Regulatory Framework: China’s Pension System

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China’s Three Pillar Pension System since 1997

- For Urban Workers Prior to EA Introduction

Unified Pension System

Pillar I: Basic Pension (Mandatory)

Pillar II: Com’l Group Pensions & Social Insurance Agency Schemes & Other Employer /Industry Int’l Managed Schemes (Voluntary)

Pillar III: Individual Pension & Savings (Voluntary)
China’s Three Pillar Pension System since 1997

- For Urban Workers after EA Introduction

Unified Pension System

- Pillar I: Basic Pension (Mandatory)
- Pillar II: Enterprise Annuity (Voluntary)
- Pillar III: Commercial Group Insurance & Others (Voluntary)
Old Age Pension for Others

- **Rural Sector:**
  - 70% of China’s 1.3 billion population
  - 75% of China’s old-age population in rural areas
  - Voluntary social insurance scheme in individual account form
  - Low coverage: 50 million
  - Contributions: Individuals with supplement from village collectives
  - Benefits: granted for 10 years depend upon IA balance
  - Administered by local(county) social insurance agencies
  - Regulator: MOLSS and Ministry of Civil Affairs
  - Key regulation by MOC- Basic Models (Trial) of County Level Social Insurance (1992)

- **Public and Civil Servants:**
  - High replacement rate of 90% final earnings or more
  - Funded by government
  - Benefits linked to year of service only
  - To be reformed soon
Pillar I: Basic Pension

Main Features:

- Mandatory
- Covers 122 million of 266 million urban workers in 2004
- Two components: Social Pooled Fund (PAYG) + Individual Account (Funded)
- Contribution:
  - ER: 20% (17% goes to SPF and 3% goes to IA)
  - EE: 8% (IA)
- Benefits: Targeted replacement rate of 58.5% of declared City Average Salary, based on
  - Social Pooled Fund: 20%
  - Individual Account: IA balance/120
- Key regulator: Ministry of Labor and Social Security (MOLSS)
- Administrator and Investment Manager: County/City/Provincial Social Insurance Agency
- Tax: fully pre-tax deductible
- Retirement age:
  - Female: 50/55
  - Male: 60
Pillar I: Basic Pension (cont’d)

Key Issues:
- Notional Individual Account
- Huge funding shortfall and future pension liabilities
- Low coverage: 45-50% (active worker/total urban workforce) in 2000-2004
- Highly decentralized administration
- Low investment return as results of limited investment options
- Liaoning/Heilongjiang/Jilin Pilot: Notional Individual Account to be fully funded; more centralized administration; IA assets to be managed by professional investment managers allowing more investment options*
- National Social Security Fund: Fund of last resort
Pillar II: Enterprise Annuity (EA)

Main Features:

- Trust form
- Individual account
- Eligibility: all employees
- Contribution:
  - EE match ER (various);
  - ER’s contribution rate can vary depending upon different class of employees;
  - Max limit: 1 month previous year’s payroll for ER and 2 month total for ER and EE;
- Payment options: lump-sum or installment
- Plan sponsor (ER) must comply with Pillar I contribution requirements
- Main regulator: MOLSS
Pillar II: Enterprise Annuity (EA) (cont’d)

Main Features:
- Individual account is transferable if new employer offers EA plan; otherwise stays with previous providers
- Tax policies:
  - ER contribution: up to local government, 4-5% of payroll as business expense
  - EE contribution: No
  - Benefits payment at retirement: various, some 100% exempt from income tax
- Investment limit:
  - 20% in money market instruments (CD or treasury bills);
  - 50% in fixed income products and convertible bonds of which min 20% in government bonds
  - 30% in equities (stocks, mutual fund and investment linked insurance products)
Pillar II: Enterprise Annuity (EA) (cont’d)

- **Main Features:**
  - Generally no member choice
  - Providers (Trustee, Custodian, Investment Manager(s) and Administrator) must be qualified by MOLSS and their financial regulators (CSRC, CBRC and CIRC)
  - EA plans must be filed with local social security agencies; (except 187+ SASAC supervised companies who need to file with MOLSS directly)
  - Plan fees:
    - max of 1.4% asset based fees by trustee(0.2%), investment managers(1.2%) and custodian(0.2%)
    - plus max RMB 5/member/mo. for administration services paid by ER directly
Pillar II: Enterprise Annuity (EA) (cont’d)

- Framework Regulations issued in May 2004
  - Document 20: “Temporary Provision of EA” by MOLSS

- Implementation regulations issued in Feb. 2005
  - “Provisional Measurers on certifying EA Fund Management Institution Qualifications”
  - “Guiding Standard of EA Administration Information System”
  - “Guiding Standard of EA Administration Information System”
  - “Rules used by reviewing Experts in certifying EA Fund Management Institution Qualifications”
Pillar II: Enterprise Annuity (EA) (cont’d)

**EA Framework-Trust Form:**

**Enterprise**

- Sign Trust contract

**Plan Trustee:**

- EA Council comprising representatives of employee, management and/or professionals
- OR: Other Authorized Institutions (Trust co, fund mgt co. & pension service co)

**Investment Manager(s)**

(Fund co., securities co., trust co. insurance co’s asset mgt co. and other investment co)

**Independent Custodian**

(Banks only)

**Account Administrator**

(Any legal entity with Rmb.50m registered capital)
Pillar II: Enterprise Annuity (EA) (cont’d)

- Roles of Each Providers
  - Trustee
  - Investment Managers
  - Custodian
  - Administrator
  - Other intermediaries: Consultant, accountant & auditor, actuary and legal advisor…
Pillar II: Enterprise Annuity (EA) (cont’d)

- Licensing
  - Primary Licensing by respective financial service regulators:
    - Banks and trust companies: CBRC
    - Insurance companies: CIRC
    - Securities and fund management companies: CSRC
  - Secondary qualification approval by MOLSS for four EA roles
  - Timing of the license issuance:
    - Periodically decided by MOLSS
    - 1st group of applications is submitted on 16-27 May 2005 and expected to be issued within 1-2 months
  - Capital requirements of four major providers (in RMB):
    - Trustee: 100m
    - Custodian: 5b
    - IM: 1b for securities co. & 100m for others
    - Administrator: 50m
Pillar II: Enterprise Annuity (EA) (cont’d)

- Licensing (cont’d)
  - Intermediaries: No special licenses are required
  - Other special features:
    - Custodian banks: File with CBRC only prior to apply for EA custodian qualification with MOLSS
    - Administrators: No primary regulator, direct application to MOLSS
    - Pension service companies as trustee:
      - No clear definition
      - CIRC approved “pension insurance companies” to enable insurers are qualified to apply for EA Trustee
      - Can other financial services regulators approve pension service company?
Pillar II: Enterprise Annuity (EA) (cont’d)

- General License Procedures for four major providers:

  - Obtaining own financial regulator’s agreement letter (except custodian banks and independent administrator)
  - Submit application documents to MOLSS
  - Expert panel to review application documents
  - Final announcements by MOLSS
  - Final approvals by MOLSS & other relevant regulators
  - On-site examinations
### Pillar II: Enterprise Annuity (EA) (cont’d)

#### Who can be what?

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Pillar III: Commercial Group
Pensions and Others

- Commercial group pension products offered by insurance companies and regulated by CIRC

- Other forms of individual savings
Pillar III: Commercial Group Pensions

- Main Features:
  - Offered by domestic life insurers through direct sales force, more foreign jv life companies are issued licenses since Dec. 2005 to do group business
  - Participating policies with 2-2.5% guaranteed return account for over 80% of all group policies sold in recent years
  - Investment linked policies are offered by few insurers
  - Tax treatment could be more attractive than EA
  - Contributions mainly made by ER in single pay, regular pay or flexible
  - With individual account
  - More restricted investment requirement: fixed income securities, bank deposits, mutual funds(less than 15%) and equities (less than 5%, not applicable to investment linked and universal policies)
Pillar III: Commercial Group

Pensions (cont’d)

Key Issues:

- Become “unqualified” plans after the introduction of EA
- Identical product features by all insurers
- Sometimes used for income tax avoidance purpose
Questions & Discussion

Thank You