China Pension Report: Pillar three, Year zero

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EY 安永
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Building a better working world

Background and summary

Welcome to EY's new China pension report. In 2022, China's pension reform achieves a breakthrough by officially launching the tax-deferred individual retirement account (IRA) system, thus complementing its three-pillar pension system. While the year of 2022 will be remembered for the introduction of the IRA, all sectors of the industry saw growth.

Given the importance of this development, most of this year's report will be focusing on the third pillar. We will list the aspects of its design we consider important to the industry's future growth. But we will also review the development of other sectors. We will finish the report by giving our predictions on some of the key issues we find important to the future of the industry. Our three key takeaways from the development in 2022 are:

1. **The launch of IRA marks the establishment of a three-pillar pension system in China,** which is the most important development in years and the most sweeping change since the launch of the Public Pension Fund (PPF). Not only the new arrangements encourage, if not urge, more than one billion people in China to start their individual pension saving, they also ensure different types of service providers to compete on a level playing field.
2. **Fund managers and banks are so far the most active contenders, but others will follow through quickly.** The allure of the reward, of course means intense competition. This is already evidenced by how fast banks and asset managers charge at the new opportunity. We expect insurers and Wealth Management Companies (WMC) to respond more competitively soon.
3. **Change your pace if you see yourself in the end game.** While the initial result is encouraging, it is but a fraction of the long-term dividend can be expected. With the fast development will come the rapid change across consumer demand, regulatory framework and competitive landscape. Service providers now need to increase their pace.

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01

A new era of China's pension system, and the financial services industry

1.1 The launch of personal pension, or IRA

On 8 April 2022 , the State Council released *Opinion on Promoting the Development of Personal Pension*, announcing China will build an individual-based pension regime with tax concessions to complement its existing arrangements. The opinion contained many details that later would be assimilated into the more detailed rules issued by various regulatory bodies but did not receive as much attention as the derivative rules we will see later did. Yet like many long-term initiatives, when breakthrough happens, it is often mistaken for inertia.

On 3 November 2022, China's Ministry of Finance (MoF) and State Administration of Tax (SAT) jointly issued *The Announcement on Individual Income Tax Policies around Individual Pension*, thus ushering in the era of China's three-pillar pension system. The new rules can be applied retrospectively to 1 January 2022, but it did not specify the geographic scope of the tax concession, other than the three pilot places of Shanghai, Fujian and Suzhou Industrial Park that were already on a tax-deferral pilot for pension insurance annuities. But the industry would not have to wait for too much longer.

Chart 1: Summary of this announcement

#	Requirement area	Detailed requirements
1	Qualification of participants	Workers in China who are covered by PPF, either working in the urban or rural area
2	Participation channel	Participants need to open an individual account on the National Online Service Portal or with a commercial bank
3	Contribution frequency	Contribution can be made monthly, by installments or by year; the contribution amount (cap) will be accumulated by natural year and renewed every year
4	Withdrawal frequency	Withdrawals can be made monthly, in installments, or in a lump sum; the policy encourages withdrawal over longer period of time (meaning monthly or in installments)
5	Participation requirement	Voluntary participation of individuals, market-based operation; there is no legal obligations on employers
6	Contribution cap	RMB12,000 per person per year; individuals cannot put in more than this amount into his IRA in a year
7	Investment products	Savings deposits, wealth management products, commercial pension insurance, pension Fund of Funds (FoFs), and others
8	Withdrawal conditions	Each person's IRA has a lock up period, and withdrawals can only be made when the following conditions are met: ▸ Reaching the age qualified to start withdrawing from PPF account ▸ Total loss of working capacity ▸ Emigration to overseas ▸ Other circumstances as stipulated by the State
9	Individual tax policy	Up to RMB12,000 per year is deducted from the income calculation on a factual basis ▸ During the accumulation phase, income tax is temporarily not levied on the investment income from the IRA ▸ During the decumulation phase, the pension is not excluded from the "consolidated income", and a 3% individual income tax is levied, (compared with the 7.5% individual income tax (IIT) rate in the 2018 pilot version of the personal tax deferred commercial endowment insurance), and the tax paid is included in the "income from wages and salaries" item
10	Account management	IRAs are treated as special and dedicated fund accounts and managed according to the rules governing the personal RMB settlement Class-II accounts ▸ IRA accounts can be moved between banks ▸ Commercial banks should deal with the transfer of funds separately, and the annual payment amount in the transferred funds should be calculated cumulatively Commercial banks should keep full information of personal pension fund accounts for at least 15 years from the date of account cancellation

Sources: MOHRSS, MoF, SAT, CBIRC, CSRC, EY Parthenon Analysis

Different stakeholders in China's pension reform have touted different versions of third-pillar products, but this is the first and only design that comes with the defining feature of the third pillar of tax concession. It is also the first that has got the endorsement from all the relevant authorities. This national policy is quickly cascaded down across different government functions.

The China Securities Regulatory Commission (CSRC) announced *Interim Regulations on Business Management of Personal Pension Investment in Mutual Funds* on 4 November, the same day when the joint announcement came out.

Chart 2: Summary of CSRC's announcement

#	Requirement area	Detailed requirements
1	Roles and responsibilities	The general principles and basic requirements for fund managers, fund sales institutions and other institutions to carry out the business of IRA investment in public funds, as well as the positioning and the responsibilities of the Fund Industry Platform should be clarified
2	Product management	The types of fund products that IRA funds can invest in include: ▶ Pension target funds with a size of not less than RMB50 million at the end of the last four quarters or not less than RMB200 million at the end of the previous quarter ▶ Equity funds, hybrid funds, bond funds, FoFs and other funds prescribed by the CSRC with a stable investment style, clear investment strategy, sound operational compliance and suitable for long-term investment by IRA funds
3	Sales management	Fund sales business with the following conditions can carry out the sale of personal pension funds ▶ Good business conditions, stable financial indicators, strong public fund sales capabilities; the last four quarter-end equity funds and balanced funds holdings of not less than RMB20 billion, of which the size of individual investors holdings is not less than RMB5 billion ▶ Sound corporate governance, internal control and rigorous compliance management; no criminal penalties or major administrative penalties in the last three years; not subject to any major administrative supervision measures for similar business in the last one year; no major violations of laws and regulations for similar business in the period of rectification or suspected major violations of laws and regulations for similar business being investigated by regulatory agencies investigation by the institution; no major changes that have affected or may affect the normal operation of the company; no pending major litigation or arbitration matters ▶ Completion of online testing with the Fund Industry Platform ▶ Other conditions stipulated by the CSRC
4	Personal pension sales institutions	37 in total, including 16 commercial banks, 14 securities companies and seven independent fund sales institutions
5	Personal pension fund products	40 funds with a total of 129 products, out of which 61 are one-year products, 57 are three-year products and 11 are five-year products

Sources: CSRC, EY Parthenon Analysis

As we have mentioned in our past analysis, Fund Management Companies (FMC) have been handicapped in the personal pension competition as their products were not entitled to tax concessions previously. The new rules change that and give them new ways to leverage the track record they have built.

Two weeks later, on 18 November, The China Banking and Insurance Regulatory Commission (CBIRC) announced its rules governing the IRA practice of banks and WMCs, *Notice on Printing and Distributing The Interim Measures for The Management of Personal Pension Business of Commercial Banks And WMCs*.

Chart 3: Summary of CBIRC's announcement on banks and WMCs' IRA business

#	Requirement area	Detailed requirements
1	Definition of personal pension business of commercial banks	▸ Fund account business ▸ Personal pension savings business ▸ Personal pension products distribution business, including pension wealth management products, pension insurance products, pension mutual funds, and others, as well as otherwise stipulated by the financial regulatory authorities of the State Council ▸ Personal pension advisory business ▸ Other personal pension business as stipulated by CBIRC
2	IRA account service of commercial banks	▸ Fund account opening or designation, cancellation and change services; the fund account is not limited by the number of Class II accounts held by the participant ▸ Contribution to and withdrawal from IRA funds ▸ Transfer of participants' contributions through other bank accounts, non-bank payment institutions, cash, etc., and provide participants, personal pension product sales institutions, etc. with fund transfer services related to IRA transactions ▸ Fund account information management services, recording of basic fund account information, contribution information, fund settlement information, tax withholding information, etc. ▸ Fund account information inquiry services ▸ Other matters stipulated by CBIRC
3	Fees and charges of IRA fund accounts	Annual fee, account management fee, short message services (SMS) fee and transfer fee are exempted for IRA fund accounts
4	Definition of personal pension business of WMCs	Personal pension wealth management products are public financial products issued by qualified WMCs in compliance with the relevant regulations and available for IRA investment, including: ▸ Pension wealth management products ▸ Other wealth management products with stable investment style, mature investment strategy, sound operation and compliance, and suitable for long-term investment or liquidity management needs of long-term personal pensions investments ▸ Other wealth management products specified by CBIRC
5	WMCs can entrust custodian services of the IRA business to related commercial banks, and the banks should meet the following qualifications	▸ Qualified for the custody business of National Social Security Fund (NSSF), PPF and Enterprise Annuities (EA) fund ▸ Experience in the custody business of pension wealth management products ▸ Have information systems that are compatible with the custody of personal pension wealth management products, connected with the Wealth Management Industry Platform, and can provide corresponding technical and operation support ▸ Other conditions specified by CBIRC

Chart 3: Summary of CBIRC's announcement on banks and WMCs' IRA business (Contd.)

#	Requirement area	Detailed requirements
6	Requirements for carrying out personal pension business:	▸ Commercial banks: as of the end of the third quarter of 2022, national commercial banks and urban commercial banks with strong cross-regional service capabilities that have net tier-1 capital of more than RMB100 billion, with major prudential regulatory indicators meeting regulatory requirements ▸ WMCs: as of the end of the third quarter of 2022, WMCs that have been included in the pilot of pension wealth management products are allowed to offer IRA products
7	Information reporting requirements:	▸ **Commercial bank fund account information should be reported in a timely** manner: 1. Basic personal information, including personal identification information and fund account information 2. Product investment information, including product transaction information and asset information 3. Fund information, including contribution information, fund transfer information, relevant asset transfer information, withdrawal information, fund balance information and payment of IIT information ▸ **Personal** pension wealth management products information reporting: commercial banks or WMCs should promptly report information related to personal pension wealth management products to the Wealth Management Industry Platform 1. Basic personal information is to be reported by commercial banks and WMCs that directly sell the personal pension wealth management products 2. Fund information is to be reported by commercial banks 3. Custodian information is to be reported by the commercial banks providing custody services 4. Product investment information is to be reported by the WMCs
8	Eligible banking institutions:	**The first batch of banking institutions to start personal pension business** consists of 23 commercial banks, including six large state-owned banks, 12 national joint-stock banks, five urban commercial banks and 11 WMCs

Sources: CBIRC, EY Parthenon Analysis

The emphasis on the administration side of the business is a strong indicator that banks are going to be the gatekeeper of the IRA business, rather than seeking expansion along the value chain. For WMCs, there is no expansion of the pension business scope, and unlikely will be before the WMC pension products trial that started in 2021 comes to maturity. Currently there are about RMB100 billion worth of such products outstanding until 2026, but we are almost certain to see new pension wealth management products brought to the market under the IRA framework in 2023. Similarly, more banks may be allowed to offer pension saving products, which currently are on a trial capped at RMB4 billion, as IRA offerings. The slight asynchronism gives other product manufacturers a head start to compete for banks' distribution shelf, but it warrants urgency rather than complacency.
On 21 November, CBIRC announced the insurance version of governing rules, *Notice on Matters Related to The Development of Personal Pension Business by Insurance Companies*.

Chart 4: Summary of CBIRC's announcement on insurers' IRA business

#	Requirement area	Detailed requirements
1	Requirements for insurance companies conducting personal pension business	▸ The net equity at the end of the previous year is not less than RMB5 billion and not less than 75% of the company's paid-in capital ▸ The comprehensive solvency ratio at the end of the previous year is not less than 150%, and core solvency ratio is not less than 75% ▸ The liability reserve coverage ratio at the end of the previous year is not less than 100% ▸ Comprehensive risk rating of not lower than B for the last four quarters ▸ No major penalties from financial regulators in the last three years ▸ Have a sound information management system, and the banking and insurance industry personal pension information platform (hereinafter referred to as the banking and insurance industry platform) to achieve system connection, and information registration and interaction in accordance with the relevant requirements ▸ Other conditions specified by the CBIRC ▸ Pension Insurance Companies (PIC) with outstanding pension business, rigorous business management and sound internal management can be exempted from the requirement that the owner's equity at the end of the previous year is not less than RMB5 billion.
2	Insurance products requirements to qualify for personal pension	▸ The insurance period is not less than five years ▸ The insurance liability is limited to the payment of survival insurance benefits, the payment of expiration insurance benefits, death, total disability, disability, or nursing status ▸ Meet the payment requirements of the participants in the personal pension system (hereinafter referred to as participants) by providing lump-sum, periodical or irregular payment ▸ Other requirements specified by the CBIRC
3	Types of services that an insurance company may provide upon authorization	▸ Assisting participants in opening personal pension accounts on The Ministry of Human Resources and Social Security (MOHRSS)'s Personal Pension Information Management Service Platform ▸ Assisting participants in the designation or change of IRA ▸ Registering the participant's information on the banking and insurance industry platforms
4	Contract management requirements	The insurance company shall sign a separate insurance contract with the participant and clearly identify the contract in the company's relevant information system and shall not accept his or her use of funds in the personal pension fund account to insure others
5	Eligible insurance companies	The first batch of insurance personal pension business includes seven products from six insurers, from both life insurance companies and PIC

Sources: CBIRC, EY Parthenon Analysis

Compared with banks and WMCs, the insurance version is even more restrictive, with particular emphasis given to internal control, compliance and risk management functions needed in place before insurers can start the IRA business. The products allowed are also rather limited. All these suggest that life insurers will approach this new opportunity with caution rather than passion.

On 25 November, MOHRSS, MoF and SAT announced that 36 geographies would be pilots to launch the IRA for their residents.

Chart 5: List of pilot geographies

Beijing	Harbin	Shenzhen
Changchun	Hefei	Shijiazhuang
Changsha	Hohhot	Suzhou
Chengdu	Jincheng	Tianjin
Chongqing	Lhasa	Urumqi
Dalian	Nanchang	Wuhan
Dongying	Nanning	Xi'an
Fujian	Ningbo	Xining
Guangzhou	Qingdao	Xiong'an New Area
Guiyang	Qingyang	Yinchuan
Haikou	Shanghai	Yuxi
Hangzhou	Shenyang	Zhengzhou

Source: MOHRSS, MoF, SAT, EY Parthenon Analysis

Although the number of 36 is rather modest for a large country like China, it has covered 27% of the country's population and 40% of its GDP. More importantly, this is also where the necessary infrastructure is available to introduce, promote and follow up with this new offering. Once the initial run satisfies the authorities, we expect the program to be expanded to cover the whole country.

And finally, on 24 November, CBIRC released IRA rules for PICs.

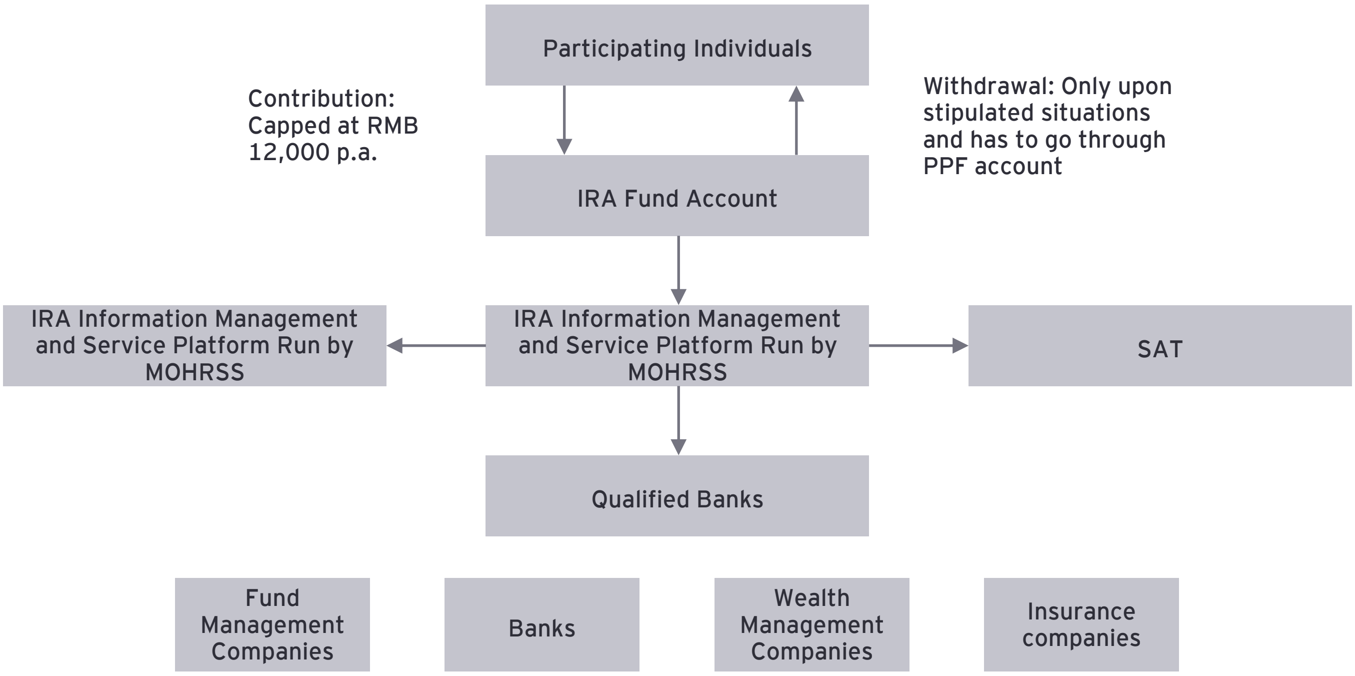
Chart 6: Summary of CBIRC's announcement on pension insurers' IRA business

#	Requirement area	Detailed requirements
1	Scope of the trial	► 14 geographies, some cities but mostly provinces, are included ► The trial starts on 1 January 2023 and will last a year ► Four PICs are admitted
2	Direction of IRA business for PICs	► PICs are encouraged to innovate and develop their business and offer a suite of different services including account management, planning, fund management and risk management to meet various demand across the full life cycle of the clients ► PICs should explore new channels to offer pension products to reach the new demographics ► PICs should explore long-term mechanisms including sales incentive, risk management and investment management, to support the growth of the individual pension business
3	Other arrangements	► PICs are encouraged to invest in the control and management mechanism of the IRA business ► PICs should invest to upgrade the IT system to support the business ► PICs can offer IRA services in geographies where they do not have a branch

Sources: CBIRC, EY Parthenon Analysis

While the rules on PIC's IRA business came out the last and seem to be more limited in terms of geographic reach and number of participants, as well as the emphasis on its trial nature, it is interesting to see special attention given to employees working in the gig economy, a group that is becoming more important in the millennial demographic, and that it allows the identified PICs to expand geographically without having to going go through the application and approval process.

Chart 7: How IRA is supposed to work



Source: MOHRSS, SAT, CBIRC, CSRC, EY Parthenon Analysis

It has been more than seven years since the last major upgrade of China's pension system, the launch of the Occupational Annuities program, and almost two decades since Pillar 2 was introduced to complement the PPF. The long wait is in contrast to the significance of the change. For people who have followed the development of China's pension industry, especially Pillar 3, that it has been a conjectural struggle inexorably moving toward a better goal is probably the most perplexing thing. However, the introduction of the IRA is not a landmark due to the long pause, but because that the proclaimed changes are far more sweeping than what was suggested by the pilot nature of the beginning.

1.2 Initial results:

While the architect of China's pension system listens to the dictates of prudence, the hibernation was justified as it thrusts the new system with a clean slate that is not available to the older schemes. By combining the universal coverage with customization flexibility, two key features of Pillar 1 and 2 respectively, the design has evoked the fail-safe recipe for success in China. And the initial results we hear from the front have certainly been promising. Between 25 November when the 36-city pilot started and the end of 2022, the trial managed to onboard 19.52 million participants, of whom 6.13 million have made their first contribution to the IRA, totaling RMB14.2 billion. On average this yields a contribution per person of RMB2,316, which indicates that most of the participants do not have much tax shield to harvest.

Customers:
Our research suggests that the main buyers of the IRA in the first three months are customers between 35-45 years old. The younger demographics need more education to develop the awareness and probably still lack the financial means to fully appreciate the Pillar 3 products. The people above 45 years old, on the other hand, have usually made retirement plans already. The first three months have led the banks to see the 35- to 45-year-old as the sweet spot to build the initial client base. More importantly, including a Pillar 3 product in these customers' portfolio gives the banks an avenue to various critical conversations with them, including financial advice, long-term planning and investment product selection. We believe that the banks as the main distributor will focus on fully penetrating the middle segment before moving to a broader demographic of 30-50 years old.

When more dimensions of customer behavior are considered, most of the initial customers exhibit low engagement level with the banks' relationship managers, despite the clear need for more assistance due to the complication of the products as well as its new nature. To change this, banks will need to automate their process and reinforce the value propositions of the IRA offerings. On the other hand, banks are not as effective in capturing the routine customers as they used to anymore, and this new business probably requires more innovative approach than any other new business we have seen in the last 10 years does.

Products:
The banks so far only carry pension deposit and pension FoFs as their IRA products. Marketing resources have been almost exclusively focusing on deposits, partly because the banks usually have deposit taking embedded in their KPI to begin with, and partly because they shun the sales suitability risks associated with pushing for riskier products. While the pension deposit certainly works well with some customers' needs, it remains an interim/supplementary product and is subject to regulatory quota. The FoFs, on the other hand, are a better fit with most customers' needs but for the time being receive few sales resources. As a result, they are, like most mutual fund products, bought, as opposed to the deposits, which are sold. This means the purchase fund flow will show more correlation with the merits of the products, including track record, brand awareness of the manufacturer and visual appeal of the marketing materials.

Propositions:

Tax benefit is one of the defining features of the Pillar-3 products. But just like the tax-deferred insurance annuities, it does not resonate with Chinese customers well. The tax credit is considered too little and the process to claim is too complicated. It is also easy to take tax deferral for tax exemption, leading to poor customer experience.

Despite the initial lukewarm feedback, tax feature remains the biggest differentiation factor of the IRA and as we have argued in last year's report, it just needs to be combined with other features to form a more integrated proposition. In fact, the difference between the IRA and earlier attempts to stimulate retail demand with tax benefits is that IRA is presented as an account instead of a product. And here probably lies the key to its success.

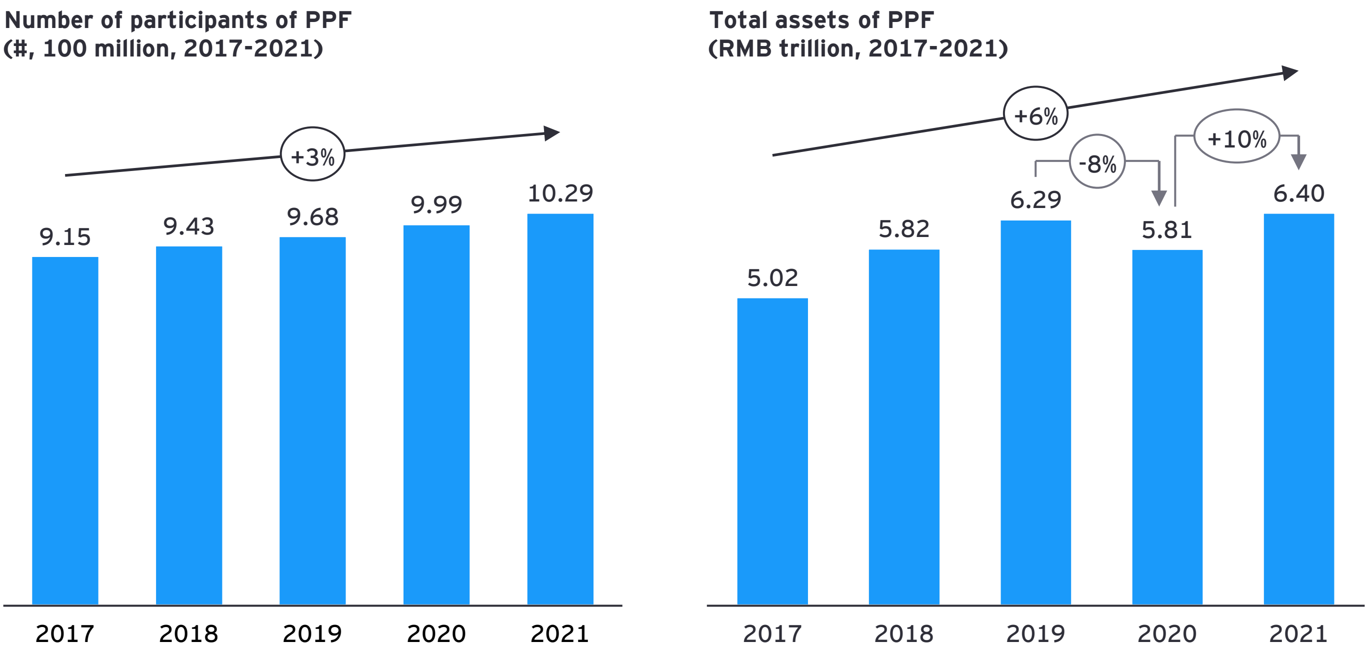
We have offered our assessment of the initial results, but it is worth noting that these are based on the first three months of a very long-term enterprise. The true effectiveness can only be attested with time and almost certainly it is going to be an evolutionary process where constant updates rather than the initial design will shape its future.

1.3 Growth of Pillar 1 and 2

The significance of the launch of the third pillar should not belittle the growth recorded by the other two pillars. By our estimate, PPF, National Council of Social Security Fund (NCSSF), Enterprise Annuities (EA) and Occupational Annuities (OA) collectively grew their asset size by close to RMB1.6 trillion in 2021.

PPF manages to return to growth after a trying 2020. And now that China has lifted its various restrictions on the emergency introduced by the pandemic, the contribution to the PPF is expected to normalize, though the Fund still needs to address the continued challenges from the demographic changes.

Chart 8: PPF size and allocation

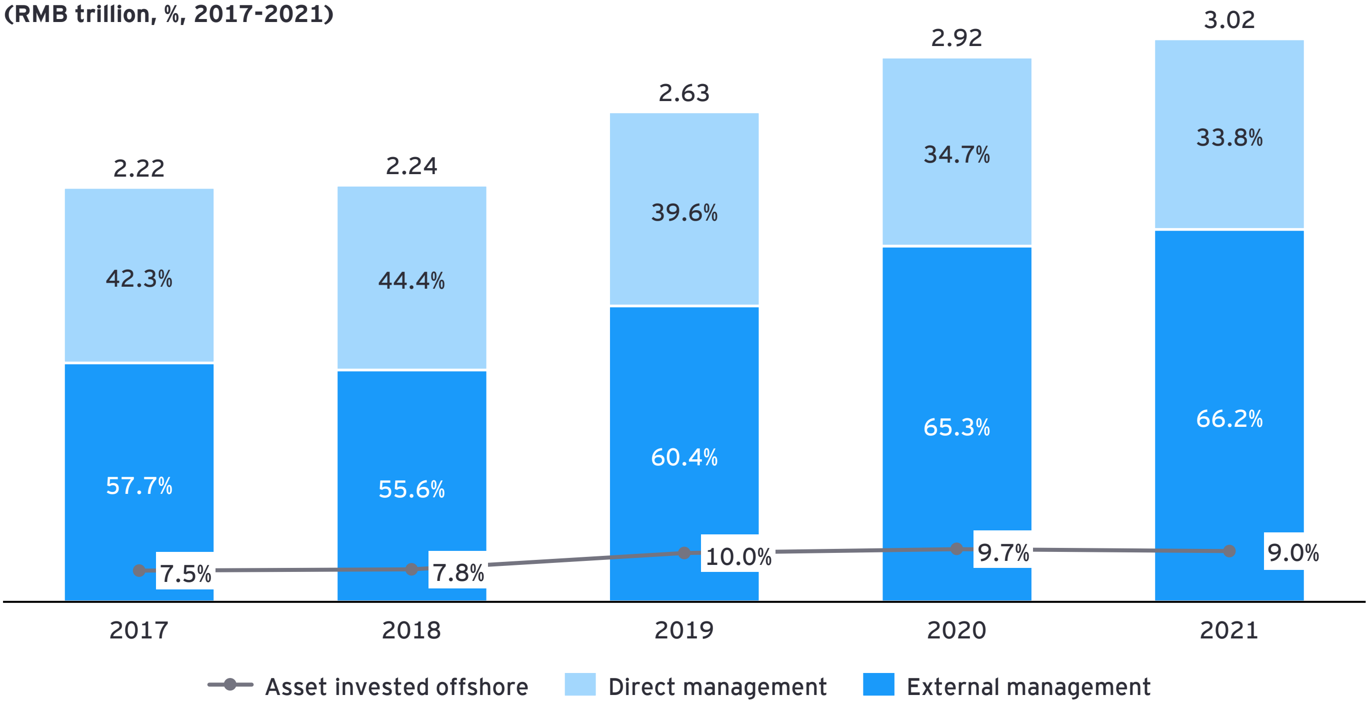


Source: MOHRSS , EY Parthenon Analysis

NCSSF continues to post growth. For the first time, the Fund reached RMB3 trillion of total asset. The year-over-year (YoY) growth came down through from 11% in 2020 to 3% in 2021, as a result of the fluctuation in the capital market (the Fund posted a return of 4.27% for 2021, as opposed to the 15.84% for 2020, and the 14.06% for the year before). Otherwise, the Fund continues to invest offshore, as well as work with external managers.

Chart 9: NCSFF asset size and allocation

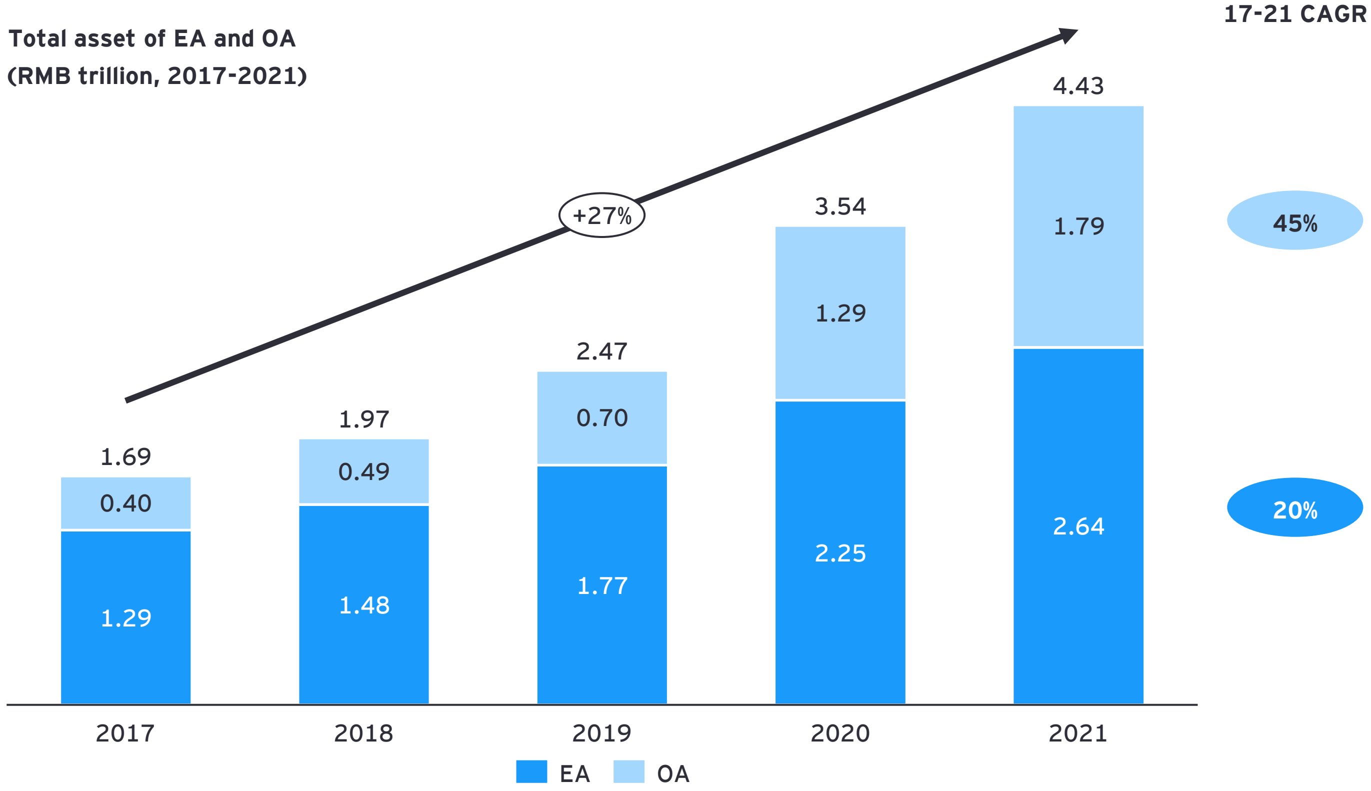
NCSSF total asset
(RMB trillion, %, 2017-2021)



Source: MOHRSS , EY Parthenon Analysis

EA's total assets registered a 17% YoY growth in 2021, slightly below its five-year Compound Annual Growth Rate (CAGR) of 20% between 2017 and 2021. This is also more of a result of the capital market volatilities, as the numbers of participating employers and employees were both growing steadily. OA also landed on a lower growth curve, with a 39% YoY growth rate, indicating that the hyper growth recorded between 2019 and 2020 is over for the sector. Collectively EA and OA for the first time reached RMB4.4 trillion in size, a RMB900 billion growth compared with 2021.

Chart 10: EA and OA size



Source: MOHRSS , EY Parthenon Analysis

02

Competitive outlook

In the new dynamics inaugurated by the Pillar 3 breakthrough, all players are no longer constrained by a license. The triumvirate of banks, insurers and fund managers, however, are not equally well prepared, and they face new competitors.

2.1 Banks

Banks are the biggest beneficiary of the IRA introduction, as the retail nature of the business offers them new opportunities to capitalize on their massive client resources and distribution network. They have indeed been the most ardent during the first few months of the new program. All participating banks seem to follow a phased approach. The first one, which starts with the introduction of the IRA, sees the banks cascade the daunting task of onboarding one billion-plus retail customers down to millions of their employees. By our estimate, about two million bank employees have been given some client onboarding targets, usually 10-50 each, over the six months starting from November 2022. This roughly translates to 20-30 million customers, which checks with the number announced by MOHRSS in January 2023. The second phase, which will likely take up the year 2023, will be to mobilize the onboarded customers to start funding their accounts. We have seen currently only about one-third of the IRA holders have actually used their accounts. We believe that the banks will start developing new customers and further deepen the relationship with the existing ones only when this phase is over.

2.2 FMC

FMCs are the other major group of beneficiaries. While banks are happy or at least busy being the gatekeeper, managers are now actively marketing their pension FoF products on the back of an impressive track record. This model requires fund managers to work and share profit with the banks, but this is a model that both sides are comfortable with and therefore blessed with minimum uncertainties. In the longer term, fund managers' success in the IRA space seems to be both guaranteed and checked by their banking partners, unless a new client acquisition/service model emerges.

2.3 Insurers

So far, we have seen seven Pillar 3 products from six insurers, the least overwhelming among all participants. We think the absence is a result of several factors. Firstly, insurers, especially the leading ones, are increasingly prioritizing their own design of the pension business model over supplementing banks with products under a bancassurance arrangement. Secondly, most of the life insurers are already offering some pension products in the form of tax-deferred annuities and will need to decide if they want to harmonize the existing products into the IRA scheme or bring new, more relevant products to fill the space. And thirdly, some insurers have more pressing issues at hand and given their clout, decided to adopt a follow strategy rather than hazard some guess on the new design. All said, we have every reason to believe that insurers will be a serious and formidable contender in the IRA space once the abovementioned issues get dealt with.

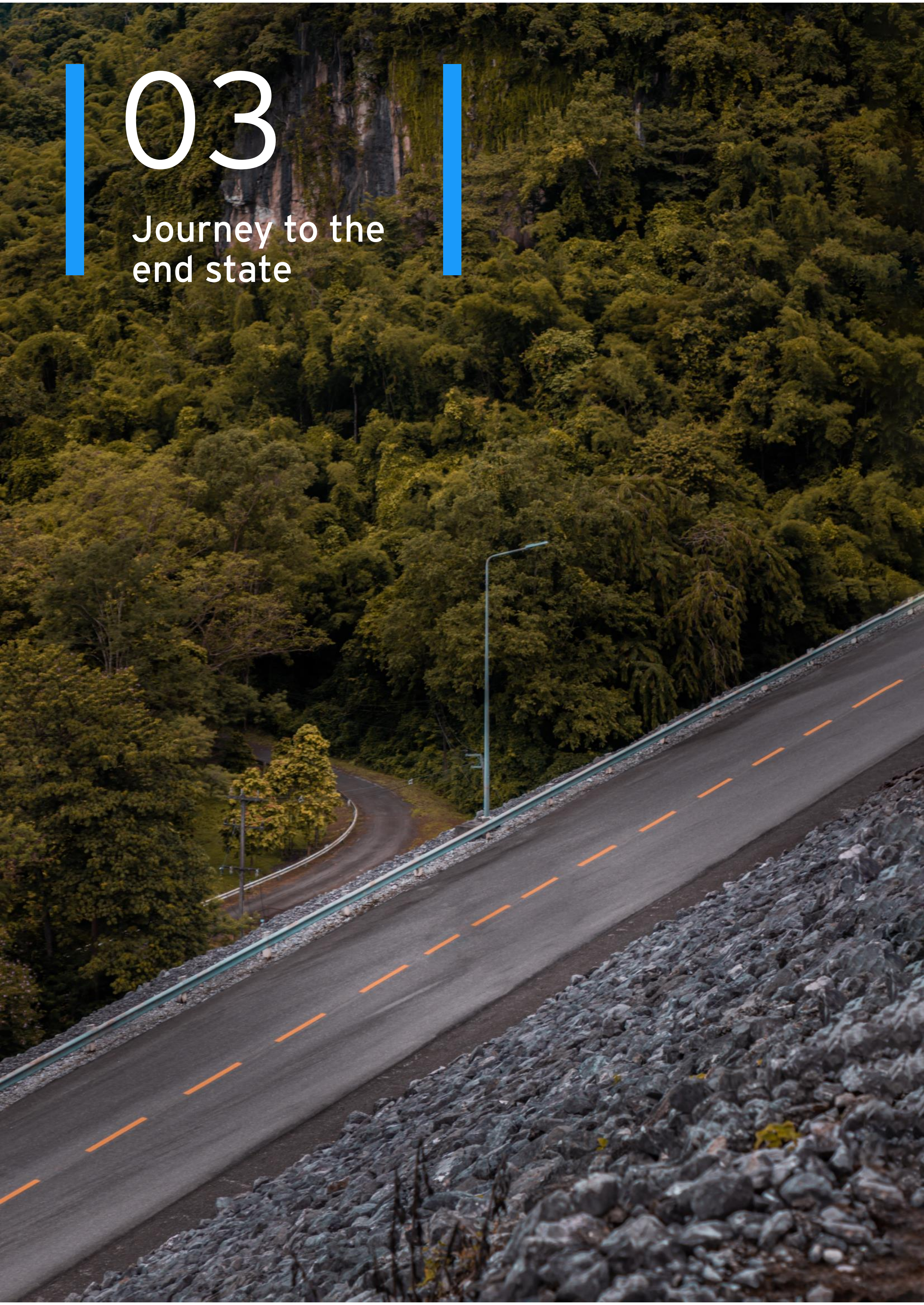
2.4 WMCs

WMCs are the youngest in China's financial services industry but an early mover in the pension space. Since September 2021, a select few of them have been offering pension products on a one-year trial basis under the auspices of CBIRC encouragement. Those products were sold out so quickly that additional quota was provided, bringing the total size of the trial to RMB95 billion. CBIRC has yet to provide an extension or normalization of the trial, but we think an upgraded version is due soon.

Foreign companies eyeing the opportunities in China's pension industry have been watching WMC with particular interest, as they can now be the controlling shareholder of a WMC joint venture. While we find the high hopes attached to WMC in the pension space more than valid, the success is far from being guaranteed. We believe the WMC will need to sort out a few key issues before they can fully leverage their endowment: freeing up resources to tackle the new business, designing products that are simultaneously similar to and different from the ones from FMCs, better anchoring the relationship with the parent bank, from service-level agreement to the strategic plan. Lastly, the JV WMCs will need to put extra effort into designing their corporate governance.

03

Journey to the end state



A year ago, at the dawn of a three-pillar pension system in China, we predicted the success of the new institution will be determined by how it connects with the individuals. For the IRA to fulfill its ambition, it will need to grow to around RMB10 trillion as a mid-term objective. A nearer-term goal is RMB1 trillion, which is still a tremendous figure. It took the second pillar 10 years to reach that milestone. With the blessing from the top, the growth of the IRA will be much faster, and this is already evidenced by the 20 million account number. But we are likely still looking at a staged trajectory and may take several years to reach the critical mass. Resorting to Chinese retail to solve the pension challenge is both a magnificent promise and a huge ask.

In this article, we have made some predictions on the key issues around customer, products, distribution and possible differentiators, based on the initial results of the pilot. However, some of the long-term trends can only be validated once more data points become available. In a market that rewards risk taking as China, we advise against approaching IRA as a wait game, despite the uncertainties still persisting. Given the speed the pension reform has picked up, all players need to adjust their pace accordingly. Banks have adopted a Minimum Viable Product (MVP) approach in response. Both pension saving products and pension FoFs have room for optimization, but instead of waiting for a version that is specifically designed for the new rules, banks have prioritized filling the shelf to capture the client base. This approach also allows the banks to start collecting valuable customers information, which will then be used to improve products and the underlying sales process. Not only the MVP allows the banks to go to the market quicker, but in fact the IRA is so gargantuan a task that it is almost impossible to gain customer endorsement if the initial products are over engineered.

The pension FoFs from FMCs, while not exactly designed as an MVP and certainly not new to the market, carry similar features, such as easy to understand (a target date), meet the key needs (long-term saving), and enough differentiations. By comparison, insurance companies and wealth management companies have yet to make similar attempts.

Once the number and scale of the MVP products reaches the critical mass, the focus will shift to new frontiers. The products will be evaluated on some more decisive features, such as easiness to use rather than easiness to buy, long-term risk-adjusted return, and compatibility with financial advice delivery. The expanded space will accommodate more contenders and allow more value addition. Market volatilities will also create windows for new, more sophisticated products to enter. And with product diversity, customers will better appreciate the services, eventually giving the advice-centric pension business a feasible revenue model.

Beyond the strategies

The IRA is less than three months old and yet participants already have to adjust their strategies. The market is large enough to offer all participants opportunities to design, implement and test different strategies and we think it is imperative to seize this facility. While the early movers have seen initial reward, the journey is long enough to accommodate a trial-and-error approach.

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