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# A Review of the National Social Security Fund in China

BY

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# PRC Population

- Total: 1.33bn
- Rural Population: 750mn
- Urban Population: 580mn

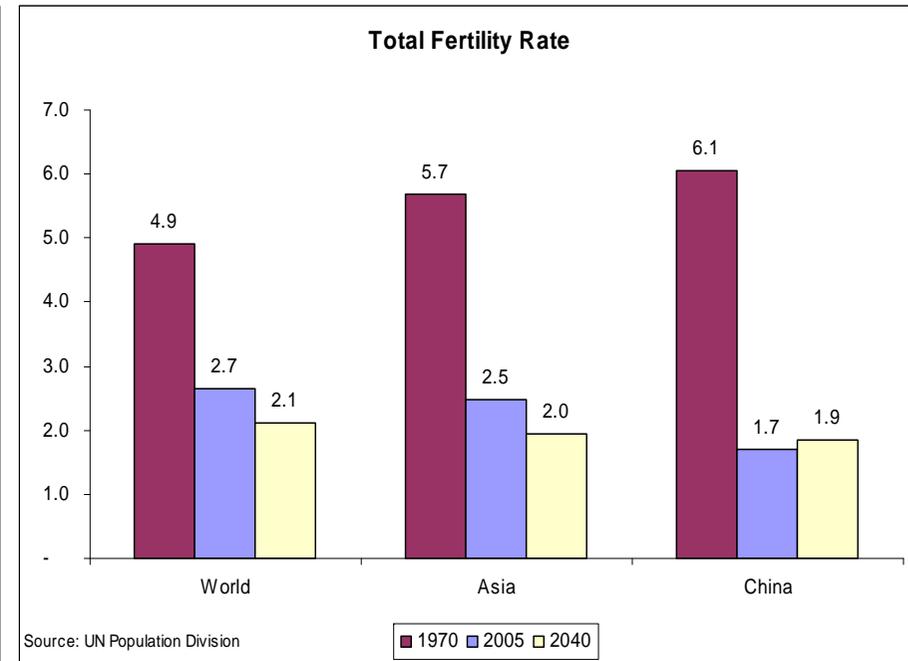
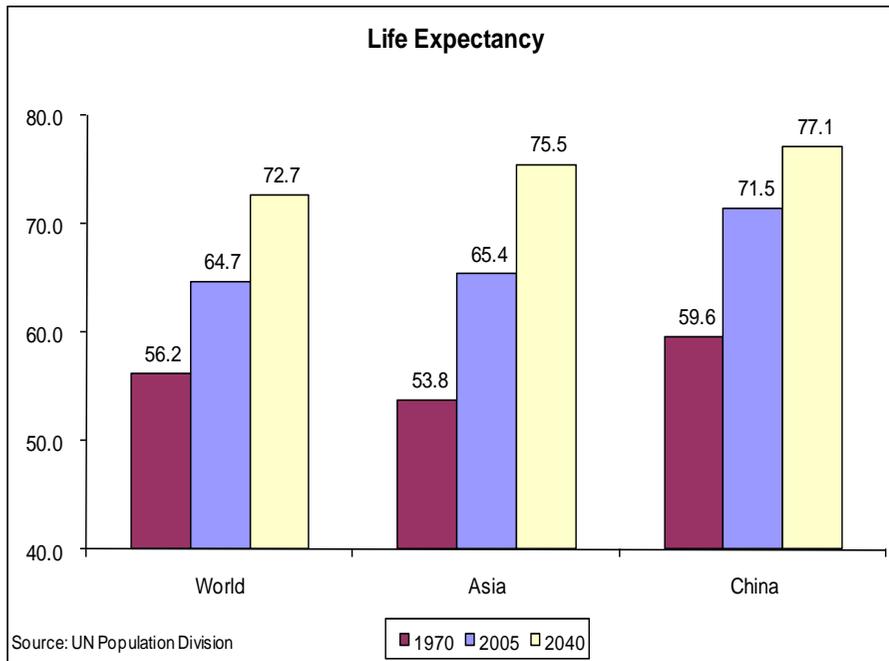
## Population Ages:

- |         |       |
|---------|-------|
| ■ 0-14  | 250mn |
| ■ 15-59 | 900mn |
| ■ 60+   | 180mn |

## Consider:

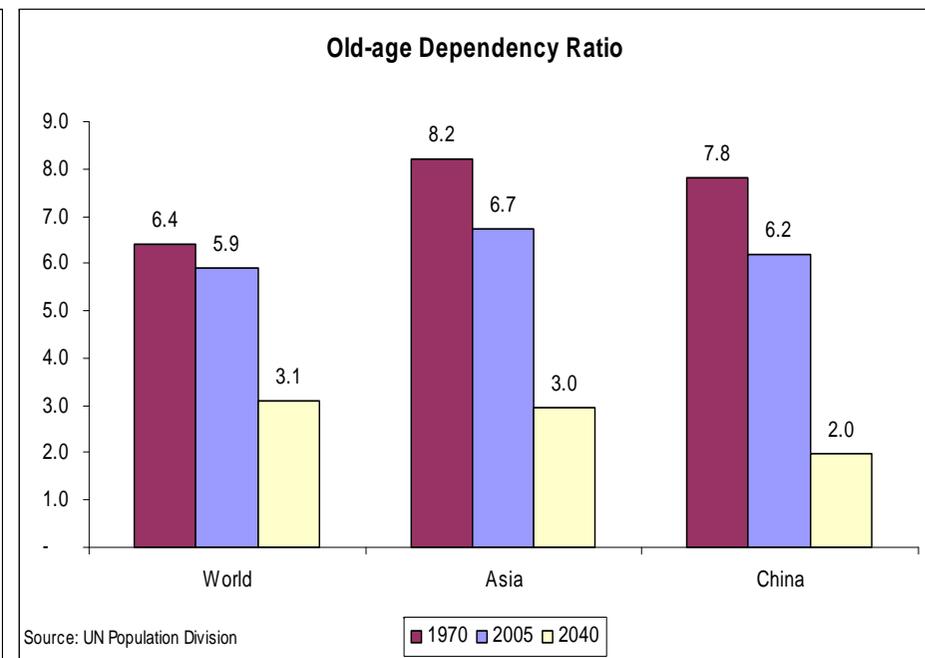
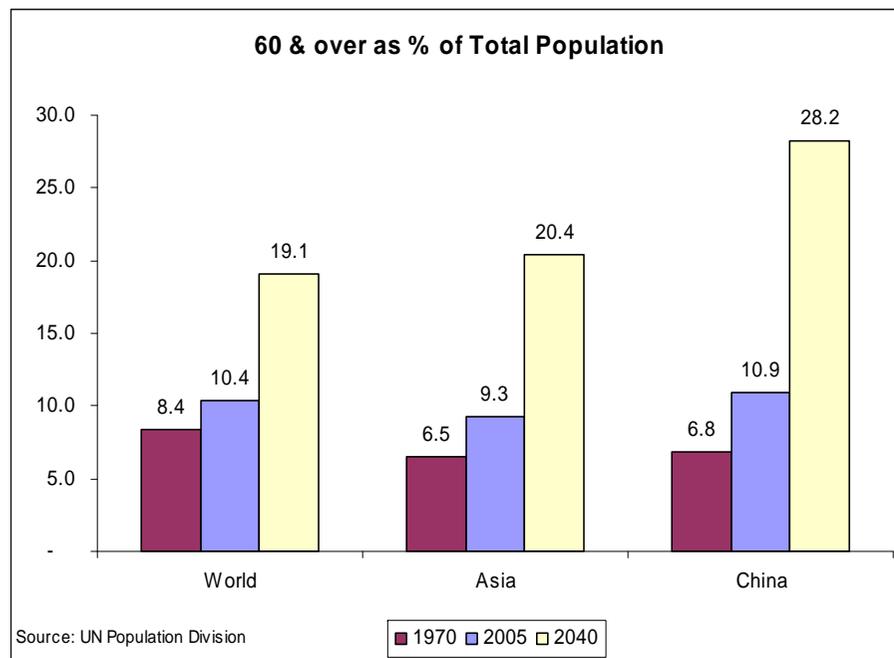
- One child policy
- Greatly improved life expectancy
- Dependency ratio deteriorating rapidly
- Population Sex Ratio(Male/Female): 1.068
- Solve population problem through migration? – NO!

# Demographic Changes Pose Challenges



Source: UN Population Division

# Demographic Changes Pose Challenges (Cont'd)



Source: UN Population Division

# Pension Reform in China

- New Unified Pension System Reform
  - Document 26 – July 1997
  - Document 38 – December 2005
  
- Expand coverage to all urban employees

# China's 5-Pillar Pension System

Pillars (World Bank)		Chinese Terminology	Funded Status	Current Assets
State	Zero	Minimum Guarantee (Di Bao)	PAYG	N/A
	I	Mandatory Social Pooling (Pillar Ia)	PAYG	?
	II	Mandatory Individual Account (Pillar Ib, administered by the state)	Should be Funded	US\$80bn?
Private	III	Voluntary Enterprise Annuity (EA, Pillar II)	Funded	US\$20-25bn?
		Other Voluntary Supplemental Pensions, e.g, Group Pension Insurance (Pillar III)	Funded	US\$25-35bn?
Private & State	IV	Family support; subsidised healthcare and housing?	PAYG	N/A
National Social Security Fund (NSSF)				

# NSSF Overview

- Established in 2000
  - A strategic reserve fund
  - A solution to the ageing problem
  - Pension fund of last resort
    - to help provinces with pension financing difficulties
  
- Grow significantly in size, statue and influence

# Administration of NSSF

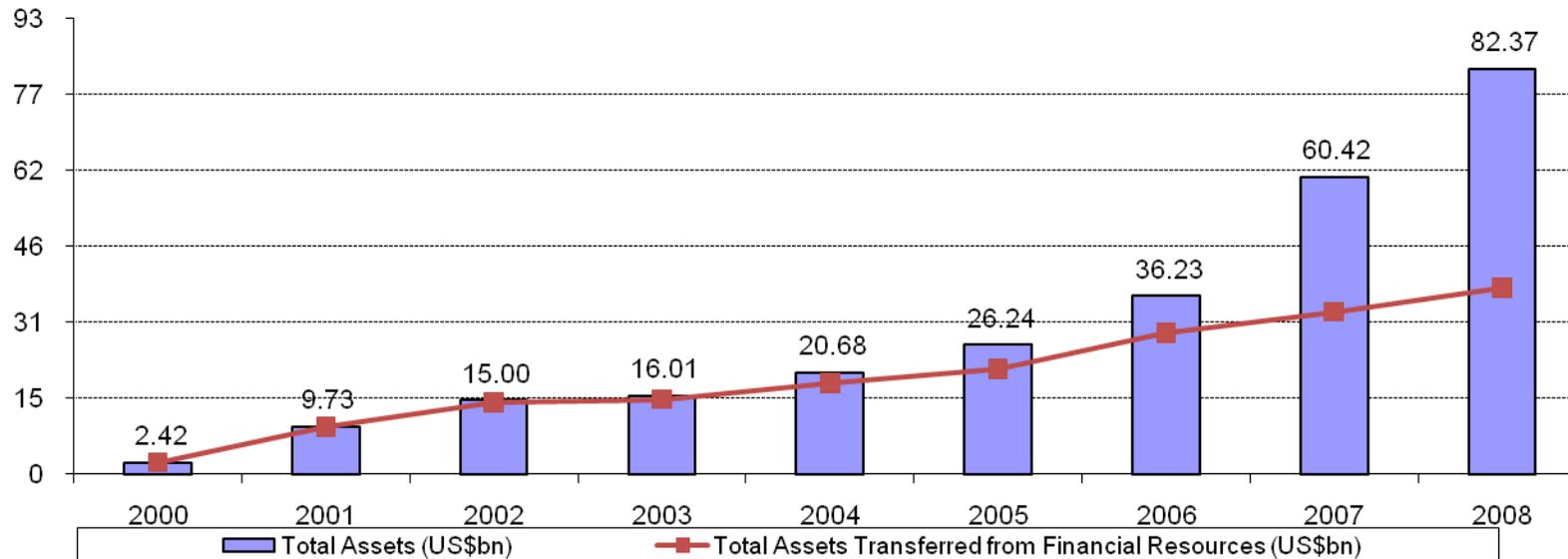
- the National Council for Social Security Fund (NCSSF)
- Responsibilities include:
  - Formulation and implementation of the NSSF's investment strategies
  - Selection of fund managers and custodians for the NSSF assets
  - Monitoring of NSSF funds performance
  - Administration of the assets of the NSSF
  - Providing financial management and accounts for the NSSF
  - Regular disclosure to the public of the financial condition of the NSSF
  - Distribution of funds according to directives jointly formed by the MoF and the MoHRSS
  - Manage individual account money for 9 provinces
  - Undertaking other duties assigned by the State Council

# NSSF Sources of Assets

- State Shares equal to 10% of IPO proceeds
  - A proportion of the IPO proceeds arising from the public offering of state-owned enterprises
  - Domestic & international
- Allocations from central government
  - Historically the largest source of asset accretion for the NSSF
- Lottery license fees
- Investment returns

# NSSF Assets

- Known as the biggest institutional investor in China's pension sector
- Asset size grew 36 fold since inception
- Now about US\$88bn total assets
- To increase to RMB1trn (US\$150bn) by the end of 2010



Source: NSSF annual reports. Currency conversion at year-end exchange rates.

# Regulatory Framework for Investments

- Investment activities governed by:
  - The Preliminary Rules
    - ❑ “The Preliminary Rules on the Administration of the Investments of the National Social Security Fund”
    - ❑ Issued jointly by MoLSS\* and MoF in December 2001
  
  - The Preliminary Rules on Overseas Investments
    - ❑ “The Preliminary Rules on the Management of Overseas Investments of the National Social Security Fund”
    - ❑ Issued jointly by MoLSS\*, MoF and SAFE in March 2006

*\* MoLSS has been renamed to “MoHRSS” since March 2008.*

# NSSF Asset Allocation

- Accounting rules changed starting from Annual Report 2008

## Investment Allocation of NSSF Assets

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
<b>Total Assets (RMB million) at year end</b>	<b>20,017</b>	<b>80,510</b>	<b>124,186</b>	<b>132,501</b>	<b>171,143</b>	<b>211,787</b>	<b>282,768</b>	<b>439,694</b>
<b>Self Managed Assets</b>	<b>20,017</b>	<b>80,510</b>	<b>124,186</b>	<b>100,613</b>	<b>109,876</b>	<b>138,758</b>	<b>177,105</b>	<b>232,754</b>
Bank Deposits	0.6	51,999	93,879	60,017	65,515	102,125	95,165	102,515
Interest Receivable	16	224	1,048	1,446	1,562	1,752	1,754	2,789
Trust Investment Receivables							3	29
Short Term Notes			98	1,073	226	198	199	1,269
Long Term Bonds with < 1 Year Maturity				15,425	4,260	4,216	570	1,570
Long Term Bonds	20,000	27,020	27,895	22,653	26,678	12,737	12,663	39,081
Index Products						3,662	4,293	1,155
Securitization Products						387	972	729
Direct Equity Investments (Bcom, China-Belgium Fund)					11,635	13,682	34,147	38,144
Trust Investments							3,000	18,500
Equity Investments							24,339	26,975
Sinopec IPO Shares / Other		1,266	1,266					
<b>Assets under Third Party Management</b>				<b>31,887</b>	<b>61,268</b>	<b>73,029</b>	<b>105,664</b>	<b>206,940</b>

Source: NSSF annual reports.

# Well-diversified Investment Portfolio

Geographical Allocation	Execution	Permitted investments	Cap
Domestic	Direct	Bank deposits	≥ 50%
		Government bonds	
	Appointment	Equities	≤ 40%
		Fixed income	≤ 10%
		PE funds	≤ 10%
International	Appointment	Equities	≤ 20%
		Fixed income	

# Appointment of Domestic Fund Managers

- 2001 – 2002
  - direct investments only
  - modest returns:  
2% - 3%
  
- Domestic appointment
  - 6 in 2003
  - 4 more in 2004

2003	Fund managers	Equity & Bond	China Southern
			Boshi (Bosera)
			Huaxia (China AMC)
			Penghua
			Changsheng
	Harvest		
2003	Custodians		Bank of Communications
			Bank of China
2004	Fund managers	Stable allocation	CICC
			China Merchants
			E Fund
			Guotai

# Strategic Investments in Pre-IPO Shares

Institutions	Year	Amount	Return
Bank of Communications	2004	RMB 10 bn (US\$1.2bn)	US\$3bn as of May 2009
Bank of China	2006	RMB 10 bn (US\$1.2bn)	
ICBC	2006	RMB 10 bn (US\$1.2bn)	
Beijing-Shanghai High-speed Railway	2008	RMB 10 bn (US\$1.2bn)	12% p.a. (Expected)

- Pre-IPO investments
  - at extremely attractive prices
  - virtually risk-free
- NSSF acting as a strategic investor

# Involvements in Private Equity

- NSSF granted permission in May 2008
- Currently restricted to domestic investments only
  - Up to 10% of the Fund's assets
  - 4 investments so far
    - ✓ China-Belgium Direct Equity Investment Fund (RMB0.15bn)
    - ✓ Bohai Industrial Investment Fund (RMB1bn)
    - ✓ CDH Investments (RMB2bn)
    - ✓ Hony Capital (RMB2bn)
  - may invest in 3 to 5 more PE funds this year
- Applying for approval to invest in foreign PE funds

# First Batch of International Investments

- Permitted by State Council to use its own FX to invest abroad in 2006
- Appointed international investment managers in November 2006
  - 5 mandates
  - 25 short-listed fund managers out of 100+ initial candidates
  - 10 winners selected in November 2006
  - Selection of 2 global custodians in July 2006
- Second batch of mandates issued in May 2008
  - Winners to be announced
- Current Allocation: 6%

# First Batch of Overseas Investment Initiatives

Mandate	Index	Target Net-of-Fees Excess Return p.a.	Tracking Error
Global (ex-US) Equities	MSCI World (ex USA)	+ 200 bps	Within 8% p.a.
US Equities	S&P 500	+ 50bps	Within 2% p.a.
Hong Kong Equities	FTSE/Xinhua Hong Kong	+ 300 bps	Within 8% p.a.
Global Fixed Income	Barclays Capital Global Aggregate Bond	+ 100 bps	Within 2% p.a.
Cash	6-month LIBOR	0	N/A

Source: NSSF website

# General Qualification Criteria for Managers

- financially stable
- at least 6 years of asset management history
- staff meets all criteria of country of domicile
- risk management system in place
- no compliance violations within past 3 years
- domiciled outside of PRC, and the regulatory authority has signed a MOU with CSRC

Applicants also required to have AUM of no less than **US\$5bn** for second selection

*Source: NSSF website*

# First Batch of NSSF Overseas Mandate Winners

Mandate	Managers
Hong Kong Equities	Allianz; Invesco; UBS/CICC
Global (Ex-US) Equities	AllianceBernstein; AXA Rosenberg
US Equities	JanusINTECH; T. Rowe Price
Global Fixed Income	AllianceBernstein; Blackrock; PIMCO
Cash	Blackrock

- Global custodians: Citibank; Northern Trust

*Source: NSSF website*

## Second Batch of Overseas Investment Initiatives

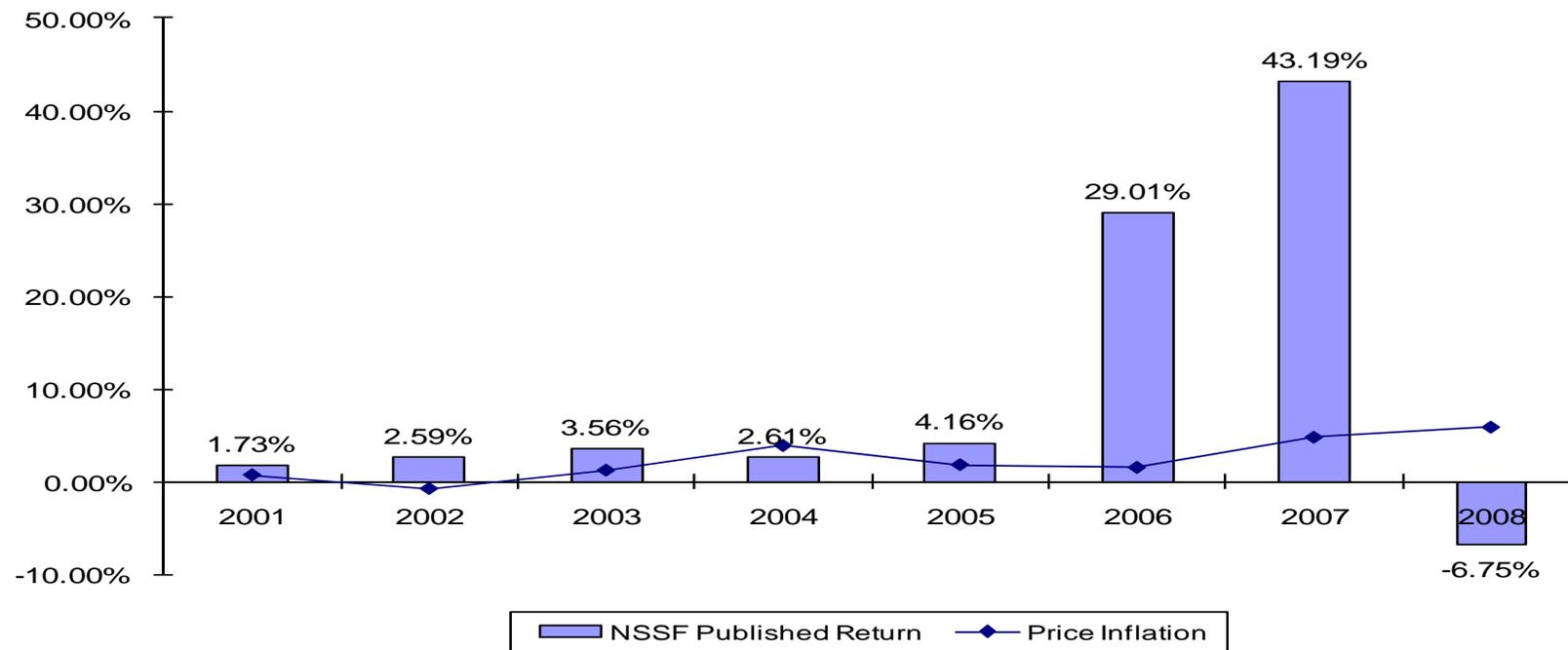
Mandate	Index
Active China Overseas Equity	MSCI China Index
Active Asia Pacific (ex Japan) Equity	MSCI All Countries Asia Pacific ex Japan Index
Active Emerging Market Equity	MSCI Emerging Market Index
Active European Equity	MSCI Europe Index
Active Global Equity	MSCI World Index

*Source: NSSF website*

- No target return or tracking error was specified.

# Investment Returns

- 9% p.a. for 2001-2008
- Profit of RMB160bn (US\$23bn)



Source: NSSF website

# Future Investment Approach

- Increase equity investments
  - From currently 20-25% to 40%
  
- Increase investments in private equity
  - Especially in infrastructure projects
  
- Reduce allocation in fixed income assets
  - Will take place gradually
  
- Increase overseas investments
  - From currently 6% to 20%

# Challenges

- **Objectives and Purposes**

- Lack of clearly defined objectives and purposes

- ❑ Does it really cover all types of social security or focuses purely on pension needs?

- ❑ How will the NSSF Funds be applied as “strategic reserve”?

- Becoming less like pension fund and more like sovereign wealth fund?

- **Legal Structure**

- Not established under trust

# Challenges (Cont'd)

- **Composition of the NCSSF**

- Key staff moved to CIC
- Strong ties with key government departments
- Inclusion of Independent Directors?

- **Investments**

- NSSF managing individual account money for certain provinces?
- Asset allocation should relate to liabilities profile, but this is uncertain

# Challenges (Cont'd)

- **Disclosure and Transparency**

- Data published only once a year in the form of an annual report
- Annual reports are abbreviated
- Increasing sophistication
- Willingness to learn from international best practices
- Adoption of accounting standards?

Thank You!  
Questions?