International Pensions Seminar

Pension Funds in China

BY

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PRC Population

Total: Close to 1.3 billion

Rural Population: 900 million

+ +

Urban Population 400 million

Ages:

0-14	100 million
15-64	275 million
65+	25 million

Consider:

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

Old System ('Iron Rice Bowl')

- Workers employed for life by State Owned Enterprises (SOEs)
- Low Wages but Total Security
- Pension at 60 (Males) or 55 (Females) = 80% of final salary
- Pensions paid by SOEs
- No Pre-funding or Reserves (i.e. pay-as-you-go)
- But what if SOEs are unable to pay pensions?
- China is very concerned about social unrest resulting from the unemployed and unpaid pensions

Pension Principles for Future

A. Reduce pension expectations
B. Cost burden to be shared by employer and employee
C. Move towards pre-funding

Reasons?

I. Population projections
II. SOE restructuring
III. Develop domestic capital markets

New System ('Safety Net')

- New Unified Pension System Reform (July 1997)
- Expand coverage to all urban employees
- Gradually raise retirement age (to 65 years for men & women)

Benefits

- Pillar I = Basic Pension of 20% of average provincial wages
- Pillar II = Individual account based on 11% contributions
- Pillar III = Voluntary Supplementary Benefits

Financing

- Employee = 4% salary contribution increasing by 1% every 2 years up to 8%
- Employer = Approx 20% of salary contribution (Subject to salary maximum and local variation)

Develop Capital Markets

- SOEs to be restructured: 2,000 – 3,000
- Merge, close, downsize or corporatize
- List on stock market through A shares?
- How much capital is required in the next 5 years? 10 years?
- How to apply pension assets to capital markets and maximize returns (deposits + bonds + equities + mutual funds + real estate + infrastructure)
- World Bank estimates pension assets of US$1.8 trillion by 2030

Problems

- Compliance
- Transitional Issues
- Administration
- Portability
- Taxation
- Funding

Implicit Pension Debt

- Pillar I and II pension assets approximately RMB¥125bn, (US$15bn) in government bonds and deposits, managed by Social Security Bureaus; however not enough for future obligations

- Pillar III pension assets managed by insurance companies; fully funded schemes

- Implicit Pension Debt
  - 63% of GDP (World Bank 1994)
  - SCORE Project

    : 60-80% of GDP

    : US$600-800bn

Interested Parties

- International Agencies;
  - World Bank, ADB, EU, OECD, UN
- Governments;
  - US, UK, Japan, Canada, Chile, France, Germany, Australia, Netherlands, Hong Kong
- Research Bodies;
  - DRC, SCORE, Universities, Special Committee
- Regulators;
  - MLSS, MOF, CIRC, CSRC;
- Need for Pensions Regulator

Solutions

- 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
  - Soft loans
- Central government to assist provinces

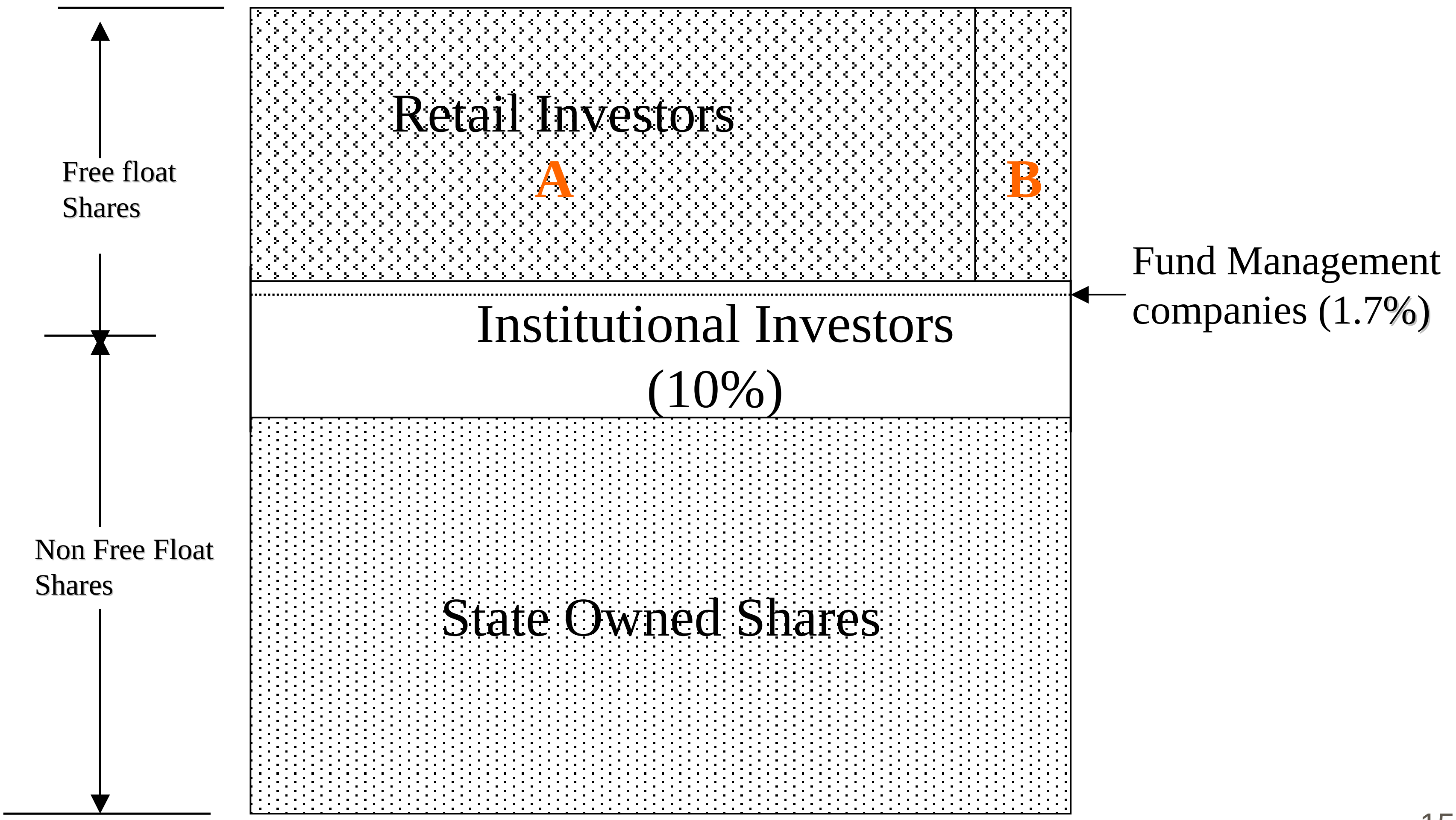
Liaoning Experiment

- Liaoning – industrial province in north east
- Very serious funding problems
- Document 42 (January 2001)
- Basic pension – 30% of local average earnings
- Individual account
  - Employees' contributions only
  - Must be properly funded
- Major problem of back funding to be solved

China's Stock Markets

- Shanghai & Shenzhen ; established in 1990
- A Shares & B Shares
- Over 1,000 listed stocks
- Market capitalization ~US$150 bn (Free float)
- 50 million investors
- Need to develop institutional investment

Structure of China's Equity Market



Source:CSRC Website

Expansion of Stock Markets

- US$750bn in total personal savings
- 0 companies 1990; 1,000 companies now; 5,000 companies by 2010
- 500 companies currently backlogged for listing
- 0 telecom stocks now vs. 100 in 2 years
- More choice from new, fast growth sectors
- Best companies available to investors for the first time
- Technology IPO's are poised to boom
- But, concern over certain market practices

Fund Management Overview

- Domestic Managers
  - currently 10
  - Will be many more
- International Influence
  - Several TAA's signed
  - Any new domestic fund managers must have international assistance
- JVs
  - Will allow after WTO
  - But exact rules not yet clarified

Opportunities for Fund Managers

- Pillar I; No
- Pillar II;
  - Short term – No;
  - Medium Term – Outsourcing by Social Security Bureaus;
  - Long-term – 401(k) plans?
- Pillar III; Via Insurance Companies;
  - Later segregated funds?
- National Social Security Fund; Possible

Impact of China's WTO Entry

- Insurance
- Fund Management
- Trustees
- Financial Innovation
- Market Share Reallocation
- Government Influences
- Regulation
- Human Resources

Possible Developments

- Open-ended Funds
- Commencement of Second Board
- Merging of Stock Markets (A shares)
- JV Fund Managers (before/after WTO)
- JV Securities Companies (after WTO)
- Development of Unit-linked Insurance and 401(K) Pensions
- Chinese Tracker Fund
- Establishment of Financial Futures Market
- Merging of A and B shares
- Free Market for Foreign Insurance (3-5 years after WTO)
- Liberalization of Pension and Insurance Funds Investment
- Privatisation of Second Pillar Pensions (Individual Accounts)
- International Investment by Institutions
- Convertibility of Renminbi

10 Year Scenario

- Chinese economy doubles to US$2 trillion GDP
- Stock Market Capitalisation = US$2 trillion GDP
- 50 % retail (domestic) with 100 million investors
- 50% institutional (domestic and international)
- Today – unfunded liabilities is big problem
- 2010 – pension funds will help stabilise and develop stock markets