

Zheng Bingwen Editor in Chief

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Zheng Bingwen

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Abstract

The China Pension Report 2011 is edited chiefly by professor Zheng Bingwen who is a very famous expert on social security issues in China. This report is the issued as the first Book which have an overall review on China's pension system. There are three parts in the book—"Development of Multi-Pillar Pension", "Reformation of Pension Systems" and "Pension Frontier Focus", in which one main report and nine sub-reports are listed.

This report in English language is a translation version of the Chinese book. For time and budget are limited, we just translate six parts of the Chinese book: Main Report, Report I, Report II, Report III, Report IV and Report IX.

The main report has an outlook at multi-layered pension systems in China. The author points out that all kinds of pension funds as well as pension coverage in China have gotten to the best scores in history, and great progress has been made in terms of the sustainability of and affordability of pension systems; however, there are still some issues and challenges obstructing the development of pension system such as the investment of public pension funds, the lack of preferential tax policy on Enterprise Annuity, and the underdevelopment of "Social Security Fund (SSF)" and commercial pension insurance etc.

The part of "Development of Multi-pillar Pension System" is comprised of four sub-reports—"Public Pension", "Enterprise Annuity", SSF and "Commercial Pension Insurance". In this part, pension coverage, pension revenue and payment, as well as the management and investment of pension funds are analyzed with detail data. Also, the trends of pension reform in future are illustrated by the author.

Two sub-reports in the part of "Reformation of Pension System" focus on the relationship between European debt crisis and pension reform. Taking Greece as an example, the author argues that the "cost of ageing" has been one of the major factors triggering European debt crisis in which lots of lessons could be drawn for China's pension reform.

The part of "Pension Frontier Focus" tracks on the news about pension reforms within and beyond China, and summaries the arguments and standpoints regarding global pension market.

Preface I

Dai Xianglong

Chairman of National Council
for Social Security Fund

At present, China's pension funds are composed of Basic Social Pension Insurance Fund, National Social Security Fund, Enterprise Annuity Fund and Commercial Pension Insurance Fund. The Chinese people are paying more and more attention to the collection, investment operation and use of all kinds of pension insurance fund. It has become an important part of the national macroeconomic policy and social wealth distribution to improve the National Social Insurance System and ensure a long-term balance between its contribution and distribution. Under such circumstances, Chinese Academy of Social Science decides to compile and publish annually *China Pension Report (CPR)*, both in Chinese and English, from this year. It is really a work of great significance for the CPR to release to the public the investment and operation status of the above-mentioned pension insurance funds, and the National Council for Social Security Fund will render its full support and cooperation to this effort.

Since late 1990s, the Chinese government intensified its effort to the reform of the management system of State-Owned Enterprises (SOEs), many workers were laid off or re-employed, whose pension, reemployment and subsistence security had become a salient problem. Against this backdrop, on August 1, 2000, the Central Committee of the Communist Party of China and the State Council decided to establish the National Social Security Fund (NSSF), and at the same time, the National Council for Social Security Fund (NCSSF) for the investment and management of NSSF's assets. The then-Premier Zhu Rongji and Mr. Wen Jiabao, the current Premier as well as the Vice-Premier in charge of NSSF all attach great importance to the expansion of NSSF and the NSSF's value protection and increment. The State Council appointed some current and former state leaders, senior ministers and representatives from different provinces as directors of NCSSF. The relevant ministries such as the Ministry of Finance and the Ministry of Human Resources and Social Security had also granted strong support to NCSSF. By the end of 2010, the total amount of assets under management of NCSSF reached RMB 856.8 billion. Among them, NSSF's equity capital was valued at RMB 781.1 billion, the individual accounts fully-funded by central budget subsidy and entrusted by some provinces to NCSSF's management valued at RMB 56.6 billion. During its 10-year operation period, NSSF had achieved accumulated investment proceeds of RMB 277.1 billion, with an average annual investment yield of 9.17%, which beat the average annual inflation rate of the corresponding

period, which was 2.14%, by more than 7%.

The social security includes social insurance, social relief, social welfare, special care and placement system. The NSSF established in 2001 is focused on coping with the shortfall between the income and expenditure of the social pension fund when the aged population reaches its peak. So literally, the name "National Social Security Fund" is too broad to reflect the main purposes of the fund. We have considered to change its name to "National Social Insurance Fund" or "National Social Pension Insurance Fund" while drafting *The Rules on the National Social Security Fund*. After rounds of consultations with all relevant parties, we hold that its name doesn't have to be revised as it has been used for 10 years, rather, we can clarify in certain clause that the NSSF is NOT established with a purpose to cover all the aspects of the social security system, but to cope with the shortfall between the income and expenditure of the social pension fund when the aged population reaches its peak.

Mr. Liu Zhongli and Mr. Xiang Huaicheng, both of whom used to be the Minister of Finance, served as SSF's first and second Chairman, and at present, I have been taking this post for 3 years and a half. All the three sessions of the Board conscientiously performed their duties and have made some contributions to the fund's value protection and increment. As for how to improve the social pension system and promote the establishment of a Harmonious Society, I had put forward some suggestions on how to enhance the pension security.

Firstly, the funding of NSSF should be institutionalized. At present, urban employees pay 8% of their wage to the pension every month and establish individual accumulated accounts, while the employers pay 20% of the total amount of wage and the government establishes the basic pension pooling account (PAYG). Nevertheless, the pooling account has more expenditures than income and has to take the fund in the individual accounts to bridge the gap. Although there is no shortfall for the pension fund on the whole, this practice doesn't accord with the reform direction which is to combine social pooling with individual accounts. I am of the belief that we should estimate the size of the gap between income and expenditures of the social pooling account in the coming 10 and 20 years. The estimation can serve two purposes. First, to promote for

more funding and expand the scale of the fund. Second, to adjust the institutional arrangement of the contribution and distribution of pension fund so as to make its payment more sustainable to avoid a huge gap in the future and ensuing social unrest. The social security system in Europe has gone far beyond its economy's growth potential. It entails the European countries a long-term sluggish economy growth and even resulted in social unrests in some countries. We have to draw lessons from this. Therefore, I suggest that we should have estimation on the size of the gap between income and expenditures of the basic social pension insurance fund in 10 years, 20 years and 30 years, meanwhile, the NSSF should have a 5-year financing objective and an annual budget allocation from the central government.

Secondly, the investment and operation of the basic pension insurance fund should be promoted steadily. As of December 31, 2010, the total surplus of the basic pension insurance fund managed by local governments reached RMB 1.5 trillion, 90% of which was deposited in banks, with an average annual investment yield of less than 2% in the last 10 years, lower than the average annual inflation rate of the corresponding period. According to the stipulations of *The Social Insurance Law of the People's Republic of China*, the basic pension insurance fund is permitted to invest in accordance with the State Council's stipulations. The Twelfth 5-Year Plan put forward the concept of 'steadily promote the investment and operation of the pension fund', and the direction of the structural reform of investment management of the basic pension insurance fund is to have its portfolios diversified, its mandated investment market-oriented and its supervision institutionalized. To this end, I suggest a 2-phase plan as follows: the First Phase includes measures that could be taken within this year. i). The state treasury could issue directed Treasury Bonds to the basic pension insurance fund with a yield 1 or 2 percent higher than bank deposits. Local governments are permitted to use these Treasury Bonds to finance from the state treasury or market in case of temporary shortfall of its fund. ii). With the approval of the State Council, those provinces with relatively more pension insurance fund surplus should be allowed to entrust NCSSF with part of its assets while a investment yield same to the yield of bank deposits of the corresponding period should be

promised. The Second Phase includes measures that could be taken in the next 2 years. One is to formulate regulations on investment of basic pension insurance fund including rules on crucial issues such as the proportional limits for various investment categories, for example, fixed income investment, stock investment and unlisted equity investment, etc. The central government could entrust either NCSSF or a specially created investment management corporation to manage the investment of the basic pension insurance fund. The investment of enterprise annuity which is a supplement to pension fund, could be entrusted to sophisticated asset management institutions through selections.

Thirdly, the administrative structural reform of NCSSF should be promoted progressively. When established, NCSSF was defined as a public institution at the ministerial level directly under the State Council which applies the same human resources and wage system as other administrative units. Nevertheless, as its core responsibility is to manage and operate NSSF, it is an asset management company in nature and its organization structure is similar to asset management companies. At present, NCSSF has a staff of 180, 75% of whom have master degrees or above, about 40 of them have been trained or worked abroad, and we have a big team of professionals who

have more than 5-years' investment working experiences. Along with the continuous expansion of NSSF's size and investment scope, the contradiction between NCSSF's legal status as a public institution and its de facto function as an asset management company is becoming more and more prominent. I suggest the central government and relevant departments carry out a unified research and work out a plan for the investment management system reform of both the national basic pension insurance fund managed by local governments and the NSSF financed by the central government.

The above-mentioned problems are rather more prominent in the current management system of pension fund and have drawn close attention of the leaders' of the State Council and relevant departments. I am confident that the problems will be progressively solved and I am convinced that China's social security system will be further perfected; the capability and standard of social pension security will be improved continuously.

October 15th 2011

Preface II

Wang Weiguang

Executive Vice President of
Chinese Academy of Social
Sciences

During the past over 30 years, thanks to the reform and opening up, China has achieved swift economic growth that attracted worldwide attention. As a large developing country, China still faced certain problems in economic and social development, such as low per capita income, unfair distribution of income, and big gap between the living standards of urban and rural residents. Facts have proved that the social security system is of great importance to easing of social issues and sustainability of economic growth. The year 2010 was an important turning point for China's economic development and modernization drive. After entering the list of upper-middle income countries with per capita income of more than USD4,000, the country will be afforded an unprecedented opportunity of turning into a high-income country over the next 10 to 20 years. During this period, establishment and improvement of social security system is crucial to guard against falling into the "middle-income trap" and achieve the transformation of economic growth and social development mode.

Since the reform and opening up, China has achieved remarkable progress in the development of social pension system with the economic and social restructuring. In 1990s, the country put forward and defined an objective of establishing a multi-level social security system in tune with the reform of state-owned enterprise; in 2006, the Sixth Plenary Session of the 16th CPC Central Committee deemed the development of social security system as an important part of fostering a harmonious society, and set forth a strategic objective of basically constructing a social security system covering urban and rural residents by 2020. In 2007, the 17th National Congress explicitly called for speeding up the building of a social security system covering urban and rural residents. In 2009 and 2011, the implementation of two pilot projects of old-age insurance systems for rural and urban residents greatly extended the coverage of China's urban and rural social security system. So far China's social old-age insurance system has basically taken shape with social old-age insurance holding a dominant position, supported by enterprise annuity system and commercial pension insurance. Despite the achievements above, we should not overlook the difficulties and challenges in China's old-age security undertaking, such as aging of population, limited coverage, insufficient security and inconsistent systems, which should be further studied and solved.

Under the backdrop, the Centre for International Social Security Studies (CISS) at Chinese Academy of Social Sciences (CASS) published the *China Pension Re-*

port, outstanding works on promoting the study of China's social security system and sharing of information resources.

Pension is an important component of the social security system of each country, pension study is a permanent research subject, and pension economics is a branch of learning emerging and tending to be mature. It is known that the sovereign debt crisis in Greece which triggered the European sovereign debt crisis cast a shadow over the global economic recovery. One of the major inducements is the pension issue. To this end, pension study is of great importance since it bears upon not only the national economy and the people's livelihood but also the momentum of development. Particularly for China, it is quite important to select a correct pension development mode in line with the country's practical situations.

CASS, as the think tank and brain trust of the CPC Central Committee and the State Council, is committed to developing China's philosophical social undertaking, deeply studying social practical issues and providing intellectual support for economic and social development. The Sixth Plenary Session of the 17th CPC Central Committee which was just dropped the curtain pointed out that we should place equal emphasis on fundamental research and application research, and on traditional discipline, emerging discipline and interdisciplinary, and cultivate the philosophical social sciences with Chinese characteristics, traits and styles, in line with the China's practical situations and characteristics of the times. The session also proposed to focus on major practical questions, enhance study of overall, strategic and forward-looking issues, expedite the industrialization and commercialization of philosophical social scientific payoffs, and better serve the economic and social development.

In order to strengthen the academic research and think tank construction in respect of social security undertaking, CASS set up the Center for International Social Security Studies in 2010, in a bid to give play to our comprehensive advantages in talent resources and scientific research, and provide theoretical research, policy analysis and information consulting services for China's social security reform. Over the past more

than one year from its inception, the Center scored remarkable achievements, held many academic workshops and undertook the research subjects assigned by national ministries, commissions and relevant institutions. The *China Pension Report* is an annual pension undertaking development document launched by the Center for the first time. It is a "knock-out" product of the Center and a significant report adopted by CASS in the innovation of philosophical social sciences. Over the past years, the series of economic and social development reports published by the Academy have become an important academic dissemination platform of the social science circle and a renowned brand of the Academy, and won wide acclaim from the academia, peers and people of all circles. From this year, the Center will publish a pension development report on an annual basis. As a kind of the series papers, it will further enrich the Academy's scientific research products, and contribute to the research and information sharing of China's old-age security undertaking.

This report is a comprehensive work revealing the overall situations of China's old-age security undertaking and pension fund market. Boasting true materials and overall data, the report summarized and analyzed the basic facts of China's pension system development in 2010, and envisioned the development prospect of the industry. Meanwhile, this report objectively and faithfully probed into the issues and restrictions that China's pension industry is confronted with, and set forth ideas and views on solving such issues. We hope to develop the *China Pension Report* into a well-known brand to serve the government departments, academia and the pension industry.

As a rewarding attempt, the report tries to have a deep focus review on the development of China's pension system for the first time, and it is by no means perfect. CISS CASS is looking forward to cooperations and supporting from the public society and making greater contributions to the development of China's pension system.

November 20th 2011

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Main Report

Promoting Pension Reform: Opportunities and Challenges for China

—Analysis on Pension Reform under European Debt Crisis

In 2010, the accumulated amount and the coverage of China's various pension funds reached a record high, and system sustainability and affordability improved remarkably. However, owing to the system design and absence of policy, there were many issues posing severe challenges to the country's pension system.

Over the past less than one year, European debt crisis has exacerbated, leading to the frequent political unrest and the resignation of prime ministers of four countries. Brian Cowen, the former prime minister of Ireland who just took office for less than two years, was the first one leaving his office; later on, Portuguese Prime Minister Socrates stepped down after vetoed by the Parliament. Papandreou, the former Greek prime minister, was finally replaced by Papademos, a senior economist and former vice president of European Central Bank, after many rounds of economic bail-outs failed. Several days later, the European debt crisis spread to Italy, forcing Italian Prime Minister Silvio Berlusconi to hand in his resignation, and President Napolitano nominated Mario Monti, a prestigious economist and former member of the European Commission in charge of competition affairs, to form an interim administration.

In these countries, particularly Greece and Italy, their

bail-out plans for the debt crisis all included a list of pension reform. If the debt crisis is the last straw resulting in the resignation of the four prime ministers, pension must be the last triggering factor for the debt crisis. So to say, pension is vital to the national well-being and the people's livelihood. In response to the European debt crisis and the political turbulence of the afore-said four countries, it is a thought-provoking problem on how to draw upon the lessons of Europe for China's pension reform.

I. The Fast-growing Basic Pension Funds are Bittersweet and the Reasons Should Draw Close Attention

The coverage of basic pension system was further extended, but the compliance rate declined year by year, and the number of abnormally retired persons kept increasing, which were two phenomena detrimental to the financial sustainability; the financial affordability of pension funds was enhanced as never before, but the expenditure growth rate was higher than that of income, the trend of interregional disequilibrium gradually aggravated, and fiscal subsidies were getting larger.

1. The coverage of urban basic pension system continued to extend, fund collection income grew steadily, compliance rate gradually declined, and the number of abnormally retired persons tended to go up

As of the end of 2010, the number of people participating in the urban basic pension system reached 257.07 million^①. Among them, the number of enterprise employees was 185.27 million (an increase of 15.05 million or 8.8% over the previous year), accounting for 72% of total; the number of employees of public service organs and undertakings institutions was 20.73 million (an increase of 0.9 million or 4.5% over the previous year), accounting for 8% of total; the number of individuals was 51.07 million (an increase of 5.62 million or 12.4% over the previous year), accounting for 20% of total. The dependency ratio of basic pension system was 32.5%, i.e., the number of employees making contribution was 194.02 million (an increase of 16.59 million or 9.4% over the previous year), accounting for 75% of total, and that of retirees was 63.05 million (an increase of 4.98 million or 8.6% over the previous year), accounting for 25% of total.

During the 11th Five-Year Plan period, the coverage of urban basic pension system continued to extend. The number of enterprise employees of business sector participating in the system kept growing, with an annual growth rate of 7.7%, 8.5%, 10.2%, 7.5% and 9.9%; and the number of retirees participating in the system grew continuously, with an annual growth rate of 5.8%, 7.2%, 7.1%, 9.9% and 8.7%.

There were two changes in the basic pension system during the 11th Five-Year Plan period should draw our attention: first, the compliance rate (the proportion of people making contribution in total people participating in the system) tended to decline year by year—90.0%, 89.9%, 89.5%, 87.7% and 86.5% respectively, of which, the rate in 2009 and 2010 dropped largely owing to the increasing enterprises in difficulty caused by financial crisis. Second, the proportion of abnormally retired people in total retirees was on a linear decrease, but the absolute number tended to go up, i.e. 22.3% (630,000 persons), 20.5% (740,000 persons), 20.1% (850,000 persons), 15.6% (860,000 persons) and 12.5% (670,000 persons) respectively from 2006 to 2010. Obviously, the decline in compliance rate and the rise in the number of abnormally retired

people were not beneficial to the financial sustainability of pension funds.

2. The financial sustainability of pension improved greatly and financial affordability stepped up year by year, but the growth of total expenditure on pension funds was higher than that of total income and interregional disequilibrium was rather severe

Due to the expending coverage and increasing scale of financial subsidies, the basic pension funds has recorded the fastest growth rate during the 11th Five-Year Plan period, with the financial affordability stepped up year by year, and the average number of fund availability months in China increased from 13.6 in 2006 to 18.6 in 2010; the growth rate of collection revenue was 22.3%, 25.3%, 25.1%, 19.8% and 17.1% from 2006 to 2010, and reached a record high in 2007.

In 2010, the total revenue and expenditure of basic pension fund (including public service organs, undertakings institutions, enterprises and others, the same below) reached RMB2,397.5 billion, of which the total revenue, the total expenditure, the current balance and the cumulative balance stood at RMB1,342 billion, RMB1,055.5 billion, RMB286.5 billion and RMB 1,536.5 billion respectively. Among total revenue, the collection revenue, financial transfer subsidies, interest income and other revenue were RMB1,111 billion, RMB195.4 billion, RMB27.4 billion and RMB8.1 billion respectively. Among the contribution revenue, regular contributions were RMB980.8 billion, and irregular contributions were RMB130.2 billion; among the irregular contributions, advance contributions were RMB7.6 billion, contributions made retroactively were RMB100.8 billion, liquidation of arrears was RMB20.4 billion, and other contributions were RMB1.4 billion. Among total expenditure, expenditure of basic pension fund of business sector was RMB941 billion, accounting for 89.15% of total, and that of undertakings institutions and public service organs was RMB114.5 billion, accounting for 10.85% of total.

The total fund expenditure increased RMB166.1 billion or 18.68% in 2010 over the previous year, faster than the total fund income (i.e. 16.79%) in the same period. Compared with 2006, the expenditure of basic pension fund of business sector increased RMB512.3 billion, with an average annual

① The section is excerpted from Report I : Management and Investment of Public Pension Funds of the book.

growth of 21.9%. Compared with 2009, it rose RMB152.3 billion or 19.3%. The main reasons for the increase in the expenditure of basic pension fund of business sector in 2010 are as follows: first, due to the upward change of pension standards, the monthly pension per capita of retirees increased RMB137 over the previous year and reached RMB1,362, leading to an increase in the pension expenditure of RMB81.9 billion, 53.8% of total growth of pension expenditure in 2010. Second, the number of retirees increased 4.43 million over the end of the previous year, leading to an increase in the pension expenditure of RMB66.2 billion, 43.5% of total.

However, the situation of each province differed greatly: if excluding the financial transfer subsidies of RMB195.4 billion, a total of 17 provinces recorded collection revenue of basic pension of business sector higher than fund expenditure, with the current balance of RMB65.7 billion merely, and the revenue of 15 provinces (including Xinjiang Production and Construction Corps) fell behind expenditure, with a gap of RMB67.9 billion.

The serious interregional disequilibrium should be attributable to not only the interregional economic disequilibrium, but also the big problems in system parameters and appearance of potential financial risks despite the continuously expanding coverage. The pension funds in some regions even could not survive without financial transfer subsidies. The situation should draw close attention from the policy-makers.

3. New rural pension pilot projects developed smoothly and rapidly, but funds faced the pressure of preserving and increasing the value and there were development disparities among regions

In September 2009, the State Council promulgated the *Guidelines for Promoting New Rural Pension Pilot Project*. A total of 838 counties (cities, districts and banners) of 27 provinces and autonomous regions and some districts and counties of four municipalities directly under the central government had carried out the pilot project by the end of 2010, and the number of people participating in the new rural pension system reached 103 million, of which the number of people enjoying the new rural pension benefits stood at 28.63 million, accounting for approximately 27.85% of total; the proportion of people enjoying benefits in insurance participants in

each province differed largely, the highest was 82.65% in Tianjin, and the lowest is merely 10.53% in Beijing.

In 2010, the new rural pension fund registered revenue of RMB45.3 billion (including individual contributions of RMB22.5 billion) and expenditure of RMB20 billion, with a considerable cumulative balance of RMB42.25 billion. Among them, two problems should draw attention. First, in the face of the continuously accumulated fund balance, the pressure of preserving and increasing the value of funds became increasingly great due to the lagged investment system. Second, as viewed from the cumulative balance, the cumulative balance differed greatly in each province: the cumulative balance in Beijing, Jiangsu and Shandong was approximately RMB5,722 million, RMB5,393 million and RMB5,266 million, accounting for 38.77% of the whole country's cumulative balance in total; the cumulative balance in Tianjin was about RMB3,642 million, and that in Shanghai, Henan, Sichuan and Hebei ranged from RMB2 billion to RMB3 billion; the cumulative balance in Tibet, Ningxia, Gansu and Hainan was less than RMB100 million.

II. Enterprise Annuity has been Sizeable but the Absence of Policy was Serious and did not Draw Much Attention from the Policy-makers

1. Enterprise annuity fund made profits in 2010 despite the volatility and decline of stock market

Enterprise annuity fund investment and management business performed well in 2010. Shanghai Composite Index dropped 14.31%^① in the year due to the European debt crisis, implementation of domestic real estate control policy and anti-inflation measures and pessimistic anticipation on economic slowdown. In the face of the sluggish stock market, most enterprise annuity fund investors increased the position of fixed income assets while reducing that of equity products, revealing their flexibility and prudence in making investment in line with the market changes. Enterprise annuity fund gained profits in 2010 amid the harsh conditions. According to statistics, all the 21 enterprise annuity fund investors were profitable in 2010, with a weighted average return of 3.41%. Among them, the top five investors registered the weighted average return of 8.95%, 8.18%, 7.40%, 5.83% and 5.62% respectively. The accumulat-

^① The section is excerpted from Report II: Management and Investment of Enterprise Annuity Fund of the book.

ed annualized return of all investors was up to 6.06%. Judging from individual portfolios, among the 991 annuity portfolios with annual weighted average return in 2010 available, 915 portfolios were profitable, accounting for 92.33% of total, and 76 portfolios suffered losses.

2. Market concentration falls within reasonable range in view of the limited overall market scale

Based on the Chinese enterprise annuity market concentration index prepared by Chinese Academy of Social Sciences Center for International Social Security Studies, the trustee market, account administrator market, custodian market and investor market basically maintained increasingly intensified and benign competition from 2008 to 2010:

—The trustee market concentration index quickly dropped from 201 points in 2008 to 162 points in 2010, indicating that the competition on the trustee market is being intensified.

—The account administrator market concentration index was the highest among these submarkets, which reached 280 points in 2008 and dropped to 270 points in 2009 and 2010.

—The custodian market concentration index was relatively high among these submarkets, which reached 234 points in 2008, rapidly dropped to 209 in 2009 and slightly rebounded to 216 in 2010.

—The investor market concentration index was the lowest among these submarkets, and kept dropping to 82 points in 2010 from 92 points in 2008, indicating that the market competition was continuously intensified.

In consideration of the extremely limited scale of China's enterprise annuity market, we deem that the relatively high concentration indices are quite reasonable. On the contrary, it should be noted that the limited scale of enterprise annuity market, instead of sufficient market competition that led to low base amount (unlikely to break even) of investors, was the very reason why each investor underperformed the market currently. Accordingly, in order to fill the business gap of enterprise annuity investor, it is necessary to accelerate the development of China's enterprise annuity and expand the total scale of enterprise annuity market as soon as possible.

3. The development of enterprise annuity has been far behind that of basic pension

In a broad sense, China's enterprise annuities have marked a development of over 20 years since the establishment of enterprise supplementary old-age insurance system in 1991. In a narrow sense however, China's modern market-oriented enterprise annuity investment management system was formally established after the two trial measures were implemented in 2004. Over the past seven years, the legal system and system framework of enterprise annuity were gradually formed and improved with a continuous expansion in fund coverage and scale and improvement of market position, and the average annual compound growth of the number of enterprises and employees covered by enterprise annuities and the scale of funds reached 11.50%, 8.48% and 32.55% respectively.

The enterprise annuity system, as an important part of multi-level old-age security system, can fill the relative deficiencies of social basic pension insurance of urban employees and narrow the benefit gap between urban employees and the retirees of public institutions. Meanwhile, enterprise annuity funds characterized by long term, stability, large scale and pursuit of long-term stable return effectively complement with capital market, promote financial development and long-term social investment, and foster a sound financial environment for the healthy and rapid development of national economy. More importantly, enterprise annuity system helps optimize enterprise remuneration system, improve corporate governance structure, attract and retain talented people and enhance the cohesive force and competitiveness of enterprises.

However, Chinese enterprise annuities have never won corresponding position and assumed the required responsibilities, especially compared with the basic pension insurance, regardless of their pace and degree of development, or the degree of attention and policy efforts have greatly lagged behind the latter. China's enterprise annuity development still had a big gap relative to the country's population and economic scale. For instance, as of the end of June 2011, China has 11,911,600 enterprises, and only 37,100 or 0.31% of them had established enterprise annuity plans by the end of 2010. Take another example, the total capitalization of China's Shanghai and Shenzhen stock exchanges stood at USD4,027.9 billion at the end of

June 2010, equivalent to RMB26.56 trillion based on the exchange rate then (one US dollar vs. RMB6.595). However, the accumulated balance of entire enterprise annuities was merely RMB280.9 billion at the end of 2010, representing 1.06% of the total capitalization of Shanghai and Shenzhen stock exchanges.

4. China did not draw up enterprise annuity tax policy as foreign countries

There are a number of factors that contribute to the serious lag in the development of China's enterprise annuities. Some of these factors relate to systems, e.g. dysfunction and incompatibility of enterprise annuity laws and regulations as well as inconsistency and instability of various policies. Some come from the environment outside systems, for instance, no substantial improvement has been made in the distorted function of the capital market that values financing but neglects investment. Some factors involve supply, for instance, it is not long since the establishment of many enterprise annuity fund management institutions, and their market publicity and business promotion skills need to be enhanced. Some factors concern demand, for instance, Chinese enterprises do not have a strong motivation to set up enterprise annuity plans during the demographic dividend period.

On the whole, the shortage of encouragement in preferential tax policy, the incompatibility of policies and the slow development of enterprise annuity collective plan are the most essential and thorniest issue that restricts the rapid development of enterprise annuity. For instance, the proportion of tax preference that the enterprises can enjoy in the course of contribution is only 5%, but there is no explicit preferential policy available for employees. In contrast, take the US 401K Plan, which was widely publicized by media not long ago, as an example, the maximum contribution of employees in US who have participated in 401k Plan may account for 25% of their salaries. If they do not exceed the stipulated tax exemption limit (the upper limit of annual tax exemption was USD16,500 in 2009. The upper limit for employees aged 50 and above was USD22,000 per annum), all contributions may be deducted from their taxable income, that is to say, making contributions out of the pre-tax salaries; the supporting contributions made by employers (based on voluntariness of employers) are generally 50%

of the contributions payable by employees, or at most 6% of the salaries of employees.

5. China should continue to enhance preferential policy for numerous SMEs to meet their potential demand

The institutional arrangements for collective plans applicable to small and medium enterprises (SMEs) are introduced late, which results in a relatively lagged development in collective plans. China has not formulated any special preferential policy in line with the characteristics of SMEs, greatly restraining the potential demand of SMEs for joining the plans. As to enormous SMEs, they do not have many employees, their enterprise annuity fund scale is small, and they are difficult to solve the issues of relative complicated plan process and high management fees. As a result, some SMEs intending to create annuity plans were rejected.

In Chapter 8 of the *Measures for the Management of Enterprise Annuity Funds* (No.11 Decree) effective on 1 May 2011, there is a general requirement for the promotion of development of collective plans. The *Notice on the Issues Concerning Pilot Program of Enterprise Annuity Collective Plans* (R.S.B.F. [2011] No. 58) issued by the Ministry of Human Resources and Social Security on 23 May 2011 is of great significance, it sets rules for the existing more than 40 quasi-collective plans, safeguards the legitimate rights and interests of contribution people, eliminates the hidden troubles of fund safety, expands the scope of investment products, and further broadens the coverage of enterprise annuity system. But on the other hand, relevant policies focused on preferential measures for SMEs participating in the insurance and their employees should be formulated as early as possible to meet their potential demand for enterprise annuity and promote the prosperity of standardized collective enterprise annuity product market.

III. National Social Security Fund Performed Well but had a Small Size as a Whole

As a strategic reserve asset to cope with the challenge of population aging, the total amount of assets under the management of National Council for Social Security Fund (NCSSF) reached RMB856.825 billion by the end of 2010^①. Among it, the equity capital of National Social Security Fund (NSSF) was valued at RMB781.057 billion, while entrusted individual

① The section is excerpted from Report III: Management and Investment of "National Social Security Fund" of the Chinese book.

account funds was valued at RMB56.636 billion.

Among NSSF's equity capital, the net amount of fiscal allocation accumulated from 2000 to 2010 was RMB443.7 billion, accounting for 56.81%. The amount of investment proceeds accumulated from 2000 to 2010 was RMB337.357 billion, accounting for 43.19%, with net investment profit of RMB266.157 billion and fund reserve of RMB73.667 billion as well as statements conversion margin of RMB-2.467 billion. Among the net accumulated fiscal allocation, the accumulated central budget allocation was RMB174.836 billion, accounting for 39.4%. Capital or equity assets derived from reduction or transfer of state-owned shares accumulated amount was RMB197.397 billion, accounting for 44.49%, and allocation from the lottery public welfare proceeds was RMB73.116 billion, accounting for 16.48%.

From its establishment in 2000 to the end of 2010, NCSSF had gained a fairly good investment proceeds with an average annual yield of 9.17%, beating the average annual inflation rate of the corresponding period (which was 2.14%) by 7.03%, thus accomplished its task of NSSF's value protection and increments. Compared with the investment benchmark, both the asset allocation and investment managers contributed extra profits. In 2010, the Chinese stock market experienced a downturn; the Shanghai Composite Index declined 14.31% in the whole year. NCSSF again made timely adjustment to its investment policy according to market change, to increase the proportion of stock investment when the stock market was in its bottom. Moreover, NCSSF further optimized its fixed income investment portfolio and increased the proportion of industrial investment. As a result, NCSSF achieved a rate of return of 4.23% in 2010.

In 2009, the State Council put forward the transfer of state-owned shares in the domestic security market, which means that after the old-and-new defining phase of the reform of listing non-tradable shares of listed corporations, all the corporations who has state-owned shares must transfer part of their state-owned shares to NCSSF at an amount accounting to 10% of the total amount of the shares they issued when they carry out the initial public offering, except that there is special regulation by the State Council. With the cooperation of relevant departments, NCSSF has established a fairly standardized

mechanism for the transfer of state-owned shares and the transfer process of the newly-listed corporations has been going on smoothly, while the retrieving part of the transfer also going well. The transfer of state-owned shares sets up a stable financing source for NSSF and it is estimated that NSSF could draw RMB20 billion to 30 billion annually from this in the future.

IV. Commercial Pension Insurance has Played an Increasingly Important Role and Relevant Policies should be Continuously Improved

Commercial pension insurance is an important component of China's old-age care system, and plays a critical role in China's multi-pillar, multi-level old-age care system. At the level of basic pension insurance, commercial insurance can provide actuarial expertise and management support for social insurance, increase efficiency, and relieve fiscal pressure on government; at the level of enterprise supplementary pension insurance, commercial insurance can provide services for inception, operation and benefit payment of pension plans as a critical component of the social security system. At the level of personal savings-oriented pension insurance, commercial insurance can play a leading role through diverse pension insurance products, make up for the inadequacy of social insurance, and enhance and improve the old-age care system.

As of the end of 2010, China had more than 50^① pension insurance business entities offering hundreds of group annuity and individual annuity products, including traditional fixed annuities, participating and universal annuities with guaranteed minimum returns, and unit-linked annuities without guaranteed minimum returns.

In recent years, pension insurance kept growing rapidly. Premium incomes from pension insurance grew from RMB31.6 billion to RMB121.5 billion by an average annual rate of 16% between 2001 and 2010, and a year-on-year rate of 41% in 2010.

In 2010, premium incomes from group annuities totaled RMB32.5 billion, up 20.2% on a year-on-year basis, accounting for 21% of all the annuities. The size of group annuities grew sharply in comparison with 2009, but has kept declining since 2005. In 2009, the size was only RMB27 billion, below that in 2003. The size of group annuities declined mainly due

① The section is excerpted from Report IV: Operation of Commercial Pension Insurance of the book.

to the significant crowding-out effect of enterprise annuities on group annuities. In essence, both group annuities and enterprise annuities are enterprise supplementary pension insurance. However, compared with enterprise annuities that enjoy tax preferences, group annuities are gradually losing advantages, and many former group supplementary pension insurance products have changed to enterprise annuities.

The insurance sector had obtained 18 licenses of the 58 licenses in the enterprise annuity market, giving full play to the insurance sector's traditional strengths in scheme consultation and design, service, and prudential investment. Among the 11 legal entities acting as trustees, five pension insurance companies managed RMB103.3 billion in assets, or 70% of the enterprise annuities under fiduciary management; among the 21 investment managers, seven insurers managed RMB113.2 billion in assets, or 46% of the enterprise annuity market.

Looking forward, the commercial pension insurance will have a promising prospect, and there are two main areas of development. The first is to pro-actively seek tax policy support for group pension insurance. Group pension insurance combines fiduciary management, account management and investment management at pension insurance companies or life insurance companies. Therefore, management cost can be lowered. Furthermore, part of the investment risk may be shared by insurance companies under agreements, so that investment risk can be reasonably shared by enterprises, insurance companies and employees. Pension insurance companies should pro-actively develop group insurance, so as to strengthen the second pillar of pension insurance and provide diverse personalized options to satisfy different enterprises and employees' old-age care demands. The second is to seek breakthroughs in personal tax-deferred pension insurance. Personal tax-deferred pension insurance is an important component of the multi-pillar pension insurance system. The practices of deferring income tax at the time of premium contribution to encourage individuals to purchase pension insurance, and setting strict conditions for benefit receipt to ensure accumulation of pension funds, have been adopted around the world. Personal tax-deferred pension insurance can help China cope with population aging, promote harmonious economic and social development, promote balanced development of three pillars for old-age

care, effectively increase people's current consumption ability, and promote stable development of the capital market.

V. European Debt Crisis was Exacerbating and Gave Six Profound Lessons for China's Pension Reform

The European debt crisis, which has lasted for two years due to various factors, should be attributable to the excessive welfare and lavish social security which have made welfare states burdensome. The emergence of aging cost and monetization have become a major factor triggering the crisis and plunged welfare states deeply into debt quagmire.

In May 2010, the IMF and Eurozone decided to provide financial aid to Greece and put forward requirements on its pension system reform^①, including resumption of "special tax" on high-value pension, appropriate raising of the age of female entitled to receive pension, introduction of a mechanism relative to the expected change of life length for the age entitled to receive pension, raising of the age of public servant entitled to receive pension from 61 to 65, setting of an upper limit of 800 euros for the pension received in the 13th and 14th months, setting of an upper limit of 2,500 euros for the pension. cancellation of pension subsidies for Easter, summer vacation and Christmas holidays, etc.

Among all countries in the EU, Greece ranked fourth in terms of public pension expenditure in 2010, which accounted for 11.6% of its GDP, higher than the average of EU countries and the Eurozone. According to the forecast of EU, Greek pension expenditure will make up 24.1% of GDP by 2060, an increase of 12.5%, ranking second among all EU countries.

The replacement rate of basic pension in Greece was up to 95.7%, ranking third in the world, which was quite incommensurate with its economic development. If calculated according to the median of male individual income, the replacement rate went up to 110.3%. Such a converse system design has been incommensurate with Greece's economic development capacity. The average replacement rate of pension in major welfare states in Europe has approached to 60%, which was more than 20 percentage points higher than that in the US (39.4%) but nearly 36 percentage points lower than that in Greece. It is observed that the heavy pension burden is an im

① The section is excerpted from Report V: Pension Reform Trends under European Debt Crisis of the Chinese.