Where did Our Money Go? Answering the Questions behind Loss of Value to Pensioners in Zimbabwe after Multi-Currency Adoption

by Taonaziso Chowta, Richard Mhlanga, and Macdonald A P Munakamwe

*National University of Science and Technology (NUST), Faculty of Commerce; Department of Insurance and Actuarial Science, P. O. Box AC 939 Ascot, Bulawayo, Zimbabwe.

E-mail: techowa@gmail.com; Cell: +263 775 189 844

*National University of Science and Technology (NUST), Faculty of Commerce, Graduate School of Business, P. O. Box AC 939 Ascot, Bulawayo, Zimbabwe.

*PricewaterhouseCoopers (PwC) – Arundel Office Park, Norfolk Road, Mount Pleasant, Harare, Zimbabwe

ABSTRACT

The turn into the year 2009 brought dollarisation of the Zimbabwean economy which saw pension funds assets and liabilities being converted into the United States dollar (USD). The derived pension values fall short of ‘policyholder reasonable expectations’ (PRE). This research defines PRE and explores the specific factors that led to the demise of pension values over the years 1997-2008. SPSS analysis of questionnaire responses and Microsoft Excel analysis of annual asset returns and exchange rates reveal; the hyperinflationary economy, prescribed asset regulations, use of the Old Mutual Implied Rate (OMIR), pension products design and the contagion effects of the 2003/04 banking crisis as the lead factors against pension build up. The researchers recommend some regulatory amendments, improved client communication and advertisement, PRE guidelines, pensioner compensation, accurate benefit projections and voluntary contributions by pensioners to regulators and pension funds.

Key words: dollarisation, hyperinflation, prescribed assets, policyholder reasonable expectations

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1.0 INTRODUCTION

Zimbabwe fully adopted the multi currency system in January 2009 as pronounced by the then acting Minister of Finance Honourable Patrick Chinamasa, [1]. The Pensions and Provident Funds Act PART IV section 16 (2) of Zimbabwe, [2] meant that pension funds would declare their statements of assets and liabilities in United States dollars (USD). Part I (2) of the act describes a “pension” to include an annuity (regular stream of cash payments) acquired through a fund; while a “pension fund” means any fund the principal object of which is to provide for the payment of a pension to a person who is or has been a member of the fund on his/her retirement.

In its simplest form Princeton University online dictionary, [3] defines a pension as a post-retirement benefit that an employee receives from his/her employer’s retirement plan whose main aim is to provide a regular source of subsistence to the ‘non working’ retired. The above definitions create an expectation on the part of a policyholder/pensioner (to be used interchangeably in this paper) for one to receive some post retirement income commensurate with the contributions made during one’s working years as explained by the State Farm insurance website [4].

1.1 Policyholders’ reasonable expectations (PRE) in South Africa

The Financial Services Board of South Africa Interpretation Note 1 of 2010 [5] of the law says; ‘...accrued liabilities of pensioners represent the present value of pensions in course of payment as at the valuation date. Such present value must take into account the rights and reasonable benefit expectations of pensioners, including, inter alia, any right or reasonable expectation in regard to increases in terms of the pension increase policy’.

1.2 Policyholders’ reasonable expectations (PRE) in the United Kingdom

In his pioneering work, Skerman [6] wrote; ‘it would be unsatisfactory not to take some account of the policyholders’ reasonable expectations when determining the value of the liabilities’. From this the United Kingdom (UK) Financial Services and Markets Act [7] uses the term ‘treating customers fairly’ and guided by it, the UK Financial Services Authority (FSA)’s 6th principle [8] is laid down as follows:

• A firm must pay due regard to the interests of its customers and treat them fairly.
• A firm must conduct its business with integrity.
• A firm must pay due to the information needs of its clients and communicate to them in a way that is clear, fair and not misleading.
• A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
• A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any client who is entitled to rely upon its judgment.

In the famous UK Equitable Life case, Lord Penrose [9] highlights that since the emphasis is on policyholders and potential policyholders, it is reasonable to infer that reasonable expectations
are a function, at the very least, of; information communicated to the policyholder or potential policyholder, by whatever means the particular office elects to employ, and related to the offices policies and practices. When joining a pension fund workers are told they are saving for retirement and then failure to provide on retirement will be failure to meet reasonable expectations. Literally policyholders’ reasonable expectations mean keeping the man on the street satisfied by the value provided by insurance companies. However, the magazine of the actuarial profession [12] criticises Lord Perse’s interpretation of P R E citing the use of scenarios and probabilities in the design and pricing of insurance products.

1.3 Impact of the macro economy on pensions value build-up

Fultz and Pieris [11] acknowledge the dynamic interplay between social security schemes and their environment in which the latter in economic sense determines the level of resources available for social security and their distribution among the population, while social security influences rates of poverty, the health and longevity of the workforce and the popular support enjoyed by the government. They concur with Bulow [12] and Watkins [13] that financial planning becomes difficult during times of inflation with the pensioners of the day being more adversely affected than current employees.

The hyperinflation years in Zimbabwe (2004-2008) made salaries, savings and pension contributions fall in worth with the passing of each day as observed by Hoto [14]. Insurers continued to come up with new products aimed at matching the hyperinflation environment and in ‘trust’ Zimbabweans bought those new products unaware that they would fail and the conversion values turned out to fall short of the expectations of policyholders/pensioners.

1.4 Zimbabwe’s Prescribed Assets Regulations

The Zimbabwean Insurance Act chapter 24:07, [15] requires insurance companies to hold part of their funds in ‘prescribed securities’ which are stated (in Part I of the Act) as (a) stocks, bonds or other like securities issued by the State, a statutory body, or a local authority, and includes, in relation to non-life insurers and the class of insurance business carried on them, treasury bills, or similar short-term bills issued by a statutory body or local authority; and (b) investments approved or prescribed by the Minister from time to time for the purposes of this definition;... and the proportions of the insurance funds which shall be held in prescribed securities so specified. It was on the basis of this legislation that the Reserve Bank of Zimbabwe (RBZ) Governor Dr. G. Gono, [16] directed all insurance and pension funds to comply with their prescribed asset requirements by end of November 2008.

Masilela [17], asserts that ‘prescribed assets are a method through which government intervenes in the market to force or influence investment resources into particular sectors of the economy. When you have strict prescribed assets government literally sets the limits with which people or investors have to invest and the specific sectors in which they have to invest irrespective of the return. The same interpretation is construed from Legat [18], while Padayachee [19] and White & Glaser [20] view prescribed assets as a way of ‘socially responsible investment’ within an economy.

In the wake of hyperinflation, most pension funds had the non prescribed portion of their assets heavily invested in stocks on the ZSE. Their actions were in line with the pioneer views from Fisher [21], that ‘stock represents a hedge against inflation’. However the fact that prescribed assets requirement of 35%, 30% and 25% for pension funds, long-term insurers, and short-term insurers respectively [1], had to be rebalanced on a month-on-month basis meant that while the other portion assets earned a market return that outpaced inflation the prescribed assets were wiped to zero and had to be further boosted thereby depleting the accumulated value as witnessed by Buckle [22].

1.5 Developments in the Financial Sector

The period 2003 to 2004 saw a number of banks being forced to close down in what become known as the Zimbabwean Banking Crisis and the main cause being poor credit risk management. The RBZ 2004 annual report [23] states that the number of financial institutions declined from forty (40) as at 31 December 2003 to twenty nine (29) as at 31 December 2004. The crisis made pension funds shift their interest bearing funds from the high yielding (banks’) money market instruments to the low yielding treasury bills. The period 2004-2008 brought an exchange rate crisis characterised by cash shortages and the dominance of the parallel exchange rate over the official one. The RBZ responded by introducing tight money laundering controls that led to longer clearing periods for cheque and real time gross settlements (RTGS) transactions that had a severe negative impact on the ZSE trading.

In response, pricing on the ZSE shifted towards full reliance on the fungibility of the multiple listed Old Mutual Plc shares described in the 2010 ZSE handbook [24]. Dr G. Gono [16] condemned ‘The practice by the ZSE where Old Mutual shares would deliberately be traded first during the two call-over slots to set the trend for all the other counters. Such practices were tantamount to adverse indexing of the ZSE to spurious speculative sentiments surrounding the Old Mutual counter via the parallel foreign exchange market (termed the Old Mutual Implied Rate (OMIR)). The use of the OMIR by the ZSE led to wild share price increases/decreases with no fundamental basis in respect of actual developments at the relevant companies. The implementation of the memorandum led to the suspension of trades on the ZSE.
2.0 OBJECTIVES OF THE STUDY

This study is the first in trying to explain the demise of pensions and other forms of savings and investments. The research contributes to the literature in a number of ways. First, the researchers draw parallels with SA and UK regulations to provide evidence on the violations of PRE during the transition to the USD of accumulated pensions. Despite outcry from both the public and Government, the Zimbabwean legislation is silent on the subject of PRE. Secondly, they contribute to the national debate on the subject of the erosion of accumulated pension values in Zimbabwe by examining the interplay between the inflationary environment, the regulations on prescribed assets, the resulting valuation of pension assets in a bid to enlighten parties to the blame game between the Government and the insurers. Thirdly, this paper assesses the post USD evolution of value in a bid to evaluate if a moratorium on postponing the time to effect conversions would have allowed pensioners to benefit from the resulting value appreciations especially for the listed stocks as observed by Legat [25].

2.1 Secondary objectives

This research traces the path followed by the pensioners’ contributions over the period 1997-2009 in a bid to answer the ‘loud’ national question ‘where did our money go?’ The researchers carry out a critical analysis of the hyperinflation, asset performance, regulations on prescribed assets, foreign exchange markets and OMIR, pension products and the transition to the USD in light of PRE and guided by the following secondary objectives:

1. To define the term policyholders’ reasonable expectations and prove that derived values did not meet policyholders’ reasonable expectations (PRE)
2. To demonstrate the impact of hyperinflation, prescribed asset returns and other factors on the value of pensions over the period 1997-2009
3. To objectively assess the roles played by the Government and insurance companies in their contributions to the pensions demise.
4. To draw conclusions and recommendations aimed at improving the future of pensions in Zimbabwe.

3.0 METHODOLOGY

Both explanatory and descriptive research design methods were used to identify the root cause of the pension values’ demise in Zimbabwe in order to get a more in-depth view of the problem as the researchers explored each and every identified research problem based on descriptive research design.

3.1 Data Collection and Analysis

This study took a survey approach hence the use of a carefully designed and standardized questionnaire and in-depth interviews that allowed respondents to answer certain collated questions to secure the desired information. For the purpose of this research, Actuarial specialists, Pension fund trustees, Pensioners and Pension administrators from Harare and Bulawayo were identified as the defined target population.

In addition to the questionnaire responses, we collected annualised data for inflation, the ZSE returns and market capitalisation, TBs, government bonds, the Old Mutual Plc London Stock Exchange (LSE) share price, the ZWD/USD Exchange rates (official, parallel and OMIR), and carried out various manipulations to come up with trends, real returns (above inflation) and projected pension accumulations. Questionnaire responses were analyzed using the Statistical Package for the Social Sciences (SPSS) version 16.0, while secondary data and some SPSS output was analyzed using Microsoft Excel.

3.2 How Pension Conversion Method Was Done

The following formula was used to calculate the USD cash payout given to pensioners:

\[ \text{USD Payout Value} = \text{Asset share} \times (\text{USD assets less reserve}) \]

Accumulated credit is an accumulation of past contributions using fund interest earned by the fund and was based on the asset share.

The researchers illustrate in Appendix I how the accumulated credit (total liability) was derived by generating random numbers representing individual accumulations and multiplying by 10,000.

3.3 Ethics Statement

This research made use of primary data that already had ethical documentation and did secondary analysis. Any sensitive company and individual specific data gathered from interviews and questionnaires was treated with strict confidentiality and experiences of individual companies masked beyond specific identification by future researchers and users of this paper.

4.0 RESULTS

The research results, based on completed questionnaire responses from 126 pensioners, 8 actuarial specialists, 20 pension fund trustees and 15 insurance practitioners and 10 interviews were equally split between actuaries and insurance professionals, representing 72%, 80%, 90%, 75%, and 71% respectively of the set target sample of respondents and interviewees. Where data could not lend itself to statistical analysis, content analysis was used especially in cases where respondents either gave suggestions or expressed their opinions. This section presents key findings of the research.

4.1 Whether Derived Pension Values Meet PRE

Responses to questions addressing PRE by all the mentioned groups of respondents were
mixed with virtually all pensioners claiming that the values given to them ‘fall short of their expectations’. While 70% of the other remaining groups were of the view that derived pension values met PRE (as it was outside the insurer’s control and that the environment was evidently bad), 10% were stuck in the middle and the remaining 20% taking the popular ‘pensioner’ opinion.

4.2 Factors Leading To Low Pension Value.

The research reveals the adverse impact of inflation on pensions with 97% of pensioners (agree–strongly agree) to lay the blame on the Zimbabwean economy at large for the loss of their value. The blame on regulation on prescribed assets was high at 70% among professionals who were involved in the daily running of insurance and pension funds.

The pensioners however partially exonerated the insurance companies and pension funds, sanctions and the specific products with relatively low blame levels of 29%, 27% and 14% respectively. Among the professionals, the conversion method used is questioned with 20% arguing that insurance companies did not make an effort to explain details of how they did the conversion because the method was flawed especially on the exchange rates used and property valuation methods as shown in the blame on dollarisation. The overall picture of the consolidated statistics is as shown in Figure 1.

4.2.1 The Impact of Prescribed Assets on the Accumulation of Pension Values

Comparisons of real returns from the ZSE and the prescribed assets (TBs and The 5 year government/municipal bonds) in Figure 2 shows that the prescribed assets performed negatively from 1998-2008 thereby destroying value on the proportion of funds invested in them.

4.2.2 Value based Impact of Prescribed Assets on the Accumulation of Pensions

Figure 3 compares value accumulations for three investment portfolios; first made up of (65% ZSE/Market and 35% TBs), second made up wholly of the ZSE and a third one with all investment in TBs based on a nominal $100 at the end of 1996. The graphs show that the weighed portfolio would have fallen to $20 in 2004 before closing at $56 at the end of 2006. The trend suggests a marked negative impact during the build up to banking crisis of 2003/04. Although the ZSE performed quite well in the post 2004 years, the real returns were to be wiped out by the 231 million percent (231,000,000,000%) official inflation figures by midyear 2008.

4.2.3 Impact of the OMIR and depressed opening USD ZSE stock prices

Although the above section 4.3 gives an indication of some possibility that ‘had the Pension Fund been wholly invested in the ZSE some value could have been preserved for the pensioners’, the events of 2008 as shown in Figure 4, indicate otherwise due to the reasons that:

1. All investments in cash and interest bearing investments could not be redeemed following the adoption of the USD as the monetary authorities
did not come up with a ‘Zimbabwe dollar demonetisation fund’ to compensate depositors and money market investors.

2. The ZSE market capitalization (a proxy of real returns) took a nose dive as the adverse effects of using the OMIR began to show.

Thus Figure 4 shows that due to regulations regarding pension fund valuations, most pension fund valuations completed during early 2009 gave depressed values of assets and hence low pensioner’s accumulated values. Since Zimbabwe suffered from a crippling liquidity crunch post dollarisation, the pensioners wanted their dues, but the payout values obtained (Value of listed stock + Non-cash investments) were rather depressed.

4.2.4 Impact of the 2003-2004 Banking Crisis

The impact of the banking crisis of 2004 was not universally evident from the research findings as shown in Figure 5 below. Actuarial and insurance professionals pointed out that the banking crisis impact was rather mild, arguing that the pension funds had time to recover from the effects of the crisis and build up value as shown in figure 3 above. Since not all pension funds had money invested with the concerned banks, 60% of the respondents felt it was more of an individual pension fund matter than the industry as a whole. It is, however important to note that due to the relatively ‘high risk’ banking sector, most insurance and pension funds had to settle for the unattractive TBs compared to high yielding money market securities issued by banks.

4.2.5 Failure of the pension promise and miss-selling allegations

Although the ‘pension promise’ seems to have failed mainly due to various factors outside the control of insurance companies/pension funds, some respondents shown in Figure 6, felt that the product seller should take some blame for the demise of their pensions. They argued that insurance companies had promised to take care of their retirement and had to keep that promise. Some insurance companies continued to sell ‘fixed pensions policies’ while those with premium revisions still failed to perform as expected, thereby raising some miss-selling allegations. Thus in line with cited authorities ([5], [6], [7], [8], [9]), Figures 1 and 6 show that insurance companies have to also share the blame with other players like the Government or they should have just not given policyholders false hope ‘through their continued sale of products’ if the environment was ‘that harsh’.

Figure 5: Impact of the 2004 banking crisis on pensions
Source: SPSS and Excel Analysis of Primary data

Figure 6: Insurance companies could have prevented the collapse of pensions
Source: SPSS and Excel Analysis of Primary data
5 CONCLUSIONS

The long term nature of pensions business makes it an inherently risky business prone to the economic changes over time. The Zimbabwean pensions industry went through a rough patch over the years 1997-2009, leading to partial/total loss of all forms of savings from ordinary savings, life assurance and pensions. From the analysis of findings; we present factors that we believe were the main causes for the demise of pensions and the subsequent failure to meet pensioner/policyholder reasonable expectations.

5.1 Inflation

Inflation had an effect of eroding value of the currency, savings in Zimbabwe dollars ceased to exist as inflation reached record figures of 231,000,000% with prices being reviewed numerous times in a single day. Inflation also led to negative real returns being experienced in the market for Government securities which made the bulk of pension fund securities. Inflation also destroyed value accumulation in both conventional fixed pensions and variable pensions as salaries lagged behind inflation.

5.2 Regulation

The government’s prescriptive high prescribed asset ratios of between (25-35%) over the period 1997-2008 became a leakage in the pension’s value flow. The post dollarisation era reveals some lack of foresight on the part of insurers and regulators who instead on declaring a ‘moratorium’ on pension funds valuations so as to allow value recovery, led to the declaration of low property valuations (due to high void levels) as well as disposal of listed stocks owned by pension funds at huge discounts, only to have restored values 1-2 years post dollarisation.

5.3 Banking Crisis of 2004 and the OMIR

The crisis led to loss of value of certain pension fund assets and due to the hostile business environment, some pension values did not recover from the loss. Although the OMIR did provide some form of currency conversion mechanism, it was somehow independent of local forces of supply and demand and hence the value destruction resulting from its continued use towards the end of year 2008.

5.4 PRE and Miss-selling of Pension Products

Findings uncover some complex interplay between the accumulation of value and the delivery of the pension promise during hyperinflation. The researchers acknowledge that the environment was quite harsh for the insurers, but we lay a partial blame for their continued sale of product that failed to live to their anticipated PRE. The researchers, therefore, conclude that PRE was violated for Zimbabwean policyholders/pensioners over the period under study.

6 RECOMMENDATIONS

To sufficiently develop a good understanding of what really happened and to allow for normalcy to return to the pension industry, the following recommendations should be taken on board by the various stakeholders:

6.1 Pension funds, Trustees, Administrators and Insurance companies

We make the following recommendations to Pension funds, Trustees, Administrators and Insurance companies.

6.1.1 Communication

Treating customers fairly is about transparency, openness and regulatory compliance all which lead to customer satisfaction while at the same time helping to control costs associated with reputation. There is need for the insurance industry, actuarial profession and pension funds to communicate with the pensioners on the conversion process so that there is clarity and understanding of the conversion process and what happened to the pension accumulations of the past years.

6.1.2 Increasing Accuracy of Benefit Projections

There must be a benefit projection which tries to forecast what the future pension will be (based on a set of assumptions) when someone retires and gives an indication of what a pensioner will earn in respect of his salary. The events of post hyperinflation indicate that the actuaries failed to accurately carry out benefit projections for their pension schemes and advise on what to do. Thus pension fund communications failed to build up reasonable expectations since when one is foretold what to expect it helps shape up expectations and is well prepared in advance and is able to evaluate alternatives.

6.2 To the Government and IPEC

We propose the following measure to the Government through its regulatory arm the Insurance and Pensions Commission (IPEC).

6.2.1 Prescribed assets reduction

For the economies to grow, prescribed assets have to be done for they are a way of social investment and a way to direct investment to the productive sectors of the economy, but this should never be at the expense of the owner of the same capital. We, therefore, call for competitive returns on prescribed assets as well as a prescribed asset ratio that does not work against value build-up in pensioners’ savings, which requires carefully designed controls and watches.

6.2.2 Change in regulatory framework

The researchers recommend active actuarial involvement in the work and reform of the IPEC providing input in the testing of all pension and life products before market launch in order to eliminate possible miss-selling of insurance products.
The regulatory body has to move ahead in adopting some international best practice in insurance and pensions and lead the sector towards ‘first world standards’.

6.2.3 Define PRE and outline guidelines
It is proposed that IPEC lay out guidelines on PRE that are tailored for the local market. This will be used for all insurance products and will provide a legal platform for prejudiced policyholders to be compensated.

6.2.4 Top up of funds
A pension is a promise to pay something meaningful when one is no longer able to provide for one self. Since value was lost and the blame has fallen more on the Government legislation on prescribed assets, there is need for appreciation from the Government to come up with some equitable compensatory mechanism through some form of social security to save the lives of the affected pensioners. The researchers propose that such scheme involve Government, parent companies of pension funds and insurance companies who paid out pensions post USD adoption.

6.3 Active members’ voluntary contributions
Value build-up is an important part of pension fund management, in a normal economy, we advise current working members of pension funds to build to individually top up their contributions by making ‘additional’ own voluntary contributions in order to cover up for the lost value.

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Appendix I Table showing how conversion process was done.

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<th>Assets</th>
<th>ZWD</th>
<th>USD</th>
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Source: MS Excel Spreadsheets