ADB

Technical Assistance Consultant's Report

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People's Republic of China: Public Finance and Financial Management Reforms

TA 7896: Output 2
Management of the Social Insurance Fund

Asian Development Bank

Management of the Social Insurance Fund

BACKGROUND

In 2010 social insurance funds (SIFs) in the People's Republic of China were estimated at about CNY2 trillion and had been increasing rapidly. Nonetheless, there were a number of deficiencies with the existing system: (i) the social security system was seen as complex with multiple schemes and inadequate coverage of the population—in particular the rural poor and migrants; (ii) social insurance management and service delivery were devolved, fragmented, and largely municipality based and this had hampered implementation; (iii) management of individual accounts and investments was not transparent and varied widely across the various tiers of government; (iv) financial and accounting regulations for SIFs, which had been issued in 1999, were in need of revision; (v) relationships between provincial and local level social insurance agencies were not well defined; (vi) the investment of SIFs was not well coordinated across various levels of government and was restricted to bank deposits and government bonds, which offered little protection against inflation; and (vi) there was no consolidated social insurance database.

The Social Insurance Law, which was passed by the national People's Congress in October 2010 and took effect in July 2011, was expected to address some of these issues. However, it was recognized that its implementation and consequent revisions in regulations and guidelines would require improved management at all levels.

OBJECTIVES

Recognizing the need for changes to strengthen the social insurance system the government requested the Asian Development Bank (ADB) for technical assistance (TA) to undertake a study on reform of SIF management. The TA, which was approved in October 2011, provided for an in depth review of four interrelated key issues:

- **(i) Strengthening of social insurance budget management.** The process for preparing a consolidated budget for social insurance was to be improved and regulations and guidelines developed. It was expected that this would tighten fund supervision, establish a sound basis for subsidies, contribute to the efficient investment of funds, and increase the transparency of SIF use.
- (ii) **Revision of financial regulations.** This was to cover standardization of individual accounts and investments; increasing transparency; broadening the range of banks handling financial transactions; standardizing interest rates; adopting an accrual accounting system; and clarifying relationships between social insurance agencies.
- (iii) **Improvement of investment strategy and systems.** This required the development of a nationwide framework for investment, covering risk management, financial control and supervision, governance structures, and a wide variety of financial instruments;
- (iv) **Expansion of computerized management information systems.** Establishment of a nationwide system to: (a) provide information about beneficiary accounts at central, provincial and county levels; (b) reduce the risk of fraud; (c) promote coordination and

increase transparency; (d) improve the monitoring of SIF performance; (e) facilitate central government supervision; and (f) facilitate portability of pension rights.

FINDINGS

The major findings of the study are that: (i) reforms of the investment management system have failed to match the rapid growth in the scale of the PRC's social insurance funds; (ii) bank deposits continue to be the main investment for the Basic Social Insurance Fund and this poses a serious risk of depreciation. However, the Enterprise Annuity Fund and the National Social Security Fund have more diversified investment approaches and in recent years, they have achieved good investment performance; (iii) current fund investment management is weak and is not uniform. It lacks standardized internal accounting and auditing systems and transparent information disclosure mechanisms. Further, decentralized management means that systems differ and there have been risks to the safety of SIFs. Decentralized management also reduces the efficiency of the funds; (iv) the parallel collection system, involving social insurance agencies and local tax authorities, reduces efficiency by increasing coordination and management costs; (v) fund collection is difficult to enforce resulting in growing arrears of social insurance; (vi) relevant laws and regulations are still being developed; and (vii) agencies have overlapping responsibilities and this contributes to conflicting policies and business practices and frequent buck-passing.

The TA the need to improve risk management provided important input for reforms of the pension system in the PRC that were introduced in August 2015. A major component of these reforms was the raising of limits on the share of social security funds that can be invested in equities to 30%. Although this was not specifically referred to in the TA's terms of reference and an appropriate ceiling for investments in equities was not addressed directly, the TA did emphasize that risk management should be improved by diversification of investments and provided important background information in relation to this matter. In addition, the Ministry of Finance has worked closely with PoBC [People's Bank of China] in revising the fiscal system for social security funds and the reports of the TA consultants provided important background material.

Other important findings of the TA were a recognition of the need for connections between the various elements of the social security system and of the importance of information sharing. The TA also emphasized the importance of centralizing social security funds and while this has not yet been acted upon it does appear to be widely accepted.

The contributions of the TA in this area were generally more theoretical than operational, and as such the specific contributions of the TA to policy reforms in the social security system are often difficult to identify. However, it is clear that the ideas emanating from the TA have had a major influence on the direction of these reforms and the TA has undoubtedly helped provide the foundations for future reform.

The implementing agency considers that the results have been outstanding and the Ministry of Finance attached great importance to the TA.

RECOMMENDATIONS

SIF Budget Management:

- promote a unified funding system;
- clarify the fiscal responsibilities of central and local governments;
- Build an information sharing mechanism;
- Standardize and improve budget methods;
- Establish a budget information disclosure system;
- Strengthen SIF budget implementation; and
- Establish an SIF budget evaluation system.

SIF Financial Management:

- Adopt accrual accounting as basis for SIFs;
- Expand the scope of the financial system for SIFs;
- Undertake further research on the feasibility of adopting a centralized receipt and payment system for SIFs;
- Unify interest rates for different insurances and strengthen management of special accounts;
- Strengthen management and supervision of SIF revenue and expenditure; and
- Establish an SIF financial information platform.

SIF Investment Management:

- Establish both short and long-term investment strategies;
- Upgrade the capacity of the administration of SIFs to improve risk control;
- Strengthen supervision and governance of SIFs;
- Review the indexation mechanism of SIF operations; and
- Establish special fund investment companies and research institutes.

SIF Information System Management:

- Establish a center to combine and coordinate the data requirements of the various levels of government—central, provincial and city.
- Develop a platform for information exchange and fund settlement across regions; and
- Improve the security of the management information system.