Corner Office Views

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Corner Office Views

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Where Is the Potential in China's Retirement Market?

China's third pillar pensions has the most promising opportunities for managers wanting to break into the country's huge retirement market

Key Points

- China has so far been relying heavily on the first pillar to fund retirement. It accounted for more than 80% of total retirement assets as of end-2019.
- The second pillar comprises Enterprise Annuity (EA) and Occupational Annuity (OA). The latter holds more opportunities for managers, as it is mandatory for all civil servants.
- Amid impending expansion in the country's third pillar, managers' patience in educating investors and consistent performances are essential in breaking into the huge market.

The Aging of the Largest Population

China's old-age dependency ratio is set to quadruple to 44% over 50 years to 2050, according to the World Bank, yet the retirement funding gap continues to widen. According to the state-run Chinese Academy of Social Sciences, the country's Basic Pension (BP) system may be depleted by 2035 as the world's largest population ages, with its chief component–the urban workers' BP–expected to run into deficit after 2028, surpassing RMB11 trillion (US$1.6 trillion) in 2050.

China has so far been relying heavily on the first pillar to fund retirement. The BP and the National Social Security Fund (NSSF) together form the first pillar of China's retirement market, which accounted for more than 80% of the total retirement assets as of end-2019. The NSSF is expected to increase its outsourcing, but it could be very selective of foreign managers.

> Regulatory change in the third pillar will encourage fund manager and insurer participation.

The second pillar, comprising EA and OA, is mostly targeted at employees working in big or state-owned enterprises (SOEs) and civil servants, but covers only a small portion of the country's vast population. The OA holds more opportunities for managers, as it is mandatory for all civil servants.

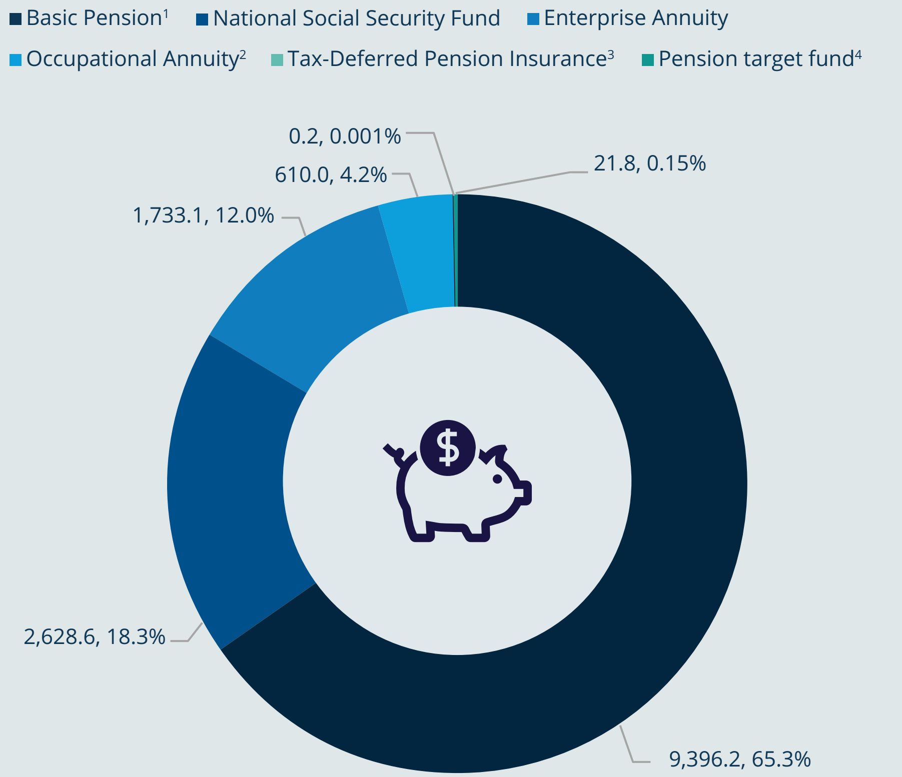
The fledgling third pillar is an area where Cerulli expects regulatory changes, which will encourage deeper market participation by fund managers and insurers.

Growth of the third pillar?

Following a guideline by the State Council's guideline in 2017, which laid out the government's intention to support the growth of the third pillar, Shanghai, Fujian Province, and Suzhou Industrial Park began to pilot the tax-deferred commercial pension insurance scheme. Under the plan, individuals can defer tax on part of their income to buy private pension insurance until they retire.

The regulator also introduced pension target funds (PTFs) in early 2018 to allow fund managers take part in the third-pillar pension space. However, they were not included in tax benefit schemes at the time of writing.

Breakdown of Chinese Retirement Assets, 2019 (RMB billions)



Source: Ministry of Human Resources and Social Security, Cerulli Associatesa

Analyst Note: [1]Excludes portion outsourced to NSSF. [2]As of end-May 2019. [3]Accumulated premium income.

Lukewarm response

As of April 2020, the tax-deferred pension insurance scheme accumulated premiums of around RMB300 million and about 47,600 scheme participants through three types of private pension products (income-determined, income-guaranteed, and floating-income products), far below the market's expectation, according to media reports. While some market players doubt that the tax-deductible amount—6% of monthly labor income or RMB1,000, whichever is lower—is sufficient to lure participants, limited pilot regions could explain the lukewarm response to the scheme.

Other possible reasons include low income, tedious processes in claiming tax deductions, unattractive product returns (2.5% to 3.5% for pension insurance products, similar to returns of money market funds, which are more liquid), a volatile stock market, and the lack of long-term oriented investment mindsets. Furthermore, no new products were included in the tax benefit scheme in May 2019, one year after the start of the pilot.

Recently, however, the authorities announced the initial design of a new voluntary retirement pension system, which will provide tax incentives for eligible mutual funds and bank-issued wealth management products. You Jun, a vice minister with the Ministry of Human Resources and Social Security, said during a press briefing in February 2021 that the new private pension scheme will be introduced on an "individual account-based, voluntary participation basis". No specific timeline was given, but he said it will be launched "as soon as possible" and it will encourage the growth of China's third-pillar pension system.

China's Retirement Investable Assets, 2015-2019 (RMB billions)

Retirement	2015	2016	2017	2018	2019
Basic Pension System[1,2]	5,953.2	6,635.0	7,731.2	8,956.1	9,681.1
National Social Security Fund[2]	1,913.8	2,042.3	2,223.1	2235.4	2,628.6
Enterprise Annuities	926.0	1,067.3	1,239.1	1,423.0	1,733.1
Occupational Annuity[3]	N/A	N/A	N/A	N/A	610.0
Individual Tax-Deferred Commercial Pension Insurance Products[4]	N/A	N/A	N/A	0.1	0.2
Pension target fund	N/A	N/A	N/A	4.1	21.8
Retirement market size	8,504.7	9,400.1	10,952.0	12,371.8	14,389.9
Outsourced AUM (%)[5]	23.1%	23.1%	25.6%	26.5%	30.7%

Source: Cerulli Associates | Analyst Note: 1.Includes worker pensions, rural citizen pensions, basic medical insurance, work injury insurance, and unemployment insurance. 22 provinces agreed to outsource RMB1,093 billion to the National Council for Social Security Fund (NCSSF) as of end-2019, and RMB908. 1 billion has been transferred to the NCSSF. 2. Provinces have outsourced RMB100 billion to the NSSF. 3. Figure as of end-May 2019. 4. Premium income. 5. Includes all third-party managers for enterprise annuities, not restricted to fund management companies.

Some managers told Cerulli that mutual fund buyers could be more responsive to tax incentives compared to insurance policyholders. Once individual account issues are resolved, they expect good prospects for PTFs to at least distinguish themselves from similar balanced funds or ordinary funds of funds.

Need for stable products

Cerulli believes that managers should provide stable products amid China's volatile stock market, so that investors can see their assets accumulate in the next three to five years, and gradually build their awareness of investing in mutual funds for their retirement needs. Managers who are patient in educating investors and show consistent performances should eventually be able to break into the huge market.

Although the retirement space seems limited for global managers at this moment, the recent rule changes on foreign ownership of pension insurance firms and FMCs will enhance the accessibility of Chinese retirement assets to some extent. Foreign managers that are optimistic about the market's long-term potential should prepare early and try to build their onshore reputation before the rules of the scheme are officially implemented.

Limited pilot regions could explain the lukewarm response to the scheme.

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