



China Pensions Reform

Winning strategies for global asset managers amid evolution in retirement market



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Foreword

The profound shift in demographics in the Chinese Mainland is not new, but the ageing population could deliver an acute challenge to the nation's economic growth prospects in the near future if the potential pensions shortfall is not dealt with properly.

The Central Government is fully aware of the challenges, and has been carrying out reforms of its pensions framework over the last three decades, with a noticeable uptick in pace since the end of 2022 as the new individual private pension system gets off the ground. China understands it needs to transform its pension system, to provide a better retirement for its large population of older people and to help ensure the long-term social stability of the country. This journey will not be simple, however. Creating a sustainable pensions framework is a complex, multi-dimensional challenge, which will require stakeholders across public and private sectors to work together. At the same time, China is facing other economic headwinds including real-estate and debt problems, post-pandemic recovery and geopolitical tensions with the United States.

Having said that, we see substantial opportunities for all participants in the pensions ecosystem to tackle this challenge and to help Chinese citizens plan for their retirement. With the urgent need for reform, China is open to new and fresh ideas, and is ready to take practical measures including taking advantage of lessons from other jurisdictions as well as embracing new technology-enabled solutions. For many global asset managers and capital market institutions, the potential pool of pension assets presents a tremendous market opportunity as it continues to grow in size and scale.

This report is co-authored by KPMG China and ASIFMA Asset Management Group to provide our perspectives on some of the potential reforms, and considerations for global asset management firms in forming a winning strategy in this space. We hope you enjoy the insights and information in this report. Please feel free to get in touch if you would like to discuss the opportunities in China's pensions market in more detail.



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Executive summary

Huge opportunities for global asset managers are opening up in China's pension market as the nation's retirement programme undergoes a major programme of reforms. In particular, the recent introduction of private individual pensions has created a new and potentially massive market.

This area is very new and has so far been undergoing pilot programmes, but the potential is promising.

A number of interrelated elements are fuelling the case for change in China's pensions system: an ageing population, rising healthcare expenses, unsustainable funding for Pillar 1, and inadequate pensions provisions. The research in this report shows that the current situation will not be able to support the nation's growing elderly population in the future.

But reform of the pensions system is already under way, and while the Central Government has not revealed a detailed plan, there are compelling reasons to believe further changes are likely. The potential reforms come under five key themes:



The **overall pension system** could see a clearer top-down vision, including further clarity on how the three-pillar system will be designed, and guidance on the overall roadmap to be more sustainable and offer adequate post-retirement income.



Streamlining of the current regulatory governance framework would make it easier for firms to participate in the market, giving them the opportunity to share their expertise in delivering products and services to help address the pension challenge.



The **operational design of each pillar** could be optimised to increase the level of participation and contribution. For example, mandatory enrollment for enterprise annuities under Pillar 2, and additional tax incentives for participation in Pillar 3.



The types of **eligible investments** for pension products could be relaxed further. Greater diversification, including more access to overseas products, would help pensions savers obtain stable, long-term risk-adjusted returns.



There will also need to be a change to **individuals' mindset and behaviour** as responsibility for funding retirement shifts from the state and family to the individual. As private pensions in particular are a new concept, education will be needed to ensure people are aware of the benefits of pension savings.

As these market reforms accelerate, Pillar 2 and Pillar 3 pension assets could grow to an estimated total of RMB 15-21 trillion by 2030, creating new opportunities for all participants, including global asset managers.

While there are huge opportunities, foreign financial firms will need to carefully consider their strategies as they enter the market. They will need to consider their circumstances and competitive edge when deciding where to play in the China pensions market. They will also need to actively consider the regulatory environment and work to build relationships with the various regulators.

Having a proven track record in investment return and risk management capabilities will help firms to win Pillar 1 mandates, which are issued quite infrequently. For Pillar 2, it is additionally important for firms to build and maintain relationships with trustees in both enterprise annuities and occupational annuities.

As the Pillar 3 framework is rolled out, key success factors will include product design, where overseas firms already have considerable experience. Product distribution is another key factor, to ensure that they reach the large potential customer base and have access to data from customers. Localised marketing campaigns as well as an understanding of the unique Chinese market will help global asset managers to access the China pensions opportunity.

01

China pensions market



From 'iron rice bowl' to individual choice

China's elderly support system has been led by the state since launch, and the pensions framework has continued to depend on state support even as the nation has undergone huge economic growth.

The first formal pensions scheme, the Basic Old-Age Insurance System for Employees (BOISE), was launched in 1951, followed the next year by the Basic Old-Age Pension System for Civil Servants (BOPSCS). These schemes were part of the "iron rice bowl" of job security and life-long benefits for urban workers, and did not require a financial contribution from individuals.

Little changed until 1991, when the Pillar 1 system was introduced. This included a reform of BOISE to include employee contributions, and a new scheme for rural residents that also included personal contributions, but with the state still playing the major role.

As of today, Pillar 1 accounts for around 60% of the overall pension system, including RMB 5.3 trillion of Urban Employee Basic Pension, and RMB 1.1 trillion of Urban and Rural Residents Basic Pension.

The National Council for Social Security Fund (NCSSF) manages both the Pillar 1 Basic Pension fund, as well as the National Social Security Fund (NSSF), which is a provident fund that covers all employees in the private sector that are not covered by the government's pension scheme.

There are opportunities for external asset managers in the Pillar 1 schemes. Investment in the Basic Pension is limited to the onshore capital market, while NSSF assets can be invested both on and offshore. Of the 55 licenced asset managers to outsource mandates under NSSF, 37 are offshore firms including Allianz, Blackrock and JP Morgan.

Pension Asset Allocation

As of 2021

 Pension Asset  Asset Manager

	Pension Asset	Asset Manager
Pillar 1	Urban Employee Basic Pension (UEBP) RMB 5.3 tn	Local governments reserve for pension payments RMB 4.9 tn
	Urban & Rural Residents Basic Pension (URRBP) RMB 1.1 tn	Managed by NCSSF RMB 1.5 tn
		Managed within NCSSF RMB 0.9 Tn
Pillar 2	Enterprise Annuity (EA) RMB 2.6 tn	Outsourced to eligible EA asset managers RMB 2.6 tn
	Occupational Annuity (OA) RMB 1.8 tn	Outsourced to eligible OA asset managers RMB 1.8 tn
Pillar 3	Individual Pension	Managed by eligible pension asset managers

Asset Management Institution

By type of financial institution

	Pillar 1	Pillar 2	Consolidated with duplicates removed (JVs)
Fund Management Companies (FMCs) ¹	14	11	16 (7)
Pension Insurance Companies ²	3	7	7 (1)
Insurance Asset Management Companies ³	3	2	3 (-)
Securities Asset Management Companies ⁴	1	2	2 (-)
Total	21	22	28

Pillars 1 and 2 are largely driven by government or large state-owned enterprises. The participation of foreign players is still limited.

Note: 1. 基金管理有限公司 2. 养老保险股份有限公司 3. 资产管理有限公司 4. 证券股份有限公司 5. Excludes NSSF
Source: MoHRSS, NCSSF, AMAC, KPMG Analysis

The launch of Pillar 2 in 2004 brought businesses into the mix for the first time. Companies started to contribute to the retirement coffers through the enterprise annuity (EA), followed ten years later by the occupational annuity (OA) for public institution employees. Contribution rates under Pillar 2 are currently 8% of salary for businesses and 4% for workers.

In 2021 China's Pillar 2 pensions assets were worth RMB 4.4 trillion, with RMB 2.6 trillion under EA and the remaining RMB 1.8 trillion under the newer OA.

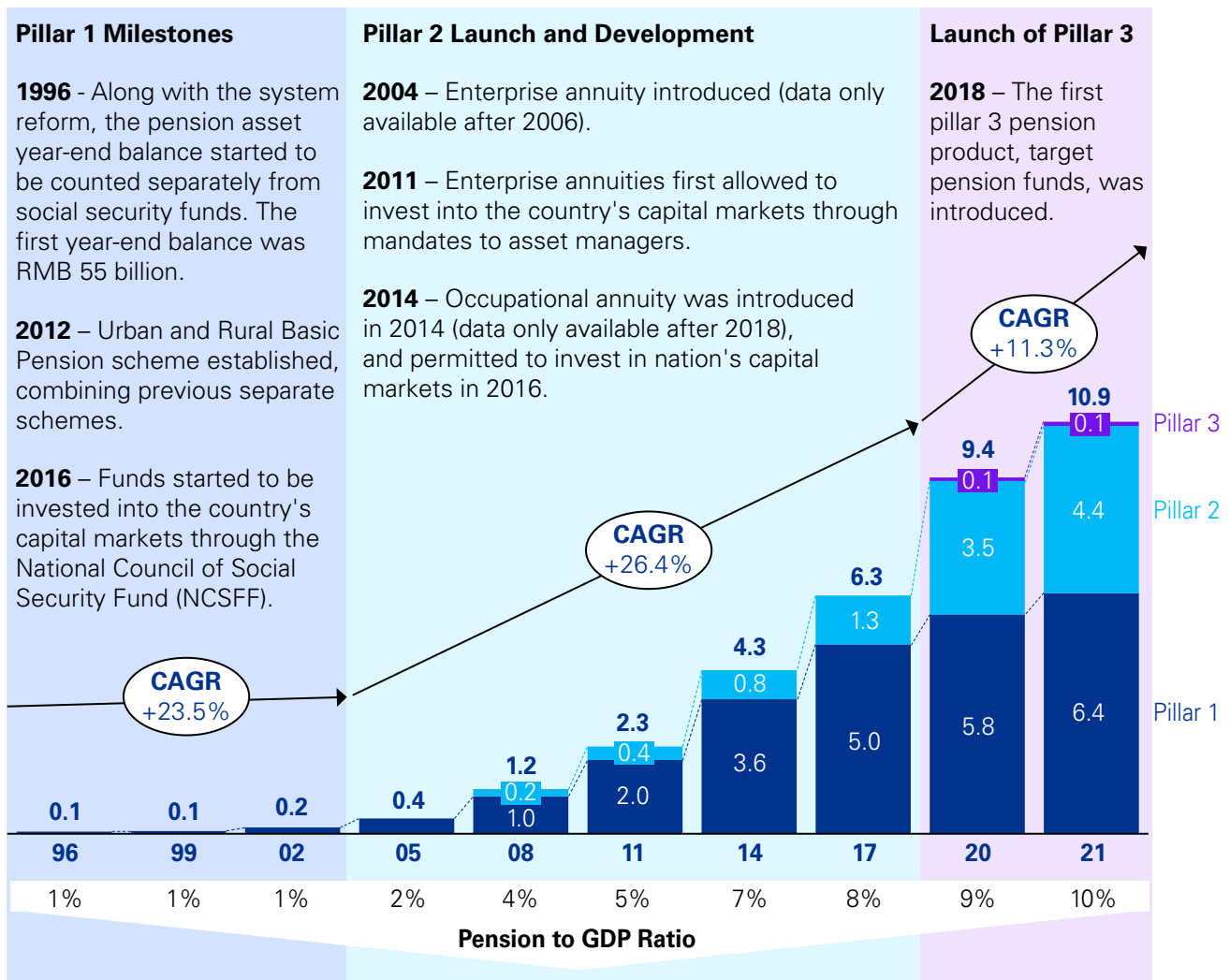
The OA is government-driven, with the Ministry of Human Resources and Social Security (MoHRSS) issuing mandates to eligible external managers. The EA is driven by the enterprises, who must establish annuity committees or hire trustees to manage the investments.

Although both Pillar 2 schemes have grown rapidly since they were introduced, they remain a small part of the overall pensions picture. The EA is voluntary and take-up has been low, with less than 0.5% of businesses having joined. The OA is mandatory, but only applies to public institutions. As a result, the basic pensions provided under Pillar 1 have continued to be the bedrock of the nation's retirement funding.

Although foreign firms are able to participate in both Pillar 1 and Pillar 2 schemes as asset managers, these are currently driven by government or large state-owned enterprises, and the participation of foreign players remains limited.

Overall Size of China's Pension Assets

By pillar, 1996 – 2021, RMB Trillion



Note: Excludes NSSF

Source: MoHRSS, Wind, World Bank, KPMG analysis

Pillar 3 impact








The introduction of Pillar 3 is likely to have a significant impact on China's retirement savings landscape. It is opening up new opportunities for foreign financial firms, who can participate across the different schemes that have been rolled out, so long as they get approval for the relevant licences.

Essentially, Pillar 3 introduces individual private pensions to the system for the first time. A number of pilot schemes for Pillar 3 were launched in 2018. The Covid-19 pandemic delayed the roll-out, but there has been a marked up-tick in activity

in recent months, with the individual account scheme officially rolled out in November 2022, followed by commercial pension pilot testing that started in 2023.

The prospective growth of Pillar 3 has the potential to not only help plug the looming gap in funding but also give Chinese people more choice in how they save for their retirement. It will also enable foreign firms to share their expertise in pensions planning with the Chinese people.

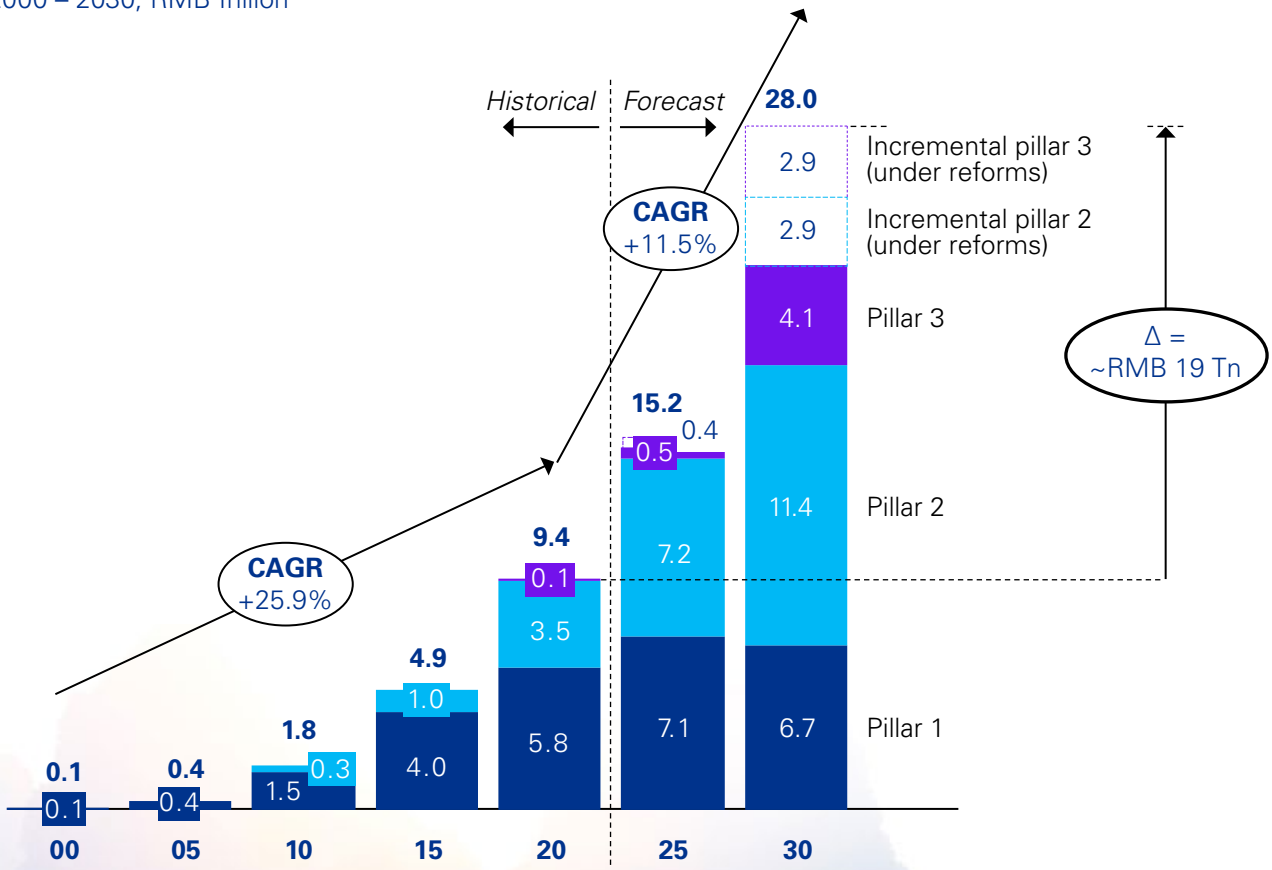
Types of schemes available under Pillar 3

 Pension Target Funds	Pilot launched 2018. 129 products selected
 Tax Deferred Pensions Insurance	Pilot launched 2018. Seen as having complex purchasing process and inefficient tax benefits
 Pensions Insurance Products	Pilot launched June 2021 and expanded nationwide in February 2022
 Pension Wealth Management Products	Pilot launched June 2021. 11 wealth management subsidiaries selected
 Pension Deposit Products	Pilot launched Nov 2022 in selected cities ¹
 Tax Deferred Individual Accounts	Pilot launched in Nov 2022, 20 million accounts set up by Jan 2023. Contributions of up to RMB 12,000 p.a. eligible for tax incentives
 Commercial Pension	Pilot launched in January 2023 in select cities. No contribution limit, but no tax benefits.

Note: 1. Selected cities include Hefei, Guangzhou, Chengdu, Xi'an and Qingdao.

China Pension Market Growth¹

2000 – 2030, RMB Trillion



Note: 1. Excludes NSSF

Source: MoHRSS, CASS, Wind, World Bank, National Bureau of Statistics, IDC, KPMG China Pension Model

As Pillar 3 is new to the market, AUM is negligible at the present time. But KPMG’s analysis suggests that the market is projected to grow to RMB 4 trillion by 2030 under the current regulatory landscape, and could grow to as much as RMB

7 trillion if some of the potential reforms are implemented.

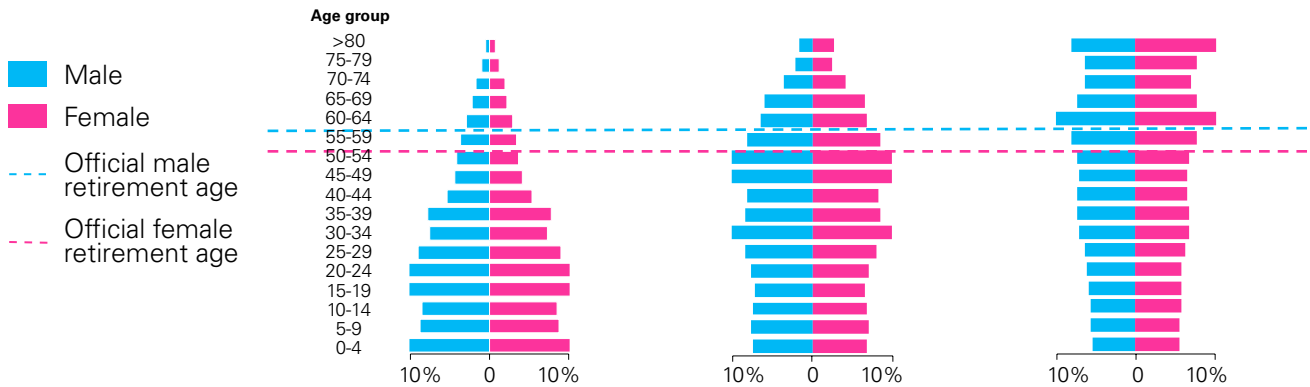
(You can read in more detail about the potential opportunities in Section 4.)

A number of interrelated factors are driving the case for pension reform in China: ageing demographics, increasing cost of living and healthcare, unsustainable funding of Pillar 1 pensions and inadequate provision to support citizens in their retirement.

Like many countries, China is currently dealing with an ageing population. In 1990, retirees made up only 10% of the population. The retired population is now more than 20%, and the proportion is expected to increase to 38% by 2050, which would create a retiree-worker ratio of 1:1.3.

China Population Pyramid¹

% of population, 1990 – 2050



	1990	2020	2050
Retirees as a % of population	10%	21%	38%
Workforce as a % of population^{1,2}	61%	62%	48%
Ratio of retirees to workforce	1 : 6	1 : 3	1 : 1.3
Average life expectancy	69	77	82

Note: 1. The population structure forecast is based on the existing child policies. 2. The working age starts at 15, the remaining population is children.
Source: World Bank, KPMG Analysis

Amid this demographic shift, the existing Pillar 1 pension funding will not be sustainable as it relies on government subsidies to close the funding deficit. To finance the widening gap on capital outflow as more retirees withdraw funds from the pension pool while fewer workers make contributions, the government will need to increase its fiscal subsidies.

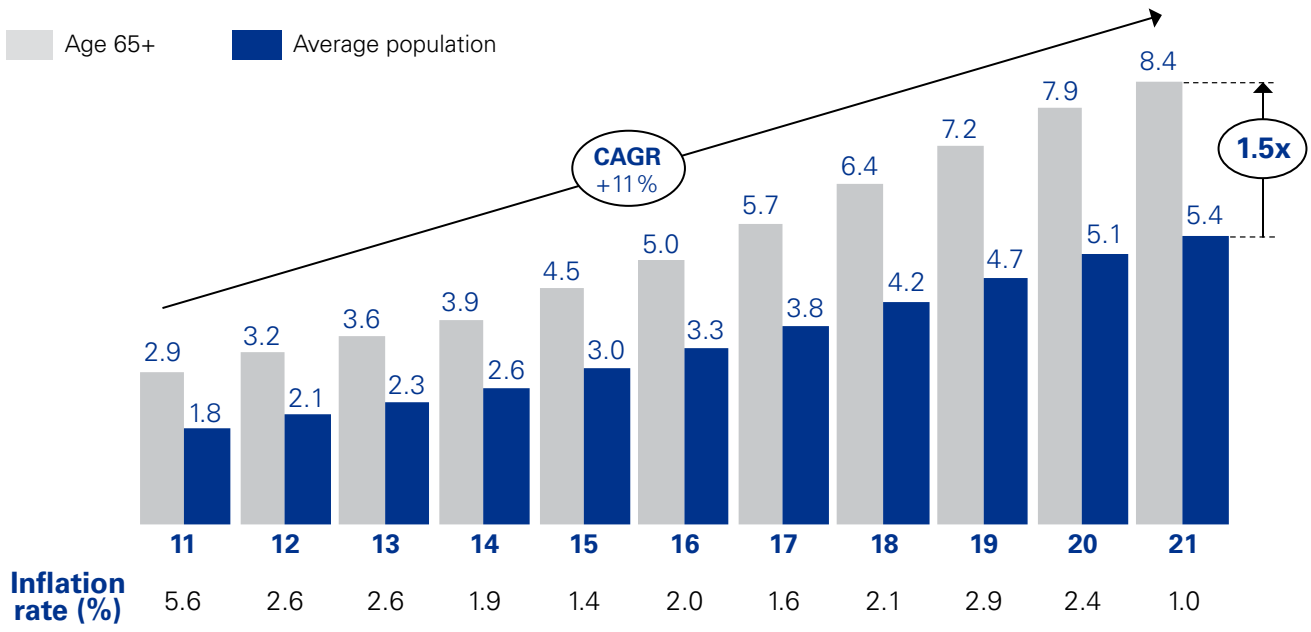
But even if the level of fiscal subsidies is maintained at the same level, forecasts from the Chinese Academy of Social Sciences suggest that the Urban Employee Basic Pension – the mandatory scheme that forms the bedrock of Pillar 1 – will switch from a net inflow to a net outflow situation by 2035. Without fiscal subsidies, this could happen as early as 2029.

The third driver in changing the pensions system is that living and healthcare costs for the elderly are increasing. Although China's inflation rate has not rocketed recently, unlike in some other jurisdictions, residents have still had to deal with steadily rising consumer prices over the past decade.

In addition, healthcare costs for the elderly people have been rising at above-inflation rates: in 2021, Chinese people aged 65+ spent an average of RMB 8,400 on healthcare, compared to the national average spend of RMB 5,400. So healthcare costs are a bigger proportion of their spending, with out-of-pocket healthcare expenses taking up around 6% of the average elderly person's income.

Annual Healthcare Expenditure

2011 – 2021, RMB '000



Source: World Bank, National Bureau of Statistics, KPMG Analysis

The higher cost for the elderly is due to higher incidences of illness associated with old age, as well as the cost of medicines, nursing care and advanced medical procedures. The nation's rising life expectancy also means that people will need age-associated healthcare for longer.

Lastly, China's pensions assets are currently insufficient to support its ageing society. The average monthly payment to recipients is around RMB 4,000, which is a replacement ratio (retirement income as a percentage of working income) of 44% compared to the OECD average of 62%, which is not enough to enable them to maintain their pre-retirement living standards.

Therefore, it is clear that the pace of reform will need to be accelerated to increase the pensions pool and ensure a comfortable retirement for citizens. This is where global asset managers can play an important role by sharing their expertise and experience in retirement investment.

Taking a broader view, pension reform would also help to re-direct China's household savings, which is currently over-indexed in real estate and cash in bank savings. In addition, property investment has become more risky recently due to the market restructuring, while bank deposits offer low returns. These factors may help to drive interest in pension products that offer long-term risk-adjusted returns.

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Potential reform and implications

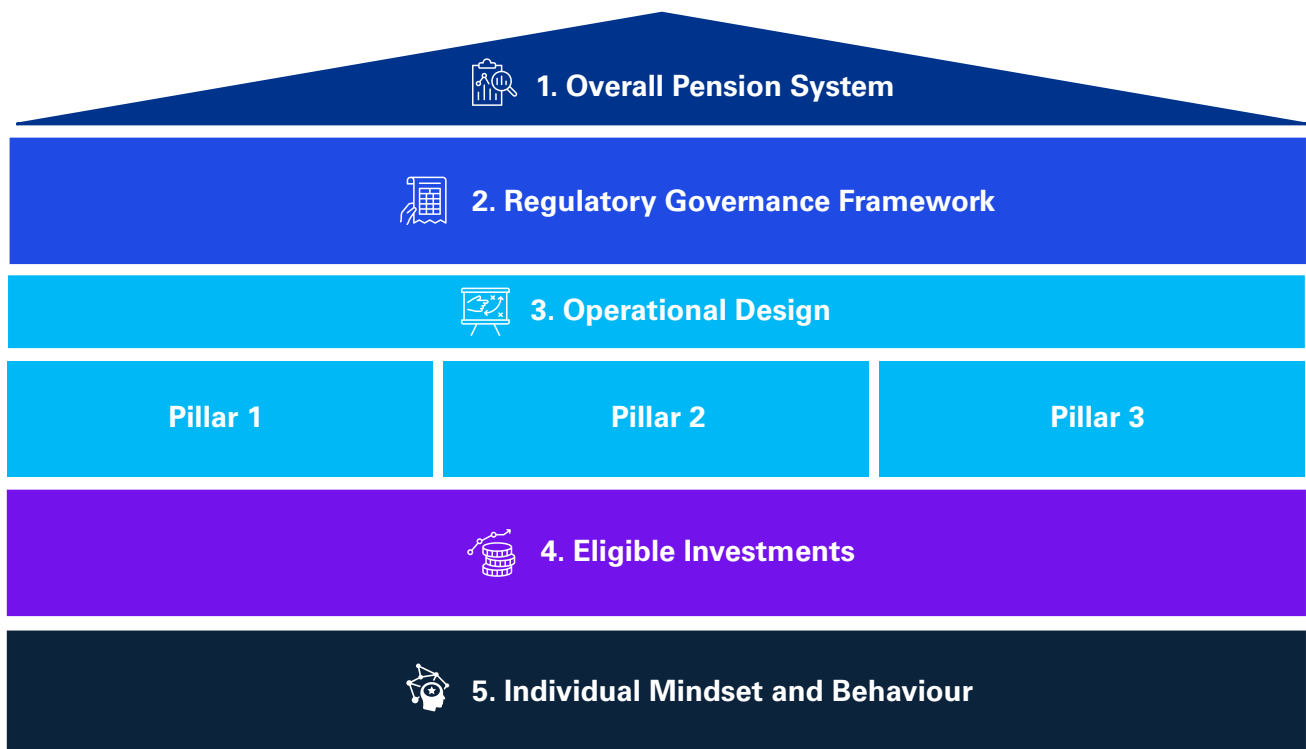


The Chinese government has taken major steps to address this expected shortfall with the reforms it has introduced over the past decades, including the launch of Pillar 2 in 2004 and the new Pillar 3. Going forward, it is expected that refinements will be made that will expand and enhance the pensions system further. Ultimately the purpose of the reforms is to share the burden among the state, businesses and individuals in a sustainable way.

In this section, we consider some of the potential reforms that could be rolled out in the future, as well as their impact.¹

There are five key themes under which the industry expects developments that could radically re-shape the nation's pension system: clear direction for the overall pension system, simple and transparent regulatory framework, changes to operational design, diversification of the eligible investments and changes to individual mindset and behaviour.

Potential Reform to China Pension



Source: World Bank, National Bureau of Statistics, KPMG Analysis

As part of the **overall pension system** reform, potential changes include setting a target replacement ratio, which will enable the government to more easily calculate the contributions that will be needed to support this level of retirement income levels. Increasing the amount of funding for pensions in China will depend on growing both Pillar 2 and Pillar 3.

More clarity over the mix of the three pillars will also help the government to assess the amount of income and to calculate how to meet their respective targets. A timeline for carrying out these reforms will be useful for both domestic and foreign firms that want to participate in the pensions market, as they can better plan their strategies and develop the most suitable products and services.

The current **regulatory governance framework** is quite complex and restrictive. Currently, different types of licence are needed across the three different pension pillars, which are granted by four different regulatory bodies: NCSSF, MoHRSS, China Securities Regulatory Commission (CSRC), and the former China Banking and Insurance Regulatory Commission (CBIRC).²
















Needing different licenses for specific eligibility requirements is especially challenging for foreign firms that are less familiar with the regulatory landscape.

¹ Direct quotes have been taken from interviews with ASIFMA Asset Management Group members

² National Financial Regulatory Administration has been officially established in place of CBIRC on 18 May 2023

Overview of Licenses and Main Regulatory Bodies

By pillar and license type

	 CBIRC ¹	 CSRC	 MoHRSS	 NCSFF
	Pillar 1/ NSSF Fund	Pillar 2	Pillar 3	
Entity licensing	 or 	 or 	 or 	
Pillar licensing			 or 	
Product licensing			 or 	
Distribution licensing			 or 	

Note: 1. National Financial Regulatory Administration has been officially established in place of CBIRC on 18 May 2023
Source: KPMG interviews with ASIFMA Asset Management Group members, KPMG Analysis

A lack of transparency is another issue. Industry participants have also reported that the criteria for being granted a licence can be unclear, and has led to some uncertainty over whether a business is eligible for a licence or not.

“

Although the China pensions market is a great opportunity, it is a major investment for foreign firms to obtain the licences required. The market is quite fragmented and there are several different regulators, so obtaining the different licences required from the different regulatory bodies is complex and time-consuming.”

Suggested changes that would improve the regulatory environment could include streamlining the number and processes of regulatory bodies involved and more clarification of their roles and responsibilities. Combining some of the licences and making the application process more transparent would reduce the time involved to gain approval and avoid duplication of action.

In terms of **operational change**, the three different pillars may each see further reforms. Ultimately, the aim is to increase participation and contributions across the three pillars to create a more sustainable system.

Under Pillar 1, the majority of basic pension assets are not invested, so allocating more of these into NCSFF would improve investment return.

Participation in the EA under Pillar 2 remains low. In 2021, only 117,500 out of the more than 48 million enterprises in China had joined the scheme. Creating a centralised platform for Pillar 2 would reduce the amount of admin involved and attract more SMEs to join the scheme.

“

Most businesses are SMEs, who do not currently have a strong incentive to participate in the Pillar 2 voluntary schemes. A very powerful and centralised platform would attract more SMEs to contribute.”

But a further step of making EA mandatory and introducing tax incentives for relevant companies is perhaps necessary to increase participation and therefore contributions. Under a mandatory EA scheme, workers would automatically start to contribute when they joined the workforce. Increasing the level of contributions from both employers and employees would also help to grow the overall pot.

Under Pillar 3, tax benefits on contributions to a private pension are currently capped at RMB 12,000 per year – this could be raised. Another option is for the government to provide incentives for people to save more, such as matching contributions.

Eligible investments are fairly limited in terms of location and type of investments. Potential reforms could include asset class diversification, overseas allocation expansion, and ESG-themed investments.

Currently, under Pillar 1, the NSSF can only invest less than 20% of assets in overseas markets. Permissible products regulated by the CSRC include bank deposits, treasury and corporate bills, equities, and mutual funds and derivatives for hedging purposes only.³ Other investment options include investing up to 20% in major infrastructure projects and SOEs through bond subscription, equity injection or other forms of investment. Under Pillar 2, both enterprise annuities and occupational annuities can only invest less than 20% of assets in overseas markets, via the Hong Kong Stock Connect. Pillar 3 fund-of-fund pensions products can invest in overseas markets through approved pooled investment funds and mutual funds (via the QDII quota).

Relaxing the offshore investment caps would allow China's pensions savers to enjoy access to greater diversification, and potentially higher returns, in other markets.

Industry participants also pointed to the success of cross-border programmes such as the Stock Connect and Wealth Management Connect, and noted that a "Pension Connect" scheme could benefit investors and financial institutions on both sides of the border.

Further expansion of eligibility could include broadening the range of asset class opportunities to include alternative assets such as private equity and infrastructure. Encouraging ESG-related investment across all three pillars would enable China's pension investors to access the opportunities in this growing area.

Besides the ongoing structural changes to the pensions system, there will also need to be a major **mindset and behaviour shift** among Chinese people to encourage greater participation. Education will be crucial to ensure that people understand the benefits of pensions investments.



Because pensions are a fairly new concept, it will be important to educate investors that they are a long-term investment and they should not focus on short-term ups and downs in the market cycle. Ways to educate could include case studies on themes like lifestyle after retirement."

The retirement system in China still relies mostly on a mix of family and state-run pension support. As this is not sustainable, businesses and individuals will need to play a much bigger role in the pensions framework in the future. However, there will likely be resistance. Businesses – particularly SMEs – may be reluctant to increase their HR costs, while young people may not wish to sacrifice a portion of their salary to a private pension plan when retirement is a long way long off.

Pensions education will be best served by an approach that includes insights and information from the government and financial firms. At state level, possible developments include setting retirement planning as a national education agenda and issuing guidelines and policies to encourage cooperation.



The government can play a crucial role at a national level with a campaign to educate the public on the core education framework, the benefits for saving for a rainy day and explaining the benefits of a long-term investment mindset."

As overseas financial institutions often have a great deal of experience of pensions planning in other markets, they are in a good position to share their insights and expertise and can play an important role in investor education. They can also create customized education and marketing programmes to serve different target segments.

³ Equity asset allocation and mutual funds cannot exceed 40% of the net asset value

04

Future prospects



The evolution of the pensions system presents significant opportunities for all firms, including foreign financial firms, especially in Pillar 2 and 3.

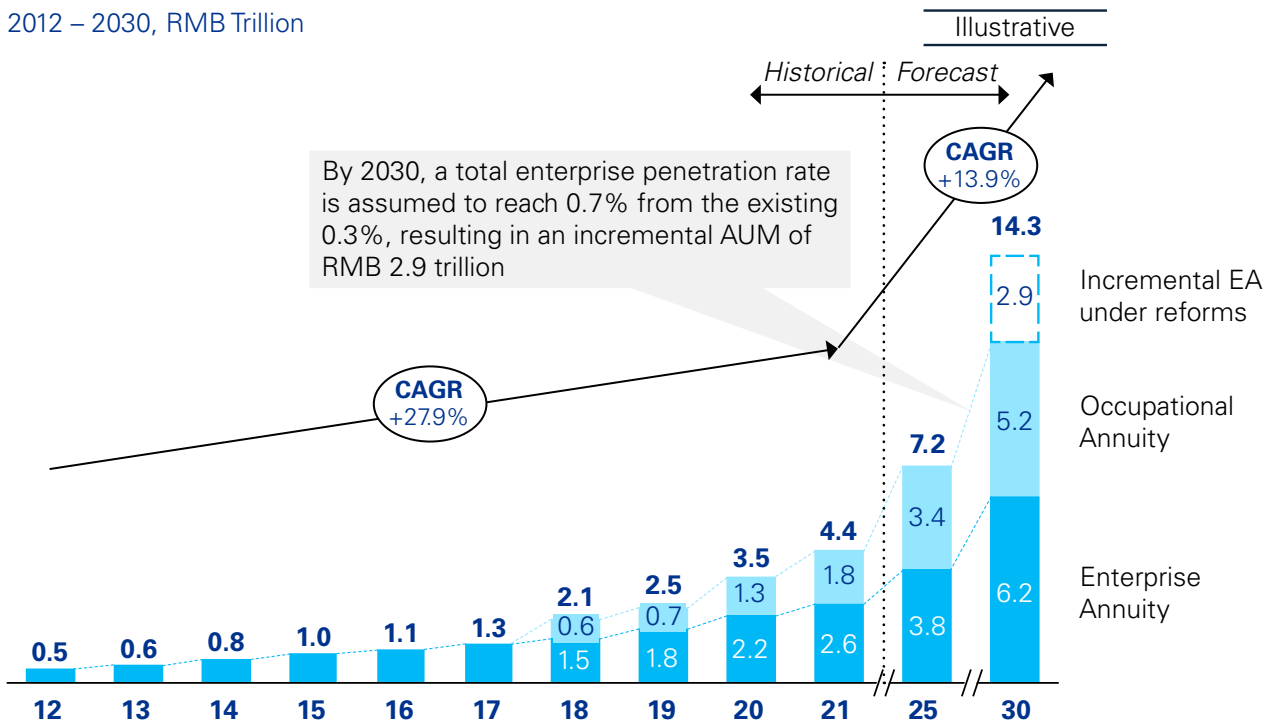
The EA under Pillar 2 has grown organically over the past 10 years from 18 million participants in 2012 to 29 million in 2021, driven mostly by SOEs and large corporates. Going forward, the market could grow to include around 150 million people by 2030.

These forecasts assume that certain reforms will take place, such as the phased introduction of mandatory participation and the introduction of a centralized digital platform.

Under this potential situation, with many more businesses and their employees contributing to both enterprise annuities and occupational annuities, the size of the pensions pool will also grow. KPMG analysis suggests that the overall pension size could grow to RMB 14 trillion if reforms including mandatory participation are rolled out.

Pillar 2 Pension Size Forecast¹

2012 – 2030, RMB Trillion



Note: 1. Enterprise sizes are categorised into large, medium, small and micro by the Provisions on Criteria for Classifying Small and Medium-sized Enterprises
Source: National Bureau of Statistics, China economic census yearbook, KPMG's China Pension Model

Introduction of Pillar 3

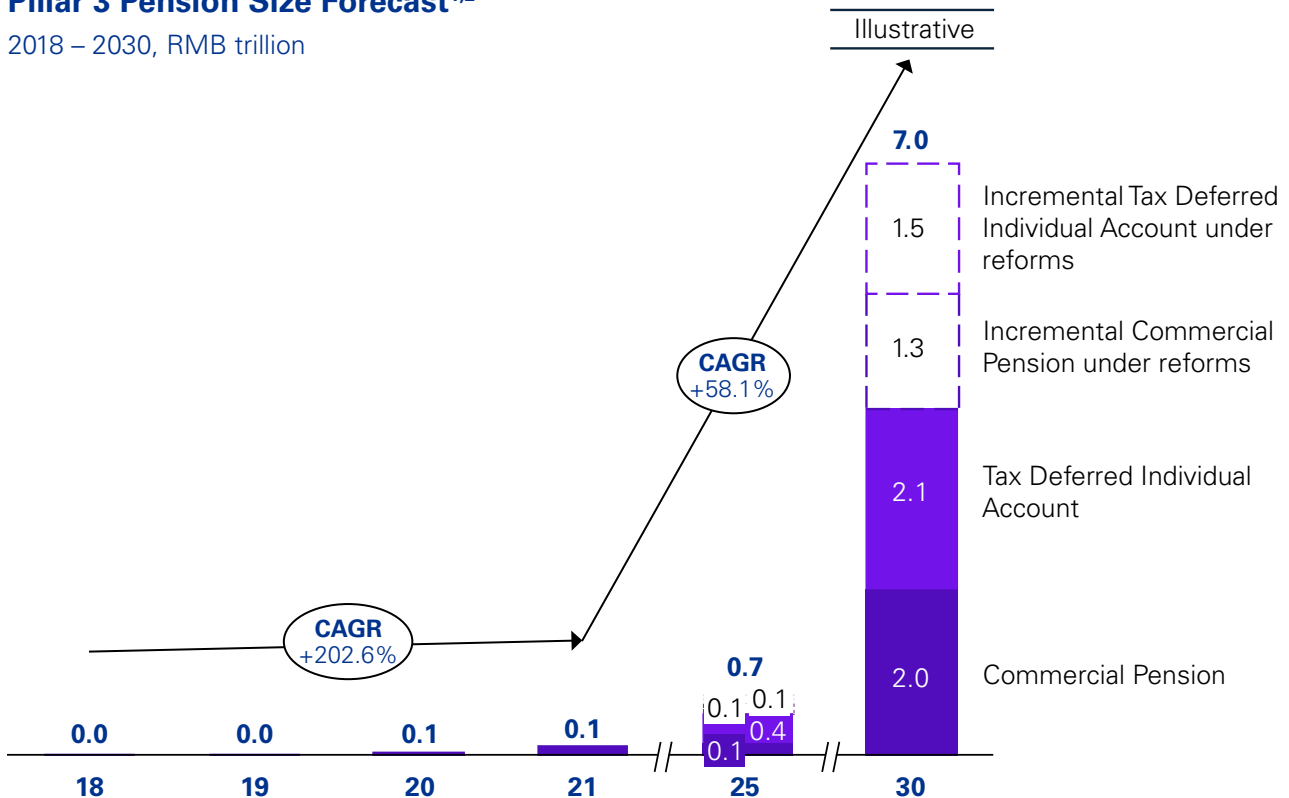
As Pillar 3 is only just getting under way, it is likely to see the most dramatic growth within the next few years. KPMG projections suggest that total assets could reach RMB 7 trillion by 2030.

The potential reforms included in this projection include changes to the tax cap and age-related restrictions.

Currently, participants in individual pensions can contribute up to RMB 12,000 annually to receive the associated tax benefits. They can also contribute to commercial individual pensions without restriction, but these do not enjoy the tax benefits. Our forecast considers the impact if the tax-benefit level was raised to RMB 20,000.

Pillar 3 Pension Size Forecast^{1,2}

2018 – 2030, RMB trillion



Note: 1. Figures may not add up due to rounding 2. The retirement age is assumed at 55 for all genders under base case scenario for simplicity purpose
Source: National Bureau of Statistics, The World Bank, Wind, KPMG's China Pension Model



Pillar 3 is very new and is still in the pilot stage, but it is more accessible than Pillar 1 and Pillar 2 for foreign players, and we are optimistic that the market will open up further. Account opening has been faster than expected under Pillar 3, with 20 million accounts already set up out of a 60 million taxable population.⁴ Contributions are expected to be slow in the beginning, but will grow in the future.”

China could also increase the length of time that people save into their pensions savings products. At the present time, saving products have a minimum age requirement of 35, which could be lowered to 30 to allow people to start saving at a younger age.

At the other end of the timeline, China's official retirement ages of 55 for women and 60 for men are currently lower than many other jurisdictions. For example, it is currently 65 in Japan and Germany, and 66 in the United Kingdom. A first step could see China's retirement age changed to 60 for both men and women.

While there is no guarantee that any of these changes will be carried out, the industry expects that they are among the reforms that may be introduced as the pensions system continues to evolve.

⁴The taxable population is based on salary level, population distribution and a taxable salary threshold of RMB 5,000 per month.

Silver economy

Another contributing factor to the potential pensions market opportunity is the growing personal wealth among the Chinese population. The nation's per-capita GDP has soared since the 1990s to reach more than US\$12,500 in 2021, according to the World Bank. This economic growth has not only lifted millions out of poverty but also created a substantial middle class.

China's silver economy is expected to reach RMB 20 trillion by 2030, and includes three major markets: healthcare, real estate and financial services. The slowdown in the property market in recent years is expected to drive interest in financial services as citizens look to other assets for returns. This trend, combined with effective education about pensions, will help to boost contributions to pensions.



05

Where to play and how to win



The changes being rolled out to the China pensions market are undoubtedly creating huge opportunities, but foreign financial firms will need to plan carefully and consider which part of the market best suits their experience and ambitions.

Some of the decisions will be limited by regulations. For example, firms that do not have a presence in the Chinese Mainland can only participate in the National Social Security Fund (NSSF) Pillar 1 scheme through a cross-border channel, or by selling approved pooled investment funds through MPF to onshore asset managers.

Financial institutions that are already onshore can potentially participate in all three pillars, so long as they acquire the relevant licences. It is worth noting

that new Pillar 1 and Pillar 2 licences have not been issued for several years.

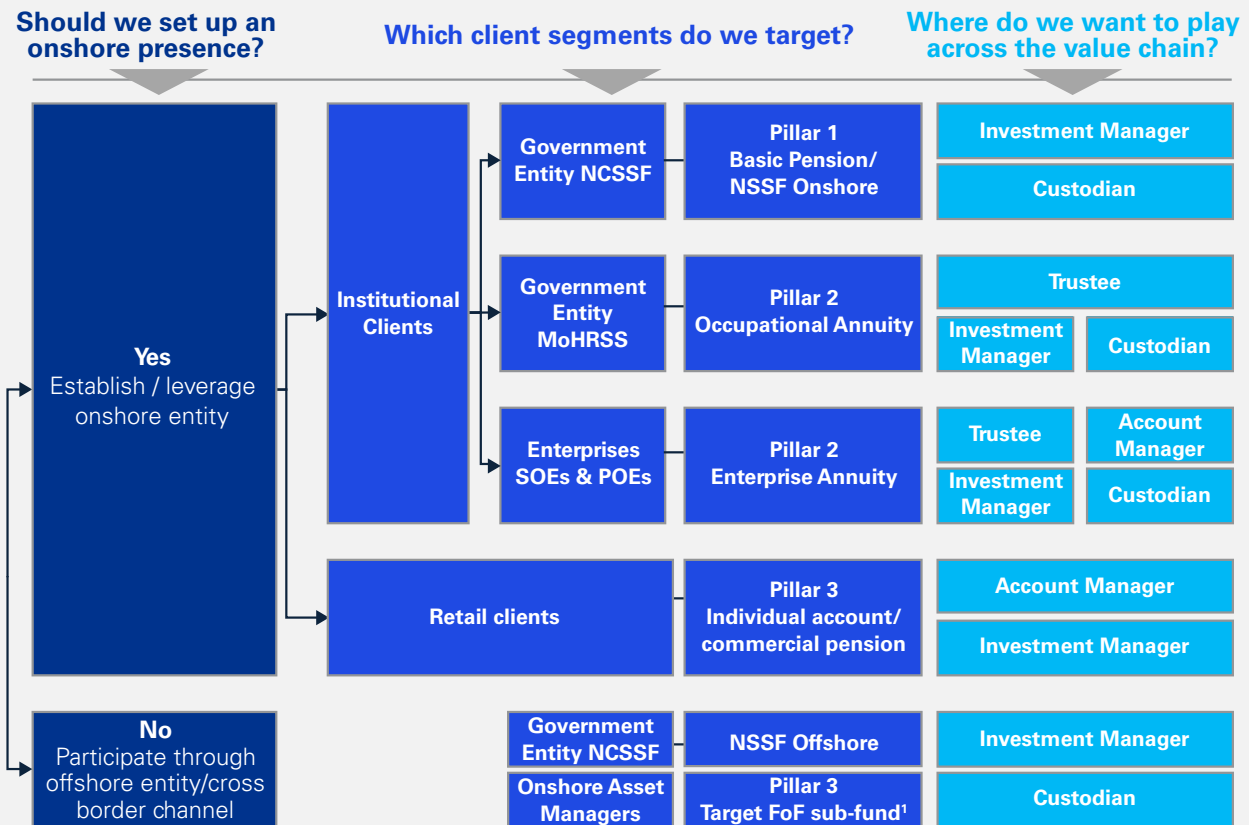
Firms will need to carefully review the market and make a strategic choice based on factors including the potential size of the market, the firm's competitive edge and alignment with their wider business strategy.

Where to play

Banks have the most opportunities across all three pillars. Financial institutions that have experience serving institutional pension clients in other markets may find Pillar 2 options a better fit, while those that already have expertise serving retail clients may be more likely to seek opportunities in the individual pensions under Pillar 3.

Where to Play in the China Pension Market?

Strategic questions for firms to ask on participation choices



Note: 1. Northbound MRF products (北上互认基金) have been included to the underlying investment scope of Pension FOF in year 2018. In 2023, CSRC has confirmed that APIF (Approved Pooled Investment Funds) as approved by Hong Kong SFC to distribute to non-MPF retails can be eligible for Northbound MRF application.

Source: KPMG Analysis

When they have decided where to focus, financial institutions will also need to consider the licences they need. As the most broad-based of the various types of financial firm, banks can apply for licences including including as custodian across all three pillars, and in account management in Pillars 2 and 3. Fund management companies meanwhile can apply for asset management licences across all three pillars.

More niche players such as insurance asset managers, securities managers and pensions insurance managers can each apply to provide services across all three pillars. Banks' wealth management subsidiaries can provide wealth products under Pillar 3.

As noted earlier, the licensing and regulatory regime is fairly complex, so financial institutions will need to consider carefully before applying.

How to win

Once foreign financial firms have decided where they want to play in China's pension market, there are key steps they can take to ensure a better outcome.

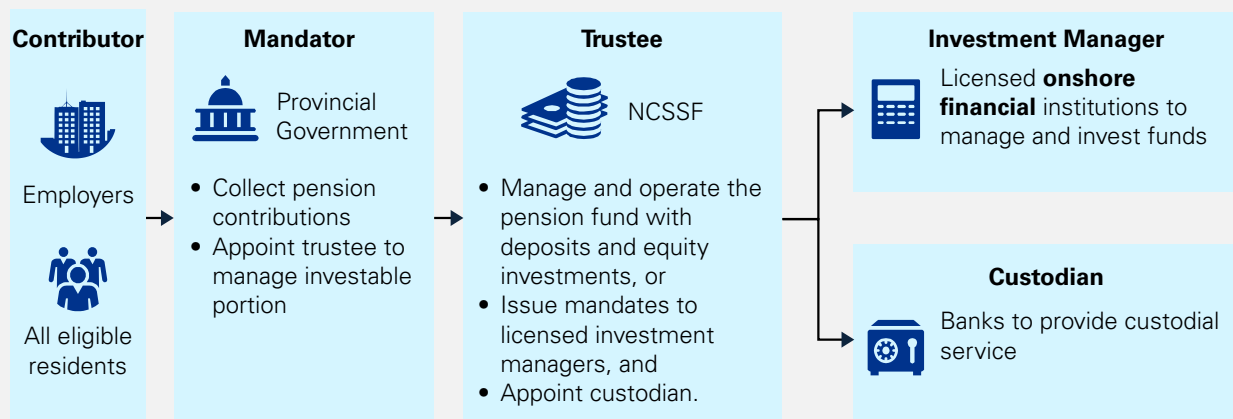
There are two different components to winning in the chosen market. The first is receiving approval from the authorities for the licences and mandates required to operate under the various segments within the three pillars. Then there is the competition with other players to win customers

and market share. The relative importance of mandates compared to market competition depends on the segment of the pensions market, as the three pillars offer quite different propositions for global financial firms.

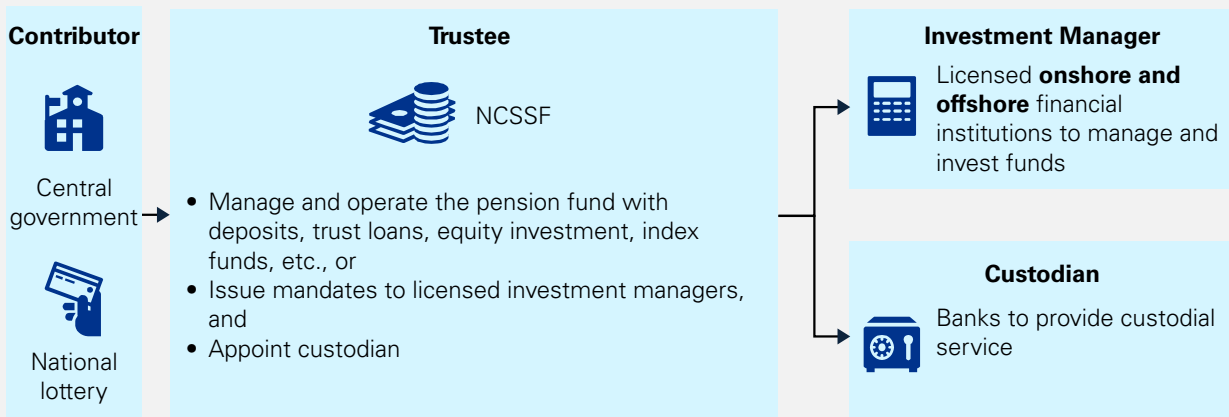
Pillar 1

In Pillar 1, a proven track record on investment returns and risk management capabilities will be key to winning mandates.

Basic Pension (UEBP and URRBP)



National Social Security Fund (NSSF)



Source: KPMG Analysis

Management of the urban and rural basic pensions (UEBP and URRBP) is only open to financial institutions established onshore, and a licenced wholly foreign-owned enterprise (WFOE) or joint venture is required to participate. Several joint ventures have already acquired licences, including ICBC Credit Suisse Asset Management. Firms that can demonstrate outstanding returns and risk management capabilities will have the best chance of being the top choice for these licences. Firms

that want to secure their place on the waiting list are advised to build and maintain their relationship with the NCSSF, so they are in a good position as licences are allocated.

NSSF is open to offshore players, who can access mandates though request for proposal. It is expected that investment capability and performance will also be key selection criteria. For onshore players, the process is similar to the basic pension.

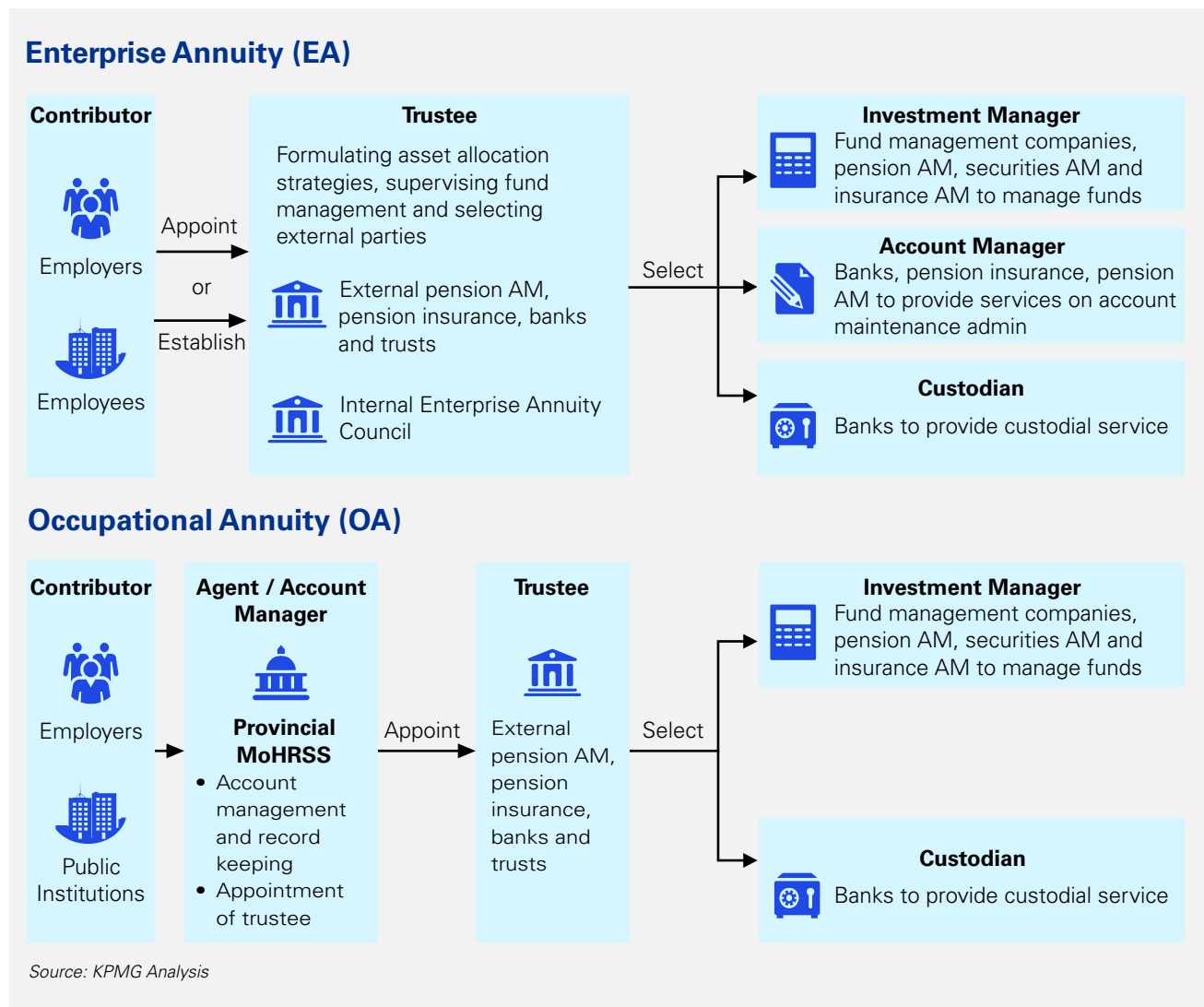
Pillar 2

Investment management of enterprise annuities and occupational annuities under Pillar 2 is only open to financial institutions established onshore, and a licensed WFOE or joint venture is required. The regular review mechanism for licensees was formalised in 2021 to maintain high standards of service, as well as to open positions for waitlisted financial institutions, according to the MoHRSS.

To be successful in this market, demonstrating strong investment performance and service capabilities will certainly be important. But firms will

also need to build a good relationship with trustees as well as with employers and employees.

Pillar 2 is a B2B model, which means a relationship-driven sales process. Annuity owners have the right to choose the trustee, who remains as the “gatekeeper” and will select and supervise account managers, custodians and investment managers. Building a good relationship with the trustee is therefore of major importance for all foreign financial service providers as they will deal with the trustee, rather than directly with the employer.



Pillar 1 and Pillar 2 have opportunities for foreign asset managers. In particular, those with experience in Pillar 2 investment globally will be able to leverage this experience in the China market.”

Pillar 3

In the longer term, the biggest opportunities for foreign firms in the China pensions market may be under the new Pillar 3, which has potential for huge growth. The introduction of individual private pensions under the Pillar 3 framework will also offer challenges for financial firms as they will be marketing directly to individuals who may have little understanding of the new types of pension products.

When planning their strategies, financial firms must look at both products and distribution.

Under Pillar 3, there are four different types of pensions products eligible for tax benefits, with a ceiling of RMB 12,000:

Type of product	Risk level	Issuer	Key features
Pension target funds	Mid	Fund management companies	Asset allocation adjusted according to risk tolerance
Insurance products	Mid-low	Pensions insurance firms	"Stable and aggressive" dual structure
Wealth management products	Mid-low	Wealth management companies	Stable closed-end investment products
Deposit products	Low	Banks	Guaranteed return based on length of term

Each type of product is targeted at a different type of customer with different risk profiles and requirements. For example, target funds are aimed at investors with a relatively higher risk appetite seeking higher returns, while deposit products offer a guaranteed return for risk-averse individuals.

Financial institutions will also need a strong brand that resonates with local customers and to help them establish trust in the market. Global financial firms may find that awareness of their brand is relatively weak in China, so localised marketing campaigns are recommended.

As the Pillar 3 market is B2C-focused, it may appeal more to foreign financial institutions that have experience serving private individual pensions in other jurisdictions. However, in a highly competitive marketplace, participants will need to ensure that their products have been developed with unique propositions that fit Chinese customers' needs.

Customer education should also form part of a firm's marketing plans. With private individual pensions being such a new product, many customers may not be aware of the time value of pension investment.

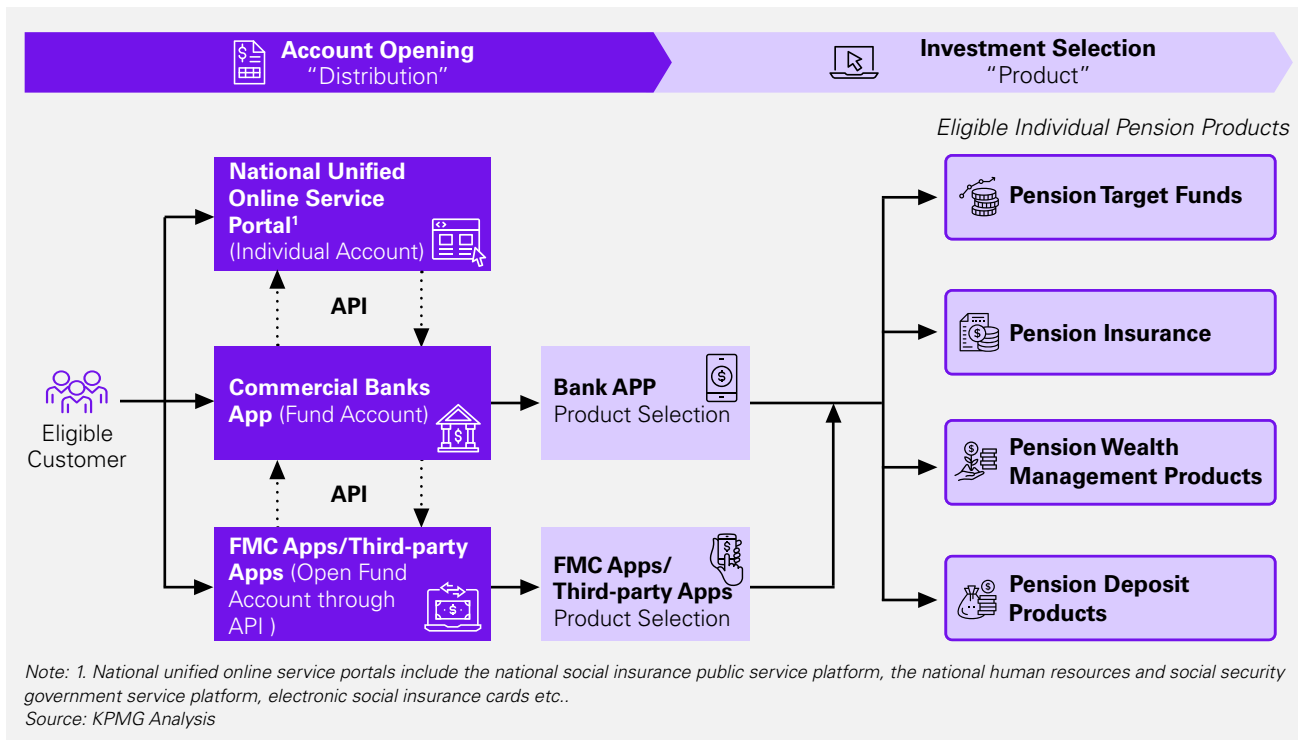
Currently, the pension products in China still have a relatively short lock-up period. Over time, there is scope to shift investors' acceptance towards products with a longer lock-up. Foreign financial services companies can bring in their expertise in designing Target Date Funds, blending a different asset mix. This will benefit younger savers, by promoting longer-range retirement planning.

“When foreign and domestic firms work together it is a mutually beneficial relationship. Domestic firms can learn from overseas experience, and the combination of experience and expertise can help to develop the overall market.”

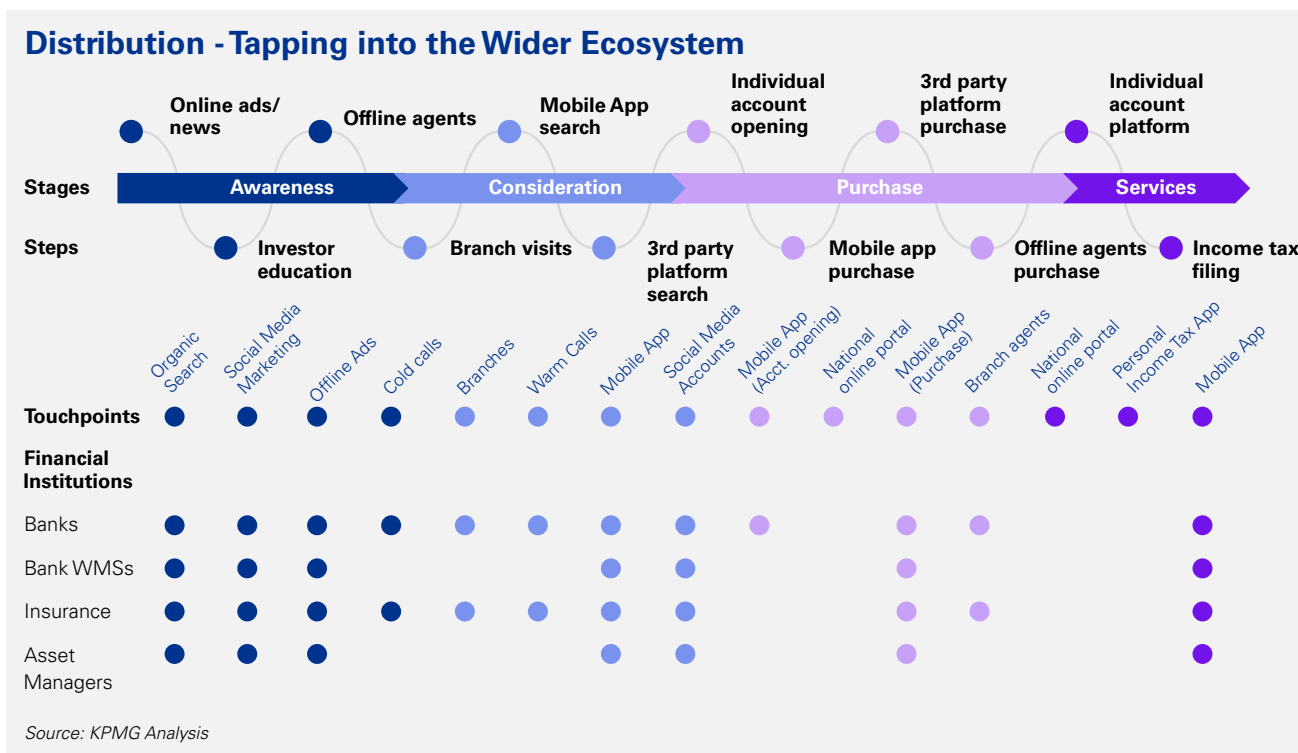
“Foreign institutions have product design capabilities and experience. But we cannot simply copy the model from other markets such as the US – it is important to develop products that are adapted to the China market.”

Besides offering the right products, **distribution** is a key factor. In the highly competitive B2C market, traditional financial firms are also competing with online firms that have started to offer financial products as part of their suite of services. Robust channel partnerships are crucial to success.

Banks can provide one-stop account opening and investment services, while third-party digital channels offer the flexibility and convenience that modern customers demand. Asset managers and insurers should consider developing distribution partnerships with leading third-party outfits to increase customer engagement and expand their customer base.



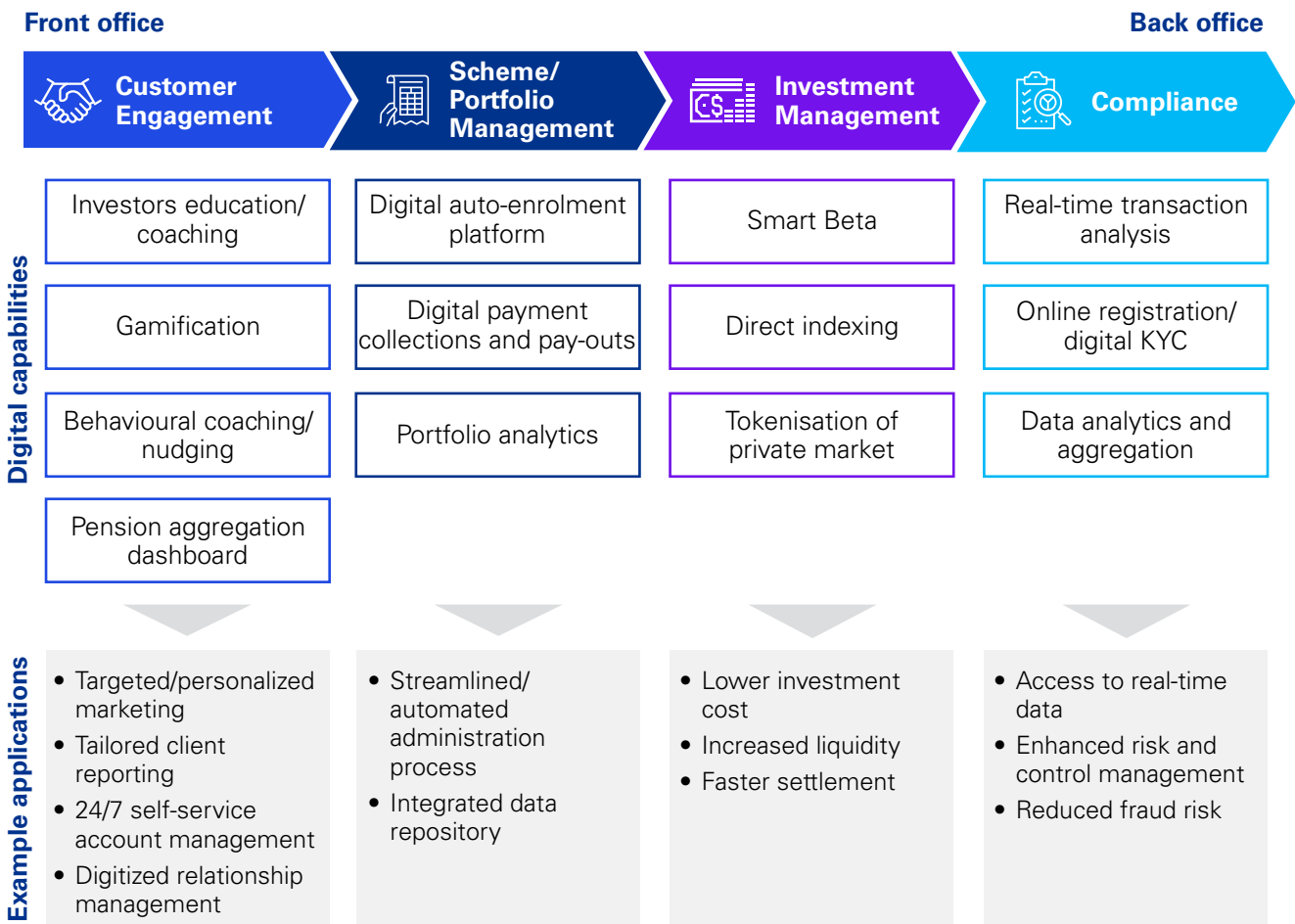
Education will be an important part of success in Pillar 3, as customers will be on a journey of growing awareness of pensions first, before they start considering the types of products and services they want to buy.



Tech-enabled innovation

Technology is likely to be a hugely important factor in the success of foreign financial firms offering pensions services in China. The four key areas cover back and front office: interactions with customers, scheme management, investment management and compliance.

The Chinese online consumer market is extremely advanced, and customers are accustomed to using their mobile to purchase services and products, and to be able to manage their accounts online 24/7. Firms should also consider offering robo-advisors besides round-the-clock access, while scheme management including digital enrollment and payout should also be available.



From a back-office point of view, fintech can also increase the efficiency of investment management by using smart beta and direct indexing. This will lower the investment cost and increase liquidity. Technology and the use of real-time data can also help financial firms to carry out compliance work including registration, KYC and transaction analysis. Overall, this will enhance risk and control management.

Overseas financial firms should be aware of the important role of social media for Chinese consumers in purchasing all types of products, including financial services. In addition, Chinese financial firms have been very active in using social media for branding and customer education, and global players should embrace this marketing approach as well. Global asset managers could consider leveraging some of the major digital third-party platforms to help them to reach more customers through social media.

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