4TH PBSS Colloquium
Pensions, Benefits and Social Security
Tokyo, Japan
October 4 (Sun) - 6 (Tue), 2009

Retirement and Savings Plans in China

David Moo, FSA
Hewitt Associates (Shanghai)

SECTION SUR LES PENSIONS, AVANTAGES SOCIAUX ET SÉCURITÉ SOCIALE DE L'AAI
IAA PENSIONS, BENEFITS AND SOCIAL SECURITY SECTION
PBSS

JSCPA

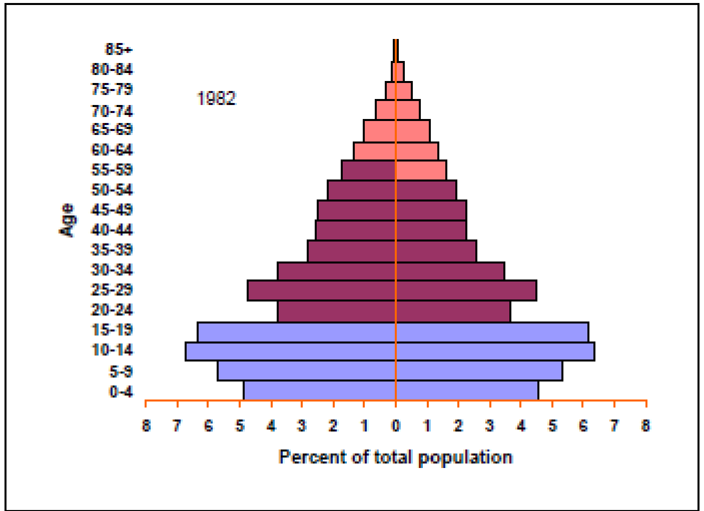
Agenda

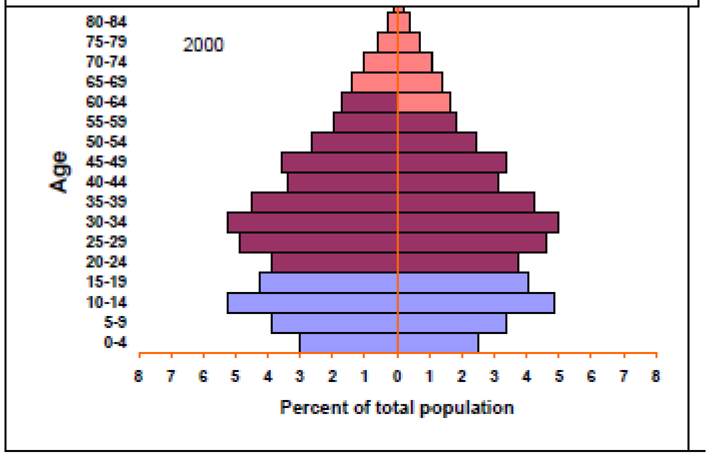
- Introduction
- Social Security
- Individual/Family Savings
- Employer-Sponsored Programs
  - Enterprise Annuity
- The Future

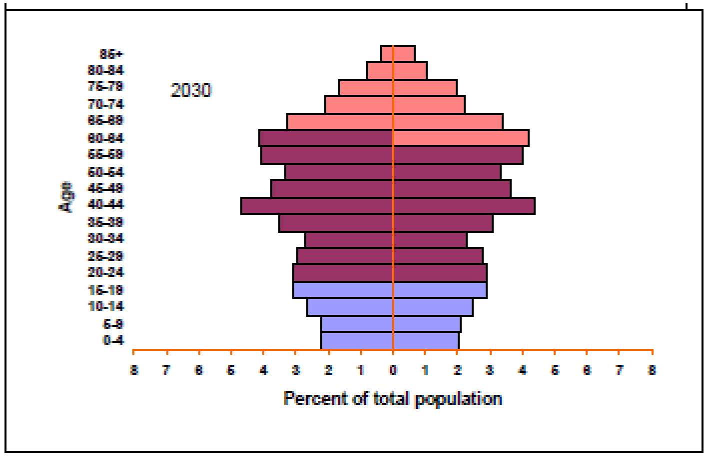
Introduction

- China is undergoing massive changes
  - Political
  - Economic
  - Demographic
- Need for long-term solutions, using all 3 retirement saving pillars

Population Age Structure (M,F)



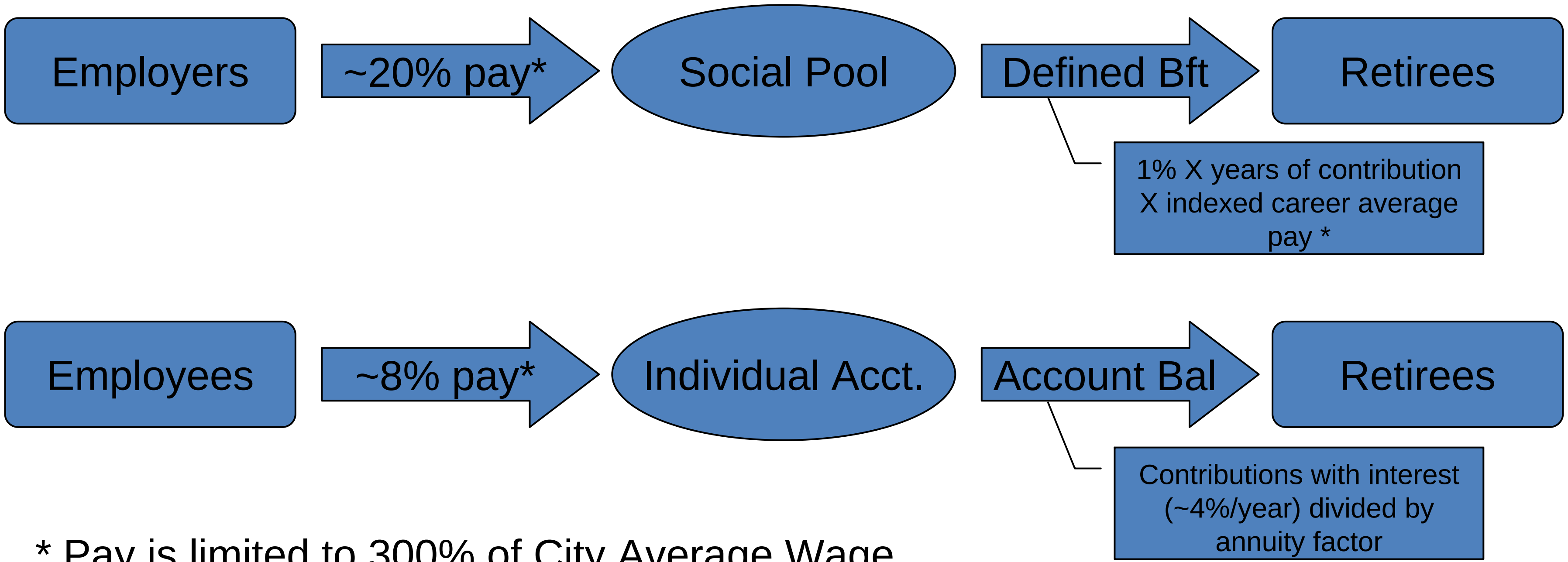




Source: UN Report by Feng and Mason, DEMOGRAPHIC DIVIDEND AND PROSPECTS FOR ECONOMIC DEVELOPMENT IN CHINA, 2005

Social Security

- Current program is less than 20 years old and changes are continuing



* Pay is limited to 300% of City Average Wage

Social Security (cont.)

- Retirement age is generally 60 (males) and 55 (females)
- DB portion is indexed with inflation; individual account balance pays as a flat annuity
- Additional transitional benefits payable to those with service under prior regime
- Satisfactory benefits for low-paid individuals; less than 10% replacement ratio for high-paid

Individual/Family Savings

- High savings rates, even by Asia standards
  - Lack of safety net
  - Cultural tendency
  - Fast increase in incomes
  - Competition for brides!
- How much will be available for retirement?
  - Intergenerational transfers (both ways)
- Typically invested conservatively

Employer-Sponsored Programs

- Important Criteria
  - Tax effectiveness
  - Low Risk
  - High Returns
  - Security (against fraud etc)
  - Flexibility

Market Practice

- About 40% of multinationals in China offer supplemental savings programs (pension, housing, or other)
- Nearly all are Defined Contribution programs, typically providing 7-10% of pay
- Pension programs pay lump sums at retirement or termination; housing and other programs allow in-service withdrawals

Social Security Bureau

- Many plans originally set up to top-up Social Security contributions, and were managed by Social Security bureaux
- After scandal in Shanghai, this practice is prohibited
- Legacy contributions being moved to EA plans

Group Pension Insurance

- No specific tax incentive
- Individual income tax typically applies at contribution
- Design restrictions based on vendor capability, including limitations on in-service withdrawals
- Security provided by well-established insurers
- High level of service quality

Non-EA Trust

- No specific tax incentive
- Fairly new to market and not overly common
- Full flexibility on design
- Individual income tax is sometimes deferred to vesting or distribution

Internal Funding

- Book reserve account, sometimes backed up with a company-owned savings account
- No tax deduction (or liability to employees) until distribution
- Full flexibility on design
- Lack of investment returns and unfunded promise are less appealing to employees

Enterprise Annuity

- "Qualified" pension system in China
  - Employer tax deductions: typically 5% of pay
  - No specific tax advantage for employees
- Plan must go through approval process from employees and authorities
- Must use government-approved vendors (trustee, administrator, custodian, inv. mgr.)

EA: Eligibility and Vesting

- Must be broad-based program
- Can only cover employees in the mandatory social security system – excludes foreigners
- Short vesting schedules (no longer than 5 years) are encouraged and sometimes required

EA: Plan Types and Contributions

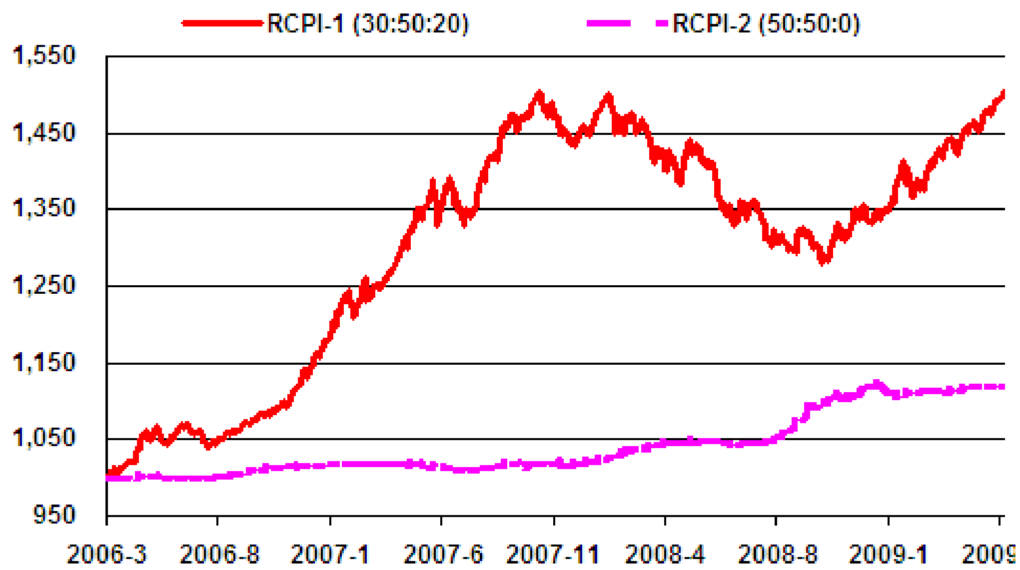
- Fully-funded defined contribution program with individual accounts
- Employee contributions are required (although there is no minimum level)
- Flat rate of pay between 5% and 8% most common
- Some programs are age/service/job level-graded or are matching schemes

EA: Investments

- Allocation restrictions:
  - Up to 50% in fixed income securities
  - Up to 30% in equities
  - At least 20% in money markets
  - No derivatives, private equity, real estate, etc.
  - Domestic Chinese securities only
- Choice of risk/return profile can be passed to individual employees

EA: Investments (cont.)

- Reuters Pension Index for aggressive (RCPI-1) and conservative (RCPI-2) portfolios:



EA: Distributions

- Benefits are payable as a lump sum at retirement, death, total permanent disability, or permanent emigration from China
- Vested account balances (including all employee contributions) transferable to a new employer’s EA plan; or can be kept in current plan as “terminated vested” account (continuing to earn returns but no further contributions)

EA: Taxation

- Specific corporate tax deduction of 5% of total payroll (with some regional variation)
- No guidance on individual income tax treatment
  - Increasing pressure to apply at contribution
  - Investment returns are tax-free
  - Distributions are typically not taxable

EA: Other Design Restrictions

- Several provinces (Shanghai, Shenzhen) limit the employer contribution amount
  - Largest employer contribution must be less than or equal to 3 (Shenzhen: 5) times the average employer contribution to all participants
  - Exception process available, but unclear if matching schemes or even flat rate contributions without caps will be allowed

EA: Prevalence

- By end of 2007, 10 million employees from 32,000 companies had RMB 152b(USD 22b) in EA accounts
- Prevalence in multinational sector still fairly low (about 5%): the tax incentives are too weak to overcome the design restrictions

The Future

- Increase in retirement age?
- Harmonization of policies across China
  - Social security system
  - National EA tax policy
- Aging, well-paid employees will increasingly demand pensions: but in what form?