Outlook for Chinese Defined-Contribution Enterprise Annuities Following the Introduction of Tax Deferral Treatment

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I. Background to and introduction of tax deferral treatment for Chinese defined-contribution enterprise annuities

1. Introduction of tax deferral treatment for Chinese defined-contribution enterprise annuities

On 6 December 2013 the Ministry of Finance, the Ministry of Human Resources and Social Security, and the State Administration of Taxation published a *Notice on Issues Pertaining to the Collection and Administration of Individual Income Tax on Enterprise Annuities and Occupational Pensions* ("Circular 103")[1] allowing the point of taxation for enterprise annuities to be deferred. (See Appendix for English translation of full text.)

The new measure came into force on 1 January 2014 and applies to two types of enterprise annuity. The first is defined-contribution enterprise annuities[2] established in accordance with the *Trial Measures for Enterprise Annuities*,[3] which came into effect on 1 May 2004. The second is public institution[4] defined-contribution enterprise annuities established in accordance with the *Provisional Implementation Rules on Public Institution Occupational Pension Plans*, which came into effect on 24 July 2011. Public institution enterprise annuities are referred to in China as "occupational pension plans." Employees of enterprises establishing enterprise annuities and public institutions establishing occupational pension plans are required to open individual accounts.

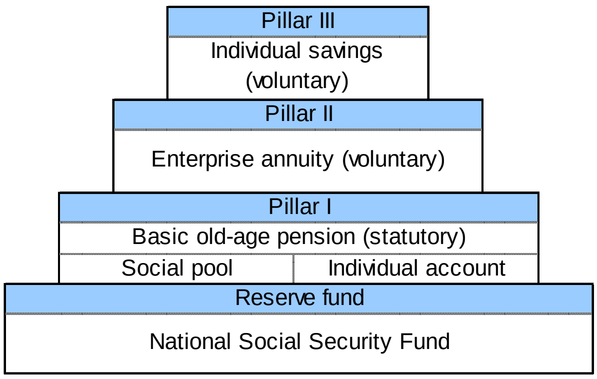
1 http://szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201312/t20131206_1021661.html
2 As a rule, the only enterprise annuities that may be approved by the Ministry of Human Resources and Social Security since May 2004 are defined-contribution plans.
3 http://www.gov.cn/gongbao/content/2004/content_62935.htm
4 Article 2 of the *Interim Regulation on the Registration of Public Institutions* defines "public institutions" as "public service organizations that are established by state organs or other organizations by using state-owned assets for the purpose of engaging in activities such as education, science and technology, culture and healthcare."

These measures to encourage the growth of defined-contribution pension plans in China by deferring tax have attracted the interest of market participants as China's equivalent of 401k plans in the US. Furthermore, although defined-contribution plans, there is no legal provision for plan members to select the investments in their individual accounts. Instead, investments are made by a fund manager or investment advisory company acting as an investment manager in accordance with an investment strategy determined by a trustee acting as a plan administrator. Nevertheless, the measures should be welcomed as a significant incentive for employees to have their pension fund assets invested in the financial markets.

2. Background to introduction of tax deferral treatment for enterprise annuities

In China, urban dwellers have a three-pillar pension system: a basic old-age pension (corresponding to employees' pension insurance in Japan) as the first pillar, an enterprise annuity as the second pillar, and individual savings as the third pillar (Figure 1). In addition, in 2000, a National Social Security Fund (NSSF) was established, funded mainly by capital and equity assets derived from the reduction of state-owned shares, central government fiscal allocation, and other investment proceeds, to provide for future expenditure on social security.

Figure 1: Structure of the Chinese pension system



Note: The basic old-age pension assumes a substitution rate of 59.2%.
Source: Felix Salditt et al., "Pension Reform in China: Progress and Prospects," OECD, 2007

The aforementioned second pillar of the pension system (enterprise annuities) is considered supplementary to the first pillar (the basic old-age pension), as are occupational pension plans.

The Q&A[5] that were published at the same time as Circular 103 by the Ministry of Finance (Department of Tax Policy), the Ministry of Human Resources and Social Security (Department of Pension Insurance), and the State Administration of Taxation (Income Tax Administration Department) traces China's pension system back to the 1980s and points out that, although the decision to create a three-pillar system consisting of a basic old-age pension, enterprise annuities, and individuals savings was made in 1991, the second two pillars have lagged behind the first. In fact,

5 http://szs.mof.gov.cn/zhengwuxinxi/zhengcejiedu/201312/t20131206_1021664.html

although, as we have seen, defined-contribution enterprise annuities have been permitted in China since 2004, their development has been constrained by the fact that their tax treatment at the points of contribution, investment, and payment has been both unclear and bereft of incentives as well as varying from one local authority to another.

What led to the easing of these constraints was the change of government at the CPC's 18th National People's Congress in November 2012, a change that happens once every 10 years. According to the aforementioned Q&A, on 3 February 2013 the State Council (under the new government) published *Several Opinions on Deepening Reform of the Income Distribution System*[6] and announced its intention to (1) upgrade the basic old-age pension, (2) improve enterprise annuities and occupational pension plans, and (3) to make greater use of commercial insurance as a means of supplementing pensions. Then, in November 2013, the reform program adopted by the Third Plenary Session of the 18th CPC Central Committee[7] revealed the government's intention to speed up the development of enterprise annuities, occupational pension plans, and commercial insurance and create a diversified social security system by providing incentives such as tax exemption and deferral.

We attribute the fact that it is only now, 10 years after defined-contribution enterprise annuities were introduced in 2004, that provision has been made for tax deferral treatment to (1) opposition during this period from fiscal and tax authorities concerned about a loss of tax revenue; (2) a clear stance on reform and policies on enterprise annuities from the new government at the Third Plenary Session of the 18th CPC Central Committee; and (3) a reflection of the views of the securities regulator and market participants (that allowing enterprise annuities to invest in financial markets will encourage reform and be good for the markets' development) at the Third Plenary Session of the 18th CPC Central Committee.

3. Details of tax deferral treatment

The tax deferral treatment of defined-contribution enterprise annuities, including occupational pension plans, applies at three points in time: when contributions are made; when assets accumulate or are invested; and when withdrawals are made from the account (Figure 2).

1) Point of contribution

First, an employee does not pay any income tax when his employer's contribution to his enterprise annuity is paid into his individual account (i.e., payment of tax is deferred). This is to encourage companies, including SMEs, to set up enterprise annuities.

6 Sekine, Eiichi, "Seichou Seisaku to Bunpai Seisaku kara Mita Chuugoku no Kin'yuu/Shihon Shijou Kaikaku" (The Reform of China's Debt and Equity Markets in Terms of Development and Distribution Policy), Capital Market Quarterly, Spring 2013 (in Japanese).

7 Sekine, Eiichi, "A Securities Market View of the Third Plenary Session of the 18th CPC Central Committee," Nomura Journal of Capital Markets, Spring 2014, Vol.5, No.4.

Figure 2: Tax deferral treatment of defined-contribution enterprise annuities

Point in time	Old system	New system (since January 2014)
When contributions are made		
Employer contributions	Taxed when paid into individual account	Taxed when paid into individual account
Member contributions	No deduction (taxable income)	Up to 4% of wages deductible
Point of accumulation or investment	No rules	Not taxed
When pension is drawn	No rules	Taxed

Note: The occupational pension plans of public institutions are also eligible for tax deferral treatment.
Source: Nomura Institute of Capital Markets Research, based on Ministry of Human Resources and Social Security and other data

Second, employees are exempted from paying income tax on their contributions, subject to a cap of 4% of their wages. The employee's tax base is his average monthly wages during the preceding year. This is calculated using the items used by the National Bureau of Statistics to compute gross wages.

2) Point of accumulation or investment

An employee does not pay any income tax when investment income from his enterprise annuity is paid into his individual account (i.e., payment of tax is deferred).

3) Point of withdrawal

When an employee reaches the official age of retirement and draws his enterprise annuity, he has to pay income tax at the rate applying to particular wage/salary items.

As we saw from the above Q&A, members of defined-contribution enterprise annuities benefit from tax deferral by paying less individual income tax. The Chinese government has actually studied the tax deferral treatment of occupational pension plans in OECD countries such as the US, France, Germany, and Japan and, in this case, has opted for the "EET model": exemption at the (entry) point of contribution and exemption at the (intermediate) point of investment, but taxation at the (exit) point of withdrawal.

II. Introduction of enterprise annuities in China

1. Data on enterprise annuities in China

China's Ministry of Human Resources and Social Security is responsible for approving enterprise annuities. Every quarter since 2013 it has published an *Overview of National Enterprise Annuity Data*.[8] Furthermore, according to the China Securities Journal of 18 December 2013, the Center for International Social Security Studies

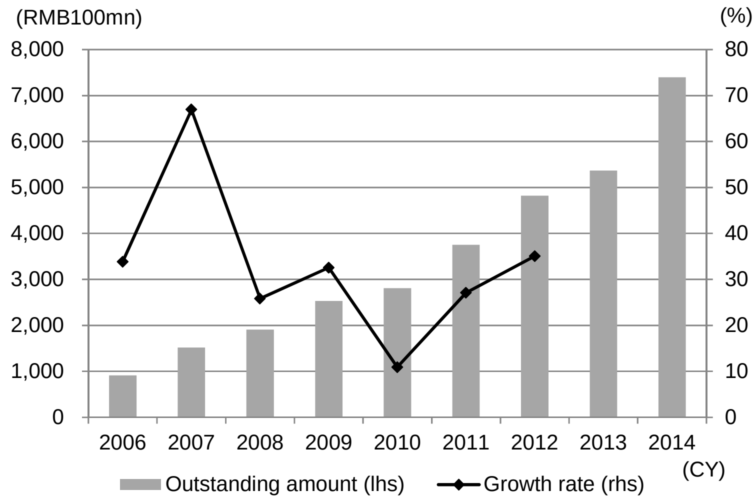
[8] http://www.mohrss.gov.cn/SYrlzyhshbzb/zwgk/szrs/

(CISS) at the Chinese Academy of Social Sciences (CASS) (CASS CISS) uses these data to compile its own enterprise annuity data. As we will see, the statistics also include enterprise annuities in transition from defined-benefit plans to defined-contribution plans. Using these data, we can say the following about the introduction of enterprise annuities in China.

2. Outstanding amount of enterprise annuity assets

In the six years from the end of 2006 to the end of 2012 the outstanding amount of enterprise annuity assets increased fivefold from RMB96 billion to RMB482.1 billion (Figure 3). As of the end of June 2013, the outstanding amount was RMB536.7 billion (¥8571.1 billion)[9](Figure 3).

Figure 3: Enterprise annuity funds in China: outstanding amount and growth rate



Note: 1. Data as of end-June 2013. Data for 2014 are estimates.
2. Data include plans transitioning to defined-contribution plans.

Source: Nomura Institute of Capital Markets Research, based on Ministry of Human Resources and Social Security and Chinese Academy of Social Sciences, Center for International Social Security Studies data

The Center for International Social Security Studies at the Chinese Academy of Social Sciences estimates that, following the introduction of tax deferral treatment, the outstanding amount is likely to increase by 24.8% from RM593.0 billion (¥9,470.2 billion) at the end of 2013 to RMB740.0 billion (¥11,818.7 billion) at the end of 2014. Similarly, Ping An Securities estimates that the amount will increase from RMB768.7 billion (¥12,276.1 billion) at the end of 2014 to RMB999.3 billion (¥15,958.8 billion) at the end of 2015, and RMB1,299.1 billion (¥20,746.6 billion) at the end of 2016.[10]

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9 We have converted amounts in renminbi to yen using the mid-rate on 28 June 2013 (RMB1 = ¥15.97).

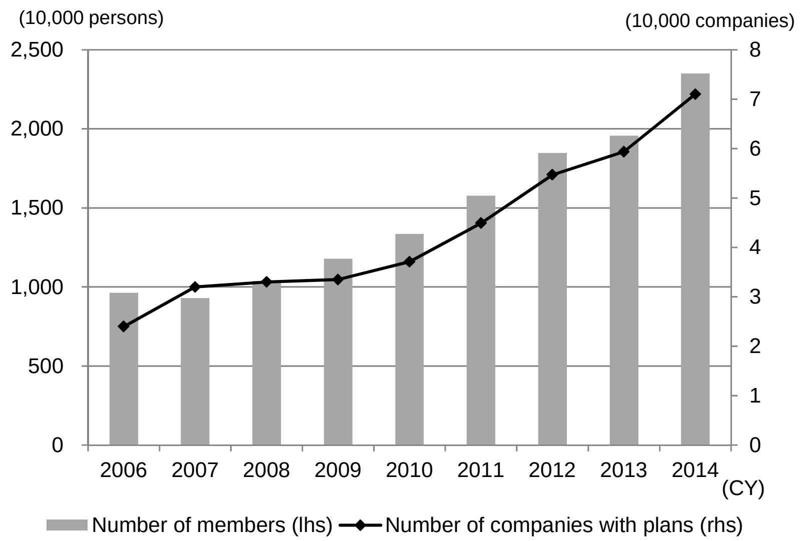
10 In a report dated 8 December 2013. Although the report is written for clients of Ping An Securities, it is reproduced on linked mainland Chinese websites.

3. Number of employees enrolled on enterprise annuities

In the six years from the end of 2006 to the end of 2012 the number of employees enrolled on enterprise annuities increased by 90% from 9.64 million to 18.47 million. As of the end of June 2013, the number was 19.57 million (Figure 4).

The Center for International Social Security Studies at the Chinese Academy of Social Sciences estimates that, following the introduction of tax deferral treatment, the number is likely to increase by 11.9% from 21.00 million at the end of 2013 to 23.50 million at the end of 2014.

Figure 4: Enterprise annuities in China: number of plan members and number of companies with plans



Note: 1. Data as of end-June 2013. Data for 2014 are estimates.
2. Data include plans transitioning to defined-contribution plans.

Source: Nomura Institute of Capital Markets Research, based on Ministry of Human Resources and Social Security and Chinese Academy of Social Sciences, Center for International Social Security Studies data

4. Number of companies with enterprise annuities

In the six years from the end of 2006 to the end of 2012 the number of companies with enterprise annuities increased by 130% from 24,000 to 54,700. As of the end of June 2013, the number was 59,362 (Figure 4).

The Center for International Social Security Studies at the Chinese Academy of Social Sciences estimates that, following the introduction of tax deferral treatment, the number is likely to increase by 14.5% from 62,000 at the end of 2013 to 71,000 at the end of 2014.

III. Operation of qualified enterprise annuity service providers in China

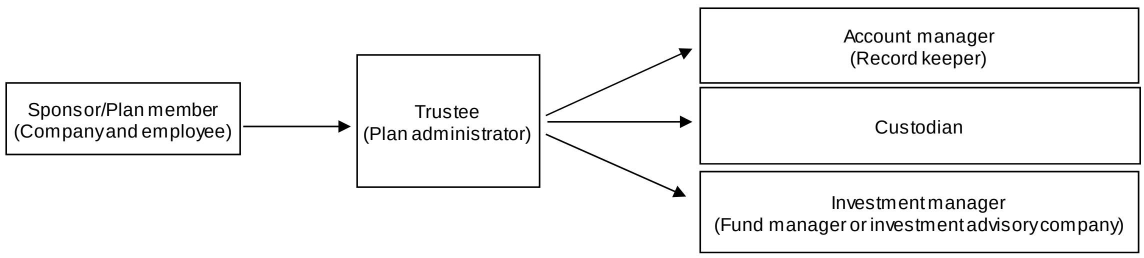
1. System of qualified enterprise annuity service providers

When defined-contribution enterprise annuities were introduced in China in 2004, a system of approval of qualified enterprise annuity service providers by the Ministry of Human Resources and Social Security was also introduced. More specifically, a regulation entitled *Trial Measures for the Fund Management of Enterprise Annuities* was issued, together with the aforementioned *Trial Measures for Enterprise Annuities*, with effect from 1 May 2004. Furthermore, the *Trial Measures for the Fund Management of Enterprise Annuities* were reissued as *Measures for the Fund Management of Enterprise Annuities*[11] on 23 February 2011 with effect from 1 May 2011.

The system of qualified enterprise annuity service providers clearly distinguishes the roles of “trustee” (equivalent to a plan administrator), “account manager” (equivalent to a record keeper), custodian, and “investment manager” (equivalent to a fund manager or investment adviser), and seeks to prevent conflicts of interest when enterprise annuity assets are invested and to ensure that mutual checks are carried out (Figure 5).

The first batch of (37) licenses for (29) qualified service providers was approved on 1 August 2005, followed by a second batch of (24) licenses for (18) qualified service providers on 19 November 2007.[12]

Figure 5: Operation of enterprise annuities in China



Company contributions: capped at one-twelfth of gross wages
Company contributions + employee contributions: capped at one-sixth of gross wages

	Responsibilities
Trustee	Choosing, monitoring, and replacing account manager, custodian, and investment manager
Account manager	Opening, keeping record of, and managing company and individual accounts
Custodian	Custody, settlement, and valuation of pension fund assets
Investment manager	Investment of pension fund assets

Source: Nomura Institute of Capital Markets Research, based on data from Ministry of Human Resources and Social Security and Nomura Institute of Capital Markets Research (ed.), Chuugoku Shouken Shijou Taizen (Compendium of Chinese Securities Markets), Nihon Keizai Shimbunsha, December 2007 (in Japanese)

11 http://www.gov.cn/flfg/2011-02/23/content_1808854.htm

12 Sekine, Eiichi, “Chuugoku no Kigyou Nenkin Shikaku no Kakudai ni Muketa Ugoki” (Moves towards Greater Recognition of Enterprise Annuities in China), Kikan Chuugoku Shihon Shijou Kenkyuu, 2008 Winter edition, Tokyo Club Foundation for Global Studies (in Japanese).

2. A closer look at qualified enterprise annuity service providers (as of end-June 2013)

1) Trustees (plan administrators)

According to the quarterly data on enterprise annuities published by the Ministry of Human Resources and Social Security since 2013 (see above), there were 1,265 enterprise annuity plans as of the end of June 2013. Of these, 1,189 were single-company plans, while 48 were multi-company plans with the same trustee, and 28 other types of plan (Figure 6). Trustees have to obtain approval for these multi-company plans, called in Chinese "collective enterprise annuity plans," under the *Circular on Issues Concerning the Pilot Program for Collective Enterprise Annuity Plans*[13] issued by the Ministry of Human Resources and Social Security on 20 May 2011. The assumption is that SMEs will seek to set up such plans. The 48 multi-company plans effective as of the end of June 2013 cover a total of 16,440 companies (27.7% of the 59,362 companies with enterprise annuities as of the same date) with a total of 2,012,132 plan members (10.3% of the 19.57 million members of enterprise annuities). The 28 "other" types of plan are both transitional plans and plans similar to multi-company plans.

Figure 6: Number of enterprise annuity plans (as of end-June 2013)

Type of plan	Definition	Number of plans	
Single-company	Plan sponsored by one company	Total	1,189
		(Breakdown) Legal person trustee	966
		Board	223
Multi-company	Plan where a number of companies use the same trustee		48
Other	Both transitional plan and plan similar to multi-company plan		28
Total			1,265

Source: Nomura Institute of Capital Markets Research, based on Ministry of Human Resources and Social Security data

The trustees (see above) of enterprise annuities may be either qualified enterprise annuity service providers or boards of trustees comprising representatives of both companies and their employees. In the case of single-company plans, 966 trustees are legal persons while 223 are boards of trustees. As of the end of June 2013, the situation with regard to trustees which are legal persons was as follows (Figure 7).

13 http://www.abchina.com/cn/businesses/custodian/regulations/supplementarypension/201208/t20120803_254307.htm

Figure 7: Enterprise annuities in China: single-company plans with legal person as trustee (as of end-June 2013)

Trustee (Plan administrator)	Number of companies	Number of members	Assets in trust (RMB10,000)
China Life Pension	6,018	3,264,546	9,457,547
Ping An Annuity Insurance	20,025	2,468,709	6,798,449
Industrial and Commercial Bank of China	694	1,325,973	4,833,894
Taiping Pension	7,426	1,115,164	2,759,962
China Construction Bank	2,117	950,082	3,208,716
Changjiang Pension Insurance	5,420	849,901	3,412,116
Taikang Pension & Insurance	3,278	333,358	840,044
China Merchants Bank	342	194,723	1,023,881
Hwabao Trust	276	151,413	584,309
CITIC Trust	24	5,640	25,062
Shanghai International Trust	6	151	488
Total	45,626	10,659,660	32,944,469

Note: Trustees are ordered according to the total number of members in the plans for which they are responsible.
Source: Nomura Institute of Capital Markets Research, based on Ministry of Human Resources and Social Security data

First, of the 45,626 companies that had single-company plans with trustees which are legal persons, 22,025 had trustee plans with Ping An Annuity Insurance, followed by 7,426 with plans with Taiping Pension, and 6,018 with plans with China Life Pension.

Second, of the 10,659,660 members of these plans, 3,264,546 belonged to plans where China Life Pension was the trustee, 2,468,709 to plans where Ping An Annuity Insurance was the trustee, and 1,325,973 to plans where Industrial and Commercial Bank of China was the trustee.

Third, of the RMB329.4 billion (¥5,260.5 billion) of assets in trust under these plans, RMB94.6 billion (¥1,510.8 billion) was in plans where China Life Pension was the trustee, RMB68.0 billion (¥1,086.0 billion) in plans where Ping An Annuity Insurance was the trustee, and RMB48.3 billion (¥771.4 billion) in plans where Industrial and Commercial Bank of China was the trustee.

What these figures tell us is that the pension subsidiaries of China's three big life insurance groups (China Life Group, Ping An Life Group, and Taiping Life Group) dominate the market for legal person trustees and that the pension division of Industrial and Commercial Bank of China is one of the top three players in that market in terms of the number of plan members and the amount of plan assets in trust.

2) Account managers (record keepers)

As of the end of June 2013, the situation with regard to account managers under single-company plans (whether the trustee is a legal person or there is a board of trustees), multi-company plans, and other types of plan was as follows (Figure 8).

Figure 8: Enterprise annuities in China: state of company and individual accounts (as of end-June 2013)

Account manager (Record keeper)	Number of company accounts	Number of individual accounts
Industrial and Commercial Bank of China	28,609	8,476,209
China Construction Bank	6,962	2,876,270
Bank of China	6,908	2,182,093
China Merchants Bank	1,716	1,368,627
China Life Pension	2,504	1,136,544
China Everbright Bank	1,978	862,864
Bank of Communications	3,058	858,992
Changjiang Pension Insurance	5,436	745,742
Shanghai Pudong Development Bank	626	351,585
Ping An Annuity Insurance	498	231,117
Hwabao Trust and Investment	308	185,202
China Minsheng Banking	232	128,594
Taikang Pension & Insurance	272	87,989
CITIC Trust	230	77,416
New China Life Insurance	25	3,785
Total	59,362	19,573,029

Note: 1. Data cover single-company, multi-company, and “other” plans.
2. Account managers are ordered according to the total number of individual accounts in the plans for which they are responsible.

Source: Nomura Institute of Capital Markets Research, based on Ministry of Human Resources and Social Security data

First, of the 59,362 company accounts, 28,609 were with Industrial and Commercial Bank of China, 6,962 with China Construction Bank, and 6,908 with Bank of China.

Second, of the 19,573,029 individual accounts, 8,476,209 were with Industrial and Commercial Bank of China, 2,876,270 with China Construction Bank, and 2,182,093 with Bank of China.

It is clear from these figures for both company and individual accounts that, of China’s four state-owned commercial banks, three (namely, Industrial and Commercial Bank of China, China Construction Bank, and Bank of China) enjoy a competitive advantage over China’s life insurance companies as account managers, reflecting their day-to-day contact with regard to financial transactions.

3) Custodians

As of the end of June 2013, the situation with regard to custodians under single-company plans (whether the trustee is a legal person or there is a board of trustees), multi-company plans, and other types of plan was as follows (Figure 9).

Figure 9: Enterprise annuity plans in China: assets in custody

Custodian	Assets in custody (RMB10,000)
Industrial and Commercial Bank of China	21,952,408
Bank of China	7,416,450
China Construction Bank	7,106,304
China Merchants Bank	4,295,385
Bank of Communications	3,877,834
Shanghai Pudong Development Bank	2,462,226
China Everbright Bank	2,407,356
China CITIC Bank	1,942,645
Agricultural Bank of China	1,417,350
China Minsheng Banking	788,555
Total	53,666,513

Note: 1. Data cover single-company, multi-company, and "other" plans.
2. Custodians are ordered according to the total amount of enterprise annuity assets in their custody.

Source: Nomura Institute of Capital Markets Research, based on Ministry of Human Resources and Social Security data

Of the RMB536,665.13 billion (¥8,571.1 billion) in custody, RMB219.5 billion (¥3,505.4 billion) was with Industrial and Commercial Bank of China, RMB74.2 billion (¥1,185.0 billion) with China Construction Bank, and RMB71.1 billion (¥1,135.5 billion) with Bank of China.

Unlike the case with trustees and account managers, only commercial banks can apply to become qualified custodians. As with the number of accounts (see above), it is clear from these figures that three such banks (namely, Industrial and Commercial Bank of China, China Construction Bank, and Bank of China) have benefited from their day-to-day contact with regard to financial transactions.

IV. Enterprise annuities' investments

1. Regulations governing enterprise annuity investments

As we have seen, the management of enterprise annuity investments has been governed by *Measures for the Fund Management of Enterprise Annuities* with effect from 1 May 2011. Article 46 stipulates that investment managers of enterprise annuities must act prudently and diversify their investments in order to ensure that they achieve an adequate return, are sufficiently liquid, and are not exposed to undue risk. Furthermore, Article 47 stipulates that enterprise annuity assets may only be invested domestically. Also, as we have seen, there is no provision under Chinese law for plan members to select investments for their individual accounts.

However, in line with the development of financial products in the past few years, the range of eligible investments for enterprise annuities was amended on 19 March 2013.

First, under the *Notice Concerning the Enlargement of the Investment Scope of Enterprise Annuities*,[14] the range of products permitted under *Measures for the Fund Management of Enterprise Annuities* has been extended to cover bank wealth management products, trust products, debt investment plans for infrastructure projects, and special asset management plans. In addition, managers are now permitted to invest in stock index futures.

Second, the *Notice Concerning Issues Regarding Enterprise Annuity Investments*[15] contains additional rules on the equity-type, mixed-type, fixed income-type, and money market fund-type of products developed by managers especially for enterprise annuities and governed by the aforementioned set of rules.

Under the above rules, deposits must constitute at least 5% of externally managed enterprise annuity net assets, while fixed-income products (including bond repurchase agreements) may not constitute more than 135% and equities not more than 30% (Figure 10).

Figure 10: Rules governing allocation of Chinese enterprise annuity assets

Type	Investments	Investment restrictions
Bank deposits	Sight deposits, T-bills, fixed-term deposits of less than one-year maturity, bond repurchase agreements, money market funds, money market fund-type pension products	At least 5% of externally managed net assets
Fixed-income products	Fixed-term deposits of more than one-year maturity, negotiated deposits, government bonds, bank debentures, corporate bonds, convertible bonds, commercial paper, medium-term notes, universal life insurance, bank wealth management products, trust products, infrastructure debt investment plans, special asset management plans, bond funds, variable insurance (less than 30% invested in equities), fixed-income pension fund products, mixed pension fund products	Not more than 135% of externally managed net assets (This figure is because of bond repurchase agreements.)
Equities	Equities, equity funds, mixed funds, variable insurance (at least 30% invested in equities), equity-type pension fund products	Not more than 30% of externally managed net assets

Source: Nomura Institute of Capital Markets Research, based on *Measures for the Fund Management of Enterprise Annuities and the Notice Concerning the Enlargement of the Investment Scope of Enterprise Annuities*

2. Enterprise annuity investment returns

1) Past rates of return on enterprise annuity investments

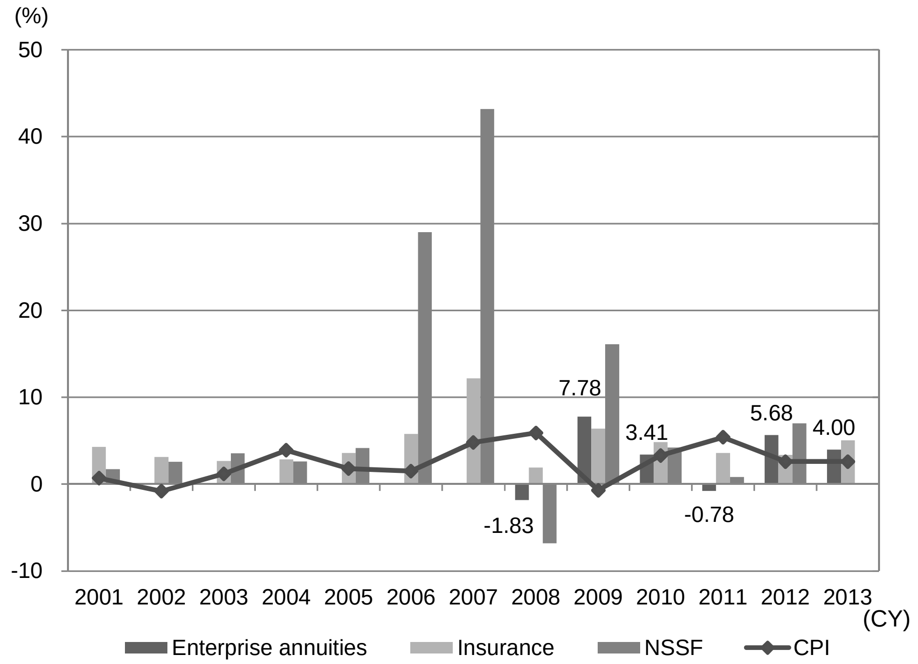
We can find statistics on the rates of return on enterprise annuity investments in *China Pension Report 2012* by the Center for International Social Security Studies at the Chinese Academy of Social Sciences and published by Economy & Management Publishing House in 2012.

Investment returns in recent years were: 2008: -1.83% (compared with a CPI inflation rate of 5.90%); 2009: 7.78% (CPI: -0.70%); 2010: 3.41% (CPI: 3.30%);

[14] http://www.mohrss.gov.cn/gkml/xxgk/201304/t20130403_97052.htm
[15] http://www.mohrss.gov.cn/gkml/xxgk/201304/t20130403_97054.htm

2011: -0.78% (CPI: 5.40%); and 2012: 5.68% (CPI: 2.60%) (Figure 11). According to the Ministry of Human Resources and Social Security, the figure for the first half of 2013 was 2.31% (compared with a CPI of 2.4%), while, according to aforementioned 18 December 2013 report on www.stcn.com, the Center for International Social Security Studies at the Chinese Academy of Social Sciences estimates that the figure for 2013 as a whole was 4.00% (compared with a final CPI figure of 2.60%).

Figure 11: Rate of return on enterprise annuities' investments



Note: 1. Enterprise annuity data for 2013 are estimates by the Center for International Social Security Studies at the Chinese Academy of Social Sciences.
2. CPI data for 2013 are from the National Bureau of Statistics; insurance data for 2013 are from the China Insurance Regulatory Commission (CIRC) (as reported on www.stcn.com on 22 January 2014).
3. NSSF data are back-adjusted because of changes in accounting policies since fiscal 2008 and are through 2012.

Source: Nomura Institute of Capital Markets Research, from National Bureau of Statistics, CIRC, and NSSF data

As China's National Social Security Fund, which took the lead in investing its assets in financial markets and overseas, gives its rates of return on investment in comparison to inflation rates in its investment report, we think it is probably safe to assume that companies with enterprise annuities will also want to compare their plans' investment returns with inflation.

2) Investment returns by type of plan and portfolio (first half of 2013)

In the *Overview of National Enterprise Annuity Data* it has published every quarter since 2013, the Ministry of Human Resources and Social Security now gives the rate of return on enterprise annuities by type of plan and portfolio. As of the end of June 2013, 2,353 enterprise annuity portfolios with assets under management (net assets) of RMB 516.1 billion were invested domestically. Of these, rates of return are given for the 2,131 portfolios (with assets under management of RMB487.0 billion) that were invested prior to 1 January 2013 (Figure 12).

Figure 12: Rate of return on enterprise annuities' investments (by type of plan and portfolio)

Point in time/Period		End-June 2013	End-June 2013	January–June 2013
Type of plan	Type of portfolio	Number of portfolios	(Net) assets under management (RMB100mn)	Weighted average return (%)
Single-company	Fixed-income	368	492.49	2.52
	Balanced (including equities)	1,593	3,784.89	2.27
	Total	1,961	4,277.38	2.30
Multi-company	Fixed-income	53	251.47	2.78
	Balanced (including equities)	82	227.95	2.10
	Total	135	479.42	2.46
Other	Fixed-income	15	59.53	2.28
	Balanced (including equities)	20	53.49	1.81
	Total	35	113.02	2.06
Total	Fixed-income	436	803.49	2.58
	Balanced (including equities)	1,695	4,066.33	2.25
	Total	2,131	4,869.82	2.31

Note: 1. The "other" types of plan are both transitional plans and plans similar to multi-company plans.
2. Portfolios which were explicitly prohibited from investing in equities were classified as "fixed income-type," while those that were not explicitly prohibited or that invested in equities during the period concerned were classified as "balanced-type."

Source: Nomura Institute of Capital Markets Research, based on Ministry of Human Resources and Social Security data

First, the rates of return by type of plan for the first half of 2013 were as follows: single-company plans: 2.30%; multi-company plans: 2.46%; and other plans: 2.06%.

Second, the rates of return by type of portfolio were: fixed income-type: 2.58%; and balanced-type: 2.25%. Portfolios which were explicitly prohibited from investing in equities were classified as "fixed income-type," while those that were not explicitly prohibited or that invested in equities during the period concerned were classified as "balanced-type." As of the end of June 2013, balanced-type portfolios with assets of RMB406.6 billion (83.5% of the total) had a lower rate of return than fixed income-type portfolios, perhaps reflecting the performance of equities in general.

3) Assets under management

According to the quarterly data on enterprise annuities published by the Ministry of Human Resources and Social Security since 2013 (see above), enterprise annuity (net) assets under management (by fund managers or investment advisers) as of the end of June 2013 were as follows (Figure 13).

Figure 13: Enterprise annuity funds in China: assets under management (as of end-June 2013)

Investment manager (Fund manager or investment advisory company)	Number of portfolios	(Net) assets under management (RMB10,000)
Ping An Annuity Insurance	341	7,478,494
China Life Pension	422	6,189,688
China Asset Management	147	4,403,074
Taikang Asset Management	231	4,166,719
Harvest Fund Management	122	3,362,593
CITIC Securities	163	3,196,503
Bosera Asset Management	144	3,095,607
Changjiang Pension Insurance	53	2,807,310
Taiping Pension	214	2,788,947
ICBC Credit Suisse Asset Management	83	2,468,650
China Southern Fund Management	79	2,375,493
Fortis Haitong Investment Management	78	2,349,709
China International Capital Corporation (CICC)	23	1,933,635
E Fund Management	63	1,659,012
Fullgoal Fund Management	32	1,097,230
PICC Asset Management	32	543,492
Guotai Asset Management	33	466,142
China Merchants Fund Management	13	353,258
Taikang Asset Management	20	341,790
GF Fund Management	23	288,349
Yinhua Fund Management	37	248,268
Total	2,353	51,613,965

Note: Investment managers are ordered according to the amount of enterprise annuity assets they manage.
Source: Nomura Institute of Capital Markets Research, based on Ministry of Human Resources and Social Security data

First, of the 2,353 portfolios, 422 were managed by China Life Pension, 341 by Ping An Annuity Insurance, and 231 by Taikang Asset Management. Taikang Asset Management's parent company, Taikang Life Insurance, established in 1996, was China's first joint-stock life insurance company, while Taikang Asset Management itself, established in 2006, was the first company in China to be authorized to act as a trustee for life insurance funds. It appears to have made the most of its first-mover advantage.

Second, of the RMB516.1 billion (¥8,242.1 billion) of (net) assets under management of these plans, RMB74.8 billion (¥1,194.6 billion) was managed by Ping An Annuity Insurance, RMB61.9 billion (¥988.5 billion) by China Life Pension, and RMB44.0 billion (¥702.7 billion) by China Asset Management (ChinaAMC). ChinaAMC is China's largest asset management (investment trust) company and appears to have made the most of that position in winning mandates from pension funds.

V. Outlook

1. Chinese enterprise annuities' scope for expansion

According to an 8 January 2014 report by China Securities Journal, less than 10% of Chinese employees belong to an enterprise annuity and most of those who do work for central state-owned enterprises (i.e., state-owned enterprises controlled by the central government). We can therefore expect more private-sector, foreign-invested, and local companies to consider introducing defined-contribution enterprise annuities as a result of the tax deferral treatment. Moreover, the fact that public institutions are also eligible for the tax deferral treatment may even encourage some central and local government corporations to set up defined-contribution enterprise annuities.

Many financial market participants also hope that enterprise annuities will become more popular. As it is, at a meeting of the 2014 National Work Conference on Securities and Futures Supervision on 21 January 2014, Mr Xiao Gang, chairman of the China Securities Regulatory Commission (CSRC), announced the policy of fostering the development of professional securities investment organizations and encouraging long-term investors such as social security funds, pension funds, and enterprise annuities to invest via professional investment organizations, thereby developing new means of access to financial markets.[16] By investing their long-term capital in financial markets, China's enterprise annuities can also serve as a direct source of funds for the issuers of equities and bonds, thereby helping the Chinese economy to switch to a new model.

2. Scope for reforms to encourage the take-up of enterprise annuities

Although it is 10 years since Chinese employers have been able to offer their workers defined-contribution enterprise annuities and plan members their own individual accounts, plan members still do not have the option to choose the products their contributions are invested in. Chinese enterprise annuities face the challenge of offering plan members proper training, while the plans themselves need to be reformed if both plan sponsors and plan members are to enjoy the full benefits of defined-contribution enterprise annuities.

Another issue is that enterprise annuity assets may only be invested domestically. Plan members may therefore in future be able to enjoy the benefits of diversification and invest in overseas financial products to generate a return from global financial markets. To do this, their plans will need to have access to overseas fund managers and investment advisers.

[16] http://www.csrc.gov.cn/pub/newsite/bgt/xwdd/201401/t20140122_243060.htm

3. Value of drawing on the experience of other countries

The CSRC is still studying 401k plans in the US with a view to introducing them in China in a modified form. Dr Qi Bin, director of the CSRC Research Center, has repeatedly said that China should adopt an enterprise annuity plan based on the US concept of 401k plans.[17]

Chinese regulators and market participants would presumably welcome the opportunity to take a fresh look at corporate pension plans not only in the US but also in countries such as Japan to see how they work (e.g., how individual accounts are set up and portability arranged) and the challenges they face, and compare them with enterprise annuities in China. We will continue to monitor the development of enterprise annuities in China.

17 A recent example is an article in the Shanghai Securities News, 21 January 2014, entitled (in English) "Harnessing the Power of Capital to the Rise of China."

(Appendix)

Notice of the Ministry of Finance, the Ministry of Human Resources and Social Security and the State Administration of Taxation on Issues concerning Individual Income Tax on Enterprise Annuities or Occupational Pension Plans

(No. 103 [2013] of the Ministry of Finance)

The departments (bureaus) of public finance, departments (bureaus) of human resources and social security, and local taxation bureaus of all provinces, autonomous regions, municipalities directly under the central government, and cities under separate state planning; and the Financial Bureau and the Human Resources and Social Security Bureau of Xinjiang Production and Construction Corp:

In order to promote the development of a multi-level pension insurance system in China according to the relevant provisions of the *Individual Income Tax Law*, you are hereby notified of the following issues concerning individual income tax on enterprise annuities or occupational pension plans:

1. Treatment of individual income tax on contributions to enterprise annuities or occupational pension plans

1) Individuals are not required to pay individual income tax for the time being on contributions to an enterprise annuity or occupational pension plan (hereinafter collectively referred to as "pension plan") made by an enterprise or public institution (hereinafter collectively referred to as "entity") according to the measures and standards prescribed by the relevant state policies for all individuals holding offices in or employed by the entity which enter the personal accounts of individuals.

2) For the time being, of the contributions to a pension plan made by individuals according to the relevant state policies, the part not exceeding 4% of the taxable wage base of an individual shall be deducted from the individual's taxable income for the current period.

3) The part of contributions to a pension plan made by entities and individuals beyond the standards set forth in 1. 1) and 2) of this notice shall be included in the wage and salary income of individuals for the current period and be subject to individual income tax in accordance with the law. Entities offering pension

plans shall withhold taxes and declare and pay them to the competent tax authorities.

4) The taxable wage base for individual contributions to enterprise annuities shall be the average monthly wage of the individual concerned in the previous financial year. This shall be calculated using the items used by the National Bureau of Statistics to compute gross wages. If this amount is more than three times the average monthly wage of employees in the town in which the individual's place of work is located in the previous financial year, the excess shall not be included in the individual's taxable wage base.

   The taxable wage base for individual contributions to occupational pension plans shall be the total of the wage associated with the employee's job and the wage associated with his rank. If this amount is more than three times the average monthly wage of employees in the town in which the individual's place of work is located in the previous financial year, the excess shall not be included in the individual's taxable wage base.

2. Treatment of individual income tax on investment income from pension fund

Distributions of investment income on pension funds shall be paid into individual accounts, and the individual employee shall not pay any income tax on it for the time being.

3. Treatment of individual income tax of annuitants

1) When an employee reaches the official age of retirement and draws a monthly income from his pension plan after this notice comes into effect, he shall pay income tax on the full amount at the rate applying to particular wage/salary items. When an employee reaches the official age of retirement and draws an annual or quarterly income from his pension plan after this notice comes into effect, he shall pay income tax on the full amount calculated on a monthly basis at the rate applying to particular wage/salary items.

2) If an employee and his employer make pension contributions before this notice comes into effect and the individual receives a pension after this notice comes into effect, the employee and employer contributions made before this notice came into effect and the individual income tax paid on them can be deducted so that tax is paid on the remaining amount in accordance with 3. 1) above. If an individual receives a pension in installments, he shall deduct the contributions made before this notice came into effect as a percentage of his total contributions from the amount of income tax payable in the current year and pay tax on the remaining amount in accordance with 3. 1) above.

3) If an individual receives the funds in his individual pension account as a lump sump because he has gone to live overseas or his named beneficiary or heir receives the balance because the individual has died, the recipient of the funds in, or the balance of, the individual account as a lump sum may spread the amount over 12 months. These monthly amounts are taxable in accordance with 3. 1) and 2) above. If an individual receives the funds in, or the balance of, his individual pension account as a lump sum for any other reason, he may not pay the tax in installments. In such a case, the lump sum received shall be treated as one month's salary with tax payable in accordance with 3. 1) and 2) above.

4) When an individual receives a pension, the trustee [i.e., plan administrator], acting on the plan sponsor’s behalf, shall ask the custodian to deduct and pay the tax that is due. The account manager [i.e., record keeper] must provide the custodian with details of the amount payable and a copy of the individual income tax payment form concerned as soon as possible. In accordance with the trustee’s instructions and the documents provided by the account manager, the custodian shall deduct at source the amount of tax due from the individual on the pension he has received in the current year, make an application to the local tax office, and pay the tax.

5) Plan sponsors (employers) and custodians must submit applications for all tax amounts deducted and paid on behalf of all plan members in accordance with the *Individual Income Tax Law* and the relevant sections of the *Law on the Administration of Tax Collection*. Custodians are required to cooperate with the relevant managers and submit applications to the tax authorities to deduct tax at source in accordance with the law.

4. Employers that have sponsored a pension plan must submit a draft of the plan agreement as well as the registration and confirmation documents issued by the Ministry of Human Resources and Social Security along with any documents requested by the local tax office to the local tax office not later than 15 days after the start of the following month. Similarly, if there are any changes to the draft plan agreement, trustees, or custodians, employers must resubmit the above documents to the local tax office not later than 15 days after the start of the following month.

5. The finance, tax, social security, and other related authorities as well as pension organizations must cooperate more closely to ensure that the government’s policies are gradually implemented.

6. In accordance with the provisions of the *Trial Measures for Enterprise Annuities* (Order No. 20 of the former Ministry of Labor and Social Security), the enterprise annuities referred to in this notice are a supplementary form of old-age pension that may be voluntarily joined by employers and employees in accordance with the law provided they are members of the basic old-age pension. Similarly, in accordance with the provisions of the *Provisional Implementation Rules on Public institution Occupational Pension Plans* (Law No. 37, 2011), occupational pension plans are a supplementary form of old-age pension that may be voluntarily joined by public institutions and workers in accordance with the law provided they are members of the basic old-age pension.

7. This notice comes into force on 1 January 2014. The following laws are simultaneously repealed: the *Notice of the State Administration of Taxation on Issues concerning the Administration of the Imposition of Personal Income Tax on Enterprise Annuities* (No.694 [2009], State Administration of Taxation) and the *Announcement of Supplementary Provisions on Issues concerning the Personal Income Tax on Enterprise Annuities* (No. 9 [2011], State Administration of Taxation).

Ministry of Finance, Ministry of Human Resources
and Social Security, and State Administration of Taxation
6 December 2013