



The PRC Social Insurance Scheme to Cast Its Net on Foreign Employees and Their PRC Employers

Introduction

Until recently, contribution into China's Social Insurance Scheme—comprised of basic pension, basic medical insurance, work-related injury insurance, unemployment insurance and maternity insurance—was only mandatory for employed PRC citizens¹.

Effective July 1, 2011, the new *Social Insurance Law of the PRC*, for the first time in PRC history, announced in a thinly worded one-line sentence that foreign employees will be required to participate in China's Social Insurance Scheme². The new law did raise concern about the elevated cost of doing business in China. At the time of its issuance, however, it was only viewed as a preliminary measure. The *Provisional Measures on Foreign Workers Participating in Social Insurance in China* (the "Measures"), which are due to take effect on October 15, 2011, signal that the authorities will, in fact, be pursuing this reform aggressively.

In this issue of our China Update, we will discuss the impact of the Social Insurance Scheme on PRC-based employers and their foreign employees. In doing so, we will address some commonly raised questions, including:

- Who are defined as "foreign employees" under the Social Insurance Scheme?
- How much are the social insurance premiums? Who is responsible for their payment?
- Are there any exemptions that would exclude employee or employer contributions into the Social Insurance Scheme?
- What are the employee benefits under the Social Insurance Scheme?
- What are the consequences for non-compliance?

¹ In certain cities, such as Shanghai, foreign employees had been given the option under local rules to participate in certain categories of the Social Insurance Scheme on a voluntary basis.

² The housing fund, which also falls under the Chinese social welfare program, however, is governed by a separate regulation and is not currently applicable to foreign employees.

I. Foreign Employees

a. Foreign Employees

Under the Measures, “foreign employees” are defined as persons without Chinese nationality who are legally employed in the PRC, as evidenced by:

- 1) a work permit³ and a temporary PRC residence permit, or
- 2) a permanent PRC residence permit.

Foreign employees include those who are:

- 1) employed directly by a legal entity (*i.e.*, a company, a social group or a public institution) established in the PRC; or
- 2) employed by an overseas employer, and dispatched to its branch or representative office established in the PRC.

The Measures stipulate that a PRC entity, branch or representative office (“PRC Employer”) is required to register each foreign employee with the local social security agency⁴ within **thirty (30) days** after submitting an application for his/her work permit. It is assumed that foreign employees already registered within the employment system in the PRC, will be required to enroll into the Social Insurance Scheme after October 15th, when the Measures come into effect.

The government bodies in charge of work permit issuance, as well as the local social security agencies, will jointly police compliance of this registration requirement.

b. Quasi-Foreign Employees

In practice, residents of Taiwan, Hong Kong and Macau employed in mainland China have not been historically subject to mandatory participation in the Social Insurance Scheme, despite being required by law to do so⁵. Similarly, mainland PRC citizens holding permanent residency of other countries have also been overlooked from participation in the scheme despite the legal requirement to do so⁶.

We believe that when foreign employee participation in the Social Insurance Scheme begins to be enforced, so too will mandatory participation by such quasi-foreign employees.

II. Premiums Payable

We anticipate the contribution scales for PRC employers and foreign employees to be the same as those applicable to local staff.

For local staff, both the premiums payable by an employee and his/her employer, are based on the employee’s salary and are calculated at a certain ratio, which differs from locale to locale. In most cities, the base for the monthly premiums is capped at 300% of the local average salary.

³ Work permits include Alien Employment Certificates, Foreign Expert Certificates and Press Cards (R).

⁴ Such agencies are under the administration of the local Human Resource and Social Security Bureau, under local agency names such as the “Social Security Fund Management Center” or the “Social Security Fund Management Bureau.”

⁵ See the *Provisions for the Administration of Employment of Taiwan, Hong Kong and Macao Residents in the Mainland* issued by the Ministry of Labor and Social Security on June 14, 2005 (Lao Dong He She Hui Bao Zhang Bu Ling [2005] 26)(Article 11).

⁶ See the *Reply on Issues Related to Social Insurance of Persons Who Have Obtained Permanent Residence Permit of Another Country and Returned to PRC for Employment During Such Employment* issued by the Ministry of Labor and Social Security on September 10, 2001 (Lao She Ting Han [2001] 198).

Below we outline the contribution scales applicable to local PRC hires in Shanghai in 2011. This chart gives an indication of the applicable rates that can be expected for foreign employees:

	Base	Rates		Total
		Employer	Employee	
Pension		22%	8%	30%
Medical	The employee's average monthly salary in 2010, subject to a cap of 300% of the average monthly salary in Shanghai in 2010, <i>i.e.</i> , RMB 3,896 x 300% = RMB 11,688 as the maximum	12%	2%	14%
Maternity		0.5%	0%	0.5%
Unemployment		2%	1%	3%
Work-related Injury		0.5%	0%	0.5%
Total		37%	11%	48%

In rare cases, the ceiling on the contribution base has been removed by the local government, such as in Dalian⁷. This should be of great concern to employers with high-earning foreign employees.

The Social Insurance Law has been effective since July 1, 2011, prompting speculation on whether the contributions for foreign employees will be retroactively applied to that date. However, no official answers have yet been provided.

III. Exemptions

The only current exemption under PRC law from participation in the Social Insurance Scheme applies to employees from a country or region that has a bilateral social insurance exemption treaty with China.

To date, China has only signed such treaties with Germany and South Korea. The German treaty covers basic pension and unemployment insurance; the South Korean treaty only covers basic pension. If not specifically exempted under a treaty, participation is still required in the other categories of insurance under the Social Insurance Scheme.

If an exemption applies, and the employee is not entitled to benefits, the employee and his/her employer will not have to pay the associated premiums.

IV. Benefits Available

Maternity and work-related injury insurance benefits are comprised of medical allowances and subsidies that are distributed to the insured upon occurrence of an insurable event.

Detailed below are the other three types of insurance.

a. Medical and Pension Programs

Among the five insurance schemes, only the medical and pension programs involve a personal account that can be (i) withdrawn in one lump sum when leaving the PRC, and (ii) inherited.

⁷ Effective September 1, 2001, in Dalian, the ceiling for an employer's contribution into the Social Insurance Scheme was removed. See the *Dalian Notice on Changing the Employers' Contribution Basis to the Total Salary of the Employee in the Previous Month* issued by Dalian Social Insurance Fund Management Center on August 25, 2011.

1) Medical Insurance

A personal medical insurance account is comprised of (i) the entirety of the medical insurance premiums contributed by the employee, and (ii) a portion of the medical insurance premiums contributed by the employer. The remainder of the employer's contribution is allocated to the national medical insurance fund pool.

Certain medical expenses will be covered by resources from the personal medical insurance account and the national medical insurance fund, provided they were incurred in designated hospitals or pharmacies.

Typically, private hospitals are not qualified for the program. This renders the benefits of little use to most foreign employees working in China who, for a variety of reasons, prefer private international clinics and hospitals.

2) Pension

An employee's personal pension account is comprised only of the premiums contributed by the employee. The portion contributed by the employer is entirely allocated to the national fund.

Upon reaching the statutory retirement age (generally 60 for men and 55 for women), and provided the employee and his/her employer(s) have contributed to the pension scheme for an aggregate of fifteen (15) years⁸, the employee will be entitled to a monthly pension, which is drawn from both the personal pension account and the national pool.

Although the Measures provide that the monthly pension can be collected abroad if the foreign employee makes annual declarations that he/she is alive, either by (i) providing the local social insurance agency an "existence certificate" issued or certified by the Chinese embassy or consulate, or (ii) appearing in person at the local social insurance agency, the Measures are silent regarding how this payment system will actually be implemented.

3) Withdrawal and Inheritance

For foreign employees that leave China before reaching the statutory retirement age, the Measures provide that upon his/her departure, the employee may either (i) withdraw the balance of the amounts in the personal medical and pension accounts in one lump sum, or (ii) retain both accounts and resume contributions when the employee resumes employment in China.

In addition, the balance in an employee's personal account can be inherited after his/her death.

b. Unemployment Insurance

There is an apparent regulatory contradiction as to whether unemployment insurance can actually benefit an unemployed foreign employee. By law, upon termination of employment, foreign employees are required to give up their residency status obtained through employment. Further, according to the Social Insurance Law, an employee's entitlement to unemployment insurance benefits terminates once they "move abroad."

⁸ If the contribution falls short of an aggregate of fifteen (15) years at retirement, the employee may choose to (i) retrieve the balance from the personal account in one lump sum, or (ii) make up for the shortage in contribution and then start to collect the monthly basic pension.

V. Liabilities and Remedies

a. Administrative Penalties for Violation

1) Failure to Register

An employer that fails to register an employee within the time limits prescribed by law (see Section I above) and continues to do so after an order for rectification, will be subject to:

- i. a fine equivalent to 1-3 times the amount of the overdue social insurance contribution; and
- ii. a fine between RMB 500 to RMB 3,000 imposed on each member of management and any other personnel of the employer identified as being responsible for the violation.

In addition, any premiums deemed by the authority as applicable, but were unpaid due to the failure to register, will be retroactively levied.

2) Failure to Contribute

When an employer fails to fully and timely make social insurance contributions, including employee contributions it is responsible for withholding, it may be subject to:

- i. a late penalty at the rate of 0.05% per day from the date on which the contribution becomes due; and
- ii. an order to pay the overdue amount within a specified time limit; and
- iii. in the event of failure to comply with (ii), a fine equivalent to 1-3 times the overdue amount, in addition to the late penalty.

b. Employee Remedies

Article 8 of the Measures provides that a foreign employee may initiate mediation, arbitration or litigation according to PRC law for social insurance disputes with its PRC Employer.

There is no consensus as to whether PRC employment laws are applicable to employment of foreigners in all cases. This includes cases where there is an “offshore agreement” signed between a foreign employer and its foreign employee based in, or seconded to, China that precludes PRC law as the governing law. However, the above provision may be an indication that at least the issues relating to the Social Insurance Scheme shall be subject to the PRC law.

According to Article 38 of the *PRC Labor Contract Law*, if an employer fails to contribute to the Social Insurance Scheme in accordance with the law, an employee will be entitled to:

- i. the right to unilaterally terminate the employment contract; and
- ii. severance pay.

VI. Recommendations

It is clear at this stage that regulators have not considered the logistics of implementing the Measures. We expect local governments to clarify the procedure with their own location specific rules. Nevertheless, PRC employers are well advised to, in accordance with the national rules briefed above, begin budgeting for additional future employment related costs. This would include reviewing salary structures and existing commercial insurance packages offered to foreign employees working in the PRC, as well as their employment contracts, and closely monitoring regulatory updates, both on the national and local levels.

If you have any questions regarding this update, please contact the Sidley lawyer with whom you usually work.

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