



International Pension Forum

“Impact of Pension Funds on Capital Markets – PRC Experience”

BY

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Overview

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- Stock Markets
- State Owned Shares
- Tracker?
- Fund Management
- QFII
- QDII
- Insurance in China
- PRC Population
- Pensions
- Regulation
- Problems
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Map of China





History

“Shanghai offers a wide variety of entertainment. There is local and foreign speculation in commodities and stocks, gold bars and silver. Prompt execution of orders is given in all the leading and most of the minor markets of the world. London, Paris and New York stocks are quoted, as well as local issues, of which there are many, both bonds and shares. Closing quotations of the New York Stock Exchange are available in Shanghai very early in the morning...there is perhaps a wider range of foreign exchange in Shanghai than in any other place in the world. Any known currency can readily be converted into Chinese money, or vice versa”.

All About Shanghai – 1934



Stock Markets - Chinese Universe Constituents

- China (Shanghai + Shenzhen)
 - 1,377 shares in total
 - 1,236 A shares
 - 110 B shares
- Plus 750 stocks listed in Hong Kong
 - 72 - H shares
 - 83 - Red Chips
- Other China plays: Taiwan, New York, Singapore
- Big issues
 - Internal – overhang of State Owned Shares
 - External – PE's to converge with Hong Kong



Stock Markets

- A shares
 - ordinary equity shares, denominated in Rmb
 - the only class of shares that can legally be traded by individuals or legal persons within China
 - overseas investors are not permitted access except through QFII
- B shares
 - ordinary shares, same ownership rights as A-shares
 - traded in US\$ in Shanghai and HK\$ in Shenzhen
 - originally created for non-mainland residents, opened up after March 2001 to domestic investors with hard currency
 - undervalued relative to A-shares



Stock Markets

- H Shares

- established in 1993
- listed on the Hong Kong Stock Exchange
- trade in Hong Kong dollars
- currently about 73 listed in Hong Kong
- subscription to H shares restricted to non-mainland Chinese residents

- Red Chips

- Hong Kong domiciled and Hong Kong listed
- at least 35% controlled by mainland Chinese
- method by which Chinese companies access overseas equity financing



State Owned Shares

- A shares still 2/3 owned by State
- Legal person shares
 - held by state institutions or other SOEs
 - can only be traded OTC between authorised institutions
 - 1/3 market cap
- State shares
 - Non-tradable, held by State Council via SASAC
 - 1/3 market cap



Tracker?

- Non-tradable shares represent overhang for stock market
- Demand for increased liquidity
- Possibility of bringing shares to market via HK-type or Taiwan-type Tracker Fund
- Consider appropriate Index



Fund Management

- About 45 authorised domestic managers
- Nearly 20 international companies involved
- Now US\$40bn AUM
- Investment funds contain about 10% of stock market free float
- Competition to intensify with insurers and banks entering market



Fund Management

- 'Big 10' dominate with 50% market share
- Sino-foreign JVs account for 18% market share
- 54 Closed-end funds, AUM US\$26bn
- 100 Open-ended funds, AUM US\$14bn
- Product segmentation
 - 30% closed-end
 - 42% balanced
 - 13% money market
 - 10% equity
 - 3% guaranteed
 - 2% fixed income



International Fund Management

<p>Different Arrangements</p> <ul style="list-style-type: none">■ Technical Assistance Agreement■ M.O.U.■ Establish new J.V.<ul style="list-style-type: none">- Need to get JV licence from CSRC- Need to get funds approved by CSRC■ Buy in to existing manager	
<p>Names</p> <ul style="list-style-type: none">■ ABN Amro■ AIG■ Allianz Dresdner■ Bank of Montreal■ BNP Paribas■ First State■ Fortis■ Franklin Templeton	<ul style="list-style-type: none">■ ING■ Invesco■ JP Morgan Chase■ Merrill Lynch■ Prudential■ Pramerica Financial■ Soc Gen



QFII

- Qualified Foreign Institutional Investor
- Announced late 2002
- Restrictive regulations
- Now 23 institutions accepted
- U\$2.9tn quota approved
- Can buy A shares, funds, bonds, IPO's
(but not for currency speculation)



QDII

- Reverse of QFII
- Will help ease pressure on Chinese Renminbi
- But could be very negative for A share market
- Chinese insurers able to invest foreign currency
- Also N.S.S.F. with its foreign currency
- Timing 2005?



Insurance in China

- 6 national domestic life companies
- 20 international companies with J.V.'s
- Growth rate extremely high
- Low interest rate/mismatching problem
- Life companies very restricted on investments
- WTO restrictions to ease
- Life Companies now establishing
 - fund management subsidiaries
 - pension insurance company subsidiaries



Life Licences-International Companies

Aegon

Aetna

AIA

Allianz

Aviva

AXA

Cathay Life

Cigna

CMG

CNP

Generali

ING

Manulife

Met Life

New York Life

Nippon Life

Prudential (UK)

Samsung Life

Skandia

Standard Life

Sun Life of Canada



PRC Population

Total:	About 1.3 billion
Rural Population:	800 million
+	+
Urban Population	500 million

Consider:

- One Child Policy
- Greatly improved life expectancy
- Dependency Ratio deteriorating rapidly

Ages:

- | | |
|---------|-------------|
| ■ 0-14 | 90 million |
| ■ 15-64 | 360 million |
| ■ 65+ | 50 million |



Pensions

	<u>Contributions</u>		<u>Benefits</u>
<u>State Pillar Ia</u>	<u>Employee</u> Nil	<u>Employer</u> 17%	Pension of 20% of average local wages
Pillar Ib	8%	3%	Pension based on 11% contributions
	Contributions capped and subject to local variation		
<u>Private Sector Pillars II & III</u>	Variable		Variable



Pensions

- Pillars Ia and Ib pension assets may be RMB 140bn (US\$17bn) in government bonds and deposits, managed by Social Security Bureaus; however not nearly enough for future obligations
- Pillar II pension assets about RMB 30 bn (US\$4bn)
- Pillar III pension assets placed with insurance companies, about RMB 60 bn (US\$7 bn)
- National Social Security Fund about RMB 160 bn (US\$20 bn)
- The government is considering several initiatives to meet the pensions shortfall
 - Special taxes
 - Lottery
 - Issue of recognition bonds
 - Sale of State Owned assets
 - Launch of Chinese Tracker Fund



Opportunities for International Fund Managers

- Pillar Ia; No
- Pillar Ib;
 - Short term – No;
 - Medium Term – Outsourcing by Social Security Bureaus;
 - Long-term – like 401(k) or M.P.F. plans?
- Pillar II; As segregated funds
- Pillar III; Via insurance companies
- National Social Security Fund; Possible



Regulation – Financial Services

- Banking – P.B.O.C. → C.B.R.C.
- Investment Funds – C.S.R.C.
- Insurance – C.I.R.C.
- Pensions – (M.L.S.S., M.O.F., C.S.R.C., C.I.R.C., C.B.R.C.)



Problems in China

BANKING	Deposits US\$1.4 tn	Bad loans US\$350 bn (25%)
PENSIONS	State Liabilities US\$1,000 bn	Funding shortfall US\$950 bn (95%)
LIFE INSURANCE	Assets US\$140 bn	Bad policies US\$20 bn (15%)



China's Capital Markets – New Developments

- Open-ended Funds
- JV Fund Management Companies
- JV Securities Companies
- Development of Unit-linked Insurance and 401(k) Pensions
- Commencement of Second Board
- QFII and QDII systems
- CDR's
- Chinese Tracker Fund
- Merging of Stock Markets
- Establishment of Financial Futures Market
- Free Market for Foreign Insurers
- Liberalization of Pension and Insurance Funds Investment
- Convergence of A and B Shares
- Privatization of Individual Account State Pensions
- Convertibility of Renminbi
- International Investment by Institutions



Year 2010 Scenario

- Chinese economy increases to US\$2+ trillion GDP
- Stock Market Capitalisation = US\$2 trillion
- 50% retail (domestic) with 100 million investors
- 50% institutional (domestic and international)
- Pension Reform in China
 - Essential to maintain social stability
 - Integral to overall financial reforms
 - Fundamental to development of capital markets

THANK YOU!