
Developing the Third Pillar of Pension to Cope with Population Aging in China

Population aging is an unprecedented challenge generally faced by human society. As the world's most populous country, China has a demographic structure featured by a large aged population base, rapid growth rate, and "getting old before getting rich". These features are exerting an increasing impact on China's social, economic and financial systems, both bringing pressures and creating new opportunities. How to effectively respond to the challenges brought about by aging, and facilitate the transformation of China's economic and financial system to the high-quality track through improving the healthy and sound development of pension finance remains a significant and far-reaching proposition. In this context, the Research Institute of Finance of the Development Research Center of the State Council and Prudential Plc jointly conducted a research on the development of China's pension finance, which aims to deeply analyze the policy and institutional obstacles in the reform and development of China's pension finance in order to effectively respond to various challenges in the aging process and maximize the possible opportunities. The joint research was carried out in two phases and mainly focused on the research on the third pillar of Chinese pension system in 2019. This abstract summarizes the research results of the first phase.

I. Aging has exerted a profound impact on the economy and finance

China's aging population is an inevitable result of the modernization process. Since the launch of the reform and opening up, China has witnessed the rapid economic and social development, the continuously improved medical and health care services, the reduced mortality rate, the extended life expectancy of the population and the significant expansion of the absolute size of the aged population. At the same time, the economic and social developments and family planning policies have depressed birth rates. The size of juvenile population is decreasing, the proportion of the aged population is increasing, and the speed of population aging is constantly

increasing in China. Aging has exerted a profound and comprehensive impact on China's economy and finance.

(I) three distinctive features in China's aging process

By the end of 2019, China's population aged 65 years and over accounted for 12.6% of the total population, which has far exceeded the internationally recognized threshold of 7% for an aging society. Compared with other countries, China's aging process displays three distinctive features.

Firstly, the large aged population base and rapidly increasing proportion in the total population. By the end of 2019, China's population aged 65 and over was approximately 176 million, making it the country with the largest absolute number of elderly people in the world. From 2000 to 2018, the proportion of the world's elderly population over the age of 65 increased by 2 percentage points, while the proportion of China's elderly population increased by 4.94 percentage points over the same period, more than double of the world average. In 1980, the proportion of China's population aged 65 and over was only 5%, which was 6 percentage points lower than that of the United States. In 2018, the difference between China and the United States in this proportion narrowed to less than 4 percentage points.

Secondly, the degree of aging varies greatly between regions. According to data from the fifth national population census, only a few eastern provinces and Sichuan-Chongqing areas entered the aging society in 2000. Most provinces and cities with high proportion of the elderly population are located in economically developed areas, among which the top ranks are Shanghai (11.53%), Zhejiang (8.84%), Jiangsu (8.76%), Beijing (8.36%), and Tianjin (8.33%). As the fertility level in the eastern region declined in the first place, resulting in an increased elderly population, and China's population migration during this period was relatively limited, the dilution effect of population migration on aging was not yet obvious. Therefore, the difference in the proportions of the elderly population between the eastern and western regions was particularly obvious at that time, and the proportion of the elderly population in dynamic economic regions was higher. According to the data of the sixth national

population census, with the increased regional openness and population mobility and the change of fertility rates, the distribution of the elderly population also experienced significant changes in 2010 and the top provinces and municipalities ranking high in proportion of elderly population had changed to Chongqing, Sichuan and Anhui which had high population outflows and dropping fertility rates. The fertility rates of the economically developed provinces and municipalities including Shanghai, Zhejiang, Beijing and Tianjin with high population inflows had increased to varying degrees. The increase in population inflows and fertility rates had delayed the aging process of the population of these areas. Among them, Shanghai displayed the most obvious performance. In 2010, the proportion of the elderly population in Shanghai fell down by 1.41% from the level of 2000. In an overall view, compared with 2000, areas with higher degrees of population aging gradually spread to the peripheral regions with Bohai Rim, the Yangtze River Delta, and Sichuan–Chongqing as the centers in 2010. The aging of the population presented a gradual progression from the eastern coastal areas to the central plains to the western inland, and from economically developed areas to relatively underdeveloped areas.

Thirdly, “getting old before getting rich” and huge pressures on the economic development. China’s aging level in 2018 was equivalent to the United States in 1985, Japan in 1990, South Korea in 2013, and Hong Kong, China in 2003. The GDP per capita of these four economies at that time all exceeded US \$ 18,000, while China’s GDP per capita in 2018 was only US \$ 9423. China is still a developing country, and the aging that has occurred in this situation has put greater pressures on China’s economic and social development.

In short, when compared with many developing countries, China’s population aging is more serious and complicated; and when compared with developed countries, China’s economic and financial strength, pension security system, financial system, among others, still lag far behind and China has not been fully prepared for dealing with the ageing challenges yet. More attention should be paid to the pressures of aging on China’s economic and social system and systematic plans should be

considered.

(II) Full range of impact of aging on the economy and finance

Demographic factors play a vital role in economic development, which is being proven by more and more domestic and foreign practices. The full range of impact of aging is reflected in many aspects such as economic growth and its drive, macro-economic risks and risk management, social wealth and its management, among others.

In terms of economic growth and its drive. The transformation of the economic growth stage is closely related to the increasing aging population. Such facts as the weakened population growth momentum, the peaking of working-age population, and the gradually disappearing demographic dividend have, become an important factor driving China's transition from high-speed growth to high-quality development. The experience of Japan and other countries shows that the deepening of aging is closely related to the decline in the savings rate and investment rate, the reduction in the trade surplus, and the increase in capital outflows. This means that an aging society must seek new economic development momentum beyond investment and exports, and the role of innovation will become increasingly prominent. It should be noted that the aging society's innovation power is not necessarily lower than that of the youth-dominated society. Many empirical studies have shown that for workers with higher education levels, their innovation abilities will not decline with age. This means that in an innovation-led society in the future, the significance of continuing education will become more prominent and it is imperative to increase investment in continuing education and lifelong learning. This has become a key link for China to successfully shift the driving forces for growth and development.

In terms of macro-economic risks and risk management. Societies with a higher proportion of the elderly population are more vulnerable to specific risks. For example, the COVID-19 pandemic has exerted a huge impact on countries such as Italy and Spain, which is directly related to the particularly severe aging situation in these countries. The huge elderly welfare expenditure will increase the financial

burden and even cause a systemic financial crisis, which can be proven by the euro zone sovereign debt crisis, which began with the Greek crisis. In addition, aging highlights such problems as poverty, pensions, and long-term care for the elderly, and increases the sensitivity of the public to wealth inequality. How the government can better control the risks related to longevity has increasingly become a problem for the governance of a country and society.

In terms of social wealth and its management. Preparing for savings for an aging society will create huge demand for capital investment and asset management. International experience shows that contractual saving institutions such as pension funds and insurance funds will develop rapidly with the increase of aging, providing a long-term, stable and reliable source of funds for capital market development, and profoundly changing a country's financial ecology. Through years of accumulation, pensions have played a pivotal role in the international asset management market. The share of pensions in the asset management market has continued to rise since 2000, reaching 36% of the global asset management market in 2019 with approximately US \$ 51 trillion of assets under management. How residents allocate their assets in different forms such as insurance products, financial investments, and real estate to meet future retirement needs will also shape the future financial system to a large extent.

In short, all aspects of the future economy such as the economic planning, development strategies, industrial system construction, financial system optimization, and policy and system guarantees must take into account the impact of an aging population and continuously increase their weights.

II. The development of the third pillar helps to improve the pension system and promote the high-quality development of the financial and insurance industry

After more than 30 years of development, China's pension system has made great strides in the public pension system, but the commercial supplementary pension system urgently needs to be cultivated. China's pension assets have achieved rapid

growth during the period of rapid expansion, but the unreasonable structure will restrict the sustainability of the pension system. The development of the third pillar of pension system can not only improve the pension system, but also optimize the financial structure and promote the transformation and high-quality development of the life insurance industry.

(I) The development of the third pillar helps to improve the pension system

The development of the third pillar can increase the scale of pension assets and their capabilities in providing security. In 2018, the pension assets accumulated by the three pillars of the Chinese pension system were about 8.6 trillion yuan, accounting for only 9.56% of GDP (90 trillion yuan), while the pension assets of top 22 countries or regions with the largest sizes of pension assets accounted for 67% of their GDP in average. The shortage of pension assets in China made it difficult to meet the requirements of the aging population for pension security, resulting in an urgent need to develop a multi-level pension security system including the third pillar to increase pension assets.

The development of the third pillar helps to correct the structural imbalances of the pension system. In 2018, among the total pension assets in China, the first pillar was 5.82 trillion yuan, accounting for 67.67%, the second pillar was 1.48 trillion yuan, accounting for 17.21%, and the third pillar was 1.3 trillion yuan, accounting for 15.12%. The pension system is featured by the dominance of the first pillar. The main reason for the unbalanced development of China's three pillars is that the roles of market mechanism have not been fully utilized in the pension system, and the development of corporate annuities and commercial pension insurance has been slow. When the three-pillar pension system structure is seriously unbalanced, the income structure of retirees is simple. With the extension of personal life expectancy, efforts shall be made to develop the third pillar of pensions through the improvement of system design and product innovation, and channel personal wealth into long-term pension financial products, which can give full play to the status and roles of

commercial supplementary pensions in the pension system and further optimize the national retirement income structure.

The development of the third pillar can enhance the sustainability of basic endowment insurance. As the first pillar, the basic endowment insurance for urban employees has assumed almost all the responsibilities of old-age pensions, but it is facing serious pressure for sustainable development. Firstly, the system maintenance rate has gradually increased. As the population aging has intensified, the system maintenance rate (the ratio of the number of pensioners to the number of payers of endowment insurance premium) of China's urban employees' basic endowment insurance has gradually increased from 31.65% in 2011 to 37.7% in 2019, an increase of about 6 percentage points, and the pressure from pension insurance payment is constantly increasing. Secondly, the growth rate of fund income is lower than the growth rate of expenditure in most years and China is facing pressure from low revenue and high expenditure. From 2005 to 2018, the arithmetic average growth rate of the basic endowment insurance fund for urban employees in China was 19.3%, while the arithmetic average growth rate of the fund expenditure during the same period was 21.4%. In most years, the growth rate of the fund income was lower than the growth rate of expenditures, resulting in the decreasing cumulative number of months in which the fund's accumulated balance can meet immediate payments. Accelerating the development of the third pillar and implementing the structural transformation of the pension system can promote the sustainable development of basic endowment insurance.

(II) The development of the third pillar can optimize the financial structure

The outstanding features of China's financial system are insufficient development of direct financing, the stagnant development of long-term institutional investors in the capital market, and underdeveloped contractual financial and institutional investors represented by insurance. At the end of 2019, the stock of social financing reached 251.31 trillion yuan, of which bonds and stocks only accounted for

27.2%. At the same time, the total assets of the insurance industry were 20.56 trillion yuan, accounting for approximately 7.28% of the assets of banking institutions, and the proportion in the assets of the financial industry is relatively low. The financial structure dominated by indirect financing has resulted in the accumulation of financial risks mainly within the banking system. At the same time, the bank's low-risk appetite has made it difficult to tilt credit resources to technology-based and asset-light enterprises, and provided limited financial support for economic transformation and industrial upgrading.

Promoting the development of the third pillar can channel vast hoards of resident savings to flow into the capital market and promote the expansion of the market scale. At the same time, the roles of the insurance industry in accumulating long-term funds as contractual financial institutions can be further played, and the development of bonds and stock markets can be promoted through investment to serve the real economy while alleviating the structural imbalance between direct and indirect financing. In addition, pension and insurance companies, as institutional investors, can also promote the optimization of the capital market structure and enhance the stability of the capital market.

(III) The development of the third pillar can promote the high-quality development of the life insurance industry

The development law of the international life insurance industry shows that with the increase in the ageing of the population, people's focus on risk gradually shifts from death risks to old-age and health risks, and the proportion of pension services in the life insurance industry that covers survival risks is increasing. As China's population aging has become increasingly serious, pension business, as an important direction for the transformation of China's life insurance industry development model and high-quality development, will become a new business growth point and a key area for the industry to play its roles as the depository of long-term savings.

III. The third-pillar pension market in China has displayed a pattern of open competition despite many constraints

(I) Open competition of various financial institutions

Driven by the need for pension security accelerated by aging, the third-pillar pension market has displayed a pattern of open competition, and various financial institutions such as insurance companies, funds, banks, and trusts have gradually formed their respective advantages.

The insurance industry is a pioneer in participating in the development of the third pillar. Firstly, the insurance industry actively carried out the pilot projects of personal tax-deferred commercial pension insurance. By the end of 2019, 23 insurance companies had obtained qualifications for operating personal tax-deferred commercial pension insurance business. As of the end of 2019, 67 products had been approved for marketing; 19 companies had issued insurance policies; the premium income was about 1.24 billion yuan, and the cumulative number of participants reached 47,000. Secondly, the insurance industry increased the supply of insurance products for the elderly, continuously enriched the product types, broadened the scope of protection, and strengthened claims settlement. As of the end of 2019, there were more than 2,400 insurance products for the elderly, accounting for 1/3 of all products sold by life insurance companies, and 162 exclusive insurance products for the elderly. Among the valid insurance policies of commercial insurance companies, the number of insured persons aged 65 and over was 59.18 million, with a total of 149 million valid policies. The penetration rate of commercial insurance (number of people purchasing commercial insurance / total population) for 65-year-olds and above was 35.5%. From 2015 to 2019, insurance companies have accumulatively settled 57.53 million claims, involving 234 billion yuan, for senior citizens aged 65 and over. Thirdly, the insurance industry developed old-age security management products. In 2018, the end-of-period management scale of the old-age security management business was 648.333 billion yuan. Among them, the end-of-period management scale of the individual old-age security management business reached 613.343 billion yuan, accounting for 94.6% of the total scale of the old-age security business.

The public fund industry began to invest in the third-pillar pension industry in 2016. The China pension target securities investment funds were officially launched in 2018. By September 2019, a total of five batches of 79 pension target securities investment funds were approved involving a cumulative scale of more than 15 billion yuan. At present, the issuance of pension target funds is very limited. However, compared with other financial institutions, fund companies' products usually have higher investment returns and more diverse and flexible designs, which can effectively meet the differentiated needs of consumers in pension investment and can become the potential core product providers for the third pillar.

The banking industry (including trusts) also has the potential advantage of participating in the development of the third pillar. Incorporating the banking industry into the third-pillar pension system will not only help meet the risk preferences of Pillar 3 account holders and achieve complementary product configurations, but also help accelerate the process of integrating a unified account platform and quickly promote the popularization of the third pillar.

(II) The major factors restricting the development of the third pillar

The development potential of the third pillar has not been fully released in China due to the room for improvement in the areas of income distribution, pension structure, tax incentives, and regulatory systems.

Firstly, the imbalance in national income distribution has resulted in insufficient personal pension preparations. Since 2008, China's labor compensation as a percentage of GDP has gradually increased to 48% in 2017, but it was still below the level of the 1990s. The decline in the labor compensation as a percentage of GDP has led to a decline in the share of residents' income, resulting in insufficient personal pension preparations.

Secondly, the unbalanced pension structure is not conducive to the development of the third pillar. Firstly, the boundary between the government and the market in the pension system needs to be clarified. The basic endowment insurance for urban employees in China originates from the labor insurance system under the state-unit

security system in the planned economy era, and it has a certain path dependence on and thinking set for the government to assume responsibilities. In the process of transition to a market economy, the state changed the former labor insurance system of enterprises owned by the whole people to a social insurance model shared by the state, enterprises and individuals. In order to quickly realize the transformation of the old-age insurance system and expand its coverage, the government has played a leading role in the reform of the old-age insurance system. This has led to the focus on government responsibilities in China's pension security reform and the underutilized roles of the market mechanism, resulting in the excessively high proportion of public pensions, and the insufficient development of market-oriented occupational and personal pensions. This has not only resulted in increased responsibility and pressure on the government's provision of social security, but also prevented market players from smoothly entering the market and playing their due roles. Secondly, the burden for payment of basic endowment insurance premiums is relatively heavy and squeezes the development space of the third pillar. In recent years, China's employer pension insurance contribution rate has been reduced from 20% to 16%, which has greatly reduced the burden of payment. However, from an international perspective, the employer contribution rate of 16% and the aggregate contribution rate of 24% are still relatively high and not conducive to the establishment of a multi-pillar pension system. Thirdly, there is a lack of connection between the three pillars of the pension system. The individual account functions of the different pillars of the Chinese pension system overlap each other, but there is still a lack of channels and connection mechanisms for capital flows.

Thirdly, preferential tax policies need to be improved. Firstly, tax incentives need to be expanded. China's adoption of the EET-based tax-deferred model has certain incentives for high-income groups, but low- and middle-income groups may not be able to access them because their income does not reach the threshold, which is not conducive to improving the fairness and coverage of the system. Secondly, the tax-deferred pension policy needs to be improved. The pre-tax deductions are too low

to increase consumer demand; the calculation method of the taxes deferred is very complicated and not easy to operate; the actual tax rate of 7.5% in the collection stage greatly reduces the coverage of preferential tax policies; and the tax deferral operation process is complicated, increasing the difficulty of participating in the pension insurance.

Fourthly, the carrier for the implementation of fiscal and taxation policies needs to be converted from the product system to an NDC (Notional Defined Contribution) pension system. At present, the institutional targets of the third-pillar preferential tax policies are various financial industries, currently only for the insurance industry, which falls under the product system. But the carrier of preferential tax policies of the third-pillar pension is the third-pillar personal account, not the product or industry. There are two main factors that affect the transition from the product system to the NDC pension system. The first factor is that a unified information platform for various financial industries has not yet been established. The three platforms of China Banking and Insurance Information Technology Co., Ltd. (CBIT), China Securities Depository and Clearing Corporation Limited (CSDC) and the People's Bank Credit Reference System represent the insurance industry, fund industry and banking industry, respectively, and need further integration. The second factor is that the range of participating financial institutions and products needs to be expanded. At present, funds, banks and trusts have not yet been included in the scope of financial institutions and products covered by the preferential tax policies.

Fifthly, the regulatory system for the third pillar operation needs to be improved. Personal pension involves multi-departmental responsibilities and there might be a regulatory gap or duplicative regulation under the framework of separate operation and separate regulation. Therefore, it is necessary to establish a transparent, efficient and coordinated regulatory framework for the preferential tax personal pension to improve regulatory efficiency.

IV. Revelations from the developments of private pensions in major international economies

In order to meet the challenges of population aging and improve the sustainability of the pension system, in the new round of reform of the global pension system, major international economies began to promote the development of private pensions in the 1980s through such policies as financial subsidies and tax incentives oriented at efficiency improvement, which serves as positive references for the development of third-pillar pensions in China.

(I) Bring into play the role of market mechanism and enhance the sustainability of the pension system

Since the 1980s, major international economies have undertaken structural reforms in pensions, and actively developed private pensions to share the risks on the public pension system brought about by aging. After the past 40 years of development, the major international economies have generally established a multi-pillar pension system, and private pensions have seen rapid development. Firstly, private pension assets have continuously increased as a percentage of GDP. In 2015, among the OECD countries, there were 7 countries where private pension assets accounted for more than 100% of GDP, and only 3 countries standing at less than 5%. Secondly, the private pension coverage has increased significantly. In 2013, at least 18 of the 34 OECD countries covered more than 50% of the working-age population with private pensions. Thirdly, private pensions continue to increase their contribution to the income of retirees. In 2014, the average public pension substitution rate in 19 of the 34 OECD countries reached 26.6%, and after the private pension replacement rate is taken into consideration, their total average substitution rate reached 55.9%. The significant development of private pensions has improved the sustainability of the pension system.

China can learn from international experience, give full play to the roles of the market mechanism in the pension system, develop private pensions represented by the second and third pillars to correct the structural imbalances in the pension system and reduce old-age poverty by providing sufficient retirement incomes to more and more elderly people through various channels.

(II) Free up the development space for private pension by reducing the basic endowment insurance rates

From 2006 to 2018, the average value of total social insurance rates (mainly endowment insurance rates) in 166 countries and regions around the world was 20% to 21%, displaying a slight decrease (0.7%). Among them, the total insurance rates of Central and Eastern European countries, OECD member countries and emerging economies have dropped significantly. Due to institutional transition, Central and Eastern European countries who had designed high-rate to resolve the transformation costs in the past, had reduced the total insurance rate from an average of nearly 40% to nearly 30% through structural reforms in the past decade, with a cumulative reduction of more than 8 percentage points. The total insurance rate of OECD member countries fell from 30% to 25.6%, a decrease of 4.4 percentage points, indicating that high-income countries are also implementing “burden reduction” measures on the social insurance payment side with great efforts. Due to the large number of emerging economies in the Asia-Pacific region and the larger downward adjustments, the overall average insurance rate of emerging economies has shown a significant downward trend, with a decrease of about 4.5 percentage points.

As a transitional economy, the basic endowment insurance controlled by the Chinese government is the dominant pension plan, and has brought payment burden on the payers, which is much higher than the payment rate of most countries. The burden of basic endowment insurance payment has squeezed the development space of private pensions, which not only caused the structural imbalance of the Chinese pension system, but also increased the burden of corporate social insurance, which is not conducive to improving international competitiveness. Therefore, in the reform of the old-age security system and policy adjustment, the interactive relationship between private pensions and basic endowment insurance should be fully considered, and the space for the development of private pensions should be provided by effectively reducing the contribution rate of basic endowment insurance.

(III) Increase the demand for private pensions through fiscal and tax incentive policies

Major international economies usually adopt fiscal subsidies and tax incentives to promote the development of private pensions. The first is direct financial subsidies. For example, in Germany's Riester Pension Plan, the state's full-amount allowance for each insured person is 175 euros / year, and each child born before 2008 receives a subsidy of 185 euros / year, and each child born after 2008 receives a subsidy of 300 euros / year. The second is tax relief and deductions. The most adopted approach is the EET taxation model, while many countries also choose the TEE model. Fiscal and tax policies have obvious incentive effects on private pensions. In 2011, the OECD countries brought an increase of 1.6% of GDP to private pension expenditures at the cost of an average tax reduction of 0.4% of GDP, indicating a four times amplification effect of taxes on pensions.

In 2018, China initially established the EET-based preferential tax model for tax-deferred commercial pension insurance, but there is still much room for improvement. It is necessary to learn from the international diversified fiscal and tax incentive policies and enhance the public's demand for private pensions.

V. Policy recommendations to promote the development of the third pillar of pension system

In order to further improve the China model socialist market economy and promote the development of the third pillar of pension system, we can fully absorb international experience, give play to the roles of market mechanisms in the reform of the pension system, and improve the multi-pillar pension system.

(I) Adjust the pattern of income distribution and improve the ability of the individuals to support their own pension plans

Efforts shall be made to maintain sustained economic and employment growth, increase residents' income, and increase personal readiness for retirement. Through large-scale tax cuts and adjustments in income distribution, labor compensation shall be synchronized with labor productivity, and residents' income growth shall be

synchronized with economic growth in order to increase residents' income and their ability to pay, and enhance their self-protection in terms of pension plans.

(II) Promote structural reform of the pension system and release the development space for the third pillar

The role of market mechanisms in the pension system shall be brought into full play. It is imperative to coordinate the development of personal pensions consisting of basic endowment insurance, enterprise annuities and occupational annuities, and personal tax-deferred pensions, and build a three-pillar pension system that is integrated and jointly supported by the government, enterprises, and individuals. Efforts shall be made to develop private pensions, build a relatively balanced pension system with a multi-pillar structure, and correct the structural imbalances in the pension system.

The contribution rate of basic endowment insurance shall be reduced to provide space for the development of the third pillar. Although the level of China's first-pillar contribution rate has decreased, it still ranks in the forefront of the world. The contribution rates of the three pillars of pension insurance can be uniformly adjusted to appropriately reduce the contribution rates of the first pillar, create conditions for increasing the contribution rates of the second and third pillars, and focus on increasing the replacement rates of the second and third pillars.

The connection mechanism between the three pillars of the pension system shall be established. The personal accounts of the first pillar as well as the second and third pillars of China are all based on the individual old-age insurance accounts. Therefore, in policy design, the individual basic endowment insurance account, enterprise annuities, and occupational annuities and individual tax-deferred commercial pension insurance can be interlinked to achieve the connection of preferential tax policies, investment management, payment, account records, and fund transfer. Firstly, the preferential tax policies shall be connected. The proportion or amount of tax benefits entitled to by individuals in Pillar 2 and Pillar 3 should be connected, that is: if the individual employee's personal contribution to the enterprise annuities or

occupational annuities has not reached the upper limit of the proportion or amount of tax preference, the employee may add the difference to the upper limit of the account payment for individual account; if the employee's employer does not establish an annuity plan, the entire proportion or amount can be added to the upper limit of the individual account. Secondly, the connection of investment management. The second and third pillars shall adopt the entrusted investment and operation model, and professional financial institutions (including pension insurance companies, fund companies, trust institutions, etc.) shall conduct investment operations in the market and unify the governance structure, investment policies and welfare payment methods to facilitate the insured and establish a unified market competition order. Finally, payment, account records and fund transfers shall be connected. It is necessary to allow insured persons who meet certain conditions to transfer individual accounts in the first pillar directly to the second pillar or the third pillar, and realize market-oriented investment management; and allow the resigning personnel to transfer the funds attributable to the individuals in their enterprise annuities (and/or occupational annuities) to their third-pillar accounts.

(III) Optimize fiscal and tax incentive policies

The tax deferral policy of EET shall be improved. Firstly, measures shall be taken to appropriately raise the pre-tax deduction standard for tax-deferred old-age insurance against the background of raised threshold and addition of special expense deductions for personal income tax. For example, the monthly deduction limit can be increased to 2000 or 3000 yuan. At the same time, it is necessary to establish a dynamic adjustment mechanism in which the deduction amount is linked to the average indexed wage growth. In the future, with the economic development and the increase in income levels, the pre-tax deduction amount will be dynamically increased. Secondly, the proportional limit of 6% shall be abolished and the pre-tax deduction shall be uniformly deducted according to a fixed standard to facilitate employee to out the insurance and corporate human resources departments to assist in tax deferral procedures. Thirdly, measures shall be taken to reduce the actual tax rate in the

pension collection stage to about 3%, encourage low- and middle-income taxpayers to participate in the tax-deferred pension plan, expand the coverage of commercial pension insurance, and better achieve the policy goals of tax-deferred pension insurance. Fourthly, the pre-tax deductions for tax-deferred pension insurance shall be incorporated into the special deduction items for personal income tax, thus to further simplify the pre-tax deduction process.

Apart from the EET model, the TEE-based tax incentive model shall be implemented. The EET model helps to increase the options of pension account holders, expand the coverage of the pensions, and increase the scope of benefits from tax incentive policies. In addition, the TEE model also provides different options for high-income groups and enhances the flexibility of the tax incentive model.

Efforts shall be made to explore direct subsidized personal pensions. In order to enable the group whose annual income has not reached the threshold for individual income tax to participate in the third pillar, a certain proportion of financial subsidies can be given to benefit the low- and middle-income groups and improve the fairness and coverage of the system.

(IV) Improve the NDC-based pension system

Efforts shall be made to establish the unified third pillar system and the management service information platform. With the CBIT platform of the China Banking and Insurance Regulatory Commission and the CSDC platform of China Securities Regulatory Commission as the starting points, effort shall be made to transform from the “dual platform” to a “uniform platform” and establish a platform for a unified personal pension system for all financial industries to connect with the tax management system and provide support for financial institutions to participate in the third pillar.

Efforts shall be made to expand the range of participating financial institutions and products. The scope covered by the third pillar should include commercial endowment insurance, fund products, bank wealth management, trusts and other financial products suitable for investment. Expanding the range of participating

financial institutions and products can help promote competition in the personal pension account market and enrich product forms, thereby increasing public options and improving the efficiency of the personal pension account market.

(V) Improve the regulatory system for the operation of personal pension system

Mutual cooperation, good interaction and smooth communication between various regulatory authorities are important foundations for promoting the healthy and rapid development of the personal pension system.

The financial and taxation authorities shall be responsible for tax regulation, which includes the formulation and adjustment of preferential tax policies for personal pension, the general education of tax policies for consumers, the evaluation of the efficiency and effectiveness of tax policies, the punishment and correction of tax policy abuses, among others, to prevent tax evasion and tax loophole, and ensure the fair use of tax policies.

Financial regulatory authorities shall implement functional regulation and subject regulation. The China Banking and Insurance Regulatory Commission and the China Securities Regulatory Commission shall formulate rules and standards for the regulation on operational behaviors of tax-subsidized personal pensions, and implement functional regulation over the “tax-subsidized personal pension accounts” and operational behaviors. At the same time, the China Banking and Insurance Regulatory Commission and the China Securities Regulatory Commission shall separately exercise subject regulation over financial institutions within the scope of regulation.

An inter-departmental communication mechanism shall be established to strengthen the coordination and coordination of regulatory efforts, reduce the regulatory gap and duplicative regulation, improve the operational efficiency of regulatory institutions, and form a synergy of regulatory efforts.

Efforts shall be made to gradually transform from quantitative restriction regulation to prudential regulation. In the initial stage of system operation, the

regulatory model can adopt a combination of quantitative restriction regulation and prudential regulation. With the development of the personal pension market and the maturity of the operating experience of the participating entities, regulation should transform to the prudential regulation model, encouraging various financial institutions to provide differentiated pension investment services through market-based competition. We should steadily liberalize the scope of pension investment and promote diversified pension asset allocation through such means as equity investment, real estate investment, and cross-border investment using risk-controllable channels such as "HK Stock Connect" products. At the same time, the risk-bearing mechanism shall be improved through the establishment of a relative yield guarantee mechanism and a rational assessment mechanism, among others.