on  
Private Pensions in Asia

Stan Feng  
Mercer, Beijing

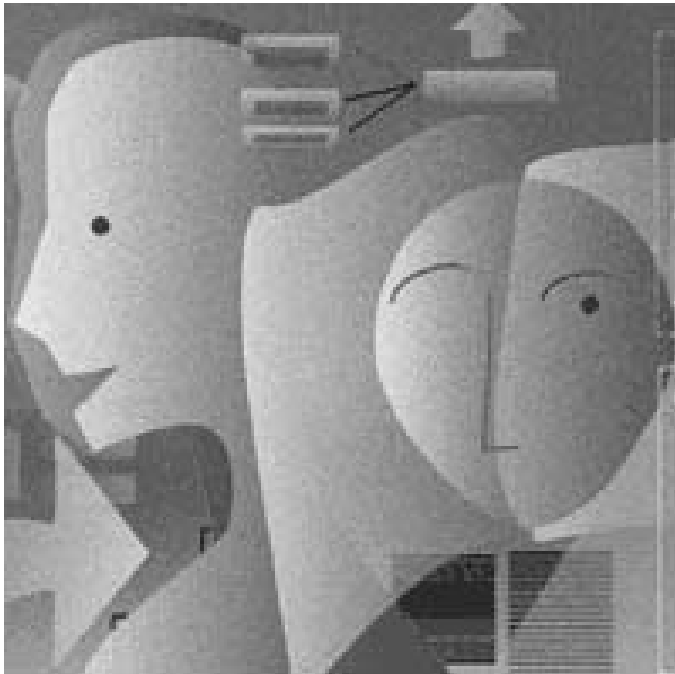
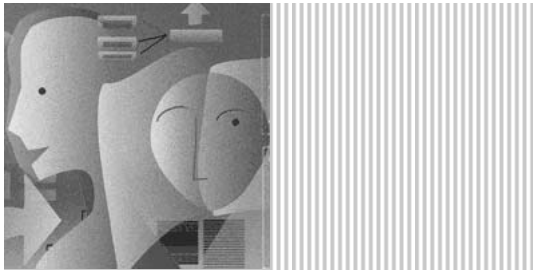
**MMC** Marsh & McLennan Companies



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# Overview of China



# Overview of China

## Economic Growth

Since the opening of China (1979), economic growth has displayed impressive results, especially in the 90's and this decade

- China is in the top 10 in GDP
- Per capita GDP increased more than 250% since 1990; growth has been over 7% for the past few years
- Strong consumer spending; retail sales growth rate of 10% in 2001
- 2004 actual GDP growth rate is **9.5%**

Country	1990			2004 Estimates		
	Population (millions)	GDP (US\$ billions)	GDP per capita (US\$)	Population (millions)	GDP (US\$ billions)	GDP per capita (US\$)
China	1,134	364	321	1,300	1,463	1,120
USA	249	5,234	21,020	292	11,278	38,360
Japan	124	2,961	23,976	127	4,366	34,350
UK	57	833	14,614	60	1,927	31,860
France	56	957	17,066	60	1,911	31,640
S. Korea	43	238	5,561	49	563	11,630
Hong Kong	6	70	12,086	7	174	24,640
Singapore	3	35	13,037	4	95	22,330

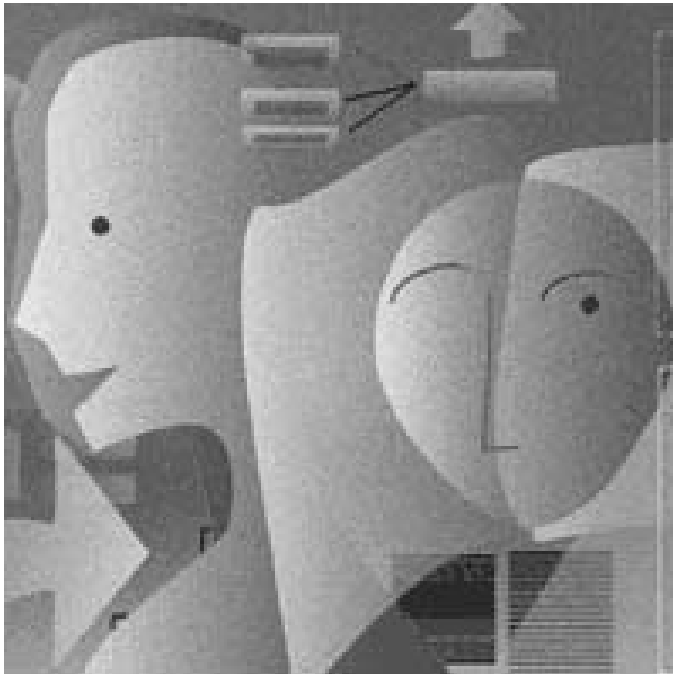
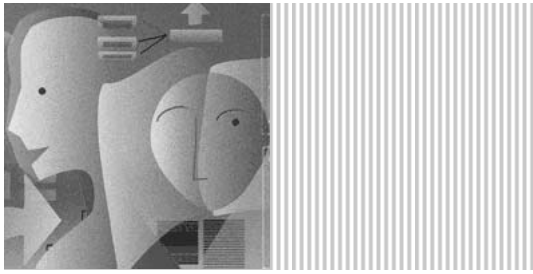
Source: the *Economist*



## Overview of China

### Aging Population

- Many developed countries (such as Japan, Sweden, and Germany) took almost a **century** to have an aged population (at least 15% of the population greater than age 65)
- China's one-child policy is placing a severe strain on workers supporting the elderly (that is, the dependency ratio is deteriorating); this is also exacerbated by promoting late marriage and deferred childbearing
- Heavy pressure on “only” children in terms of filial piety duties
- China will become “aged” in **one generation**



# **Social Security Fund**



# **Social Security Fund**

## Overview

- Established in November of 2000, as the 'Fund of last resort' for provincial governments' Social Security payments
- The National Council for Social Security Fund (SSF) was established at the same time to manage and administer the fund
- The financing:
  - Central government fiscal allocations
  - 10% of proceeds from State-owned Enterprises shares listing
  - Lottery proceeds
- Current asset size: accumulated assets of RMB170 billion by the end of 2004



# Social Security Fund

## Asset Allocation

- Asset allocation (as of the end of 2003)

	Amount (in RMB Billions)	Percentage (%)
Bank Deposits	60.0	45.3
Short-term Bonds	1.1	0.8
Long-term Bonds	38.1	28.7
Outsourced Assets	31.9	24.1
- Equities	6.7	5.1
- Bonds	8.9	6.7
- T-bond repos	16.3	12.3
Interest Income	1.4	1.1
Total Assets	132.5	100

Source: SSF Annual report and Pension Funds in China





# **Social Security Fund**

## Outsourcing

- Key qualification for managers investing SSF assets
  - Registered in China and approved by CSRC
  - Net assets of RMB50 million
  - 2 years operating history in China, prudent management and good reputation
- Outsource to investment managers
  - First mandate in 2002 : 6 domestic fund managers
    - Boshi, Changsheng, China Asset, Harvest, Penghua, Southern
  - Second mandate in October 2004: mixed with domestic, JV, and securities firm
    - China Merchants, China International Capital Corp (CICC), E-Fund, Guotai



# Social Security Fund Performance

- Target return: avoid a negative return over any 5-year time period; beating inflation and 1-year deposit rate
- Investment performance:

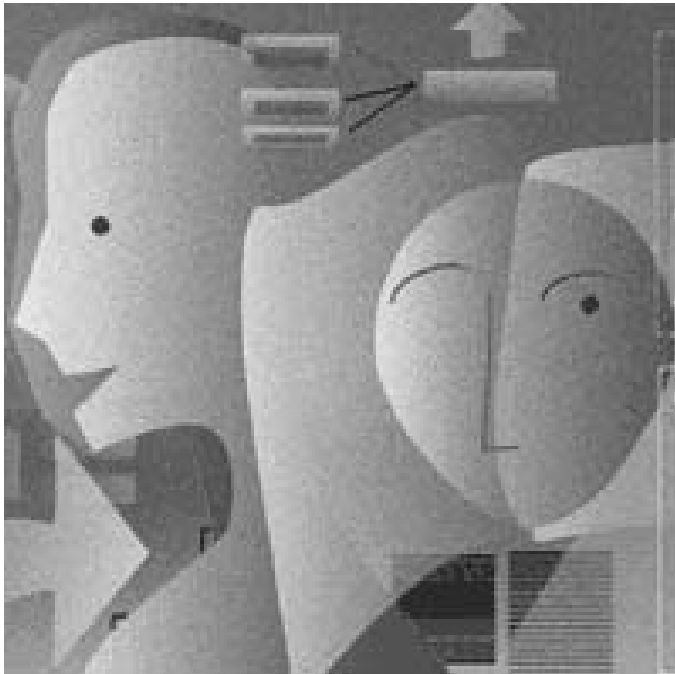
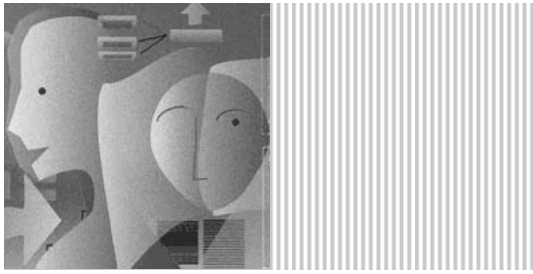
	Investment Return (%)	Inflation (%)	1-year bank deposit (%)
2001	2.25	0.7	1.98
2002	2.75	(0.8)	1.98
2003	2.71	1.2	1.98
2004	3.10	3.9	2.25



# **Social Security Fund**

## What's next

- SSF would like to receive stocks rather than cash for SOE overseas listing
- To enhance the return, more outsourcing will be expected
- Stock investment % will be increasing to 20% (now about 11% at the end of 2004)
- Overseas investment has been approved with details being worked out
  - SSF has indicated it will invest up to 5% assets overseas
  - Consultant is helping SSF in selection of international investment managers

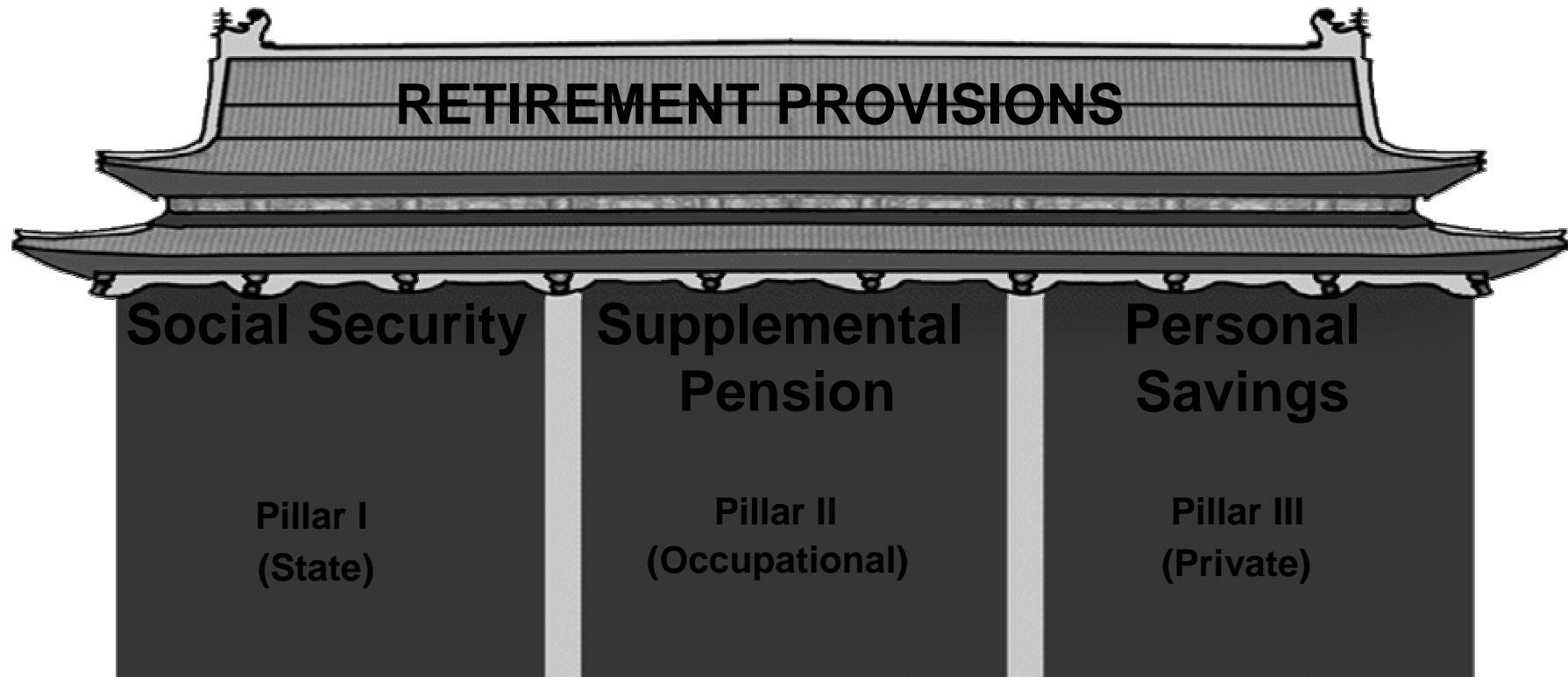


# Enterprise Annuity



# The Three-Pillar System

- China's current Social Security System was implemented in 1997, when China accepted the recommendations by the World Bank to adopt a Three Pillar Pension System





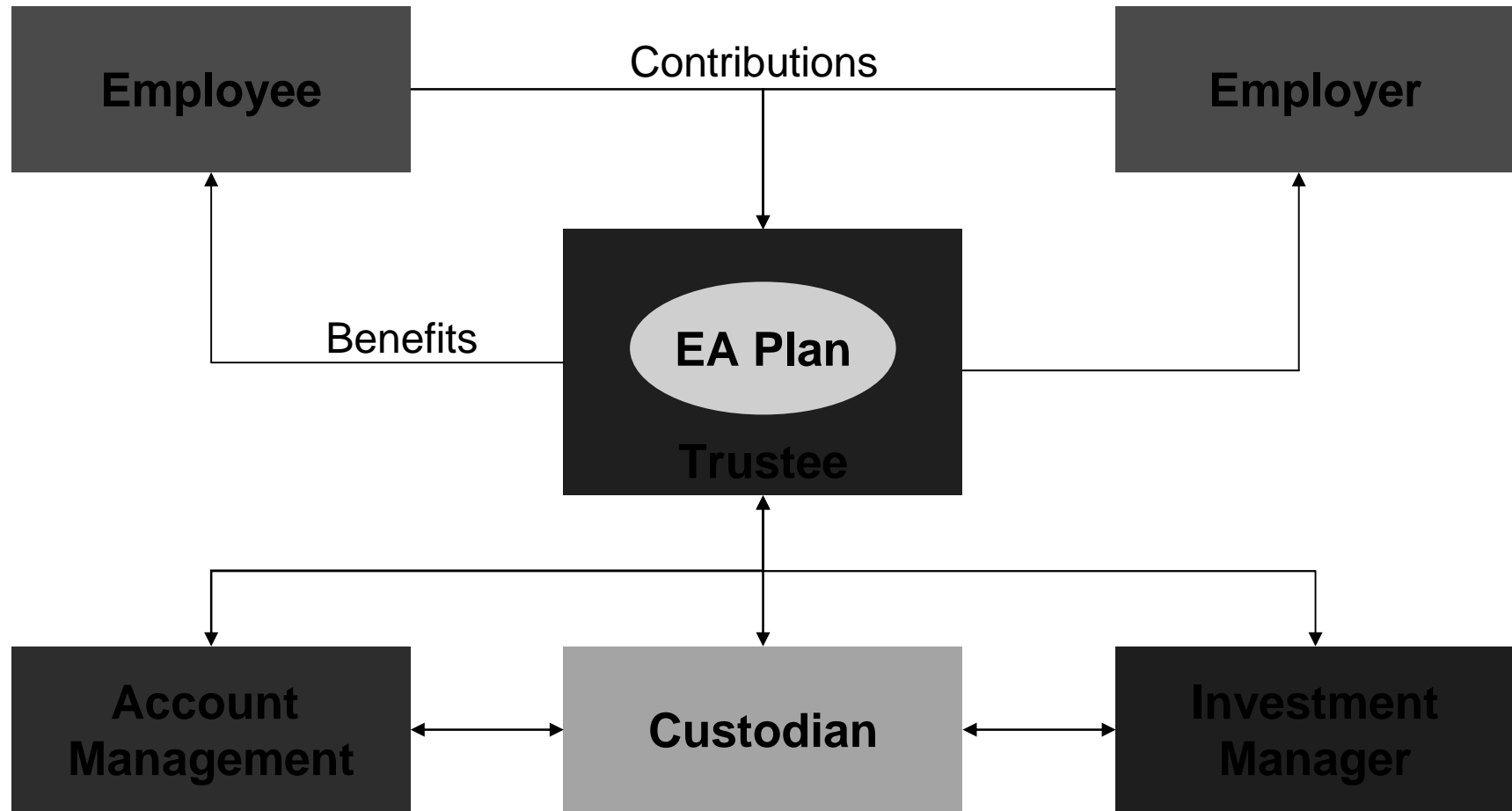
# Enterprise Annuity

## Overview

- In April 2004, the Ministry of Labor and Social Security issued legislation on Enterprise Annuity or EA:
  - Occupational voluntary DC schemes, and considered as China's 401 (k)
  - Applicable to all employees
- EA must be set up under trust arrangements. The plan trustee appoints EA service providers (plan administrator, custodian and investment manager)
- Fees for EA providers are capped:
  - Trustee: up to 0.2% of assets
  - Plan administrator: RMB5 per month per participant
  - Custodian: up to 0.2% of assets
  - Investment manager: up to 1.2% of assets



# Enterprise Annuity Structure





# Enterprise Annuity

## Design

- Contributions:
  - Both employer and employee are required to contribute
  - Maximum employer contribution: 1/12 of last year's payroll
  - Maximum employer and employee contribution: 1/6 of last year's payroll
  - Contributions are portable when changing jobs
- Benefits:

<b>Basic Social Pension</b>	<b>Enterprise Annuity</b>	<b>?</b>
- Payable at legal retirement age (60 for male and 55 for female)		
- Or at death, emigrate overseas		
<b>Pillar I (State)</b>	<b>Pillar II (Occupational)</b>	<b>Pillar III (Private)</b>
- Paid as a lump sum or annuity		
- The plan design needs to receive labor department's approval





# Enterprise Annuity

## Investment

- Conservative assets allocation limits are set
  - Money Market:  $\geq 20\%$
  - Fixed Income: 20% - 50%
  - Equity:  $\leq 30\%$ , and Stocks:  $\leq 20\%$
- Participant investment choice will unlikely be common in the beginning
- Investment managers must set aside 20% of management fees in a reserve fund until reaching 10% of net assets under management



# Enterprise Annuity

## Recent Developments

- The legislation to provide guidance for service providers to apply for license has been released in early February of 2005
- Ministry of Labor and Social Security will review EA license application in min-May, and it is expected that by July, EA products will be available in the market
- Taxation is not directly addressed in the existing legislations, and the labor ministry is working with relevant ministries in coming up with a nationwide tax relief policy
- In the meantime, many provinces have issued their own tax relief policy, providing tax relief on employer contributions ranging from 4% to 8% of salary