

**ASIAN DEVELOPMENT BANK**

**TAR:PRC 34096-03**

**TECHNICAL ASSISTANCE**

**TO THE**

**PEOPLE'S REPUBLIC OF CHINA**

**FOR**

**ADVISORY SUPPORT**

**FOR**

**THE NATIONAL COUNCIL FOR THE SOCIAL SECURITY FUND**

**October 2003**

## **CURRENCY EQUIVALENTS**

(as of 15 September 2003)

Currency Unit	–	yuan (CNY)
CNY1.00	=	\$0.1208
\$1.00	=	CNY8.2767

## **ABBREVIATIONS**

ADB	–	Asian Development Bank
MOF	–	Ministry of Finance
CSRC	–	China Securities Regulatory Commission
MOLSS	–	Ministry of Labor and Social Security
NaCSSEF	–	National Council for Social Security Fund
NSSF	–	National Social Security Fund
PRC	–	People's Republic of China
SASAC	–	State Asset Supervision and Administration Commission
SIA	–	Social Insurance Administration
SOE	–	state-owned enterprise
TA	–	technical assistance

## **NOTE**

- (i) In this report, "\$" refers to US dollars.

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## I. INTRODUCTION

1. The Government of the People's Republic of China (PRC) reconfirmed its request for continued Asian Development Bank (ADB) support to implement the Social Security Reform Program during the 2003 Country Programming Mission. The Fact-Finding Mission visited Beijing during 11–15 August 2003, and reached an understanding with the Government on the objectives, scope, cost, financing, and implementation arrangements for the technical assistance (TA).<sup>1</sup> The TA logical framework is in Appendix 1. The Government has assigned high priority to social security reform due to population aging, poor financial performance of state-owned enterprises (SOEs), linkage to capital market development, and severe financial and management stress of the old social security system. The ongoing social security reforms are designed to reduce the fiscal burden, remove rigidities in the labor market, and reduce poverty by improving social security coverage.

## II. ISSUES

2. An important milestone of the social security reform was the promulgation of Document 26 in 1997 by the State Council, which laid the conceptual framework for a multipillared pension system to replace the pay-as-you-go scheme.<sup>2</sup> The implicit pension debt is large and needs to be financed as part of the reform program.<sup>3</sup> The National Social Security Fund (NSSF), established in September 2000, serves as a supplemental adjustment tool and reserve to cover future social security expenditures. NSSF was established and entrusted with an initial CNY20 billion of budgetary allocation in December 2000 initially. To manage the funds it has raised, the central Government administers NSSF through the National Council for the Social Security Fund (NaCSSEF).

3. The NaCSSEF board<sup>4</sup> has three committees: for investment, risk management, and expert appraisal. The chair is supported by a secretariat with six departments: administration, finance and accounting, investment, legal and compliance, equity management, and information systems. NaCSSEF manages its own bank deposits and purchase of treasury bonds through the primary market. Investment in stocks, corporate bonds, financial institutions bonds, and other fixed-income instruments in the secondary market are to be managed and operated by outsourced specialized investment managers.

4. NaCSSEF's investment policies are set out in the Provisional Measures on Investment Management of NSSF, issued jointly by the Ministry of Finance and Ministry of Labor and Social Security and adopted at the first annual meeting of NaCSSEF in December 2001. According to the provisional measures, NSSF needs to invest no less than 50% in bank deposits or treasury bonds, no more than 10% in corporate bonds and financial institutions bonds, and no more than 40% in stocks and investment funds.<sup>5</sup> NSSF's holdings are now over CNY120 billion,<sup>6</sup> with 98% held in fixed-income instruments and only a small proportion invested in equity markets.<sup>7</sup>

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<sup>1</sup> The TA first appeared in *ADB Business Opportunities* (Internet edition) on 4 March 2003.

<sup>2</sup> The pillars are social pooling with individual accounts, enterprise-sponsored schemes, and individual market-based insurance. This structure was also adopted for health insurance.

<sup>3</sup> Implicit pension debt is the total amount of pension obligations that Government needs to cover to make the pension system actuarially sound, which is estimated at 50–150% of gross domestic product (GDP).

<sup>4</sup> The board is composed of 15 members appointed by the State Council. Five are government representatives from the Ministry of Finance (MOF), Ministry of Labor and Social Security (MOLSS), and trade unions; five are regional representatives, and five are representatives from the central Government.

<sup>5</sup> Funds allocated from MOF cannot be invested in stocks and investment funds.

<sup>6</sup> The budget allocations during the first year of operations totaled CNY60.7 billion.

<sup>7</sup> The portfolio composition at end-2002 was the following: treasury bonds, 22%; bank deposits, 76%; stocks, more than 1%; and corporate bonds and financial institutions bonds, less than 1%. The return on the portfolio was 2.6%.

5. The skewed allocation of assets reflects (i) unknown structure of NSSF liabilities,<sup>8</sup> hence the impossibility of matching the duration of assets against liabilities; (ii) uncertainty of future funding; and (iii) concerns about the overvaluation of many stocks listed on domestic exchanges, and the underdeveloped corporate bond market. NaCSSEF has yet to develop a well-stipulated investment policy and establish risk tolerance. NaCSSEF's risk avoidance investment policy obviously cannot be a long-term approach if its objective is to maximize returns on investments. Managing risk requires a portfolio that is diversified across instruments, maturities, and borders. To improve asset-liability management and better manage risks, policy breakthroughs are needed to broaden and deepen the capital markets and improve their governance, and to enable NaCSSEF to invest part of its assets in markets abroad.<sup>9</sup>

6. **State-Owned Enterprise Share Management.** The Government envisaged major funding sources for NSSF to include budget allocations, proceeds earned from divesting state shares, state lottery, and issuance of long-term government bonds. Typically, only one third of shares of public listed companies are tradable on the stock exchanges and about two thirds are in the form of "state shares" and "legal-person shares" and non-tradable. In June 2001 the State Council issued the Provisional Rule for Raising Funds for Social Security through Liquidation of State Shares and requested for every initial public offer or subsequent rights issues to issue 10% of state shares in stock exchanges for NSSF funding. However, the market reaction to the rule was negative and stock markets dropped significantly. The China Securities Regulatory Commission (CSRC) thus called off such practice in October 2001.

7. The Government since then has been contemplating other means of liquidating state shares, and one proposal is to directly allocate shares to NSSF. NaCSSEF recently established the Equity Management Department to coordinate policy with other government agencies in this issue, and eventual management of state shares.<sup>10</sup> However, poor financial performance and poor corporate governance of SOEs will be a major concern for NSSF. Experiences from other countries show that social security funds are not suitable organizations to manage SOE shares due to potential state interference. Valuation of non-tradable shares may also present a problem for NSSF in assessing their return and actuarial soundness. The soundness of the existing approach and a specialized government investment corporation to manage state shares before liquidation and transfer of proceeds to NSSF should be assessed. As the most significant institutional investor, however, NaCSSEF can greatly improve corporate governance by exercising its shareholders' rights. NaCSSEF's experience will help advance SOE restructuring and capital market development reforms.<sup>11</sup>

8. **External Investment Managers and Custodians.** In June 2003 NaCSSEF selected, through competitive biddings, six fund management companies as outsourced investment managers to manage the NSSF fund.<sup>12</sup> Each fund manager has been allocated CNY2 billion–3 billion. NaCSSEF has prescribed a dozen investment mandates with specific portfolio characteristics regarding instruments, sectors, duration, and risks. The investment managers

<sup>8</sup> MOF and MOLSS are jointly responsible for NSSF's expenditure policy. The Government has promised not to touch the proceeds from NSSF for the next 5 years, but NaCSSEF wishes this period to be extended to 20 years.

<sup>9</sup> The PRC adopted a framework for qualified foreign institutional investor in 2003 but its reciprocal form, the qualified domestic institutional investor, is still under development.

<sup>10</sup> The department has four divisions: allocation, to coordinate with government agencies in deciding what shares to allocate to NaCSSEF; shareholders rights, to exercise shareholder's ownership rights and represent NaCSSEF in enterprise governance issues; operations, to oversee equity share-related transactions; and the general administration office.

<sup>11</sup> Given that state shares cannot be traded in the stock exchanges, NaCSSEF either has to hold these state shares and receive dividends, or transfer these shares to other strategic investors, or, as some have proposed, eventually set up an exchange traded fund similar to that of Hong Kong, China's Tracker Fund to gradually liquidate SOE shares to the capital market.

<sup>12</sup> NaCSSEF does not have a secondary-market license but has to contract fund management companies for secondary-market investments. NaCSSEF has, however, obtained a special license from CSRC as the strategic investor.

are obligated to adhere to the portfolio characteristics of the assigned investment mandates; in return, NaCSSEF pays a management fee at a fixed percentage.

9. NaCSSEF has engaged two custodian banks—Bank of China and Bank of Communications<sup>13</sup>—which serve all payment and settlement operations of investment managers. The banks are also responsible for external investment managers' daily investment position reports, which are further processed by various NaCSSEF departments to manage risk and comply with regulations. Since NaCSSEF does not receive daily reports from investment managers, timely and accurate reporting by custodian banks is important for regulatory compliance, risk management, and performance evaluation.<sup>14</sup> No system is in place to detect erroneous reporting and cross-checking with other sources. Foreign custodian banks have comparative advantage in service quality, risk management, and regulatory compliance. However, since they do not have full Renminbi licenses, NaCSSEF may have difficulty engaging them now. Perhaps after the World Trade Organization phase-out period when foreign banks get full Renminbi licenses, NaCSSEF will be able to choose foreign banks as well.

10. NaCSSEF is developing a comprehensive risk management and performance evaluation framework combined with an on- and off-site monitoring and supervision framework for external fund managers and custodians. This will help NaCSSEF monitor compliance of investment managers in the short run, evaluate and select better investment managers in the medium run, and control volatility on risk-adjusted returns for NSSF in the long run. All these are essential for NaCSSEF to meet its investment and risk control objectives. The investment department monitors day-to-day compliance of investment managers and, jointly with the legal and compliance department, evaluates the performance of investment managers, focusing on overall risk management. The finance and accounting department monitors and evaluates custodian banks' performance.

11. Due to NaCSSEF's long-term investment objectives, enforcement of managers' best practices will help change the speculative environment and establish investment standards and benchmarks in the capital market. NSSF is not yet structured as a trust.<sup>15</sup> External investment managers are engaged through contracts rather than through trusts.<sup>16</sup> NaCSSEF and the Government should examine together the feasibility of setting NSSF up as a trust, and improve its contract management to safeguard responsibilities and accountabilities among various parties, including using the trust arrangement, to further clarify their legal obligations and protection. NaCSSEF should specify the criteria and selection process for professional external managers and not interfere in their investment decisions once the contracts are awarded.

12. **ADB's Operations and Strategy.** ADB has been a key partner with the Government in providing knowledge-based products to support social security reforms<sup>17</sup> and to build an

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<sup>13</sup> Bank of China is the one of the four state-owned commercial banks, and Bank of Communication is the largest joint-stock bank and the fifth largest commercial bank in the PRC, after the four state-owned commercial banks.

<sup>14</sup> Because NaCSSEF receives monthly reports from investment managers, it cannot reconcile reports submitted by custodians. It may involuntarily be in violation against CSRC regulations such as the mandatory report requirement for 5% ownership in a particularly stock.

<sup>15</sup> Under such trust arrangement, the central Government will be the trustor. The beneficiaries should be the provincial or other social security systems where funding for social security is short. NaCSSEF may be appointed trustee, which would make it accountable by giving it various responsibilities imposed by the Trust Law and other obligations imposed by the Government in the trust document, and also entrust NaCSSEF with authority to administer the entrusted assets.

<sup>16</sup> Although the PRC adopted the Trust Law in 2001, no investment fund has ever been created as a trust with well-defined trustee and beneficiary relationships.

<sup>17</sup> ADB. 1998. *Proposed Technical Assistance to the People's Republic of China for Pension Reform* (for \$2.4 million); ADB. 2001. *Policy and Institutional Support for the Social Security Reform Pilot Program*. Manila (for \$1 million).

enabling policy and regulatory environment.<sup>18</sup> TA 3733, completed in 2003, helped NaCSSEF in (i) organizational structure and policy framework; (ii) asset allocation to balance investment duration, risk and return, and investment benchmarking; (iii) internal operational and risk control procedures; and (iv) methodologies to select fund managers and custodians. The TA team also analyzed the potential impact of NaCSSEF in the PRC capital market. Because of the success of the TA, NaCSSEF asked for more assistance.

### III. THE TECHNICAL ASSISTANCE

#### A. Purpose and Output

13. The objective of the TA is to strengthen the institutional capability of NaCSSEF by establishing a sound risk management framework supported by an efficient management information system to prudently manage external investment managers and custodians, and to examine the soundness of allocating non-tradable state shares to NSSF.

#### B. Methodology and Key Activities

14. The scope of the TA includes (i) integrated risk management systems that cover management of external investment managers and custodians, (ii) a policy and management framework for non-tradable state shares, and (iii) an efficient and secure management information system. Specifically, the TA will do the following:

- (i) Strengthen risk management systems for investment managers and custodian banks by (a) developing procedures for day-to-day monitoring and supervision to ensure adequate adherence to investment mandates and operation guidelines and compliance with all relevant banking and securities market regulations; (b) facilitate effective and coordinated information exchange among various stakeholders, external and internal, and with NaCSSEF; (c) strengthen performance evaluation and adopt targeted benchmarks; (d) identify legal issues in mandated investment contracts and custody contracts, particularly focusing on issues of conflicts of interest, connected-party transactions, and moral hazard, and discuss the pros and cons of restructuring NSSF as a trust and utilizing trusts vis-à-vis contracts for external fund managers.
- (ii) Assess the soundness of allocating non-tradable state shares to NSSF and examine the feasibility of establishing a buffer such as a government investment corporation before channeling proceeds to NSSF. Establish strategies and risk management guidelines for equity management toward equity investment by (a) developing methodologies for risk control for internal management and outsourced management, (b) developing operational procedures for different types of equities, either of listed or non-listed companies, and (c) studying successful and unsuccessful equity management and investment operations of other countries and identify lessons from them.
- (iii) Enhance the quality of the management information system by (a) establishing strategies to adopt adequate computer hardware, software, and database technologies to ensure system integrity and data security; (b) helping select the

<sup>18</sup> ADB. 1995. *Fiscal Policy and Regulatory Framework for Social Security System Reform*. Manila (for \$540,000); ADB. 2000. *Policy Support for Social Security Reform under the Tenth Five-Year Plan*. Manila (for \$150,000); ADB. 1999. *Development of Economic Laws*. Manila (for \$1.4 million); ADB. 1999. *Capacity Building for the Insurance Sector Regulatory and Supervision System*. Manila (for \$700,000); ADB. 1999. *Capacity Building of the Capital Markets' Regulatory System*. Manila (for \$1 million).

database management system and design flow charts to build an integrated database system; and (c) recommending information technology project management procedures based on international best practices for successful project development.

### **C. Cost and Financing**

15. The total cost of the TA is estimated to be \$720,000 equivalent, including foreign exchange cost of \$370,000 and local currency cost of \$350,000 equivalent. The foreign exchange cost of \$370,000 and the local currency cost of \$130,000 equivalent for a total of \$500,000 will be financed on a grant basis by ADB's TA funding program. The Government will contribute \$220,000 in kind (office space, counterpart staff, transportation, and other services). Details of the cost estimates for the three components and the total are in Appendix 2.

### **D. Implementation Arrangements**

16. NaCSSeF will be the Executing Agency. A working group will be established, under the leadership of the director general of the NaCSSeF administrative department to work as the consultants' counterpart. NaCSSeF will provide office space, counterpart staff, transportation, and other support, and will arrange appointments for consultants with relevant agencies and organizations.

17. The TA will engage three international consultants for a total of 6 person-months, comprising a risk management specialist (3 person-months), a state share management specialist (2 person-months), and an information system specialist (1 person-month), with one functioning as the team leader. Three domestic consultants will have the same expertise as the international consultants but will be engaged for 3 person-months each. Additional international and domestic specialists will be engaged to cover specific technical areas, such as evaluation of international custodian banks and divestiture of state shares, and will be identified during TA implementation as the need arises. The terms of reference for the consultants are in Appendix 3. The TA will be tendered to an international firm based on a simplified technical proposal, using the quality- and cost-based selection method. The consultants will be selected and engaged in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB on the engagement of domestic consultants. The consultants will procure the equipment to implement the TA in accordance with ADB's *Guidelines for Procurement*.

18. The consultants will submit (i) inception reports 2 weeks after their services start, (ii) interim progress reports at appropriate stages of TA implementation, (iii) draft final reports before the conclusion of the contract, and (iv) final reports 2 weeks after incorporating NaCSSeF and ADB's comments. All reports have to be submitted in English and Chinese. The TA will start in February 2004 and be completed in December 2004. Trainings abroad will be selectively conducted through seminars and internships with major institutional investment institutions. Workshops will be organized near the end of the implementation period to invite comments from international and domestic experts in the field and disseminate TA findings.

## **IV. THE PRESIDENT'S DECISION**

19. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$500,000 on a grant basis to the Government of the People's Republic of China for Advisory Support for the National Council for the Social Security Fund, and hereby reports this action to the Board.

## TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<b>Goal</b> Strengthen institutional capabilities of National Council for Social Security Fund (NaCSSEF)	A sound and prudent risk management system for external investment managers, custodians, and state non-tradable shares, supported by efficient management information system	Progress reports by consultants and NaCSSEF Supervision by review missions	Government support for continued reform is effective. Sound recommendations are accepted and implemented.
<b>Purpose</b> Establish a sound management system for state non-tradable shares Adopt an integrated risk management system that covers external investment managers and custodians Improve the management information system	Strategies and risk management guidelines for equity management and investment operations Procedures for day-to-day monitoring and supervision to ensure adherence to investment mandates and performance evaluation criteria, and adoption of targeted benchmarks Proper strategies to adopt adequate computer hardware, software, and database technologies to ensure system integrity and data security	Progress reports by consultants and NaCSSEF Supervision by review missions	Related government agencies coordinate closely.
<b>Outputs</b> Analyze experience of foreign institutional investors, study successful and unsuccessful equity management and investment operations of other countries, and identify lessons from them Facilitate effective and coordinated information exchange among various parties, external and internal to NaCSSEF Enhance the service capacity and quality of the management information system, help select the database management system, and design the flow chart to build an integrated database system	Identify active or passive strategies that NaCSSEF could adopt toward equity investment and methodologies for risk control for internal management and out-sourced management; and develop operational procedures for different types of equities, or listed or unlisted companies, focusing on transactions such as agreement transfer, replacement, auction, leasing, equity-debt swap, and collateral for unlisted equities Develop operational guidelines and compliance with all relevant banking and securities market regulations, and identify legal issues in mandated investment contracts and custody contracts Recommend proper information technology project management procedures based on international best practice for successful project development	Progress reports by consultants and NaCSSEF Supervision by review missions Various tasks completed on time	High-quality preparatory work by the NaCSSEF Quality of technical assistance (TA) implementation by the NaCSSEF Quality of the TA consultants' services
<b>Activities</b> Recruit international and domestic consultants Organize training seminars and conferences to disseminate policy recommendations	Three international consultants for a total of 6 person-months, and three domestic consultants for a total of 9 person-months	Progress reports by consultants and NaCSSEF Various tasks completed on time	Counterpart support is available.

**COST ESTIMATES AND FINANCING PLAN**  
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
<b>A. Asian Development Bank (ADB) Financing<sup>a</sup></b>			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants <sup>b</sup>	225	0	225
ii. Domestic Consultants <sup>c</sup>	0	55	55
b. International and Local Travel	30	5	35
c. Reports and Communications	0	10	10
2. Equipment <sup>d</sup>	10	0	10
3. Training, Seminars, and Conference			
a. Facilitators (interpreters and translators)	0	10	10
b. Domestic Training	0	40	40
c. Overseas Training	50	0	50
4. Miscellaneous Administration and Support Costs	5	0	5
5. Representatives for Contract Negotiations	5	0	5
6. Contingencies	45	10	55
<b>Subtotal (A)</b>	<b>370</b>	<b>130</b>	<b>500</b>
<b>B. Counterpart Financing</b>			
1. Office Accommodation and Transport	0	90	90
2. Remuneration and Per Diem of Counterpart Staff	0	90	90
3. Contingencies	0	40	40
<b>Subtotal (B)</b>	<b>0</b>	<b>220</b>	<b>220</b>
<b>Total</b>	<b>370</b>	<b>350</b>	<b>720</b>

<sup>a</sup> Financed by ADB's TA funding program.

<sup>b</sup> Around \$50,000 is earmarked for additional international specialists and will be identified during TA implementation as need arises.

<sup>c</sup> Around \$65,000 is earmarked for additional domestic specialists and will be identified during TA implementation as need arises.

<sup>d</sup> Equipment to be purchased includes notebook computers, facsimile machines, and photocopiers.

Source: Asian Development Bank estimates.

## OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

### A. International Consultants (6 person-months)

#### 1. Team Leader and Risk Management Specialist (3 person-months)

1. As the team leader, the consultant will be responsible for the overall management of technical assistance implementation, timely delivery of quality interim and final reports, and recruitment and management of source persons in various technical tasks. As the risk management specialist, together with other international and domestic consultants, he or she will lead in management of external investment managers and custodians. Specifically the consultant will do the following:

- (i) Formulate a strategy to ensure that only external fund managers with track records and good internal risk controls are selected to manage funds for the National Council for Social Security Fund (NaCSSEF), and adopt international guidance on portfolio management standards such as those promulgated by the Association of Investment Management and Research.
- (ii) Establish a quick-responding short-term monitoring and supervision mechanism for outsourced investment managers and custodians, specifically to do the following:
  - (a) ensure adequate compliance of investment mandates and operation guidelines of NaCSSEF;
  - (b) ensure strict compliance of all relevant banking and securities market regulations; and
  - (c) recommend methodologies for performance evaluation and management of contractual relationship, identify the needs for targeted benchmarks, review investment mandates and guidelines, and balance the structure and investment style of investment managers.
- (iii) Recommend mechanisms to monitor performance of custodian banks to ensure compliance with all relevant banking and securities market regulations, including by doing the following:
  - (a) recommend due diligence procedures for custodians, including review of an emergency-handling system based on international best practices;
  - (b) develop benchmarks to monitor and evaluate quality of custodian services;
  - (c) discuss the need to request daily reporting from investment managers to cross-check with custodian reports;
  - (d) recommend a mechanism to systematically detect erroneous reporting; and
  - (e) comprehensively introduce services offered by international custodian banks,<sup>19</sup> including types of services, fee structure, contractual arrangement, reporting, responsibility and accountability, emergency handling, etc.

<sup>19</sup> To prepare NaCSSEF for the future engagement of global custodian service providers when it is granted Qualified Domestic Institutional Investor status.

- (iv) Recommend methodologies to evaluate performance of investment managers and custodians banks, including the following:
  - (a) identify and develop appropriate benchmarks for investments in stocks, bonds, and bank deposit and overall National Social Security Fund (NSSF) investment (combining portfolios);
  - (b) recommend a decision-making process based on various outputs of performance evaluation methodologies such as the Global Investment Performance Standards in calculating and evaluating the performance of external managers in stocks and bonds;
  - (c) develop peer-group comparison methodologies, including identification of peer groups;
  - (d) conduct attribute analysis and return decomposition analysis for stock, bond, repurchase agreements, and investments according to industry, investment style, and asset class;
  - (e) conduct risk-adjusted return analyses; and
  - (f) recommend methodologies to evaluate performance of bank deposits and bond investment.
- (v) Identify key issues in management of legal contracts with fund managers and do the following:
  - (a) identify the overall framework of the contract and main factors to be considered;
  - (b) discuss the pros and cons of the 2-year contract vis-à-vis longer term contracts and indefinite termed contacts;
  - (c) clarify whether specific investment guidelines of stocks and bonds, etc. should be clearly specified and what factors should be included;
  - (d) explain the appropriate proxy voting policies in the stock investment through external managers;
  - (e) consider factors that will decide fund managers' management and performance fees; and
  - (f) decide the format and content of outsourced fund managers' weekly, monthly, and yearly reports to NaCCSeF.
- (vi) Identify key issues in management of legal contracts with custodians and do the following:
  - (a) identify the overall framework of the contract and main factors to be considered;
  - (b) explain the difference between a custody contract and a trust contract;
  - (c) explain the difference in rights and responsibilities between trustee and custodian;
  - (d) decide whether a custodian is to be paid a performance fee;
  - (e) elaborate custodians' role in risk evaluation and performance analysis of mandated investment;
  - (f) elaborate custodians' role in corporate action, information accumulation, and transmission;
  - (g) elaborate independent institutions' role in evaluating custodians' internal control; and

- (h) decide reporting formats for information to be reported to NaCSSEF.
- (vii) Identify legal issues regarding mandated investment contracts and custody contracts, particularly involving avoidance of moral hazard, with special attention paid to the following:
  - (a) relationships among the mandated investment contracts, custody contracts, and third-party contracts of NaCSSEF, managers, and custodians; and contracts between managers and custodians;
  - (b) relationships among fund managers, custodians, and NaCSSEF in the contract;
  - (c) drafting of articles concerning breach of contract responsibilities and penalties in mandate investment contracts and custody contracts;
  - (d) potential legal risks in implementing mandate investment contracts and custody contracts;
  - (e) articles in custody contracts to ask custodians to take measures to limit other parties to make pledge, freeze, or enjoy other claims to the mandated assets; and
  - (f) authorization systems and management regulations of the original contract and duplicate copy.
- (viii) Recommend policies to ensure efficiently coordinated information exchange within NaCSSEF, and to monitor investment managers and custodians, performance review, and external audit.
- (ix) Work with policymakers to examine the feasibility of restructuring NSSF as a trust, and discuss the pros and cons of utilizing “trust” vis-à-vis entrusted contracts for outsourced investment fund managers.

## **2. State Share Management Specialist (2 person-months)**

2. In consultation with the fund management and information system specialists, the consultant will take the lead in tasks related to the management of equity shares, especially policy on non-tradable state shares. Specifically the consultant will do the following:

- (i) Assess the soundness of allocating non-tradable state shares to NSSF and examine the feasibility of establishing a buffer such as a government investment corporation before channeling proceeds to NSSF.
- (ii) Identify issues involved with active or passive strategies that NaCSSEF could adopt for equity investment, based the experience of foreign institutional investors, especially pension management institutions.
- (iii) Develop methodologies for equity management and risk control and discuss the merits of internal management and outsourced management based on best international practices.
- (iv) Tailor operational procedures for different types of equities of listed or unlisted companies, focusing on transactions such as agreement transfers, replacement, auctions, leasing, equity-debt swaps, and collateral for unlisted equities.

- (v) Study successful and unsuccessful equity management and investment operations of other countries and identify lessons from them.

### **3. Information System Specialist (1 person-month)**

3. In collaboration with the fund management specialist and state share management specialist, the consultant will lead information system development. Specifically, the consultant will do the following:

- (i) Analyze how the information system will influence NaCSeF's investment and risk management activities.
- (ii) Discuss the pros and cons of various systems and recommend strategies to adopt computer hardware, software, and database technologies for information and file management, with measures for system integrity and data security.
- (iii) Help select the database management system after recommending conceptual issues to be considered.
- (iv) Develop a flow chart to construct an integrated database system for fund management and risk control.
- (v) Recommend an information technology project management strategy based on international best practices, and identify key factors to develop information technology.
- (vi) Evaluate the situation and identify measures to ensure system integrity and information safety.

### **B. Domestic Consultants (9 person-months)**

4. Consultants with extensive in-country and sector knowledge, and good government and business contacts will be recruited. The consultants will help the international consultants quickly become familiar with their tasks by translating various documents into English; researching and compiling key government policies, regulations, and procedures; and providing advice to ensure that the international consultants' output is appropriate and implementable. The domestic consultants are expected to possess sufficient experience in their fields, and will include a risk management specialist (3 person-months), state share management specialist (3 person-months), and information system specialist (3 person-months).