On Risks and Control of Social Security Fund Entering Security Market in China

Hongbo Duan

School of Management, Hebei University PHD CAS UUM

Yanfang Gu & Xuesheng Gao

School of Management, Hebei University

E-mail: duanhongbocn@126.com

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Abstract

On the basis of broad literature and data, this paper elaborates the connotation of the risks of social security fund entering security market. We analyze risks facing social security fund entering security market in China from two perspectives: external environment of China's capital market and internal operation of social security fund. And then we propose corresponding policy countermeasures to risks prevention appropriately.

Keywords: Social Security Fund, Enter Security Market, Risks Control

Preface

Along with the reform of social security system, different types of social security funds are emerging in China, whose balance is increasing as well. Forecasted by World Bank, the total amount of China's social security fund will reach $ 1.8 trillion in 2030, becoming the third social security fund in the world. Various social security funds are willing to invest by entering security market in order to maintain the original value or gain. Moreover, capital market also needs organization investors like social security fund to stabilize market. At present, Chinese academe seldom study the risks problems of social security fund entering security market systematically and comprehensively. Therefore, we shall analyze risks facing social security fund entering security market in China from two perspectives: external environment of China's capital market and internal operation of social security fund. Then we propose corresponding policy countermeasures to risks prevention appropriately and actively explore effective countermeasures to risks prevention, which makes practical and instructive sense.

1. Social Security Fund Entering Security Market and Connotation of the Risks

1.1 Concept of Social Security Fund Entering Security Market

Social security fund entering security market is a narrow concept in this paper. In capital market social security fund is used to buy debenture, financial bond and stock except national debt. In the past, China's social security fund was only invested in bank deposit and national debt, while its entering security market predicates further enlarging of investment scope. Along with the development of market economy, especially social security financing mode of entire- or partial fund's accumulation are established in more and more countries and whole market system, including capital market, grows strongly, diversified investment operation of social security fund becomes necessary.

1.2 Connotation of Risks of Social Security Fund Entering Security Market

The risks of social security fund entering security market mean, during the process of investment operation of social security fund entering capital market, due to external economic environment, internal management, supervision and unsure changing of other factors, the real income of social security fund is different from anticipated income, which causes the possibility of loss.

2. Analysis on Risks of Social Security Fund Entering Security Market

Next we are going to analyze risks facing social security fund entering security market in China from two perspectives: external environment of China's capital market and internal operation of social security fund.

2.1 External Overall Risks

Generally speaking, the effective operation of social security fund has objective requirements to security market, which represents as: large capacity of security market and high quality of listed companies, governmental

appropriate interference and good system of laws and regulations, alternative and diversified investment tools, especially reasonable tools for risks prevention. However, mechanism construction of China's security market which started in 1990s is imperfect yet, without a set of comparatively steady mechanism platform, therefore, as an organization investor, social security fund necessarily confronts a series of risks problems when entering capital market.

2.1.1 Systematic Risks of Market Entry

Systematic risks are also called market risks, which refer to those influencing all investors. These risks are usually unavoidable and eliminated. The analysis on external systematic risks facing social security fund entering market not only rests on capital market, but also on possible losses caused by macroeconomic fluctuation, macroeconomic policy change, etc. Therefore, systematic risks consist of policy and law risks, buying power risks, interest rate risks and so on. Statistic data show: The systematic risk of Shanghai Stock Exchange in China is around 2/3, and 1/3 of non-systematic risks. The high systematic risks of China's security market can be reflected by high hand change rate and Price/earnings. Hereinafter Table 1 and 2 show the situation of hand change rate and Price/earnings in China's stock market in recent years. However, in 2002, the hand change rate of New York Stock Market in U.S.A is just 67.1%, and Tokyo 49.6%, Toronto 36.7%, Sydney 53.8%, Hong Kong 57.9%, Singapore 32.8%, so obviously the one in China is far higher than average level of that in other countries.

The high Price/earnings of China attributes to governmental guidance in stock market, so the price of share is not determined by market value rule. Exorbitant Price/earnings indicates the price of share greatly deviates from its real value, which results in market bubble. Therefore, portfolio technique should be applied to the investment of China's social security fund so as to prevent non-systematic risks, and much more systematic risks in the baffling capital market.

2.1.2 Non-Systematic Risks Facing Market Entry

Non-systematic risks refer to the risks facing the security invested in certain industry or company, which are caused by a particular factor directly. Generally speaking, they should be dispersible. But current China just has single investment object, it is hard to decentralize risks by portfolio. The overall quality of China's listed companies is low. Many listed companies slide down after entering market and some even lose, so they are worthless for investment, which increases the investment risks of social security fund.

2.1.3 Other External Risks Facing Market Entry

Next we shall analyze the risks of social security fund caused by unreasonable security market structure, policy risks and law risks of that.

(1) Risks Caused by Unreasonable Capital Market Structure

Besides systematic and non-systematic risks, unreasonable capital market structure also can bring risks problems for China's social security fund entering market. One unreasonable structure represents as so few investment variety. At present, national debt and circulating Share A are the only choices for social security fund to invest in China's security market. On the other hand, corporation debt hasn't been developed well and transaction of money market tools develops slowly in recent years. The balance of corporation debt just accounts for 1% of GDP in China, while high to 30-40% in U.S.A and even 6.89% in Thailand with least developed corporation debt in 2004.

(2) Policy Risks

Firstly, stock policy risks too much attribute to powerful administration. An effective market has to necessarily be a high marketization. Secondly, policy changing brings risks. As part of social economic life, social security fund entering market must be influenced by governmental economic policy and politics. So they have to notice the potential risks caused by policy changing. Inappropriate policy interference will not benefit market rules, so that market can't effectively distribute resources. And the living environment of social security fund will become even hard.

(3) Law Risks

When laws or regulations on security market and fund management are not definite or without test, economic subjects probably encounter risks. Economic subjects might break or disobey laws, regulations, rules, conventions or ethic standards, which may result in loss of gain or capital. The law risks of social security fund entering market mainly come from the following two aspects. Firstly, it is lack of well-established law and regulation system for social security fund investing. Well-established law and regulation system, including

restriction, rule and mechanism restriction and discipline management, is the premise of investment operation of social security fund. The law and regulation system for social security fund investing in China has not been formed properly. Secondly, it is lack of relevant laws for social security fund. Owing to the characteristics of social security fund, the relevant laws are still trivial and non-systematic and need a great deal of corresponding laws and regulations to supplement. Under this situation, the "rule of man" convention left by planned economy hasn't been eliminated completely. Many established laws are never carried out. All these factors bring unsure law risks to social security fund for its investment in security market.

2.2 Operation Risks of Social Security Fund

The operation of social security fund also will bring risks besides the above described external risks. They represent as the following two aspects.

2.2.1 Multi-Level Agency Relationship Resulting in Agency Risks

The investment operation of social security fund has extended and multi-level agency relationship. First, basically social security fund belongs to labors, so the management organizations of social security fund do financing on behalf of labors. Thus it is the first layer of agency relationship which is between labors and management organizations. Second, most management organizations consign fund companies to invest, so the ownership and management of social security fund are separated. At this time, management organizations are principals, and fund companies are agents. Thus it is the second layer of agency relationship. Certainly, there is also another agency relationship inside Fund Company, i.e. professional directors being consigned by shareholders to manage the companies. When principals have different targets from those of agents, agency risks should not be ignored.

2.2.2 Operation Risks of Fund Companies

Operation risks are caused by imperfect or problematic internal program, staff, system and external matters. Usually speaking, compared to ordinary individual investors, fund companies have higher level of management, but not absolutely. China's fund industry is still at developing stage, so managerial level of fund directors hasn't been tested by market completely. Their own problems might produce risks for social security fund entering market. Some fund companies haven't steadily built up business concepts of valuable investment and risks decentralization. Due to historical reasons, various dishonest behaviors from previous self-support to be the banker, centralized investment and associated trade, still exist to different extent. All these behaviors are harmful to the fluidity management of fund and risks control, and also difficult to adapt keen market competition. It is obvious that China's social security fund entering market through fund companies can't ensure to gain fixed income. If the managerial level and financing ability of fund directors don't go further, they will bring operation risks too.

3. Proposals on Risks Control of Social Security Fund Entering Market

3.1 Standard Development of Capital Market and Promoting Quality of Listed Companies

This is the most important part to prevent risks of China's social security fund entering market. Standard operation is the basic guarantee of long-term and stable development of security market. The quality of listed companies directly influences the investment gain of China's social security fund. Standard development of capital market needs: healthy, orderly and reasonable security issuance market, quality guarantee of listed companies, good information disclosure system, good capital market supervision system, strict punishment on insider trading of listed companies and on buying or helping others buy own stocks, and implementation of "delisting" system of listed companies. Especially we should actively us successful experiences and failing lessons of foreign stock market for reference and consider China's current situation, so as to positively and safely solve share distribution problems and lower systematic risks of stock market. By property right reform, listed companies have to be based on laws to establish modern enterprise mechanism, consummate corporation management structure, promote corporation inherent quality, implant core competition of corporations and improve own sustainable development.

3.2 Establish Healthy and Complete Supervision System of Social Security Fund Investing

Operation supervision on social security fund investing is an important part of social security system. Its fundamental targets are to establish healthy and complete supervision mechanism and independent and efficient supervision system on investment operation of social security fund, to maintain safety of social security fund, to fulfill value-ensured and gains, and to further sustainable development of social security system.

3.3 Consummate Laws and Regulations System on Social Security Fund Investing

Firstly, external law system, including "Law of Finance", "Law of Investment", "Law of Trusteeship" and "Law

of Fund", which can ensure effective running of financial market should be consummate, which makes significant sense to safe investing running of social security fund. Secondly, the establishment of "Law of Social Security" and "Law of Managing Social Security (Insurance) Fund" should be expedited. And basic fund managerial problems should be standardized to guarantee full pay of social security fund in time. Also illegal using of fund is forbidden. Thirdly, relevant single law has to be made according to different characteristics of social security fund. And professional managerial regulations of social security fund should be made as well. Thus we pay high attention to laws and put investing running of social security fund into laws scope, so that the fund could really step into standard operation and healthy development.

3.4 Promote the Development of China Fund and Foster Fund Managers

Under the background of China's expediting developing organizational investors, managerial level of fund industry is directly related to risks control ability of China's social security fund entering market. In order to entirely promote managerial ability on fund, marketing ability and customer service ability, the urgent affairs currently are to establish managerial structure of Fund Company based on requirements of modern enterprise, and to prevent "insider's control". At the same time, market function should be developed sufficiently. Competition will force fund companies to enhance internal management and focus on services to investors. They will emphasize on long-term market image and achieve business reputation in the market, in order to consummate capital market.

3.5 Consummate and Regulate Current Information Disclosure System

According to practical experiences all over the world, compelling information disclosure system is a fundamental construction of market, which is confirmed both theoretically and practically in recent years. Due to plenty of problems of information disclosure regulation in China, it is urgent to concentrate to consummate it. The information disclosure regulation system should be open and transparent, with detailed outline, clear on layers, easy to handle, fair implementation, in order to promote market efficiency and reduce unnecessary risk factors. Firstly, we should start from information source and make clear of duty and responsibility of every economic subject for information disclosure. Secondly, we have to enhance civil compensation liability taken by relevant persons. Thirdly, information disclosure should be in time, effective, and sufficient. And its content, format and standard must be unified and regulated. Lastly, we need to expedite the construction of actuarial, accounting and audit firms, risk rating companies and other agency organizations.

4. Conclusion

At present, China is on a key day of developing economy and society. The construction of healthy and complete social security system is an important part of reforming socialism economic system and of establishing socialism harmonious society. Social security fund entering market is the necessary choice of its sustainable running. However, risks prevention of social security fund entering market is a complex and systematic project. So we should consider China's real situation to explore a long-effect system to benefit risks prevention of that. We also need to commit ourselves to consummate capital market per se, simultaneously, establish assistant measures relevant to social security fund entering market, which will certainly benefit our people.

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Table 1. Hand Change Rate of Share A in China's Stock Market, 1996—2003 (%)

Year	1996	1997	1998	1999	2000	2001	2002	2003
Shanghai	760. 05	534. 99	355. 3	421. 56	324. 26	235. 71	214. 00	250. 75
Shenzhen	949.68	662.32	411.14	371.61	298.14	207.15	198.79	214.18

Data Source: Almanac of China's Finance and Banking (2000-2004)

Table 2. Average Price/earnings in China's Stock Market, 1998—2003 (%)

Year	1998	1999	2000	2001	2002	2003
Shanghai	34.38	38.13	58. 22	37.71	34.43	36.54
Shenzhen	32.31	37.56	56.03	39.79	36.97	36.19

Data Source: Almanac of China's Finance and Banking (2004)

Table 3. Comparison between Stock Financing and Corporation Debt, 1998—2003 (Billion Yuan)

Year	1998	1999	2000	2001	2002	2003
Value of Stock Financing	80.36	89.74	154.10	118.21	77.98	82.31
Value of Corporation Debt	14.89	15.8 0	8.30	14.70	32.50	35.80

Data Source: Almanac of China's Finance and Banking (2004)