

# MERCER

Human Resource Consulting



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## China Pensions... What's Going On?

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## Today's Speakers

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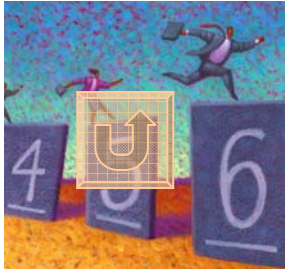


## Today's Agenda

- Setting the Context – Overview of China Marketplace
- The Iron Rice Bowl
- Pension Plans in China



# Setting the China Context



## Setting the Context

### Overview of China Marketplace

- 1.3 Billion People
  - 66% of economy in coastal areas; but, only 30% of population
- GDP USD 1 Trillion; #1 by 2050
- Foreign Direct Investment
  - New focus on value-added services (e.g., R&D)
  - Surging competition
- Labor Market
  - Abundant supply of low costs labor, but difficult to find talent
  - Year over year salary growth rates begin to accelerate
  - Rising business costs - little pricing power



## Setting the Context

### Overview of China Marketplace – Historical Influences

- Economic environment
  - GDP averaging 8% to 9% for the last 20 years
  - Inflation – <2% estimated for 2006; continue to decrease
  - Unemployment – 4.6% per official statistics (urban)
  - Salary increases averaging between 7.5% to 8.0%
  - Limited capital markets
- Demographic factors – the “one” child policy
- Geographic implications
  - Labor market varies city by city
  - Greatest demand in 2nd tier cities



## Setting the Context

### Overview of China Marketplace...What do we hear?

***How do we...  
get,  
develop,  
retain  
the talent we  
need to meet  
our growth  
targets?***

- Which interventions will help?
  - Is pay the only answer? or, can benefits be used?
- How can human resource programs be designed to:
  - support both short- and long-term talent needs
  - be sustainable in the long-term
  - provide consistency and internal equity
  - respond to employee preferences
  - bolster growth and recognize performance differences
- How do we address regulatory, political and cultural differences and provide effective governance?



# The Iron Rice Bowl



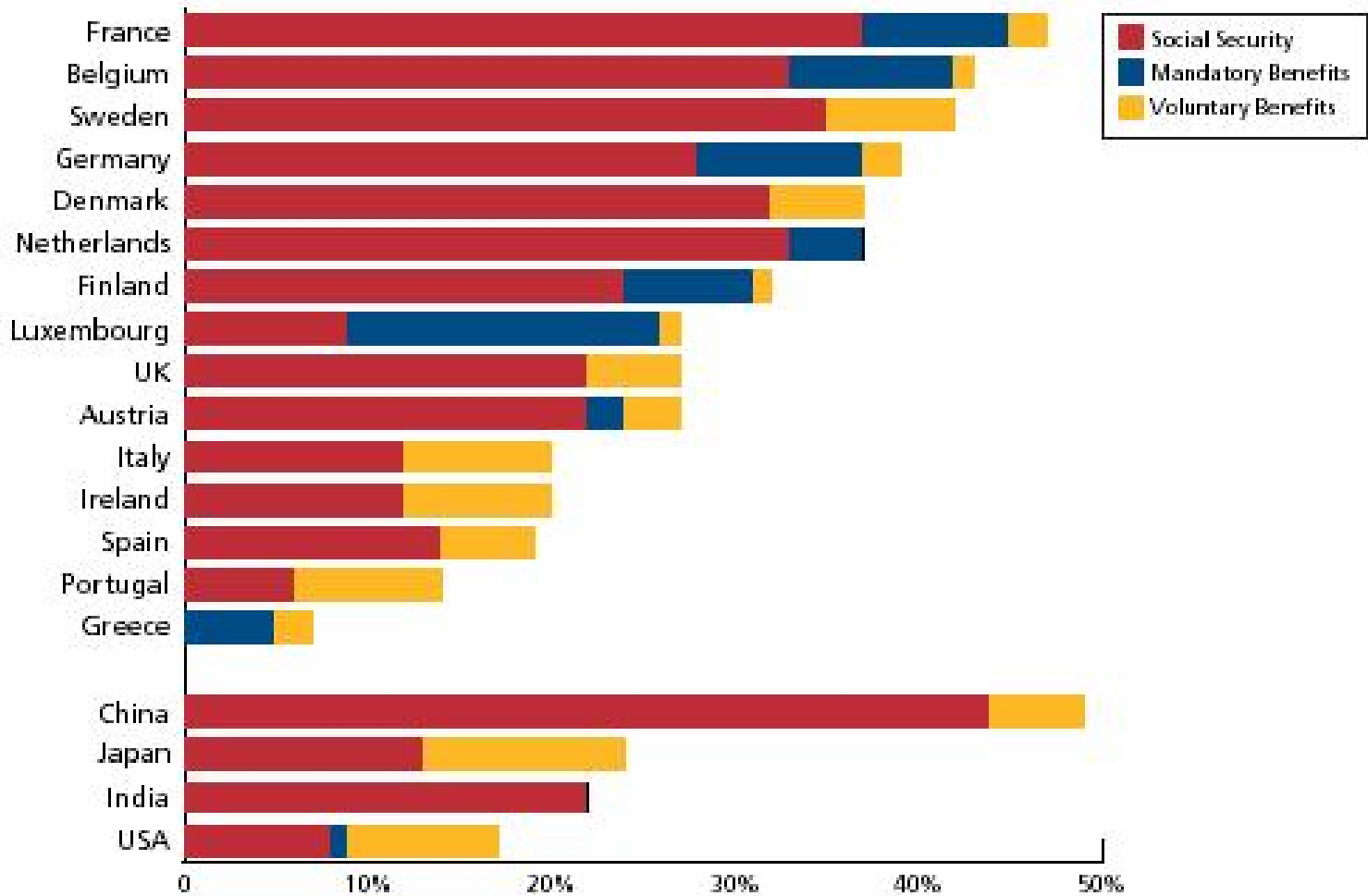
## Social Security System Background

### The Iron Rice Bowl in the 1950, 1960, and 1970

- State-owned enterprises were responsible for all their employees' salaries and benefits - cradle to grave provision
- After retirement, employees received a generous pension of 80% of final salary (based on years of employment and final salary at retirement)
- No funding: pay-as-you-go system (i.e. current work force paid for retired employees)
- Other benefits:
  - Medical care,
  - Education,
  - Life-long security,
  - Housing and transport subsidies

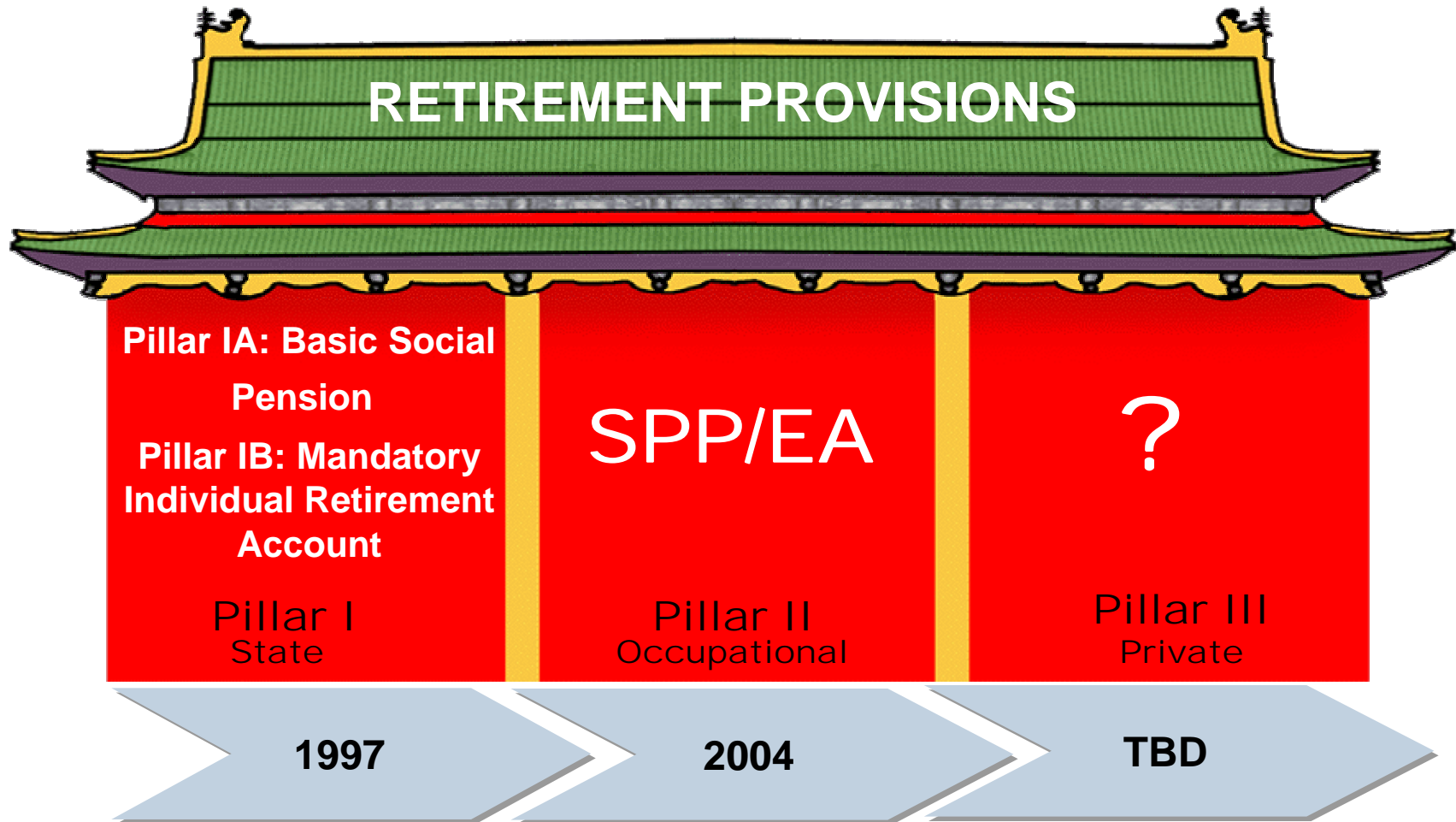


# Benefits Contribution as Percent of Pay





# Three Pillars of Retirement Savings Concept State Council Document No.26 (1997)





## Issues with Government Pension Provision

- Compliance:
  - Some state-owned enterprises have difficulty in complying with contributions
- Funding:
  - Pillar I (pay-as-you-go system) resulted in unfunded liabilities
  - Although Individual Accounts and Pooled Accounts were supposed to be separate funds, some provinces combined them
- Misappropriation
  - Shanghai Pension Scandal



# The Shanghai Pension Scandal



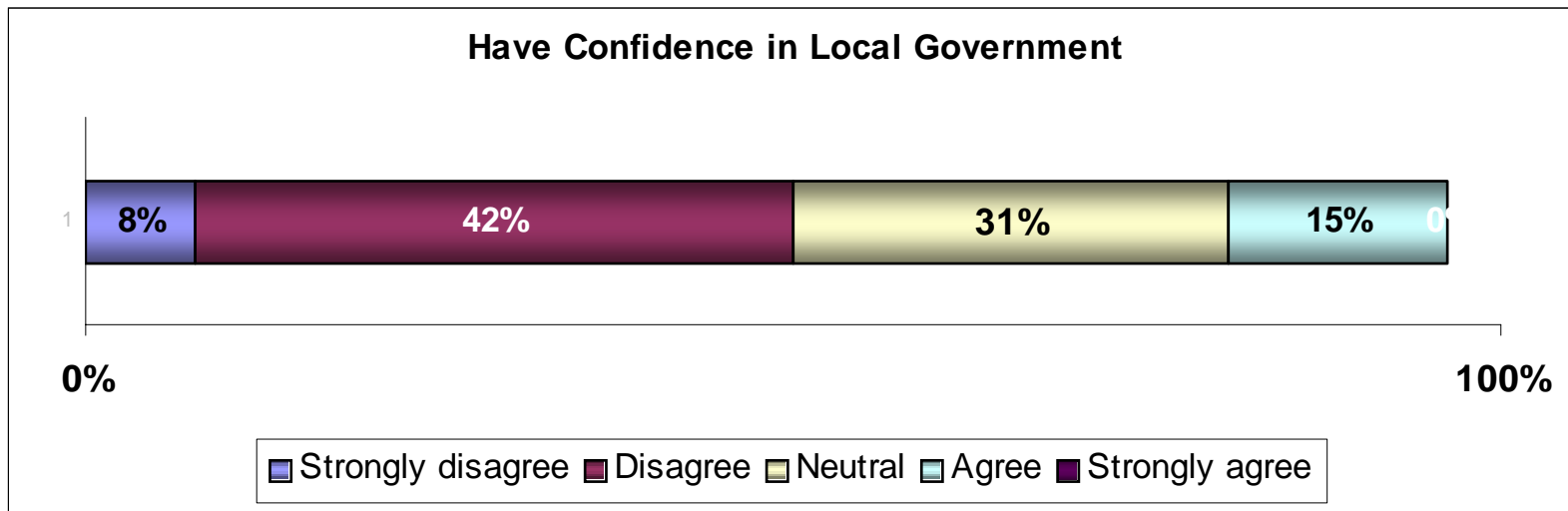
## Shanghai Pension Scandal

- SEADC is the largest government-managed supplementary pension fund in China
- US\$400 million pension fund misappropriated, representing 1/3rd of SEADC total supplementary pension assets
- Ramifications: pension and political
- Multinationals must act before 12/31/2007



# What Impact Will Scandal Have on the Pension Market?

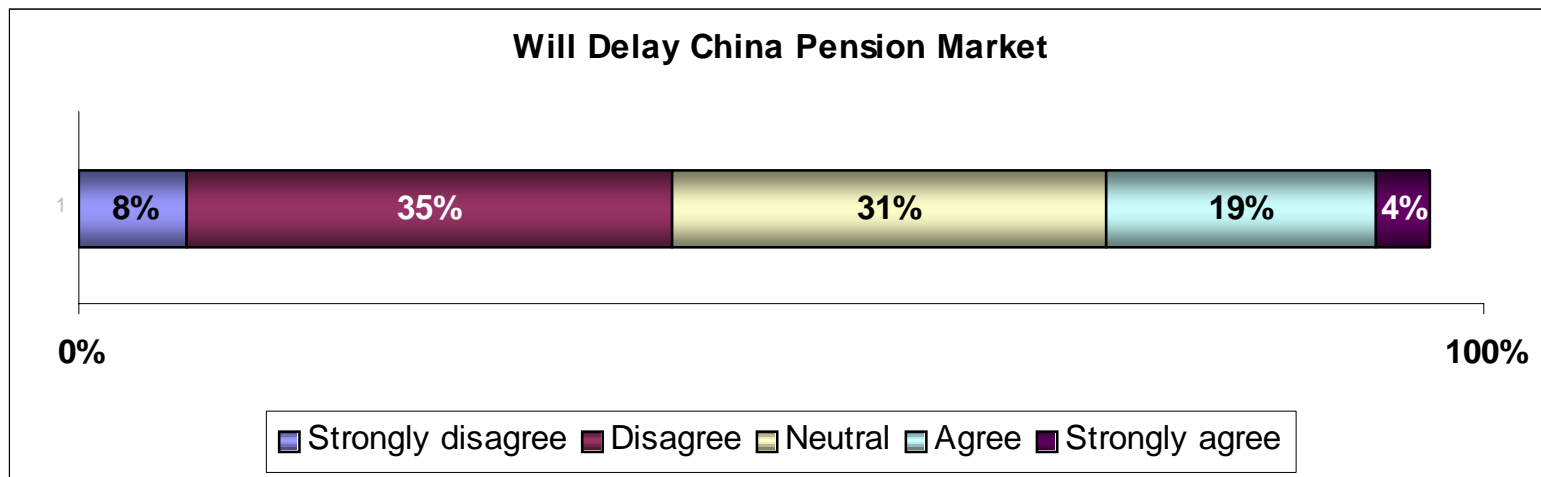
- Less than 20% of surveyed companies remain confident in the local government (i.e. SEADC) to manage their pension assets





# What Impact Will Scandal Have on the Pension Market?

- Most of surveyed companies do not agree the scandal will delay the development of China pension market





## Impact of MoLSS New Policy No. 34

- In September 2006, Ministry of Labor and Social Security (MoLSS) issued a policy whereby it
  - Prohibits local labor and social security bureaus (i.e. SEADC) from accepting supplementary pension contributions
  - Requires all local labor and social security bureaus transfer existing supplementary pension funds to licensed Enterprise Annuity (EA) providers by the end of 2007
- Policy was issued aiming at SEADC misappropriation of supplementary pension funds
- Companies are required to take transition actions with existing supplementary pension fund by 2007
- MoLSS and SLSSB are formulating transition guidelines
  - Expected by first quarter of 2007

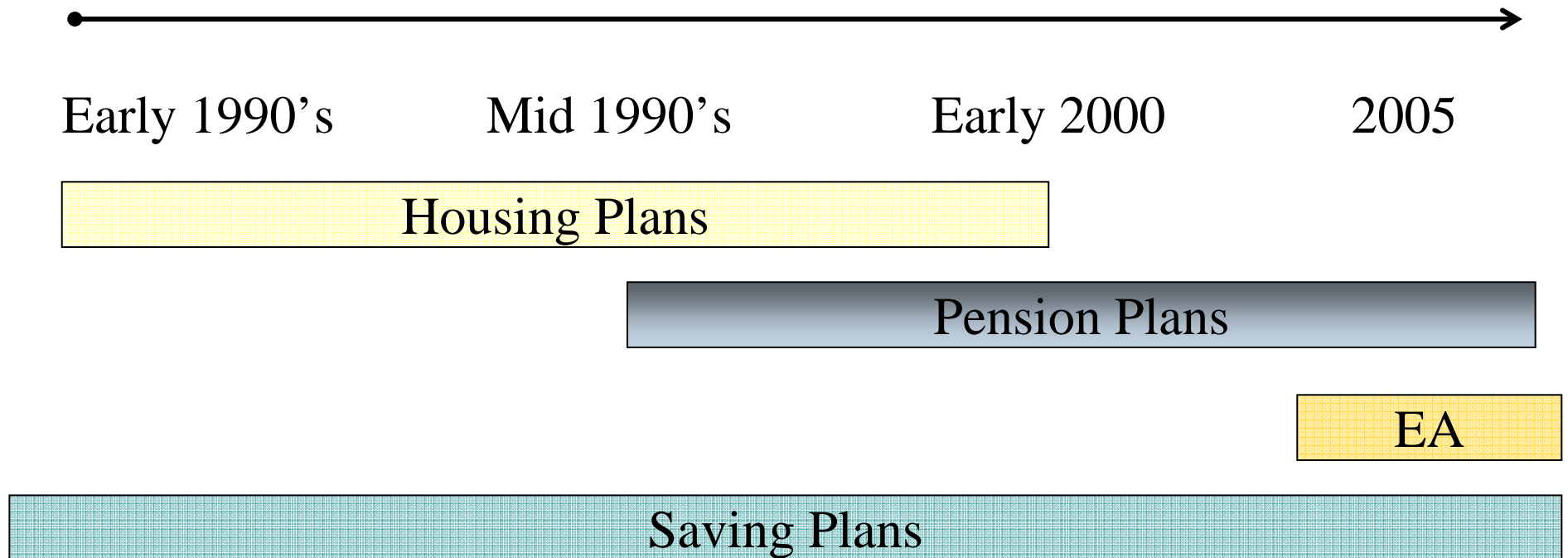


# Supplementary Pension Plans in China



# What do Saving Plans in China Mean?

## Evolution of Saving Plans in China

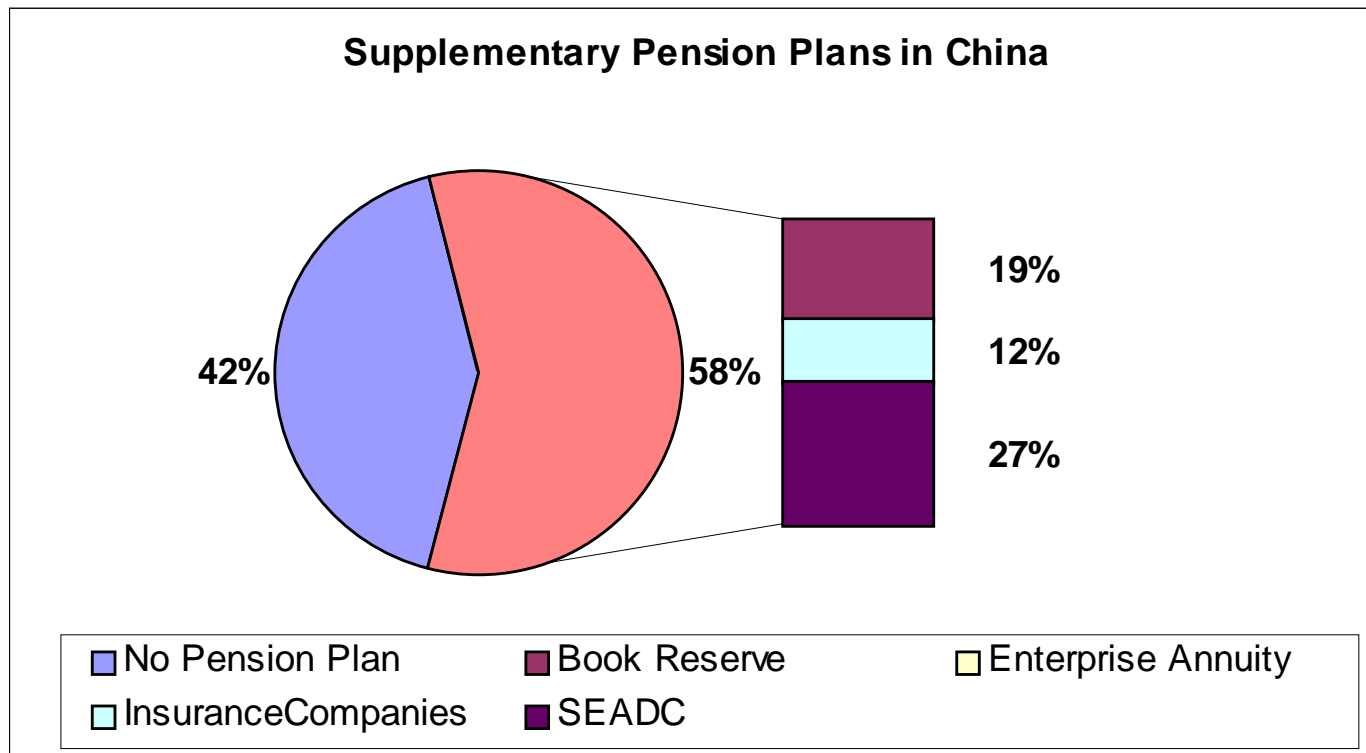




# China Pension Market

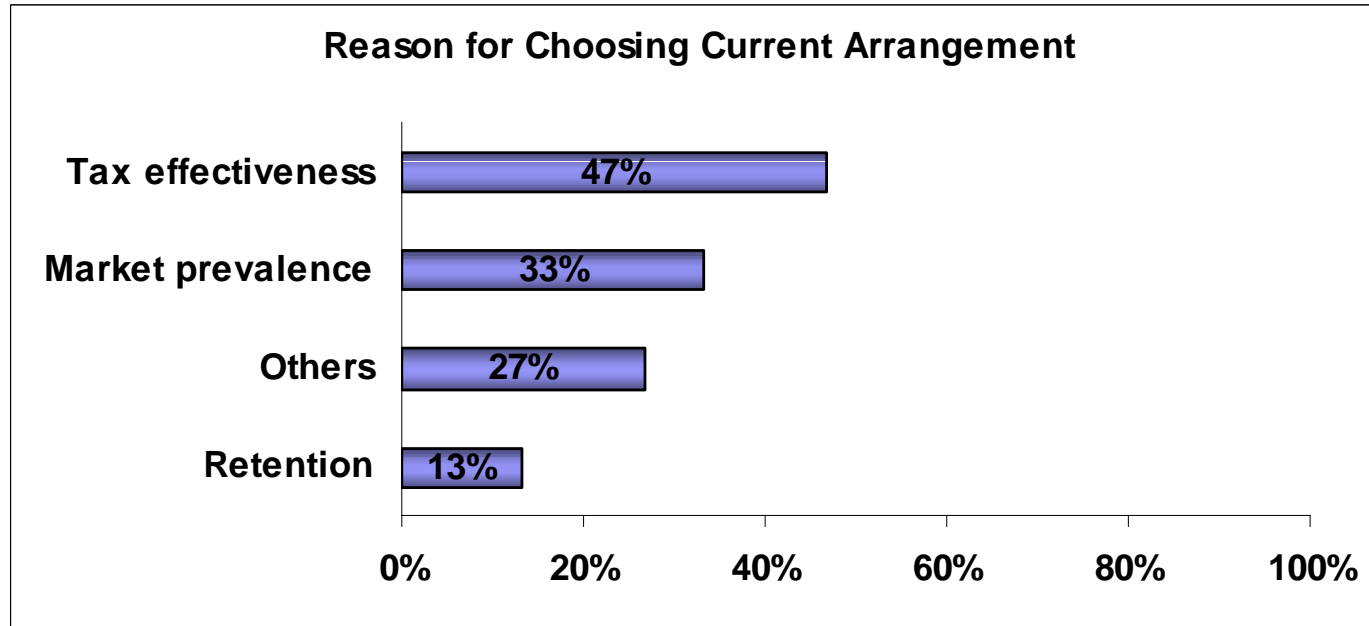
## Example: Shanghai

- 58% of surveyed companies have a supplementary pension plan
- For those that already have an SPP, most of them choose SEADC or company book reserve





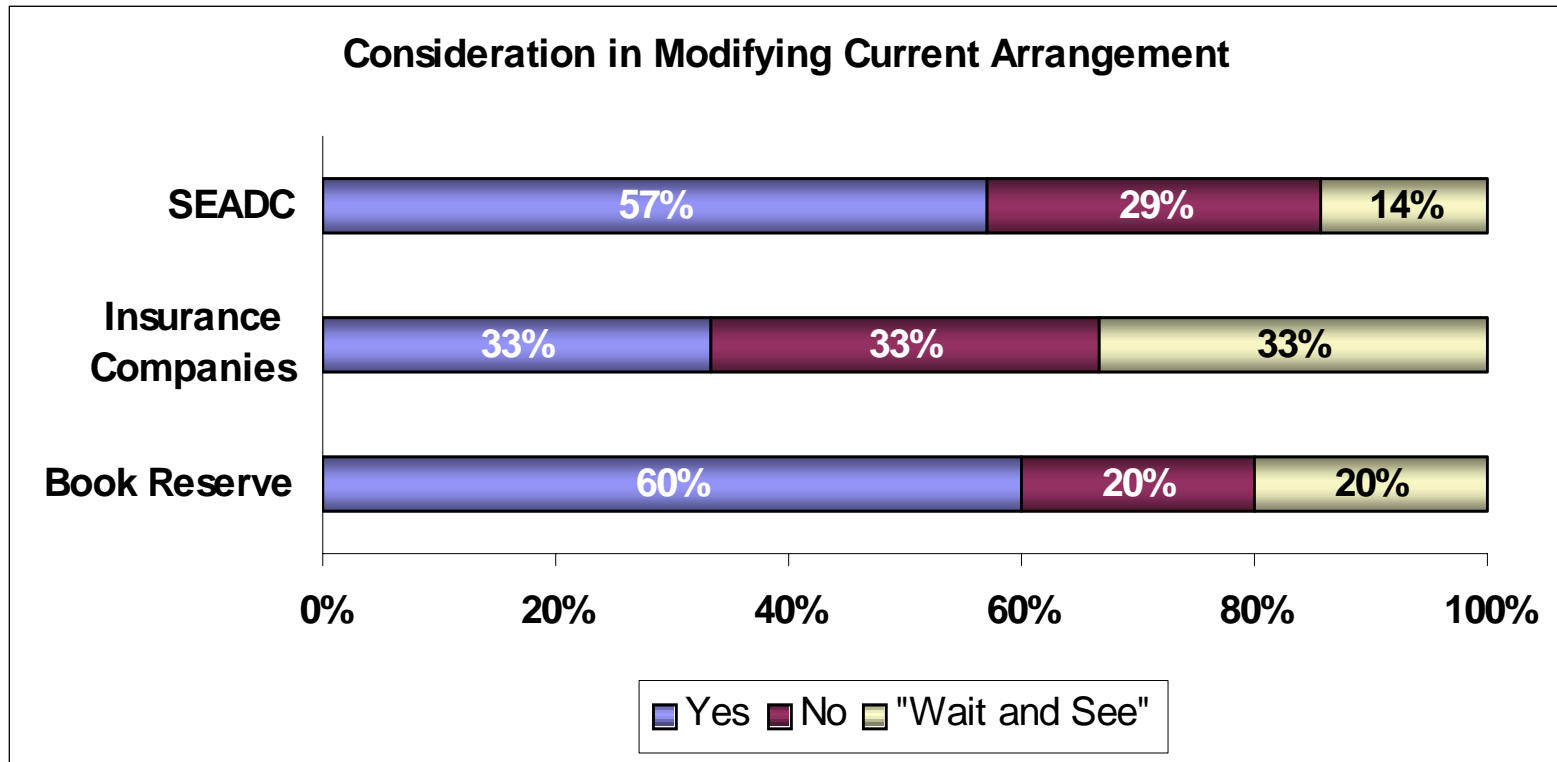
## Companies That Have a Supplementary Pension Plan



- “Others” are historic reasons, (e.g., company benefits consistency)
- Companies responded that the main reason for using SEADC is its tax effectiveness



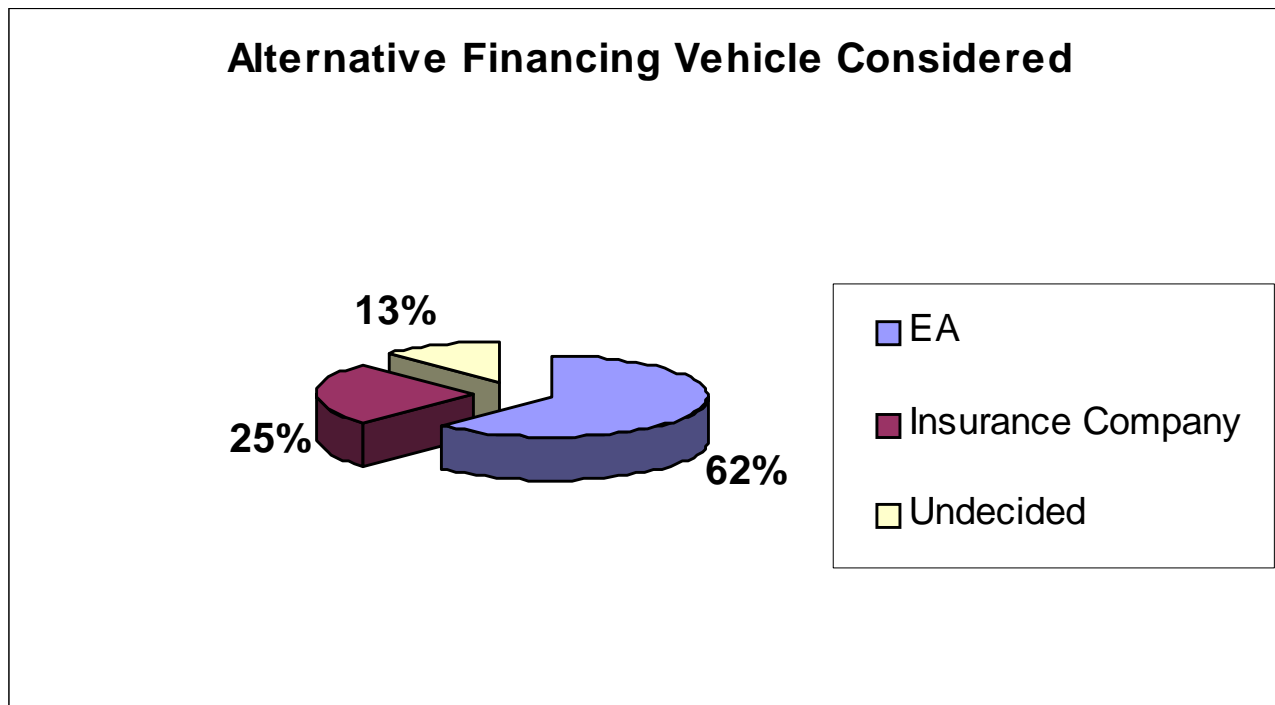
## Companies That Have a Supplementary Pension Plan





## Companies That Have a Supplementary Pension Plan

- 62% of companies that plan to modify their current pension arrangement indicate Enterprise Annuity (EA) as the first choice





# Enterprise Annuity Overview



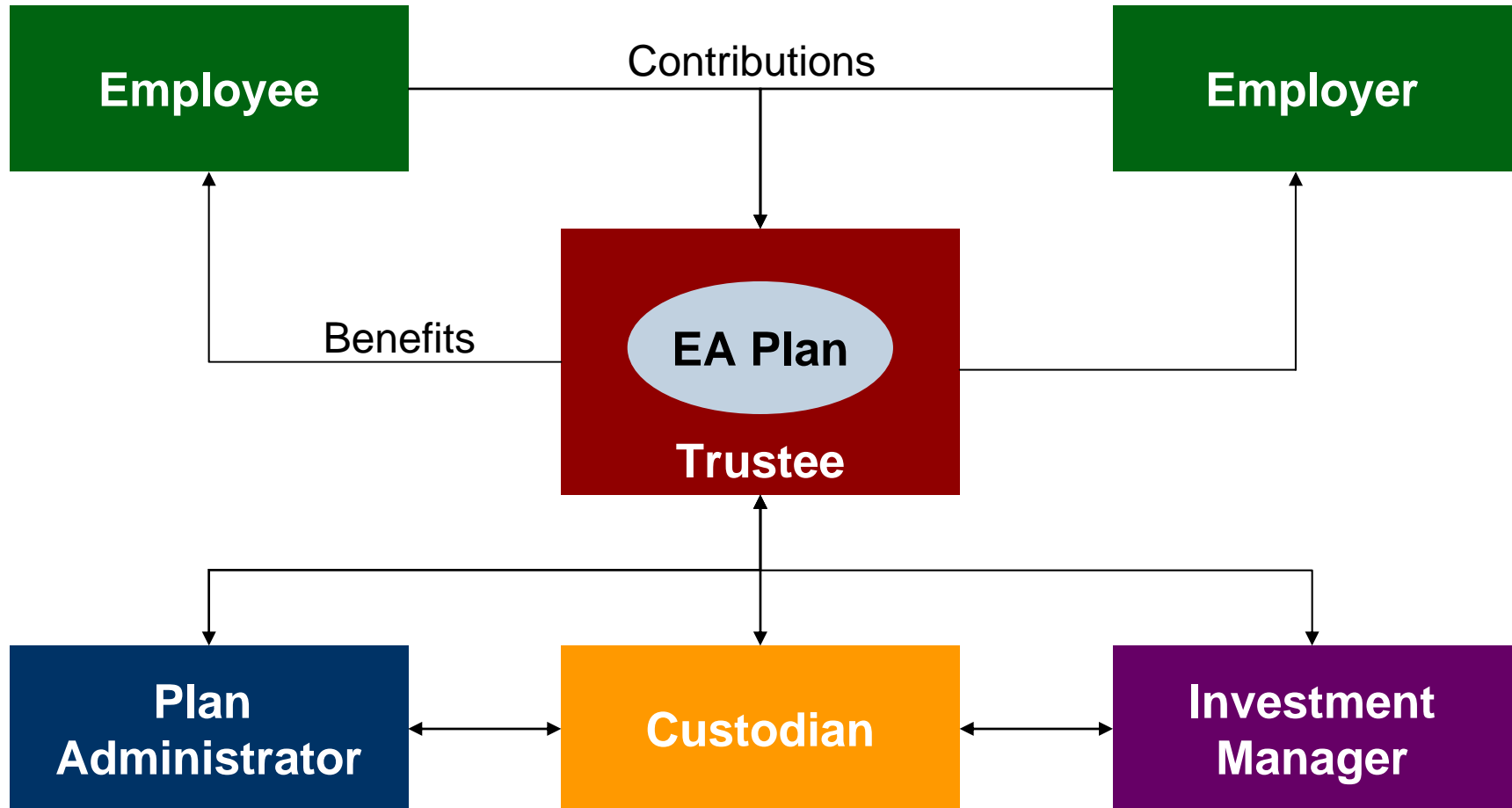
## Enterprise Annuity Legislation – Overview

- In April 2004, the Ministry of Labor and Social Security issued legislation on Enterprise Annuity (EA):
  - Considered China's 401(k)
  - Occupational **voluntary** defined contribution scheme
  - Applicable to all employees
- EA must be set up under trust arrangements. The plan trustee appoints EA service providers (plan administrator, custodian and investment manager)





# Enterprise Annuity Legislation – Structure





## Enterprise Annuity Legislation – Design

- **Contributions**
  - Both employer and employee are required to contribute
  - Maximum employer contribution: 1/12 (8.3%) of last year's payroll
  - Maximum employer & employee contribution: 1/6 (16.7%) of last year's payroll
  - Contributions are portable when changing jobs
  
- **Benefits**
  - Payable at
    - legal retirement age (60 for males and 55 for females)
    - death,
    - emigrate overseas
  - Paid as a lump sum or annuity
  
- **Tax**
  - Employer contributions are pre-tax; employee contributions are post tax;
  - Tax relief amount varies from province to province
  
- **The plan design needs to receive labor department's approval**



## Enterprise Annuity Legislation – Investment

- Conservative asset allocation limits are set:
  - Money Market:  $\geq 20\%$
  - Fixed Income: 20% - 50%
  - Equity:  $\leq 30\%$ , and Stocks:  $\leq 20\%$
- Participant investment choices are limited at the current stage
- Investment managers must set aside 20% of management fees in a reserve fund until reaching 10% of net assets under management



# What Does a Typical EA Scheme Look Like?

Typical EA Scheme Summary		
Type of Plan	Defined Contribution	
Pension Vehicle	Under a trust arrangement	
Providers	Licensed EA providers	
Eligible Employees	All employees	
Normal Retirement Age	Age 60 for male; age 55 for female	
Early Retirement Age	N/A	
Normal Retirement Benefit	Sum of accumulated employer and employee account balances	
Termination Benefit	N/A	
Vesting Scale for Employer Contribution Balance (No statutory guideline)	<u>Years of Service</u>	<u>Vesting %</u>
	Less than 1	0%
	1	20%
	2	40%
	3	60%
	4	80%
5 or more	100%	
Form of Payment	Lump sum or annuity	
Employer Contributions	4%-8%, dependent on allowable tax relief by locality	
Employee Contributions	Matching employer contributions	
Contribution Base	Employee's monthly base salary	
Investment Options	Not available at this time. Investment philosophy made by trustees and plan sponsor	



## Summary



- In China pension plans can be attraction/retention tool
  - But, consider demographics and employee preference
- With misappropriations, MNCs are required to act NOW!
- Chinese government continues pension reform
- Enterprise Annuity will be the plan of choice in the future



## Questions?

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**Please submit  
your questions  
through the  
Q&A panel  
on the bottom  
right-hand side  
of your screen**