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making financial sense of the future

Pensions, benefits and social security colloquium 2011
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Pension Reform in China

25-27 September 2011

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- **Pension Reforms and Enterprise Annuities**
 - Urban pension system
 - Enterprise Annuities
 - New rural pension system
- **National Social Security Fund (NSSF)**

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Map of China



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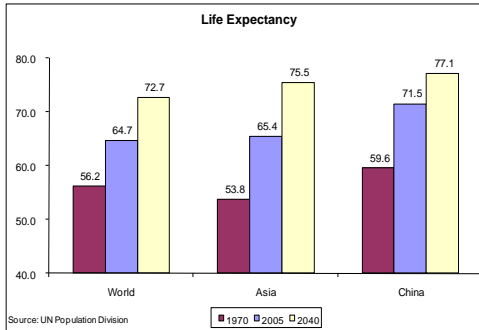
PRC Population

- Total: 1.35bn
- Consider:
 - One child policy
 - Greatly improved life expectancy
 - Population ageing rapidly
 - 400mn people over age 60 in 2040

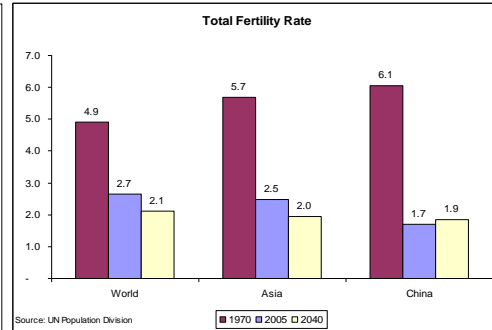
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Demographic Changes Pose Challenges



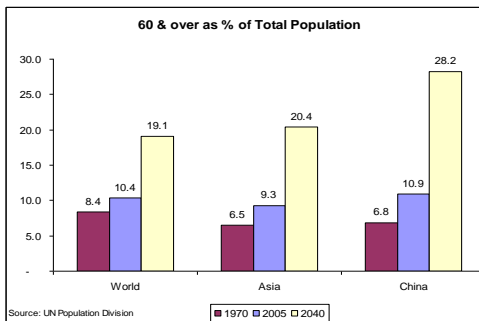
Source: UN Population Division



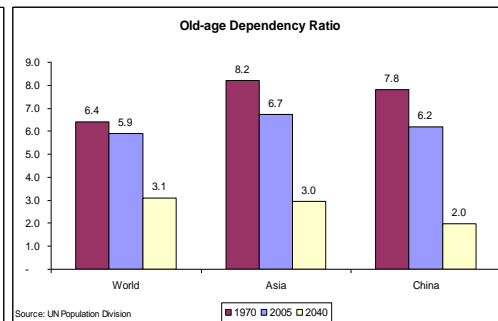
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Demographic Changes Pose Challenges (Cont'd)



Source: UN Population Division



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Old Pension System

- Urban employees typically worked for State(SOE) for life
- Retirement at 60 (males), 55/50 (females)
- Pension from SOE of 80-90% of final salary
- In 1950s not many pensioners, low life expectancy
- By 1980s very many pensioners, improved life expectancy
- Then SOEs became under pressure to downsize

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Pension Reform

- New unified pension system reform
 - Document 26 and document 38
 - Expand coverage to all urban employees
- National Social Security Fund (NSSF) established in 2000
- Regulations for Enterprise Annuities (EA) plans in 2004
- Rural population to be covered by 2020

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Urban Pension System

Pillars (World Bank)		Chinese Terminology	Contributions	Funded Status
State	Zero	Zero: Minimum guarantee (Di Bao)	n/a	Government
	I	Ia: Mandatory Social Pool Old Age Pension	ER: ~20% of salaries	PAYG
	II	Ib: Mandatory Individual Account Pension	EE: 8% of salary	Should be funded
Private	III	II: Voluntary Enterprise Annuity	ER; EE	Funded
		III: Other Voluntary Benefits	ER; EE	Funded
Private & State	IV	IV: Family support; subsidised healthcare and housing	n/a	Government or Family

Source: Stirling Finance research. ER – employer; EE – employee.

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Urban Pension System (Cont'd)

	Equities/ Linked products	Financial/ Corporate Bonds	G-bonds / Deposits
Pillar 1a (state)	-	-	100%
Pillar 1b (state) (IA)	-	-	100%
Pillar II (EA)	< 30%	< 50%	> 20%
Pillar III (non-EA)	< 20%	< 20%	< 100%

Source: Stirling Finance research

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Enterprise Annuities (EAs)

- Voluntary supplementary plans according to Ministry (MoHRSS) regulations
- Familiar structure: Trustee, administrator, fund manager, custodian
- 58 licenses have been awarded to 38 institutions
- Tax regulations (2009) and supplementary regulations (2011)
- Conversion of non-EA supplementary plans to EA format

EA Investments

- All domestic
- Investment return
 - 2006-2008: 10.5% p.a. on average
 - 2009: 7.8%
 - 2010: 3.6%

EA Investments (Cont'd)

- New Investment Measures (1 May 2011)

	Old Rules	New Rules
Liquid assets	$\geq 20\%$	$\geq 5\%$
Fixed income	$\geq 20\%$	$\leq 95\%$
Equity products	$\leq 30\%$	$\leq 30\%$
-stocks	$\leq 20\%$	

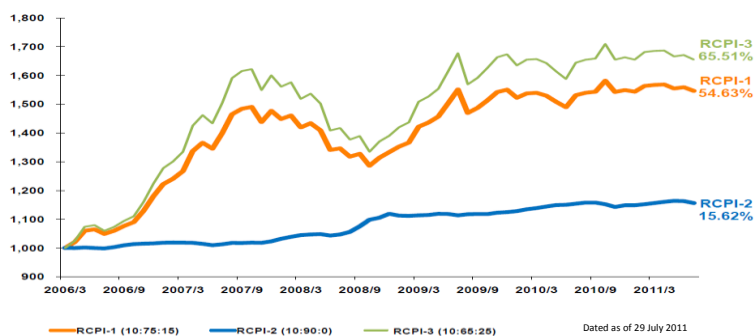
Source: Stirling Finance research

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EA Investment Performance

- Reuters China Pension Index (RCPI)
 - Performance benchmarks
 - Launched on 31 March 2006
- 3 asset mixes (cash: fixed income: equities)



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Source: Reuters.

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New Rural Pension System

- Over 50% of residents in China are rural
- Introduced in late 2008, on a voluntary basis
 - Eligibility: all rural residents
 - Pension age: 60 for M & F
 - Coverage: 23% of counties on voluntary basis by end 2010
- Cover entire rural population by 2020 compulsorily
- In very long term, rural and urban systems to converge

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New Rural Pension System (Cont'd)

Terminology	Contributions	Benefits	Funded Status
Basic Social Pool	100% from government budget	No less than RMB 55 per month	Unfunded
Individual Account	Individuals -RMB 100/ 200/ 300/ 400/ 500 per year Government - No less than RMB 30 each year Other sources	Monthly pension benefit of 1/139 of IA balance at pension age assuming at least 15 years' contributions; otherwise, lump sum payable	Funded (accumulated in accordance with 1-year bank deposit rate)

Source: Stirling Finance research

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National Social Security Fund (NSSF)

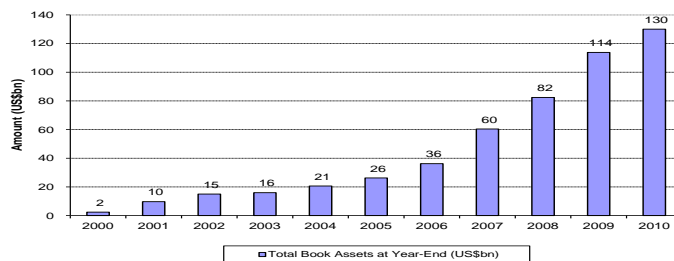
- Established in 2000
 - Pension fund of last resort
 - Strategic reserve fund
- 4 sources of funds
 - Growing significantly in size, stature and influence
 - Acting like Sovereign Wealth Fund

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NSSF Assets

- Assets:
 - The biggest institutional investor in China's pension sector
 - US\$130bn total assets as of end 2010
 - Aiming to reach RMB1.5trn (US\$231bn) by 2015



Source: NSSF; Stirling Finance research

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NSSF Investment Portfolio

- Well diversified Portfolio

Geographic Allocation	Execution	Permitted investments	Cap
Domestic	Direct	Bank deposits	>= 50%
		Government bonds	
	Appointment	Equities	=< 40%
		Fixed income	=< 10%
		PE funds	=< 10%
International	Appointment	Equities	=< 20%
		Fixed income	

Source: Stirling Finance research

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Appointment of Domestic Fund Managers

- 2001 – 2002
 - direct investments only
 - modest returns: 2% - 3%
- Domestic appointments in 3 batches

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International Investments

- Use FX to invest abroad in 2006
- Appointed international investment managers in November 2006
 - 5 mandates with 10 winners selected
- Second batch of mandates issued in May 2008
 - 5 mandates with 12 fund managers selected
- Current allocation: 7%

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First Batch of Overseas Investment Initiatives

Mandate	Index	Target Net-of-Fees Excess Return p.a.	Tracking Error	Managers
Global (ex-US) Equities	MSCI World (ex USA)	+ 200 bps	Within 8% p.a.	Allianz; Invesco; UBS/CICC
US Equities	S&P 500	+ 50bps	Within 2% p.a.	AllianceBernstein; AXA Rosenberg
Hong Kong Equities	FTSE China Hong Kong	+ 300 bps	Within 8% p.a.	JanusINTECH; T. Rowe Price
Global Fixed Income	Barclays Capital Global Aggregate Bond	+ 100 bps	Within 2% p.a.	AllianceBernstein; Blackrock; PIMCO
Cash	6-month LIBOR	0	N/A	Blackrock

Source: NSSF

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Second Batch of Overseas Investment Initiatives

Mandate	Benchmark	Appointed Fund Managers
Active China Overseas Equity	MSCI China Index	Schroders; Bosera; Baring
Active Asia Pacific (ex Japan) Equity	MSCI All countries Asia Pacific ex Japan Index	Martin Currie; JF; Principal
Active Emerging Market Equity	MSCI Emerging Market Index	Batterymarch; Morgan Stanley; Schroders
Active European Equity	MSCI Europe Index	Newton; Fidelity
Active Global Equity	MSCI World Index	Prudential (UK); Wellington

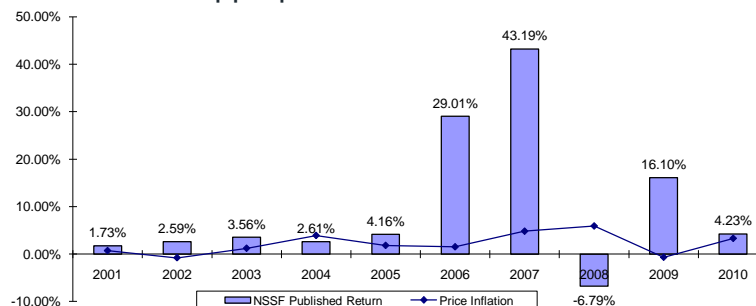
Source: NSSF

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NSSF Investment Returns

- Investment returns as at 31 December 2010
 - 9.2% p.a. since inception
 - Price inflation (2.1%), earnings inflation (10%-12%), and asset inflation (15%-20%)
- Is diversification appropriate?



Source: NSSF; Stirling Finance research.

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Final thoughts

- Total PRC reserve USD 3.2 tn
- But implicit pension debt twice as great!

Thank you!
Questions or comments?

