



# China Pensions Landscape

*The year in review and  
what's ahead*



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# Introduction

Welcome to KPMG's third annual report tracking developments in China's pension industry. This is a topic of great economic significance. As the world's most populous country, China has an ageing society and is developing the infrastructure to take care of a growing number of elderly people. The topic also has business significance, especially for financial companies able to find opportunities in the fast-growing pension sector.

This report updates and builds on our findings from last year. That report identified sector convergence as one of the most distinct features of the Chinese pension industry, as well as highlighted several strategic themes that will influence its long-term development. In the pages that follow, we explain the most recent developments and their strategic implications.

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# 2018 – Overview



There have been a number of significant developments over the last 12 months demonstrating that both government and the broader Chinese public are paying greater attention to the pension system. In addition to more discussion about the country's pension deficit, there were a number of regulatory changes, such as the increased amount of active management of pension funds and the start of tax benefits for individual pension contributions.

Here is a summary of the key development highlights affecting each pillar of the pension system:

## Pillar One – Government scheme

There were increased efforts to better utilise external professional investors, with the Public Pension Fund (PPF) announcing a series of qualification requirements as well as vendor selection results on external fund managers and custodians. The government also made two important announcements. First, all enterprises must contribute to their employees' PPF accounts in proportion to actual salaries. Second, all contributions to and expenses from local PPF accounts must be centralised at the provincial level by 2020. These are critical steps to ensure the accountability and, consequently, the long-term sustainability of the national pension scheme. That said, the amount of central government subsidy and the number of provinces running a PPF deficit continue to grow.

The National Council for Social Security Fund (NCSSF), on the other hand, continues to enlist share transfers



from state-owned enterprises (SOEs) to consolidate its financial status. In parallel, the NCSSF is receiving more investment mandates from provinces. Its PPF money under management stood at RMB 750 billion at 3Q 2018, according to various sources. The fund has also announced an environmental, social and governance (ESG) focus, a sign that it will upgrade its requirements for external managers.

In light of expenditures in the government scheme being higher than expected, the first pillar appears overall to be poised for a less robust rate of growth over the long term. Constraints on central government expenditure mean that the growth rate will largely be affected by how quickly more state-owned companies' shares can be injected.

## Pillar Two - Enterprise annuities and occupational annuities

Enterprise annuities continued on their steady, if lukewarm, growth trajectory. The scheme is still in the process of fully incorporating rules issued jointly by the Ministry of Human Resources and Social Security (MoHRSS) and the Ministry of Finance (MoF) in December 2017, meaning detailed operational guidelines have yet to be fully fleshed out.

The occupational annuities scheme is facing a similar situation. The market has seen steady funding of occupational annuities plans, but it has not yet seen

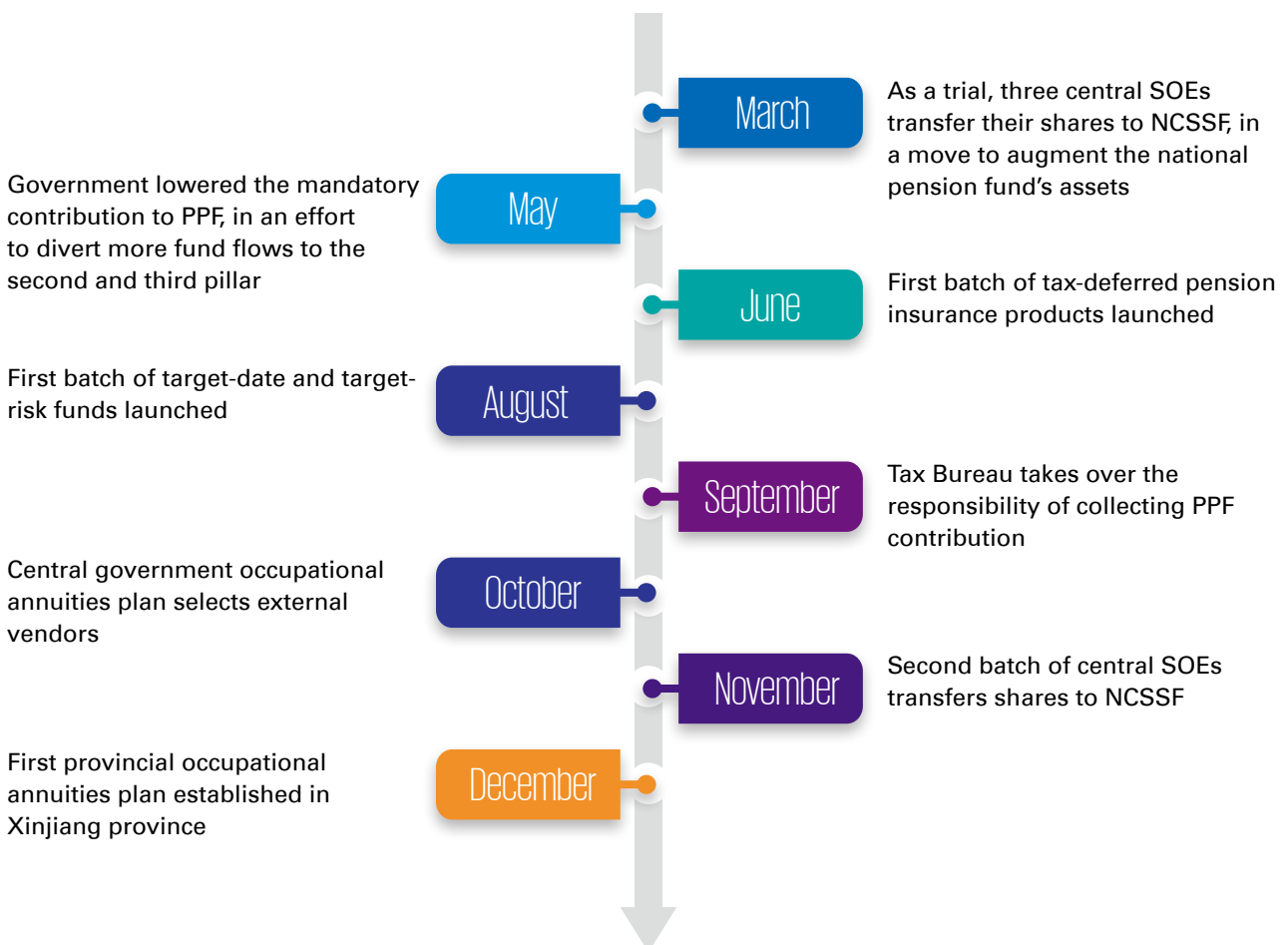
fully developed national rules converted into directives that can be acted on a provincial level. Despite some short-term uncertainties and slow growth numbers, a stronger platform was secured for Pillar Two – including the use of external managers, detailed operational guidelines and continuous funding – and it now looks likely to realise its long-term potential and faster growth.

## Pillar Three - Private pensions for individuals

The biggest development for the overall system happened in this pillar, due to the introduction of the first tax-deferred pension insurance products, which marked the start of private pensions in China. On a trial basis, the tax benefits will be offered in three locations: Shanghai, Suzhou Industrial Park, and Fujian province. Fund managers in China have also launched their own version of the pension products, with target dates and target risk funds, though tax incentives have yet to be offered.

We estimate that the total size of China's pension assets grew by 20 percent in 2017 to RMB 11 trillion (USD 1.6 trillion) and will likely finish the year 2018 with a similar growth rate. Furthermore, the pace of change over the last year prompts us to maintain our forecast for the size of China's pension system by 2025 at RMB 45 trillion (USD 6.7 trillion).

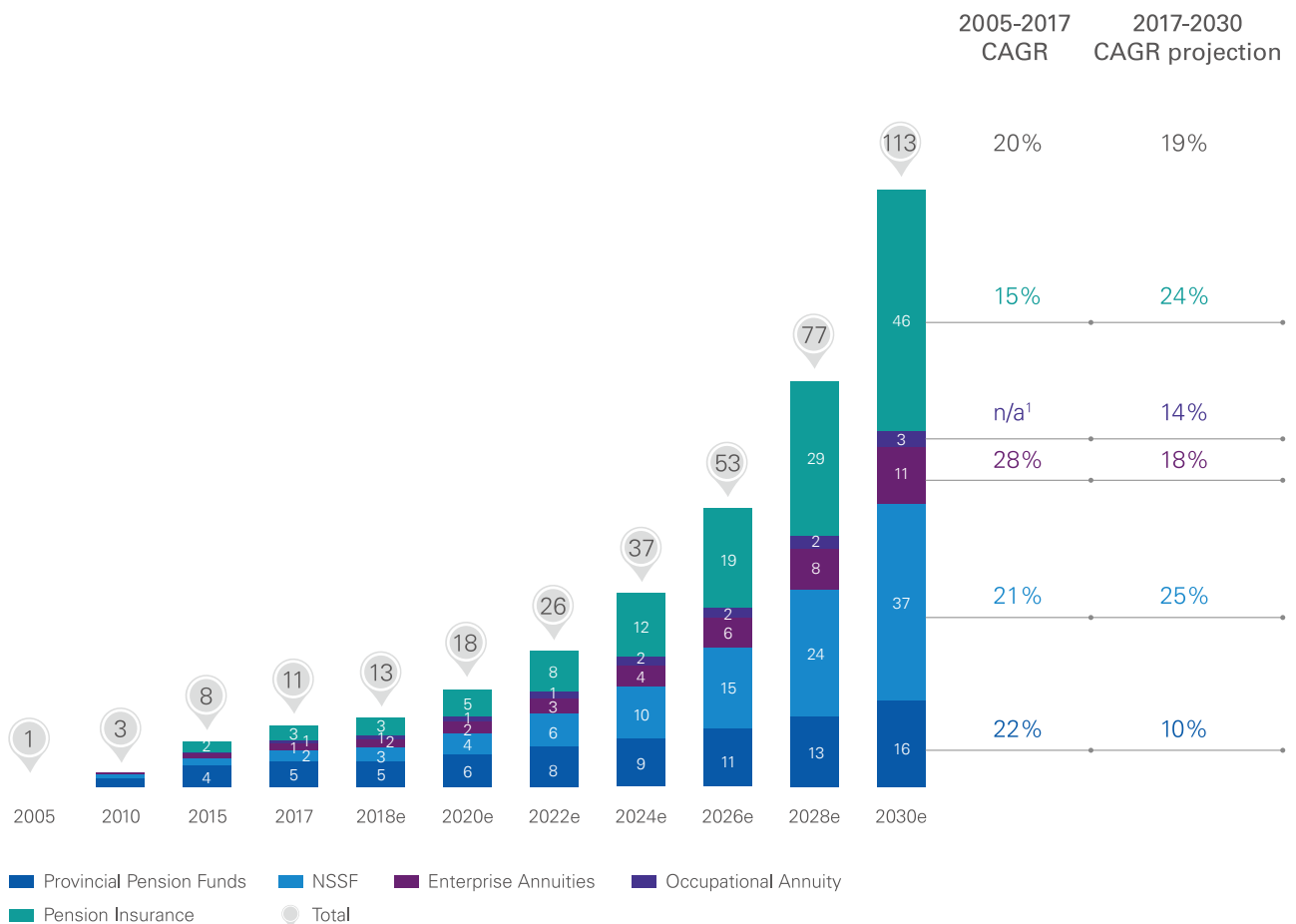
## 2018 key events in China's pension industry development



Sources: CBIRC, CSRC, NCSSF, Chinese provincial authorities and KPMG analysis

# China pension market size expected to reach 113 trillion by 2030

## China pension market size projection (2005-2030, CNY trn)



Note(s): 1. Occupational annuity officially launched in 2015  
 Sources: MOHRSS, CBIRC, CSRC, AMAC and KPMG analysis

# Key developments



## 1 Rapid product development and inter-industry competition

The tax concessions in the third pillar have motivated insurance companies and fund managers to improve their product offerings in order to compete for growing demand from private individuals. Insurance companies are currently the only companies allowed to offer pension products that incorporate the new tax benefits; these come from six insurers that have a specialised pension subsidiary. Another six insurers include several joint ventures. Apart from the tax incentives, the products do not differ greatly from what was available in the past. In the healthcare insurance sector, the tax benefit alone is not enough to determine the growth of an entire product category. Product manufacturers must make a significant strategic investment in the category before the business can flourish.

Asset managers are currently unable to offer products allowing the buyer to enjoy tax benefits, which means they compete by offering innovative features. Common characteristics of their pension products include target risk and target date. It stands to reason that once the trail of pension insurance products succeeds, the tax benefits will not only be rolled out on a national scale but also be extended to products from fund management companies.

The growth in private pensions means that more products will hit the market once a national framework is provided. Fund managers will likely be more active





in product development than their counterparts in the insurance industry, as they respond to encouragement from the securities regulator, as well as capitalise on their investment expertise.

The success of these products will be measured according to their ability to attract inflows. Strong product design will not be enough to secure new business, as it will need to be accompanied by investor education, robust fund administration, transparent reporting and risk management.

## 2 New developments in pension tech

Pension tech is still in its early stages in China. The local fintech industry remains highly skewed towards payments, and there are no standalone companies dedicated to providing pension-tech solutions. The industry clearly needs to gain momentum, and we expect ambitious and progressive companies to allocate resources into this technology. There are three areas of the financial industry that could generate a breakthrough:

- **Robo-advisors:** We expect robo-advisors will be more prominent in the pension space over the next 12 to 18 months. It is a move that makes sense, as they would be a natural partner for companies providing retail pension solutions. Local companies include the client-facing Licai and

Clipper, as well as other fintech companies that focus on middle- and back-office functions.

- **General financial apps:** Popular payment apps such as WeChat Wallet have expanded the range of products distributed. Alipay, for example, has recently included pension products in its offering.
- **Traditional financial companies:** Banks, insurers and asset managers are often overlooked in discussions relating to fintech, but these traditional players are investing significant capital to upgrade their retail customer experience. China Merchants Bank, for example, runs the country's best known and largest robo-advisor. The pension-tech breakthrough may come from a traditional company.

## 3 Sectoral convergence

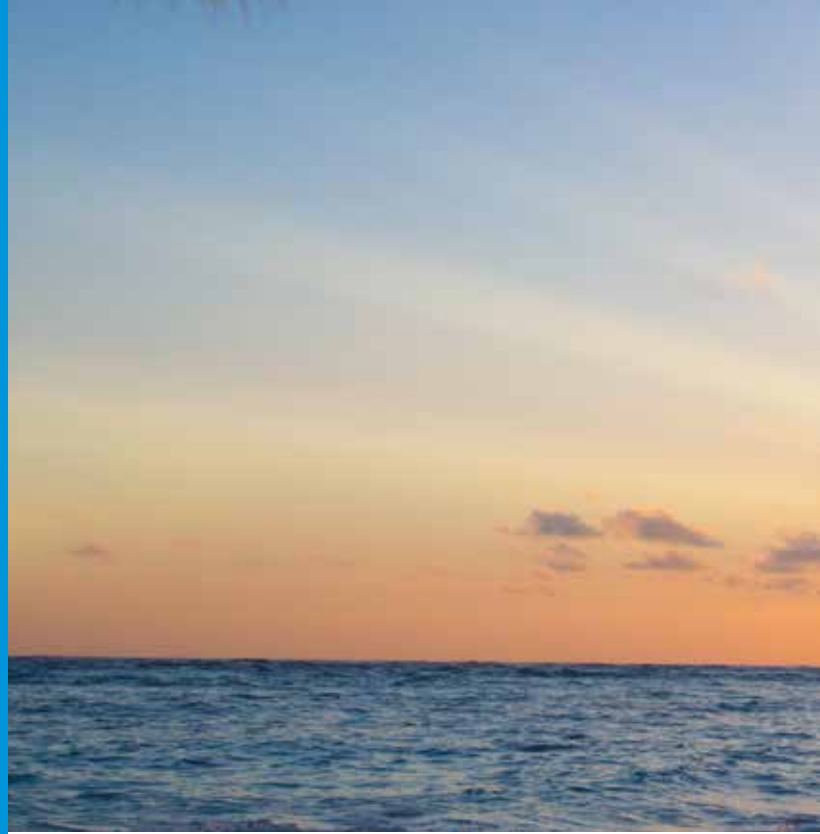
There is more to pensions than finance, as evidenced by the variety of related industries involved in elderly care. These sectors are coming together, and a number of noteworthy developments have emerged over the past year.

- **Care facilities:** Insurers and property developers are growing more interested in investing in care homes specialising in elderly residents. They are able to generate returns over the long term that are hard to find in China's securities market.

- **Technology:** Devices in the Internet of Things (IoT) and care appliances used by the elderly can also enhance the provision of pension services via the data provided from sensors monitoring everything from body mass to blood sugar levels, placed in devices as diverse as watches, scales and location sensors. As the ecosystem becomes more interconnected, opportunities will arise for a centralised commercialisation of the data points.
- Once the available information reaches a critical mass, the adoption of devices will accelerate rapidly. The initial challenge for companies in this space is penetrating an older demographic that is not as accustomed to technology as younger consumers. The solution will likely be to sell via relationships with facilities and properties. This could also create incentives and value for parties in different industries to collaborate.



# Forecast



There are several important trends we expect to play out over the short to medium term:

## 1 Regulations

**Broader tax incentives.** The current tax regulation allows participants to defer up to RMB 85 of tax for every RMB 10,000 contributed to the pension scheme. But when participants start drawing money from the pension savings account, the draws will be subject to a 7.5 percent weighted tax rate. It is expected that more tax benefits will be provided to make the system more attractive, thus attracting greater contributions to the pension pool. At the same time, regulators and policymakers will likely reduce the administrative costs that scheme participants currently have to pay.

**More licenses.** In order for the pension industry to grow, more licenses will have to be granted to service providers across all three pillars. Only a few companies were allowed to take part in this year's trial programme. We expect that the next batch of licenses will be granted about 12 months following the initial launch, once the regulator is comfortable with day-to-day operations in the industry.



## 2 Differentiated pension solutions

Pension solutions in the retail market remain generic in nature, as China has yet to produce a financial company offering a distinct solution. A looser regulatory framework should allow product differentiation, while demand from both elderly and middle-aged consumers will promote innovation. This means we could be close to the stage where the country's pension system turns into a meaningful business for the entire value chain of the financial industry.

## 3 Environmental, social and governance (ESG)

One way pension providers can differentiate themselves is by offering ESG products. Although no Chinese companies have made ESG part of their pension provisions, a number of companies have been asked to include ESG criteria when they pursue opportunities from overseas clients. Government policy also points in this direction, as regulators encourage listed companies to enhance their ESG reporting. We believe it is only a matter of time before ESG becomes a significant part of how asset owners select their external managers, which in turn will filter down to the pension industry.





# Conclusion

In 2018, China's pension industry witnessed several important breakthroughs, some of which the industry had waited years to see. These included the injection of state-owned assets, tax deferrals for pension insurance products, and the funding and professional management of occupational annuities assets. At the same time, 2018 brought a continuation of earlier patterns such as demographic changes presenting challenges in striking a balance across the three pillars while a reliance on professional third parties kept increasing.

In 2019, further developments within the current framework are expected, including more government funding, additional awards for external managers, and the likelihood of tax benefits for pension products offered by fund management companies. That said, how China's pension industry can respond to the long-term challenges will depend on how quickly various participants with different backgrounds and even divergent goals can contribute to building a stronger national framework.



# About KPMG

KPMG member firms and its affiliates operating in mainland China, Hong Kong and Macau are collectively referred to as “KPMG China”.

KPMG China is based in 21 offices across 19 cities with around 12,000 partners and staff in Beijing, Changsha, Chengdu, Chongqing, Foshan, Fuzhou, Guangzhou, Hangzhou, Nanjing, Qingdao, Shanghai, Shenyang, Shenzhen, Tianjin, Wuhan, Xiamen, Xi’an, Hong Kong SAR and Macau SAR. Working collaboratively across all these offices, KPMG China can deploy experienced professionals efficiently, wherever our client is located.

KPMG is a global network of professional services firms providing Audit, Tax and Advisory services. We operate in 153 countries and territories and have 207,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

In 1992, KPMG became the first international accounting network to be granted a joint venture licence in mainland China. KPMG was also the first among the Big Four in mainland China to convert from a joint venture to a special general partnership, as of 1 August 2012. Additionally, the Hong Kong firm can trace its origins to 1945. This early commitment to this market, together with an unwavering focus on quality, has been the foundation for accumulated industry experience, and is reflected in KPMG’s appointment for multi-disciplinary services (including audit, tax and advisory) by some of China’s most prestigious companies.

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Publication number: HK-STRATEGY19-0001

Publication date: March 2019