

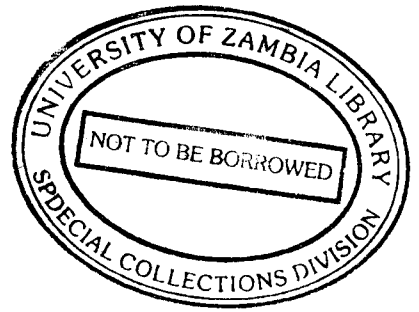
LAW REFORM IN THE FINANCIAL SERVICES SECTOR: A CASE
STUDY ON PENSION SCHEMES IN ZAMBIA

BY

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UNIVERSITY OF ZAMBIA

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DIRECTED RESEARCH

ON

**LAW REFORM IN THE FINANCIAL SERVICES SECTOR; A CASE STUDY ON
PENSION SCHEMES IN ZAMBIA**

By

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**SUBMITTED TO THE UNIVERSITY OF ZAMBIA LAW FACULTY IN
PARTIAL FULFILMENT OF THE CONDITIONS FOR THE AWARD OF THE
BACHELOR OF LAWS (LL.B) DEGREE.**

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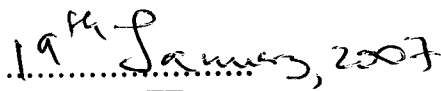
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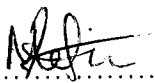

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DECLARATION

I MOMBA KALYABANTU – Computer Number 22095063, do hereby declare that the contents of this directed research paper are entirely based on my own research and that I have not in any manner used any persons work without acknowledging the same to be so. This is the first submission of this work, it is not the subject of any previously submitted work in any University.

I bear absolute responsibility for errors, defects or any omissions therein.

DATE...19th January 2007.....

SIGNATURE........

DEDICATION

To my Father Mr. Samu Chikanda Kalyabantu. Dad, You taught me to persevere, stay focused and reach for the sky, in the best way possible, by example. Ndalumba, I love you.

To my sister Milimo and my brothers Mazuba and Peter Kalyabantu for the constant moral, emotional and material support you have given me. It's been a rough road, but thank God we made it. I love you guys.

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LIST OF ABBREVIATIONS

CSPF/PSPF	Civil Service Pension Fund/ Public Service Pension Fund
DB/DC	Defined Benefit/Defined Contribution
CRC	Constitutional Review Commission
ICESCR	International Covenant on Economic Social and Cultural Rights
ILO	International Labour Organisation
ISSA	International Social Security Association
LASF	Local Authorities Superannuation Fund
NAPSA	National Pension Scheme Authority
NRG	Northern Rhodesia Government
NPS	National Pension Scheme
PPFO	Pension Protection Fund Ombudsman
PFA	Pension Funds Adjudicator
PIA	Pensions and Insurance Authority
PICZ	Professional Insurance Corporation
STEP	Social Protection for Excluded People
SADC	Southern African Development Community
UDHR	Universal Declaration of Human Rights
ZSIC	Zambia State Insurance Corporation
ZCCM	Zambia Consolidated Copper Mines
ZESCO	Zambia Electricity Supply Corporation
ZAPFM	Zambia Association of Pension Fund Managers

Life is a voyage, in the progress of which we are perpetually changing our scenes: we first leave behind us our childhood, then our youth, then the years of our ripened manhood, then the better and more pleasing part of old age.

SENECA

INTRODUCTION

Successive governments in many countries have enacted legislation to encourage both individuals and employers to plan for the provision of an adequate level of income in their retirement. These initiatives are evidenced in the existence of commercial financial institutions such as banks and non-bank financial institutions such as pension schemes and insurance companies, which are designed to operate as avenues of lifetime savings for their citizens.

This paper will focus on one branch of non-bank financial institutions namely, the Pension Schemes. In Zambia about 80% of the population lives in abject poverty and this among other things such as international pressure has influenced over the years, the development of State pension schemes to provide a range of pension benefits that are dependant on a person's employment status and their level of contributions. The Zambian government has endeavored to establish various schemes namely, the Zambia National Provident Fund (ZNPF), the Public Service Pension Fund (PSPF), the Local Authority Superannuation Fund (LASF) and the National Pensions Scheme (NPS). Sadly however, is the fact that the majority of these social security schemes have been plagued with significant weaknesses occasioned by deficiencies in their design, financing, administration and legislation; and thus the benefits available from these schemes are inadequate for individuals who wish to maintain a reasonable standard of living in circumstances of old age, invalidity or (to surviving dependants) death. There are however private occupational pension schemes organized by individual companies to operate complementary to the National scheme; and these have generally operated with greater efficiency as compared to the State run schemes.

This paper will by and large focus on the Zambian laws pertaining to pension schemes and the growing necessity of ensuring that the various pieces of legislation are streamlined and harmonized in order to increase the effectiveness and efficiency of these schemes. The paper will also consider the weaknesses and constraints within the pension sector and assess the legislation with a view to identify gaps, weaknesses, ambiguities

and other shortcomings that exist in the pension schemes, which tend to limit the smooth operations of the pension scheme, and thereby provide alternative reforms. A number of foreign examples will also be analyzed to provide a wholesome picture of how the issues of pension schemes have been dealt with globally, identifying which models and methods are most suitable for Zambia to achieve growth and sustainability in the pension industry.

CHAPTER ONE

GENERAL OVERVIEW OF THE PENSIONS INDUSTRY

Introduction

Pension provision in most countries is a combination of public provision, publicly mandated private retirement savings and voluntary private retirement savings. This mix of pension provision has emerged in order to ensure sustainability and efficiency in the pension schemes, by reducing the burden on governments being the sole contributor to pension schemes.

History and Development of Pension Schemes in Zambia

The history of pension schemes and pensions legislation in Zambia owes its origin to the Law on pensions as it developed in Britain. Zambia, being a former colony based and modelled the vast majority of its laws on those in force in Britain. A brief discussion on the origins of the British laws on pension schemes thus becomes necessary.

A Colonial legacy

“As early as the nineteenth century there was in England a systematic provision by employers for the retirement and old age of their employees. Pensions at this stage were viewed as a benevolent charity on the part of the employer¹”. In 1834 a superannuation Act gave statutory definition to a non-contributory pension scheme for male civil servants that defined the pensionable age and the level of benefit; while there were other pension schemes for widows and various schemes for industrial employers on a trust fund basis. There was continued development until the beginning of the First World War when pensions were set up by means of trust fund schemes under which contributions were invested in insurance policies and provident funds. The latter were usually financed by joint contributions and the benefits were in the form of a lump sum payable on death, incapacity or retirement. By 1921 a Finance Act was passed which provided inter alia, that both employee and employer contributions qualified for full tax relief. The following year the Local Government and Other Officers Act was passed, under which local authorities were enabled to

¹ Michael Pilch and Victor Wood, (1960) Pension Schemes. Hutchinson of London p.18

provide for the superannuation of their employees², while some pension schemes for employees were maintained through the medium of insurance.

The next landmark in the history of British pension schemes was in 1928 with the emergence of the Group life and Pension scheme where benefits for a whole group of employees could be secured under a single master policy. An employer who wanted to establish such a scheme could either seek approval of the scheme as a superannuation fund under the Finance Act 1921; or could relay on the provisions of the Income Tax Act 1918 where a tax rebate could be claimed on the contributions. There were thus three schemes by 1928 namely: the Group life, the privately administered Superannuation Fund and the Provident Fund. However in the early 1940s another pension scheme based on endowment assurances gained popularity. Later the Finance Act of 1947 set out the various schemes and laid down the limitation on the amount and nature of pension scheme benefits.

In 1952 an Income Tax Act implemented among other things, exemption from income tax the investment income of insurance companies in conformity with the Millard Tucker recommendations of 1950³. “Between 1945 and 1979 the Labour government introduced a “universal” contributory social insurance scheme (known as the National Insurance) to provide protection from loss of finances resulting from accidents, sickness, unemployment, maternity or old age. These benefits were intended to ensure that the needs of everyone in the household were met, and in 1976 the Child benefit was introduced and was paid to all families with dependent children⁴”. Between 1979 and 1997 there was an attempt to remove the earnings-related element and make all benefits flat rate in order to reduce public expenditure on social security and encourage occupational and private provision, nevertheless expenditure increased due to high unemployment. From 1997 to 2004 the attitude on social security had somewhat changed. After the election in 1997 of the new Minister of State for Welfare Reform, Frank Field advocated for a new social insurance system that would also extend to, among other things, unemployment

² Ibid p19

³ Ibid p 30

⁴ International Social Security Association (ISSA); International Social Security Review Vol. 57, No. 2 April – June 2004. p. 89

insurance to self-employed workers. This motion was however quashed in favour of a strong commitment to employment as the best means to social security.

Zambia's pension industry today is not necessarily the same as that of Britain; however the earliest pension schemes in Zambia were based on the British scheme structure of the time. In 1924 the British government colonized Northern Rhodesia and as such transplanted most of its laws to the territory. "It has been contended that social security at the time aimed mainly at protecting the interests of the white settler community working in the colony and those of indigenous workers in sectors that were strategic to British interests⁵". In fact the earliest legislative provision was by way of Ordinances that mainly provided for War pensions and Widows and Orphans pension. Later the law provided for formal employment pensions.

Development of Zambia's pension industry

The first pension fund was established by the Northern Rhodesia Government (NRG) in 1954 and catered for the settler community working in the local authorities. In the same year the Local Authority Superannuation Fund (LASF) was established under an Act⁶ of Parliament to cater for members of municipalities, employees in local authorities (except the Ministries) and utility companies. Prior to November 1, 1961, there was no contributory pension scheme for indigenous employees of the Public Service. At the time, only a small gratuity was paid when such officers retired. "In November however, the government introduced a contributory pension scheme for pensionable indigenous public servants⁷". As the years followed up to 1965, other schemes were established to accommodate workers in the private sector and the mining industry. An Act of Parliament of 1968⁸ established the Civil Service Pension Fund (CSPF) that was divided into the Civil Service (local conditions) Pension Fund, and the Civil Service (expatriate conditions) Pension Fund. Only the employer made contributions until 1995 when the fund became contributory to include employee contributions. Sadly however, before 1995 government did not pay into the fund but rather borrowed the money in the form of 'loans', and is currently paying

⁵ M. C. Ndilila, M. Kalenga, E. Mumba, G. Zimba; A synopsis of the Economic and Legislative Environment and Place of the Insurance Industry. A Conference Paper submitted to the Strategic Insurance Conference for Senior Executives – 16th September – 5th October, 2001 Stockholm – p21

⁶ CAP 284 of the Laws of Northern Rhodesia

⁷ PSPF Publication. The Transformation Road Map, July 2003. p.3.

⁸ CAP 410 of the Laws of Zambia.

back in the form of debt swaps⁹. The two funds of the CSPF operated as such up until 1996 when the civil service fund was changed by an Act of Parliament¹⁰ to form the Public Service Pension Fund (PSPF), which effectively abolished the Civil Service (expatriate conditions) Pension Fund. This PSPF caters for the entire public service including teaching service and defence forces.

From about 1968 to 1992, the Zambia State Insurance Corporation (ZISC) was the only manager for all pension schemes in Zambia. The majority of the schemes were parastatal schemes under the ZIMCO group of companies such as; Medical Stores, Zambia National Housing Authority, National Hostels Board etc. However ZNPF, LASF and PSPF were managed by their own Acts. In 1992 however, with the liberalization of the economy a number of institutions cropped up such as Madison Insurance Company Zambia Limited, African Life Financial Services Limited, and Professional Insurance Corporation that became pension scheme managers mainly for the private companies.

Only in 1966 was there a concerted effort to establish a pension scheme for the full coverage of all formal sector employees by the establishment of the Zambia National Provident Fund (ZNPF) that was formed as a compulsory retirement savings scheme and operated as a defined contribution scheme¹¹. In addition to this national scheme, ZNPF members were allowed to subscribe to other supplementary schemes offered by private sector employers. For example in the 1980s the Zambia consolidated Copper Mines (ZCCM) provided a pension fund for its employees under the management of the Mukuba Pension Fund.

By the late 1960s the position of pension schemes was as follows: the Ministry of Local Government supervised the LASF; the PSPF was under the supervision of the Cabinet Office, while the Ministry of Labour and Social Security managed the ZNPF, the private occupational

⁹ Government offered PSPF and LASF shares in the Parastatal Companies e.g. the Zambia Sugar Company under the Zambia Privatization Trust Fund. This covered not only the debt but also the contribution arrears.

¹⁰ No. 35 of 1996 - the Laws of Zambia.

¹¹ Ibid

schemes, the Worker's Compensation Fund (WCF)¹² and the Pneumoconiosis Compensation Board¹³. This is still the case to date, although the latter was integrated into the WCF.

Sadly however, the ZNPF quickly became plagued with various problems ranging from high administrative costs, low contributions, inadequate benefits, poor structural design, and fiscal pressure from government in terms of investment choices, inflation, political interference and poor legislation. Thus it became apparent that the ZNPF was unsustainable and as such reforms were imperative. The solution came in 1996 by way of a complete transformation of the Fund through an Act of Parliament¹⁴. The Act changed the ZNPF to the National Pension Scheme (NPS) (and provided for the National Pension Scheme Authority – NAPSA which is a body corporate established from the corpus of the ZNPF administration to administer the NPS) which was to run on social insurance principles; it however only became operational in the year 2000. The rationale for such a change was couched in these words; “it became necessary to transform to a pension scheme because of structural weaknesses of the provident fund (lump sum benefits which are usually eroded by inflation and thus eroding the benefits – unlike the pension scheme system of periodical payments till death of a member, non-indexation of contributions, investment risk borne by the individual as opposed to the scheme in a pension scheme) which resulted in the Fund losing popularity among its members¹⁵”.

As regards the operation of the pension schemes, the pension Managers as well as the individual companies had to be affiliated to a multi-employer trust fund approved by the Ministry of Lands pursuant to the provisions of the Lands (Perpetual Succession) Act¹⁶. Additionally, the Income Tax Act¹⁷ provided the conditions under which a fund could be set up and included provisions for tax exemption. Up until 1997, the Income Tax Act was the only law regulating pension schemes in Zambia. However in 1996 the Pensions Scheme Regulation Act (PSRA)¹⁸ was enacted and established the Pensions and Insurance Authority (PIA) in 1997 that is the overall regulator and

¹² Provides employment injury protection to all workers in several industries (public and private) except the Police and Armed forces, and controlled by the Workers compensation Fund Control Board (WCFCB).

¹³ Covered mine workers occupational infections.

¹⁴ CAP 256 No. 40 of 1996 of the Laws of Zambia.

¹⁵ NAPSA; Questions and Answers on the Transformation of the Zambia National Provident Fund (ZNPF) to the National Pension Scheme Authority (NAPSA). 1999/2000. p.1

¹⁶ CAP 186 of the Laws of Zambia.

¹⁷ CAP 323 Schedule 4 and Section 37

¹⁸ No. 28 of 1996 - the laws of Zambia.

supervisor of the entire pension industry in Zambia except for the NPS (NAPSA). Thus, to date the Pensions and Insurance Authority Act of 1996 as well as the Amendment Act of 2005¹⁹ regulate all pension schemes in Zambia excluding the NPS. The NPS is regulated by its own Act, and membership is compulsory for all formally employed persons including the Civil Service and employees in Local Authority who joined after 1st February 2000. All pension schemes are obligated to register with the Registrar of pensions and insurance before they can operate in Zambia pursuant to the provisions of the PSRA²⁰.

Definition of Pension Schemes

The word pension is often used synonymously with the words social security. It is thus important that the two are distinguished from each other. The International Labour Organization (ILO) defines social security as; *“The protection that society provides for its members through a series of measures, against the social and economic distress that otherwise would be caused by the stoppage or substantial reduction of earnings resulting from sickness, maternity, employment injury, unemployment, invalidity, old age and death, the provision of medical care; and the provision of subsidies for families with children”*. Social security is a broad word which primarily refers to a field of social welfare where individuals in a given society are offered protection against socially recognized conditions in turn for all working individuals’ mandatory support of those in the society needing protection for those same socially recognized conditions including poverty, old age, disability, unemployment, and families with children and other dependants. “The term can be used to refer to; income maintenance which mainly involves the distribution of cash in the event of interruption of employment, including retirement, disability and unemployment; services provided by administrations responsible for social security which may include medical care, aspects of social work and even individual relations; basic security which entails providing access to basic necessities. However the most popular term and definition used in many developing countries like Zambia is *social insurance*. *Social insurance* entails people receiving benefits or services in recognition of their contributions to an insurance scheme. The services typically include provision for retirement pensions, disability insurance, survivor benefits, medical care and unemployment insurance²¹”.

¹⁹ No. 27 of 2005

²⁰ Part III

²¹ http://en.wikipedia.org/wiki/social_security.

There is a diversity of social security arrangements operating in the world. “First there are the *Social Assistance Schemes* that comprise of social welfare programs usually administered under the Ministry of Community Development and Social Welfare in a given country. Here participants can get free financial assistance from the government in circumstances of old age, invalidity and where one is out of employment. There are also the *Occupational Pension Schemes* which are pension schemes set up for specific groups of formally employed people usually within a specific industry. For example a mining company may set up a pension scheme only for its employees²². Thus these are schemes incidental to one being employed. They are set up by the employer for the benefit of the employees. Furthermore, there exist the *Employer Liability Schemes* that are set up by employers of a specified industry to cover employees’ work injury related benefits. Common industries in this vain would be the manufacturing and mining industries where occupational injuries are high. Another social security scheme takes the form of *Provident Funds*. *Provident Funds* are savings schemes set up for all employees. They guarantee a lump sum payment at retirement or otherwise for each employee comprising of the total contributions made to the Fund by the employee as well as the interest earned on such contribution. Lastly there are the *Social Insurance Schemes* where all members (employees and employers) make monthly contributions at a certain percentage to a fund held and administered by an insurance company which acts as a fund manager. These schemes are designed on the principle of risk sharing by all members of the scheme (i.e. any risk that may be incurred on the investment projects undertaken by the fund manager, is equally shared by all the members of the fund), while the benefits paid from the scheme relate to a number of factors including a member’s total contribution, the interest earned and any liabilities towards the fund manager²³”.

“A pension however is an income given to a person usually after retirement. Pensions are typically payments made in the form of a guaranteed annuity²⁴ to a retired or disabled employee. A pension created by an employer for the benefit of an employee is commonly referred to as an occupational or employer pension. Labour unions, the government, and other organizations may also sponsor pension provision. Occupational schemes are forms of deferred compensation,

²² Such as the Zambia Consolidated Copper Mines (ZCCM) Mukuba Pension Fund.

²³ <http://www.napsa.co.zm/policy.htm>. p1

²⁴ A sum of money paid each year

usually advantageous to both the employee and employer for tax reasons²⁵. Many pensions also contain an insurance aspect, since they often will pay benefits to survivors or disabled beneficiaries, while annuity income insures against the risk of longevity. Thus the common use of the term pensions is to describe the payments a person receives upon retirement, usually under pre-determined legal and/or contractual terms²⁶. The Constitution of Zambia (Amendment) Act²⁷ defines pension benefits as ‘any pensions, compensation, gratuities or other like allowances for persons in respect of their service as public officers, as officers in the department of the clerk of the National Assembly or as members of the armed forces or for the widows, children, dependants or personal representatives of such persons in respect of such services’. Clearly this definition needs to be amended so as to make it less restrictive and to broaden the categories of people that are eligible to take part in various pension schemes.

Types of pension plans

Pension plans can be divided into two broad types namely, *Defined Benefit* and *Defined Contribution* plans. A defined benefit (DB) pension scheme is one where the member knows how much the pension will be (either as a fixed amount, or related to average salary over employment, or final salary); often this is indexed to inflation or wage growth. The benefit in a DB plan is determined by a formula that can incorporate the employee’s pay, years of employment, age at retirement, and other factors. Traditional DB plan designs (because of their typically flat accrual rate and the decreasing time for interest discounting as people get closer to retirement age) tend to exhibit an accrual pattern of benefits, where the present value of benefits grows slowly early in an employee’s career and accelerates significantly in mid-career. This plan tends to be less portable and typically pay their benefits as an annuity, so retirees do not bear the investment risk of low returns on contributions or of outliving their retirement income. With such features many employers have tended to adopt the DC plan instead as these are less costly.

A defined contribution (DC) scheme is one where the member pays in a predetermined amount (or as a percentage of salary) and receives either a lump sum or a pension at retirement that is

²⁵ I.e. there is a tax exemption on money deducted for pension contribution, and thus provides a tax-free income in retirement for the employee while the employer’s tax burden is reduced.

²⁶ <http://en.wikipedia.org/wiki/Pensions>

²⁷ CAP 1 of the laws of Zambia. Amendment of 1996

determined by the investment return that has been made on the contribution. Typically the DC plans works in such a way that contributions are paid into an individual account for each member, then contributions are invested, for example in the stock market, and the returns on the investment (which may be positive or negative) are credited to the individual's account. On retirement the member's account is used to provide retirement benefits, often through the purchase of an annuity that provides a regular income. DC plans have become more widespread all over the world, and are now the more dominant form of plan in the private sector in many countries. In the DC plan, investment risk and investment rewards are assumed by each individual, employee or retiree and not by the employer. Additionally, participants do not typically purchase annuities with their savings upon retirement, and thus bear the risk of outliving their assets. Here investment decisions are made only where there is representation from the employees, the employer and actuarial. "There is also a *Hybrid* plan that combines the features of both the DB and DC plans. The Zambian pension industry incorporates both the DC and DB plans²⁸".

Current types of pension schemes in Zambia

"In Zambia, pension schemes have been set up as occupational pensions and can be divided into two broad categories namely Statutory or Public and non-Statutory or Private²⁹". The Statutory schemes are established by Acts of Parliament and include the National Pension Schemes (NPS), the Local Authority Superannuation Fund (LASF), the Public Service Pension Fund (PSPF), and the Workers Compensation Fund (WCF). The NPS was established by the National Pension Scheme Act³⁰ and is administered by the National Pension Scheme Authority (NAPSA). This is a compulsory savings scheme for any worker (over sixteen (16) years but below fifty-five (55) years old) engaged by an employer in any status (whether full time, part time or casual) including civil servants and local government employees who joined after the scheme commenced in the year 2000. The scheme operates on the basis of social insurance where both the employer and the employee must make monthly contributions to the fund at a specified percentage of an employees' salary³¹. The LASF was established by the Local Authority Superannuation Fund

²⁸ <http://en.wikipedia.org/wiki/Pensions>

²⁹ Pensions and Insurance Authority (PIA). Report on the Pensions Industry for the year 2004; January 2006. p5

³⁰ CAP 256 No. 40 of 1996 of the Laws of Zambia

³¹ Currently at 5%

Act³² and is an occupational social insurance scheme exclusively for employees in Local government, the National Housing Authority and the Zambia Electricity Supply Corporation (ZESCO). Here it is the government as employer that makes employer contributions towards the fund. Similarly, the PSPF is also an occupational social insurance scheme for employees in the civil service. Lastly the Workers Compensation Fund (WCF) is a scheme that covers or insures employees against employment injuries in all industries.

On the other hand the non-Statutory schemes include various occupational schemes set up by employers and administered by insurance companies³³ (such as the Zambia State Insurance Corporation (ZSIC), Professional Insurance Corporation (PICZ), Madison Insurance Corporation etc) for groups of workers in the Private sector, as well as those set up by the Parastatal sector such as the Mukuba Pension Fund which provided pension schemes for employees of the Zambia Consolidated Copper Mines (ZCCM).

The status of pension schemes in Zambia as of January 2005³⁴:

The *NAPSA* scheme has a total number of about 350,000 members and 12,500 contributing employers. Contributions are paid at the rate of 10% of one's total gross earnings up to a ceiling of 4 x National Average Earnings (NAE) shared equally between employer and employee. The scheme provides Retirement pension, Invalidity and Survivor's benefits, and an ex-gratia Funeral Grant. The benefits to be paid are at a rate of 40% of one's average salary at the time of claim and having contributed for a period of thirty years. If this criterion is not met receipt of pension is a lump sum plus interest earned. The *PSPF* membership is about 85,000 contributors and 52,000 pensioners. Contributions are payable by both employer (Government) and members at the rate of 7.25% of pensionable earnings. The Fund provides lump sum income in retirement, permanent invalidity and survivorship, and acts as a paying agent for government in death and early retirement cases. The *LASF* has a membership level of about 10,204 and approximately 6,139 pensioners. The level of contribution to the pension scheme by the employer is at 23% of an

³² CAP 284 of the Laws of Northern Rhodesia

³³ which were about 200 in 2004

³⁴ NAPSA Management paper; Social Security in Zambia: Submission to the Constitutional Review Commission (CRC). January 2005, p.5-9

employee' monthly earnings while the employee contributes 10% of his monthly earnings. The scheme caters for retirement, invalidity and survivor benefits. Lastly, contributions to the *WCF* are assessed on the claims experience of each industrial sector and range from 1.88% to 3.75% of insurable earnings.

On the other hand the *Non-Statutory Pension Schemes* (Occupational schemes managed by various insurance companies) provide schemes for about 30-35% of all formal sector employees, and work as complimentary schemes to NAPSA for those in formal employment. Furthermore, the *Minimum Wages and Conditions of Employment*³⁵ provides that employers, who have not set up occupational pension schemes that are approved by the Minister and where conditions of employment are not subject to a collective bargaining process, are liable to pay employees a gratuity amounting to three times the basic salary times the number of years served with the employer. These benefits are additional to those provided under the NAPSA.

The retirement age and pension benefit eligibility age for all pension schemes in Zambia for both male and female workers is 55 years. Another important characteristic of these pension schemes is that they are portable³⁶.

Objectives and Rationale of pension schemes

“Bringing the miracle of averages to the rescue of the millions”³⁷.

The subject of pension schemes is one of great concern and importance to every living and breathing adult, as old age and loss of physical strength is an inevitable eventuality for every human being. Every person would like the certainty of knowing that his future and that of his family are well secured financially. Thus a good pension scheme will ensure the continuation of a reasonable and sustainable income that will in turn ensure a good quality of life in the less productive years of one's life. The main purpose of maintaining pension schemes is “to provide a means of sustenance to pensioners to enable them enjoy a standard of living not much lower than

³⁵ Statutory Instrument No.2 and No.3 of 2000 of the Laws of Zambia.

³⁶ Portability means that a person does not lose his/her pension right if he/she moves to another organization.

Although for LASF and PSPF, it must be within the Funds member organizations.

³⁷ Sir Winston Churchill giving a description of the social insurance principle in 1911 after the enactment of the first United Kingdom (UK) contributory pension scheme.

they did during their period of employment³⁸”. In order to fulfil this objective pension funds must provide a pension adequate for this purpose; pay pensioners on time and at regular periods; and ensure that all eligible workers and employers contribute to the fund. A subsidiary function of pension funds is to invest surplus funds, (i.e. those funds that remain after pensioners have been paid their due benefits from monthly contributions) to both improve its liquidity position and to substantially add to the pool of investment funds in the country.

Zambian society has inadvertently reached a stage where the extended family and kinship system that provided support to needy members of the larger family has fast disappeared due to economic and social changes including rapid urbanization. Thus it is not surprising that cultural support from one’s family is fast becoming a thing of the past. There are various reasons for this phenomenon that include inter alia, low levels of income, high inflation, high levels of poverty³⁹ and generally an increase in the number of dependants largely as a result of the ‘absentee bread winner’ claimed by HIV/AIDS. Consequently, the majority of the needy people find themselves at the mercy of the general society with no specific members of society taking up the responsibility. This situation creates the need for society to respond with formal measures to fill the void created by the lost traditional systems. To this effect many countries have incorporated some form of social security.

Pension schemes as a basic human right

Social security schemes have been widely adopted in the developed world mainly in the form of basic security and in particular countries like the United States (USA) tax their rich citizens to sustain the needs of the needy members of its society. However in Zambia like many other African countries, the provision of social security remains the privilege of very few members of society i.e. those in formal employment. This is because the social security schemes currently in place are designed largely as *social insurance*, in which the right to a benefit is dependant on one having contributed some amount of money over a period of time. In effect the right to benefits has already been purchased. There is thus a need to incorporate a component of social assistance

³⁸ LASF; Five-Year Strategic Plan, November 2000. p. 8

³⁹ Saturday Post, October 29, 2006. The Central Statistical Office (CSO) reported that over half of Zambia’s households cannot afford three meals a day. According to the CSO Living Conditions Monitoring Survey, Luapula province is the worst hit with 82% of households in the province unable to afford three meals a day, while country wide 56% of households cannot afford three meals a day. p. 6

within Zambia's social security so as to cover the needy without the requirement of prior contributions, as well as broaden pension coverage to include individuals carrying on business in the informal sector.

There is need to have clear legislative recognition of social security as a basic human right in Zambia, especially because Zambia is party to a number of international instruments that recognize and protect the right to social security as a fundamental human right; and one that is of great significance in preventing poverty and ensuring public peace and order⁴⁰. Zambia is party to the Universal Declaration of Human Rights (UDHR) of 1948 which recognises the importance of social security in Article 22:

*"Everyone, as a member of society, has the right to social security and is entitled to realization, through national effort and international co-operation and in accordance with the organization and resources of each State, of the economic, social and cultural rights indispensable for his dignity and the free development of his personality"*⁴¹.

While Article 25 states that everyone has a right to,

"necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control".

The United Nations (UN) Convention on Economic, Social and Political Rights (ICESPR) of 1976 provides in Article 9 that; *'the State Parties to the present Covenant recognize the right of everyone to social security, including social insurance'*. The ILO has protected social security in various conventions such as; Convention 102 of 1952 on the Minimum Standards in Social Security; Convention 157 of 1982 that provides guidelines for the provision of social security for the Member States; and the Convention of 1962 on the Equality of Treatment in Social Security. In addition, the ILO administers a program called STEP whose mandate is to fight social exclusion and poverty while promoting social protection worldwide. Another organization

⁴⁰ The preamble of the UDHR echoes these sentiments: "whereas recognition of inherent dignity and of the equal and inalienable rights of all members of the human family is the foundation of freedom, justice and peace in the world..."

⁴¹ United Nations (UN) Document of the International Bill of Human Rights.

concerned with the issue of social security is ISSA⁴² founded in 1927 and of which Zambia is a member. The ISSA is an umbrella organization that falls under the auspices of the ILO and aims at the '*protection, promotion and development of social security throughout the world*'. The organization holds various international meetings to tackle issues on social security such as policy reforms and investment of funds.

At regional level, the Southern African Development Community (SADC) Treaty aims at enhancing the welfare of the peoples of Southern Africa through regional economic integration and development. "Consequently, SADC has developed a Charter on Fundamental Social Rights that recognizes social security as a right and underpins the need for the development of social security in the region"⁴³.

Benefits of pension schemes

It is thus clear that social security is deemed as being very crucial on the global agenda of human rights and development. The desperate cry for an 'all inclusive' pension scheme for Zambia becomes even more acute with the backdrop of the high levels of poverty in the country, estimated at 80% of the total population⁴⁴. It is important also to realize that there are various stakeholders that stand to gain from efficient and sustainable pension schemes. The following are some of the possible benefits of pension schemes to the individual, the country and the corporation. For the individual a pension scheme operates as a financial institution in which he may deposit money at no cost to himself for maintaining an account with a specific fund manager. Also, his money is likely to 'grow' from good investment returns on contributions made to a pension fund, and most importantly he can access that money tax-free at a time in his life when it is most needed. Thus pension schemes provide a savings system cheaper than other financial institutions such as the banks that require a service charge. With regards to Corporations, pension schemes operate to provide a form of financial savings to the business of the employer. It is true that even if an employer has no organized scheme in existence, he may still make payments out of current profits to retired employees or to his employee's dependants

⁴² International Social Security Association

⁴³ Yollard Kachinda. Social Security and the Constitution: An issue of Human Rights. NAPSA News Issue 7 3rd Quarter 2005 – NAPSA Co-hosts ISSA. p. 6

⁴⁴ Ibid. p. 6

however, it is merely business prudence to ensure that a man's pension is paid for out of profits earned by the company during the years when the employee is actually at work and contributing towards those profits, rather than leaving it to be paid after he has retired. Pension schemes thus provide for such an alternative.

The Country as a whole benefits from having pension schemes in that these typically inject large sums of money on a monthly basis (in individual funds) into the economy. Pension fund managers can ideally invest those large sums of money into profitable and viable economic ventures that will increase the pensioner's benefits, improve the economy as well as improve standards of living by raising the Gross Domestic Product (GDP) per capita, and thus reducing poverty levels nationwide.

In view of the forgoing, the ideal situation would be to entrench the right to social security within Part III of the Constitution, as is the case in South Africa. The point of this would be to enforce social security as a justiciable right as opposed to its being recognized merely as a directive principle of State policy under Article 112 of the Constitution⁴⁵. In the former case citizens can seek legal redress against the State on the basis that their social security rights have been infringed upon to the extent that the State has not provided for adequate scheme coverage by which all income earners regardless of sector can join. However it must be stated that being a developing country with a small economy and fluctuating balance of payments, complete provision of social assistance by the government would be untenable. Nonetheless, this should not give the State a free pass to ignore what little level of social assistance that it can provide. In this regard the State must embark on undertaking evaluations of the economic position of the country. What is happening now is that there is merely an assumption that social assistance cannot be provided at any level. It has been contended that "although the State has a duty to apply the directive principles in making law for the governance of the country, these principles cannot directly be enforced in the courts of law"⁴⁶. Furthermore the State is insulated from such action

⁴⁵ CAP 1 of the Laws of Zambia. "The State shall endeavor to provide to persons with disabilities, the aged and other disadvantaged persons such social benefits and amenities as are suitable to their needs and are just and equitable."

⁴⁶ Yollard Kachinda. Social Security and the Constitution: An issue of Human Rights. NAPSA News Issue 7 3rd Quarter 2005 – NAPSA Co-hosts ISSA. P. 6

through the State Proceedings Act⁴⁷. As a result, in most cases the government cops out of the responsibility of providing social security by stating that the country has a weak financial capacity to generate resources to finance such benefits. Consequently the reality is that the poor and disadvantaged continue to wallow in their hopeless circumstances while government continues to redirect funds to other activities, neglecting the pensions industry. Zambia should thus move away from this situation and employ a more adequate pension regime one backed by adequate legislative recognition and protection. President Franklin D. Roosevelt stated in describing the ideal social insurance system, that it must be one that provided economic protection “from the cradle to the grave”.

⁴⁷ CAP of the Laws of Zambia

CHAPTER TWO

CONSTRAINTS AND ISSUES AFFECTING LEVELS OF EFFICIENCY IN THE PENSION INDUSTRY OF ZAMBIA

Introduction

The operations of the pensions industry in Zambia has been less than desirable, and the pension schemes have basically failed to achieve their goal of providing efficient social insurance to the Zambian people. All of Zambia's pension schemes have been plagued with various problems some of which are still an issue today; these essentially range from lack of contributions and low level contributions, inappropriate investment strategies, huge fiscal deficit (traits that have been largely prevalent in the State sponsored schemes⁴⁸), delayed benefit payments, poor design structure, financing and administration. This chapter will thus analyse generally some of the non-legislative problems incidental to the pensions industry in Zambia as well as the specific problems of individual schemes.

General problems in the Pension Industry⁴⁹

The current pension system in Zambia suffers from a number of factors that will be analysed here under.

The unstable macroeconomic environment

The unstable macroeconomic environment caused by low levels of economic growth, high inflation and interest rates have adversely affected the value of benefits for members of pension scheme. Low economic growth means that GDP per capita is lower and the levels of contribution into pension schemes are also low as people are earning less. Consequently, the pension funds have lower levels of capital injection which means that there is less capital at pension managers' disposal to direct into investment projects, while high inflation levels means that the returns from invested capital are greatly eroded. Also, another contributing factor is the closure or downsizing of several companies after the period following liberalization in 1992. The impact of this has

⁴⁸ The World Bank Financial Sector Vice Presidency and the International Monetary Fund (IMF) Monetary and Exchange Affairs Department; Financial Sector Assessment Program, Selected Financial Sector Issues, Zambia, April 2002. p.187.

⁴⁹ The Financial Sector Development Plan Technical Committee. Financial Sector Development Plan (FSDP) for Zambia. Draft No. 2, November 2003. p. 117

been the obvious reduction of formal sector employees who were once employed in those companies e.g. the ZCCM.

Large deficits on contribution funds

The huge ‘deficit’⁵⁰ in the public sector schemes and the non-performing Real estate assets continue to haunt the pension sector and represent a serious threat to financial sector stability. For example, the un-paid contribution to the PSPF is estimated in the region of US\$500 million, while that of the LASF is at US\$30 million. This situation is due to the failure by the employer (Government) to remit contribution arrears into the fund coupled with the slow economic growth and the consequent decline in the formal employment sector; and thereby making the institutions fail to make meaningful investments. Consequently, all contributions that come through the funds are used to pay off the current liabilities due to members.

The absence of local actuaries

Zambia is mainly dependent on actuaries⁵¹ from South Africa and Zimbabwe for pension scheme evaluations. This is a problem because the foreign actuaries may not necessarily suggest investment policies that are consistent with the needs and risk tolerance of the members especially in DC schemes where the members are reliant upon the investment returns of the fund for their retirement savings. Thus the PIA in preparing draft investment guidelines that must be approved by the Minister must refrain from over reliance on the investment guidelines set up by the independent actuaries for the pension schemes regulated by the PIA. However to do this the PIA needs to be adequately provided for financially.

Change in mode of contribution and the declining formal sector

The introduction of NAPSA witnessed a change in the mode of contribution to the National Pension Scheme from a prescribed amount to a percentage of the member’s salary. This change had a net effect of increasing both the sponsors’ and member’s contributions. This rise in the contributions negatively affected the supplementary schemes to the effect that employers found it

⁵⁰ i.e. the amount constituting the contribution backlog occasioned by government’s failure to pay its contributions to LASF and PSPF.

⁵¹ These are insurance experts who calculate risks and premiums of a particular enterprise.

costly to contribute both to the compulsory NPS as well as to the supplementary schemes; thus some of these schemes have wound up.

There is a big threat to the sustainability of pension schemes as a result of the narrowing formal sector base. The only category of people eligible to a pension under the National scheme are those in formal sector employment, those that are outside this bracket are left to take up their own initiative of either joining occupational schemes or pursuing other ventures such as keeping their money in a bank. The reality is that many who are not in formal employment have little knowledge of the available occupational schemes such that even if they wanted a pension scheme, they have not joined one. The other alternatives to ensure future financial provision in this case would be to invest one's money in some business venture that he hopes will yield good returns, or simply to keep his money in the bank until the time that he may need it. The inadequacy of a bank as the main source of old age financial security is that there are various bank charges placed on one's account while the share of investment returns received may be very minimal. Furthermore there is the lurking danger of one withdrawing all or a substantial amount of his money to use for emergencies or other requirements, thus depleting his old age savings. Thus the long-term viability of the government-sponsored schemes depends inter alia upon the decline of the formal sector employment being stemmed if not reversed. However the impact of HIV/AIDS has accelerated this decline and has reduced the average contributory earnings, while increasing overall expenditure of the social security system in the short term through increased death and invalidity claims.

The following table shows the estimated number of formal sector employees and the average earnings by industry. It is sad to note that there are approximately 498,943 employees in the formal sector in a population of about 13 million people, and about a third of which are adults that should be able to be in some form of employment. This goes to show that the majority of people in this 'earning' group are in fact jobless (thus depending on others) or in the informal sector.

Number of Employees and Their Earnings by Industry, Zambia, January 2006⁵²

Industry	Total Employees	Average Earnings
Agriculture	56,139	382,473
Mining	45,821	2,936,374
Manufacturing	55,709	1,440.03
Electricity and Water	12,399	5,644,892
Construction	14,343	862,331
Trade	65,012	692,847
Transport	19,378	1,580,453
Business services	54,032	3,160,290
Personal and community services	176,110	962,535
Grand Total	498,943	1,472,191

Constraints in specific pension schemes

An analysis of the issues affecting individual pension funds is necessary to appreciate why these funds operate in the way that they do. The categories include the (ZNPF) NAPSA; the statutory schemes namely LASF and PSPF, and the private occupational pension schemes.

ZNPF / NAPSA

It has been stated that, “the sustainability of the NPS depends on a substantial increase in contribution rates in the next twenty years according to NAPSA projections⁵³”. This projection will dependent on a growing formal sector in Zambia and increased NPS participation. It is also contingent upon contributions being made by employers, satisfactory investment returns being achieved and NAPSA administrative costs being contained. However, the evidence suggests that future NPS participation levels will be much lower than those used in their projections. This situation can be attributed to the narrowing formal sector due to HIV/AIDS, the lack of job opportunities and the increasing bias towards self-employment by Zambians.

⁵² Central Statistical Office (CSO); Formal Sector Employment and Earnings Inquiry Report 2006. p. 6

⁵³ The World Bank Financial Sector Vice Presidency and the International Monetary Fund (IMF) Monetary and Exchange Affairs Department; Financial Sector Assessment Program, Selected Financial Sector Issues. Zambia, April 2002. p.188

The transition from ZNPF brought about its own constraints. For example all the assets of the ZNPF have been subsumed into the NPS but while ZNPF members' accounts are maintained distinct to those of NPS members, the assets have been commingled; and unfortunately this means that ZNPF members are fully exposed to the risks of the investments while the risk for NPS members is with the Authority. Also the failure of the ZNPF had largely resulted from poor performing assets due to poor administration and poor investment strategies. These problems, though largely diluted due to the better management and prudent investment of the fund under NAPSA, are still evident in the area of real estate that were "largely in non-productive rural locations for which the ZNPF often failed to secure legal title and in bank deposits of failed institutions⁵⁴". According to the NAPSA management report of 2005⁵⁵, the NAPSA has limited investment opportunities and is thus accumulating reserves at a reasonably high rate such that the capacity of the economy to absorb all the funds will be outstripped very fast. In other words this could lead to unnecessary pressure on the economy resulting from high inflation, and consequent loss of value of the benefits. This problem is further compounded by the apparent lack of well-developed capital markets that are suited to cover long-term liabilities such as those that accrue under pension funds.

The supervision and regulation⁵⁶ of NAPSA is somewhat limited and as such poses a danger in its duty as a trustee over the retirement funds of its members. NAPSA responds only to the Ministry of Labour (in which the Minister has wide and detailed powers of intervention into the operations of NAPSA) and is not subject to any formalized regulation such as that under the PIA. In addition NAPSA reports to a board of trustees comprising members including two from government, two from trade unions, two from employers, two from the Bankers Association (BA), two from the Association of Pension Fund Managers (APFM), a representative from the Bank of Zambia (BoZ) and the NAPSA Managing Director. This composition poses a danger in that there is likely to be a conflict of interest among them. "For example, the BoZ is responsible for selling government debt, of which NAPSA is a major investor, as well as maintaining the

⁵⁴ Ibid. p.193

⁵⁵ NAPSA. Submission to the Parliamentary Committee on Economic Affairs and Labor: study on the sustainability of the Zambian social security system. April 2005. p.13

⁵⁶ As provided in the National Pension Scheme Act, CAP 256 of the Laws of Zambia; and the various regulations issued as Statutory Instruments in 2000.

solvency and liquidity of the banking sector, in which NAPSA is a big depositor. The BA is interested in NAPSA as a source of funds, while the APFM represents the interest of competitor funds in the investment market⁵⁷. It is a drawback that the pensioners themselves are not represented at all, Trade unions only cover active members, while not all employees may be members of trade unions.

The issue of administrative costs needs to be contained for the on going viability of the NPS. NAPSA's administrative costs include the process of monitoring contributions and the procurement of foreign actuaries. The process of monitoring appears somewhat cumbersome and unreliable. Each member maintains a unique Social Security Number (SCN) (former ZNPF members have two numbers distinct from each other) and it is the duty of each employer to supply data on each employee as well as any changes in circumstances of a member such as marital status. However, much of this data is incomplete or old (i.e. not updated), and employers often send contribution money without stipulating the identity of the contributors or members under who's SCN the money will be reflected. Furthermore, the Act requires that an annual statement of account be sent to each member. Hence the NAPSA has to follow up on this as employers have not been forthcoming with such information. The cost of procuring Local actuaries is bound to be cheaper as for example payments will be made in local currency and cost quotations will be done in local currency also.

Statutory schemes (LASF and PSPF)

The other two public sector schemes have continued with their problems of delayed benefit payments due to the failure of government to remit contribution arrears. There is thus a need to provide for enforcement of penalties in this regard. The PSPF suffers from the three core ailments namely: failure to make contributions, poor investment returns, and high administrative costs. The low level of contribution rates is largely based on the fund's poor administrative capacity, it is a government funded and administered fund. Consequently the fund has no power to ensure that the government pays its contribution. It is a requirement of the PSRA⁵⁸ that all pension schemes be established as multi-employer trust funds, however the sole employer in the public

⁵⁷ Supra note 56

⁵⁸ Section 11

service is the government and as such the only 'employer' contributor. The failure to convert the PSPF on these lines means that the fund is restricted to obtain contributions from one employer (government), whereby in an event of default the fund has no alternative cash inflow. The PSPF 2000 annual report shows that essentially all of the assets of the PSPF are represented by claims on government for unpaid contributions (K.63.4 billion of K.70.8 billion net assets). The PSPF is essentially without investment income as it is without investments and without liquidity. For example in 2000 the PSPF held K.9.5 billion in various investment ventures, but it had a bank overdraft secured on real estate of K.10.3 billion, and the interest payable on the overdraft was greatly in excess of income earned on investments. The World Bank report states that, "the fund's administrative expenses of K.13 billion were around 20% of the contributions that should have been made⁵⁹".

As of February 2000 the PSPF has ceased to exist as a pension fund in the sense that it has received no new entrants. However the fund is completely incapable of meeting its obligations to its members; the long waiting list of aspirants to receive a pension is dependant on the contributions being paid by government. This has come to reflect the political needs of government. As a result some pensioners have died without receiving their pensions.

The LASF encounters similar problems to those of the PSPF. As ordained under the National Pension Scheme Act, there have been no new entrants to the LASF since February 2000. The fund covers local government employees, the Zambia Electricity Supply Corporation (ZESCO) and the Lusaka Water and Sewerage. None of these entities are current with payments on contributions. However the local authorities are deducting 10% of the employees' contribution from the paycheck but are seldom paying into the fund. The authorities are also in salary payment arrears and are in default with other creditors. It has been difficult for the LASF with its limited resources to compel government to make good on the unpaid dues of local authorities. This is also because the LASF does not have adequate enforcement mechanisms to ensure that government pays especially in view of the fact that it is funded by government.

⁵⁹ The World Bank Financial Sector Vice Presidency and the International Monetary Fund (IMF) Monetary and Exchange Affairs Department; Financial Sector Assessment Program, Selected Financial Sector Issues. Zambia, April 2002, p.202

LASF falls under the auspices of the Ministry of Local Government and Housing and has no power to enforce payment on the part of its member employers. The high administrative costs encountered by the local authorities can be reduced by cutting down on the labour force, however this in itself has adverse effects of narrowing further the formal sector base. Besides the local authorities are in no position to make cash commutations generally associated with retrenchment. The job of pursuing these defaulting employers must thus fall on to the PIA as regulator over the fund, but to do this the PIA must be endowed with the appropriate power to ensure that employers adhere to their obligation to make contributions.

Private Schemes

The issues that affect the sustainability of private schemes include are explained hereunder. The lack of adequate capacity for the regulatory framework for private pension schemes (i.e. the PIA) is somewhat incomplete in that it is not explicit on the extent it will go to regulate pension schemes. This is compounded by the fact that the PIA is just a department in the Ministry of Finance and National Planning and as such does not have as much autonomy nor finances to effectively manage the pension industry. The lack of tax incentives and a harmonized tax regime tends to discourage private savings. Since the 5% employer contribution to NAPSA is compulsory, many private companies would rather only contribute to that scheme and enjoy the tax benefit⁶⁰. On the other hand the employees of member companies do not really benefit from the monthly tax exemption on pension contributions⁶¹, therefore it is difficult to convince them to participate in the private occupational schemes. Finally, investments ventures are generally limited to fixed interest securities, equities, property, fixed cash deposits and insurance policies, which does not give the required flexibility to the pension scheme managers to invest the funds in most profitable way. In addition, fund managers encounter another cost from their investment returns broken down as: 15% levy and 1% medical fees as prescribed by the Income Tax Act⁶². Thus there is need for government to promote these schemes by creating more meaningful tax incentives, the effect of which will be increased contribution ratios, that will in turn build the schemes into strong and more viable financial institutions from which government can make

⁶⁰ e.g. ZIGI Insurance company

⁶¹ as will be elaborated further in the paper, p. 37 & 38

⁶² CAP 323 of the Laws of Zambia.

short term borrowing helping it pay off part of its liability especially within the PSPF and the LASF.

Adjudication on Pension Cases in Zambia

There are a small number of reported pension cases in Zambia. However, this does not mean that pensioners have not faced problems in the area of receiving benefits, but rather there are various other reasons such as the high cost of litigation that a pensioner is faced with if he decides to sue. Besides even if the courts pass judgment for the payment of overdue pension benefits, many schemes especially the State run LASF and PSPF are unable to make those payments in a short space of time. Nevertheless this paper will analyse a few cases which will reflect the court's attitude towards pension payments as well as the attitude of the employers in this vain, thus reflecting some of the problems in the pension schemes.

I.L. Likando and Others v. Zambia Railways Limited⁶³.

The plaintiffs were former employees of the defendant company. They were employed under the ZIMCO conditions of service and had resisted the unionised conditions of service that were inferior. The defendant company had a pension scheme where the employees contributed 10% while the employer contributed 8.33%. However at the time of retrenchment in 1992, the employees were only refunded their contributions and not those of the employer. The plaintiffs thus sought among other things such as salary appraisals, payment in lieu of notice; the employer's contributions to the pension scheme. The court held referring to the Income Tax Act fourth schedule that was contended by defence counsel as implicitly making it illegal to remove the employer's contribution; that this schedule was made pursuant to section 37 of the Act which deals with deductions to be made from an employee for the purposes of charging tax and that it did not support the decision contended for by the defence counsel. That the section only referred to Approved Funds of which the Defendant Fund was not. That the plaintiff did not leave on their own volition (as the defendant had unilaterally changed the conditions of service to replace the ZIMCO conditions with those of the unionised ones, the effect of which was to deny the plaintiffs future earnings as they were all supposed to retire at the age of sixty under the conditions they

⁶³ H.C. /02/2000 unreported

were serving) or on disciplinary grounds and accordingly they satisfied the grounds on which they could be paid the employer's contribution up to the time they left employment.

This judgment shows the court's commitment to upholding pensioners' rights in terms of their benefits. The drawback however is that this case had been pending for five years since 1995 and the fact that the Statute was contradictory to the PSRA which requires that all schemes be established under trust.

Francis Mporokoso v. Zambia Bottlers Limited⁶⁴.

Zambia Breweries acquired 100% shares in Zambia Bottlers Limited after which point the complainant was relegated to the post of supervisor of the night having previously worked as production manager. The plaintiff chose to end his employment. Management advised him that he would be declared redundant although he had the choice of early retirement that he signed off on. The plaintiff requested that he be paid in accordance with the S.I. No. 2 of 2002. However the defendant company paid him in accordance with the provisions of their own pension scheme. It was held that the essence of approving a private pension scheme for workers is that it offers better retirement benefits than under statute. But the several amendments to the S.I. pertaining to retirement benefits, (the latest being No. 2 of 2002), meant that now the statute created greater benefits than those of the pension scheme. Furthermore, that the benefits that were actually paid were not in accordance with the pension scheme provisions. Judgment was entered for the plaintiff and the defendant company was ordered to pay him the balance of his retirement benefits in line with the S.I.

The importance of this case is that it shows the level of commitment by the court to uphold the best interests of the pensioner, as the Courts are ready to pick on the best option available to this end.

This principle was also reflected in the case of **Kelvin Fungo, Edwin Masupa Mwikisa v. African Life Financial Services Zambia Limited⁶⁵** where the applicants were made redundant, and the first applicant was paid only his part of the pension contribution in accordance with the

⁶⁴ H.C. /HP/0964/2003 (unreported)

⁶⁵ H.C./HP/0906/2004 (unreported)

defendant company's pension scheme. The second applicant was not paid either his own contribution or that of his employer. There was however legislation that came into force after March 2003 when the first applicant (but not the second) had already been paid. The legislation was to the effect that a retiring employee was entitled to receive both his pension contributions together with his employers. It was held that though the liability of the employer towards the first applicant had already been extinguished before the Act came into force, the trustees acted discriminatory in that they advised that the second applicant could obtain both contributions, while they said no in the case of the first applicant. That discrimination was against the constitutional provision of Article 23 of the constitution and thus both applicants were entitled to both contributions.

Though the holding of this case was such that it upheld the rights of the pensioners as paramount, the flaw of the judgment is that the court made a law to have a retrospective effect when the language of the Act did not cater for such effect. The liability of the employer should not have been retrospective after it had already been extinguished.

CHAPTER THREE

SHORTCOMINGS OF THE LEGISLATIVE PROVISIONS ON PENSION SCHEMES IN ZAMBIA

Introduction

Another major problem facing the pension sector, and the focal point of this paper, is the legislative machinery that governs the pension schemes. Some of the provisions in the various Acts have proven to be inadequate and contradictory as will be shown later in this chapter. Having given an overview of the pensions industry in Zambia, there is a need to assess the current legislation concerning pension schemes in Zambia. This analysis will focus on the following statutes namely: the Public Service Pension Act (PSPA)⁶⁶, the Local Authority Superannuation Fund Act (LASFA)⁶⁷, the Pension Scheme Regulation Act (PSRA)⁶⁸ and its amendment Act⁶⁹, the National Pension Scheme Act (NPSA)⁷⁰, the Constitution⁷¹ and the Income Tax Act⁷². The purpose of this assessment is to critically analyse the provisions of these statutes so as to unearth provisions that are inadequate, inconsistent as well as to discover gaps in the legislation that contribute to the inefficiencies of the current pension schemes.

The Constitution of Zambia

There is negligible provision for pension schemes in the constitution, the closest glimmer of recognition of pensions is provided under the Directive Principles of State Policy⁷³. Article 112 (f) states that: *"the State shall endeavour to provide to persons with disabilities, the aged and other disadvantaged persons such social benefits and amenities as are suitable to their needs and are just and equitable."* Zambia does not have a social assistance service, and in trying to comply with sub-Article (f) the government has set up a compulsory State pension scheme based on social insurance (NAPSA). However this is inadequate as the State scheme does not apply to

⁶⁶ CAP 260 of the Laws of Zambia

⁶⁷ CAP 284 of the Laws of Zambia

⁶⁸ No. 28 of 1996 of the Laws of Zambia

⁶⁹ No. 27 of 2005 of the Laws of Zambia

⁷⁰ CAP 256 of the Laws of Zambia

⁷¹ CAP 1 of the Laws of Zambia

⁷² CAP 383 of the Laws of Zambia

⁷³ Part IX CAP 1 of the Laws of Zambia.

everybody, and this is further compounded by the provisions of Article 111 which state that: *“The Directive principles of State Policy set out in this Part shall not be justiciable and shall not thereby, by themselves, despite being referred to as rights in certain instances, be legally enforceable in any court, tribunal or administrative institution or entity.”* Thus those individuals that are excluded from NAPSA do not have any claim against the State.

In 2005 the Mung’omba Constitutional Review Commission (CRC) drafted Bill 200 to provide for a new Constitution for Zambia. The following recommendations pertaining to pension schemes were made: Part VI provides for the Bill of Rights. Article 66 therein states that:

“All persons have the right to social security, including if they are unable to support themselves and their dependants, appropriate social security assistance from the State.”

This is a very progressive provision in that it places a mandate on government to factor within its annual budget some provision for social security. This social security would however have to be backed by a piece of legislation that would itemize the extent of such coverage (to include free access to basic necessities such as medical assistance, food tickets etc.) and clearly state the screening process by which beneficiaries will be picked so as to ensure that such assistance gets to the people who really need it. Furthermore, in harnessing all these efforts and in light of the economic realities in Zambia, the government needs to create an enabling environment that will provide for an overall coverage of pension schemes; and enact legislation that mandates every ‘income earner’ in all economic sectors to be a monthly contributor to a pension scheme. This would need to be closely monitored by an independent monitoring body for all pension schemes such as the PIA (monitoring can be advanced by using the customer records available at institutions such as the Zambia Electricity Supply Corporation – ZESCO, as is the case with the current collection of television license fees). Thus the PIA would ensure that all income earners make their monthly contributions to their schemes.

Curious however, is the fact that the rest of the provisions in the Bill are centred solely on the protection of the rights of employees in the Public Service and Commissions⁷⁴. Most of the provisions here are progressive especially in light of the fact that this sector has been a very

⁷⁴ Part XIV, The Draft Constitution of Zambia – Bill 200 of 2005.

problematic one as a result of the defaults from government in making contributions. However, some provisions are inconsistent with current legislation on pensions. For example, Article 292 (1) provides that; *“a public officer shall unless where otherwise provided in this constitution, retire from the public service on attaining the age of sixty years, with the option to retire with full benefits on attainment of fifty-five years.”* The National Pension Scheme Act provides that retirement age in Zambia is 55 years. This creates an unwarranted benefit to the Public service. Besides as of 2000 the pension contributions of public officers and employees of local authorities fall under NAPSA and as such are regulated by the NPSA.

Following, the publication of the Draft Constitution, the PSPF submitted various observations and comments⁷⁵ a few of which are of particular interest for this paper. With regards to Article 293, the PSPF supported the spirit of a guaranteed pension or gratuity, but cautioned that without ‘guaranteed contributions’ on the part of the employers (government), the recommended provision would be rendered nugatory; and as such that there should be a provision compelling government to make such contributions. The PSPF stated that to have a constitutional provision which dictates that *“pensions shall be reviewed upwards periodically”* in Article 294 (1) was undesirable and that such review should instead be carried out subject to Actuarial advice; and that upholding such a recommendation would disregard the possibility of a deflation in the currency in which case an upward review would be unreasonable.

The Pension Scheme Regulation Act (PSRA)

The PSRA establishes the PIA whose regulatory powers are spelt out in the Act. However the Act *is weak to the extent that it does not confer sufficient regulatory powers on the PIA. Although the PIA started operating in 1997, it is not a corporate body*⁷⁶ but rather falls under the auspices of the Ministry of Finance and National Planning. This arrangement has adversely affected the operations of the Authority especially in terms of funding which comes from government. Thus the PIA’s capacity to evaluate the viability of individual pension schemes is somewhat impeded, and rather relies heavily on the independent actuaries appointed by the schemes. For example, the Authority has no power to establish a limit for the amount of expenses that can be charged to

⁷⁵ PSPF Management report (unpublished), Comments on the Draft Constitution and CRC Report, October 2005.

⁷⁶ And so is not a legal entity and cannot bring or be subject to legal actions in its own right.

members for the management and administration of a pension fund; in contrast many countries such as the UK place a cap on the level of fees that can be charged on pension funds that qualify for preferential tax treatment. Furthermore although the Authority has inspectors and personnel to inspect and follow up on each funds' annual reports and actuarial reports, if there are laggards in reporting (as has been the case before especially from LASF, PSPF, NAPSA Staff and the Bank of Zambia⁷⁷), the Authority lacks effective disciplinary action to deal with this. Thus the Act must be amended to confer greater powers to the PIA, i.e. it must provide adequate funding, must provide for the PIA's independence, it must empower the PIA with authority to impose effective sanctions on defaulting employers and inefficient pension fund managers.

The primary purpose of the PSRA is to lay down principles and rules of general law governing occupational pensions (NAPSA is not regulated by the PSRA). Section 2 of the principal Act provides that the Act '*shall only apply to any institution or company that establishes or manages a pension scheme except the National Pension Scheme established under the National Pension Scheme Act*'. This restriction in favour of the NAPSA is a regrettable one in that the NAPSA has become immune from scrutiny and strict accountability as it does not fall under the auspices of the Pensions and Insurance Authority (PIA) nor is it directly answerable to Parliament, and it is excluded from achieving the same standard of compliance as other pension schemes. Section 18 of the PSRA for example is very progressive in its conditions of compliance for pension schemes however NAPSA is exempt from such compliance. Thus the PIA cannot ensure that provisions of Article 18 (1) (c) providing that each scheme must have an annual statement to members are met. Or that the requirements under Article 7 (1) (b) which state that pension funds should be established in the form of multi-employer trusts separate from the employer's business, are met. Consequently the staff pension schemes of governmental entities such as the Bank of Zambia (BOZ) and NAPSA have not met these criteria. NAPSA being the only compulsory and largest scheme must surely be subject to the regulation of the PIA in this area, besides there is no logical explanation for its exemption.

Section 3 of the Amendment Act defines "member" as meaning a member of the Board

⁷⁷ Supra note 43

or a committee of the Board. This is a different definition from that of the principal Act that provided in terms of an individual who joined a pension scheme, which was more suitable and less ambiguous. Furthermore, this definition is confusing; for example Section 7 (6) (a) of the same Act states that *“the Registrar, shall at all times protect the rights, benefits and other interest of the members in accordance with their corresponding pension scheme”*; while Section 5 (3) (c) states that *“the number of trustees of whom one half shall be appointed or elected by the members and the remainder shall be appointed by the sponsoring employer”*. These sections clearly show that the intended meaning of ‘member’ is not a Board member or a committee member, but rather a member contributing to a pension scheme. Section 30A in the Amendment Act provides that those employers who fail to remit contributions within a month will be charged interest on contributions at the BoZ rate and further introduces a penalty for non compliance with the Act; however it is unclear whether the recipient of the interest payable is the fund or the Registrar.

It is obvious that entitlements under the pension scheme are worthless if the funds have been depleted. There are, thus several control mechanisms designed to give safeguards for pension funds within the Act. However with regard to investment, Section 25 (4) of the principal Act and Section 25 (2) of the Amendment Act provide that *“a pension fund shall not make unsecured loans to an affiliated employer”*. The main reason for placing restrictions on a pension schemes’ right to self-investment is to maintain the segregation of the scheme’s funds from the employer’s assets. The logical consequence that one would hope to see would be that even in cases of liquidation of a company being a pension fund or pension manager, the contributions would be out of reach even to secured creditors because in effect those funds are not really owned by the firm. The provisions of the Act though commendable are still narrow in scope. The definition should be cast wide to encompass ‘employer related investment’ which extend to “shares and other securities; land occupied or taken on lease; other property used for the purpose of any business, and borrowings by the employer or by any person that is connected with or is an associate of the employer⁷⁸”.

⁷⁸ Mr. G. Mfula; The implications of the Pension Scheme Regulation Act No. 28 of 1996 and the Pension Scheme Regulation (Amendment) Act No. 27 of 2005 on the Management, Administration and Investment of Pension Funds and the role of Trustees in pension management; Insurers Association of Zambia, Workshop on Pensions and Insurance Amendment Acts 2006. P. 7

There is further protection of pension funds through the provisions against insolvency of the employer. Section 27 of the Amendment Act slightly amended Section 32 of the principal Act by according protection “*against the negligence or dishonesty of the directors, officers or employees of a pension scheme in order to safeguard its members’ contributions*”. There is however a shortcoming to this provision in that the Amendment Act does not clearly stipulate whether the pension scheme’s claim on the employer should be given any priority in bankruptcy or winding up; i.e. whether all amounts owed by the employer to a pension scheme be treated preferentially in circumstances of insolvency. The Act must thus be amended to provide for the preferential payment of pension funds so as to guarantee the receipt of pension contribution by the pensioner or other beneficiary. This is an important factor that must be implemented quickly.

Section 5 (3) (f) of the principal Act states that, “the quorum at any meeting of the Board of Trustees shall be fifty per centum of the total number of employees”. The PSRA provides for unanimous decisions of such meetings. However this poses an absurdity in that a situation is likely to arise where only either the employer appointed trustees or employee appointed trustees form for a valid decision and pass valid decisions⁷⁹. Section 27 of the principle Act makes provision for a contributor to institute legal proceedings against a manager contravening the Act, pension plan rules or regulations so as to protest his contributions under a pension scheme. This provision is not effective in that instituting legal proceedings may be too expensive a venture for a pensioner to embark on, and resolutions by the courts may (and have) take many years to be arrived at. Thus there is need to incorporate formal internal dispute resolution procedures administered by the PIA.

Part II of the first schedule of the Appendix in Section 10 of the principle Act provides for levies being imposed on the net assets of pension funds. Unfortunately the Act is silent on the assessment criteria by which the levies will be arrived at, and thus it is difficult to predict what impact they will have on the funds.

⁷⁹ Ibid p. 10

An important oversight of both Acts is that neither has taken cognisance of the existence of the professional bodies such as the Zambia Association of Pension Fund Managers (ZAPFM) that represent schemes and employers within the public and private sectors. The ZAPFM aims at encouraging pension provision by employers by inter alia: influencing public opinion, consulting government bodies, providing education in the form of seminars and conferences and publishing information. The ZAPFM is thus intended to be a powerful instrument of education which can be used to reduce the current high levels of ‘pension contribution apathy’ and ignorance in the general populace, and as such must be given due recognition.

The National Pension Scheme Act⁸⁰

The Act provides for the establishment of the NAPSA that is mandated to control and administer the scheme. Sections 5 (2) provides that: *“In the performance of its functions, the authority shall, subject to the provisions of this Act, not be subject to the control or direction of any person or authority.”* This section is untenable, as there is need to have some regulation and supervision of the scheme to ensure that the power to manage the fund is not abused by the officers that administer it. In this regard there is need to amend this provision by adding that the scheme must be answerable to Parliament or that it must be regulated by the PIA that regulates other schemes.

Section 11 (2) providing for membership eligibility states that one should be an employee of a contributing employer. This is a narrow basis for coverage (i.e. the formal sector). Sub-section (3) further states that the Minister has the discretion to extend such coverage. However there is need to have a harmonized piece of legislation that provides pension coverage regardless of sector. Section 14 (2) states that *“a contributing employer shall be entitled to recover from his employee who is a member of the scheme, the amount of the employer’s contribution by deduction from his earnings the contribution relates.”* This provision is ambiguous and must be repealed. Furthermore, to address the problem of sluggish contributions by the employer, the Act must provide that an overall income collection body like the ZRA should ensure that payments are made in the same fashion as they do with income tax payments. Section 18 provides that the retirement age and thus the pensionable age, is 55 years. This provision is outdated and needs to

⁸⁰ No. 40 of 1996. Chapter 256 of the Laws of Zambia.

be amended to take into consideration the current levels of poverty and the impact of HIV/AIDS on life expectancy, notwithstanding that there is an option of early retirement on medical grounds.

Section 41 provides for limited investment opportunities, while subsection (d) states that investments shall be as may be approved by the Authority. Such restrictions are not in the best interests of pension schemes as they increase the risks faced by workers because the domestic economies in many developing nations are very narrow and are exposed to high local market risk⁸¹. There is a need to have a certain percentage of pension funds to be invested in other portfolio in order to maximize investment returns.

Also there is disharmony in the legislative provisions of various schemes. This is evident for example in the public schemes in terms of membership, benefit structures and contribution levels which made some schemes cheaper for employers (e.g. NAPSA 5% contribution) while other schemes made it more expensive (e.g. LASF 23%), and thus creating an inequality within the labour market.

The Local Authorities Superannuation Fund Act⁸²

The LASF Act needs to be amended in various respects to enable it to become more effective in dealing with issues affecting the fund, such as making provisions for effective enforcement mechanisms to ensure that the employer adheres to the provisions of the Act.

Section 12 under the Act provides for a narrow investment base that is undesirable for the growth of the fund, and the provision of guaranteed interest ignores the existence of fluctuating inflation rates. Section 24 (1) is ambiguous when it provides that; *“if the pensionable emoluments of a member are reduced by his employer for any reason, other than misconduct, he may elect to contribute to the Fund on the basis of his pensionable emoluments immediately prior to such reduction...”* It is undesirable that the employer is given wide powers of reducing the pensionable emoluments; there must instead be specific provisions stating the limited circumstances in which such power should be exercised. The author suggests that such reductions

⁸¹ C.B. Barry and L.J. Lockwood, “New Directions in Research on Emerging Capital Markets”, Financial Markets Institutions and Instruments. P.17-18

⁸² No. 16 CAP 284 of the Laws of Zambia

should only be lawful if they fall in line with actuarial findings from a specific assessment undertaken.

Section 28 (3) is weak in that it is not backed up by any enforcement mechanism that would ensure that a member is not prejudiced. It provides that *“the employer of the member entitled to the benefits mentioned in subsection (1) and (2) shall, out of its own revenues, refund to the committee...”* the benefits paid. The committee cannot continue making such payments if there is no guarantee that refunds will be made in the shortest possible time.

Section 43 relates to dispute settlement. It provides that all disputes shall be decided by the Committee with an opportunity for further appeal to the Minister whose decision shall be final. This is unsatisfactory in that it is likely that the Minister employed by the government may not arrive at an impartial judgment. Thus, there is need to have a provision for an independent tribunal and indeed a right of appeal to the courts.

The Public Service Pension Act⁸³

The Act essentially provides for pension provision for employees in the public sector. It has a number of provisions intended to safeguard the benefits due to employees under the Act, however the Act is still lacking in some areas that will be analysed hereunder.

The Act provides for the functions of the Board in Section 7 as follows:

“(b) to establish a scheme for home ownership by the members of the Fund and to grant, on such terms and conditions as the Board shall determine, loans to the members of the Fund for the purpose of building or purchasing their own residential property.”

The essence of pension benefits is to ensure that the members have finances to sustain them at a time when they cannot adequately provide for themselves. It is not the place of pensions Funds to offer loans as this has the effect of depleting the capital levels that were designed essentially to be used after retirement. This fortunately does not happen in practice as the Fund has no money; however the provision should be done away with.

⁸³ No. 35 of 1996 of the Laws of Zambia

It would appear logical and consistent with the spirit of the Act to have the Act applicable to every employee in the public service; however Section 10 provides that membership will comprise the members of the existing fund and “*such other persons, being employees of public service, as the Board may prescribe.*” This provision gives too much discretion to the Board to determine who is eligible and may thus operate to the detriment of some public employees. The effect of this is however mitigated by the fact that membership to NAPSA is compulsory for all formal sector employees. Section 54 makes provision for the review of pensions at such intervals as the Board may determine. This provision should be amended so as to provide for guidelines on the specific intervals in which such reviews should be done.

The Income Tax Act⁸⁴

Schedule Four of the Act provides for tax exemption as follows;

- “(i) The Pension Fund – on the income from its investment whether by way of dividends, interest or capital appreciation;*
- (ii) The Employer – on his contributions to the scheme;*
- (iii) The Employee – on the employee’s own contributions to the scheme on retirement, on his permanent disability, and to surviving beneficiaries. In this vain it is not considered as income subject to taxation.”*

The provisions of the Act only apply to benefits on retirement, death or disability, therefore one who gets his pension benefits in some other manner such as through redundancy will not have the luxury of benefiting from these provisions; or at least the Act is silent on that point. If a benefit is classified as a ‘pension’ it would be prudent and fair to have such benefits exempt from tax regardless of the circumstances on which one receives such benefit.

Tax exemptions are supposed to create incentives to make pension funds attractive to both sponsoring companies and employees and thereby encourage pension growth. However, Mr Muna Hantuba CEO African Life Financial Services (Z) Limited has underlined various loopholes in the tax legislation. He states that a detailed review of the actual interpretation of the tax regulation shows that the tax system is not as fluid or supportive to the pension industry as it

⁸⁴ CAP 383 of the Laws of Zambia.

seems on the surface. He submits that occupation schemes are subject to tax on; contributions to the fund, on the investment returns earned by the fund and on the pensions paid out to the beneficiaries. He outlines the specific areas of disincentives against the development of pension schemes as follows:

“Tax on Contribution

The tax advantages on pension schemes are stipulated under section 37 of the revised 1966 Act that up to 15% on income liable to tax or K15,000 per month whichever is less is tax allowed. Employers get a tax rebate on contributions it makes on behalf of the employees as well. As NAFSA ranks first, the total tax rebate of K15,000 per annum is swallowed by the mandatory scheme at the moment. Furthermore, in the scheme of arrangements, employee contributions to pension schemes are fully drawn from tax earnings, thus overall the tax incentive on contributions are inadequate.

Tax on Investment

Returns on all forms of investments are exempt from withholding and final tax except in few cases namely: a) Medical Levy where 1% of returns is deducted at source, b) Fuel levy that is charged at 10% of the pump price of fuel and is not selective in as far as the pension funds operations are concerned, c) Final Tax on Government Securities facilitated by the Income Tax Amendment Act No. 3 of 2003 which provides for the deduction of final tax of 15% on interest earned on government securities under sub paragraph 1 of paragraph 6, d) Returns on Unit Trusts taxation of which results into a direct tax for that portion of pension funds invested therein. Unless a scheme is designed to tax proceeds in the hands of unit holders, pension schemes will remain tax disadvantaged, and e) Value added tax (VAT) where the tax advantages spelt out in the Income Tax Act 1966 have not been extended into the VAT regime, rendering VAT as a non-recoverable cost for pension funds resulting into the cost of managing schemes prohibitive and uncompetitive. Also, since the schemes are precluded from registering for VAT, there should be no claim for VAT.

Tax on Benefits

The law provides for tax-free benefits at normal retirement age or early medical retirement or early voluntary retirement. Tax is however imposed on any pre mature withdrawals of

benefits from the pension funds. A flat rate of 10% is charged on any lump sum refund of employee contributions. Further, a punitive 40% tax rate applies in the event an employee elects to withdraw employer portion of the vesting amount at early withdrawal. Given the portability of pensions, coupled with high labour mobility, the bulk of funds tend to be withdrawn prior to retirement, resulting in effective taxation of exit benefits at 40%. Clearly this is a disincentive especially in view of the fact that the retired continue to pay taxes on till for services and basic living needs⁸⁵”.

Thus there is a need to make some improvements to the current situation as the absence of substantial tax incentives continues to significantly affect the ability of pension funds to meet their liabilities as and when they fall due. Some, suggested improvements could be that the maximum tax deductibility in the occupational schemes in respect of individual contributions must be increased substantially i.e. to the actual 15% of pay per month, if government is to encourage savings in the form of pension contributions at the individual level and in the form of pension funds at macro level. There should also be a new and sustainable tax law that the issues raised above so as to give real relief at investment and retirement stages. The VAT regime must be zero rated to reduce the cost of management incurred by scheme managers. Also the allowance for tax deductibility for pension contributions which is currently at K15,000 per month should instead be established as a percentage of earnings, possibly graduated with age to allow for greater contributions by older individuals.

In conclusion, it is clearly evident that the laws pertaining to pension schemes in Zambia all have flaws that tend to negatively affect the performance of the pension schemes. It is also obvious that these laws need to be harmonized so as to ensure that the main provisions are uniform such as the differences in contribution levels where the NAPSA provides for a contribution level of 10%, while the PSPF provides for 23% total contribution of an employee' salary. Such differences cause unnecessary inequalities in the pension industry. Also there is need to harmonise the extent of sanctions imposed on pension schemes for non-compliance with the

⁸⁵ Muna Hantuba, Taxation of Retirement Benefits Schemes Issues to consider under review of the PSRA Amendment Bill; Levies will frustrate the growth of the industry (2005), p.2-5

PSRA, the tax deductibility levels (the occupational schemes are prejudiced in this area in that they are required to pay a medical and fuel levy which the statutory schemes do not pay), and some specific definitions (such as 'member' should carry the same meaning). One of the most important issues to address is the need to have one overall regulatory body for all pension schemes to ensure accountability in all pension funds. It is also necessary that such regulatory body be vested with effective powers to monitoring and impose effective sanctions by providing it with an adequate level of funding and accountability (preferably to parliament). Lastly it is important to make specific recognition of the right to social security in the constitution, which right shall be a justiciable one; while the retirement age must be amended downwards to take into consideration the factors of poverty and HIV/AIDS.

CHAPTER FOUR

COMPARATIVE STUDY OF PENSION LEGISLATION OF SELECTED COUNTRIES

Introduction

In order to develop effective reforms for the current pension legislation it is progressive to embark on an assessment of various pension policies of other countries. This will aid in ascertaining which provisions are most effective and appropriate for enhancing the efficiency of pension schemes in Zambia. It is thus beneficial at this stage to undertake a comparative study of pension schemes in selected countries. In this regard the following countries will form the basis of the comparative study namely; the United Kingdom, South Africa and Kenya.

Pension Fund Act of South Africa⁸⁶

The Pension Fund Act of South Africa provides for a number of progressive conditions that aim at protecting the employee contributor to a fund and other beneficiaries, as well as making provision for an adequate management regime. The definitions at the beginning of the Act have been couched in wide, clear and specific terms. For example, the Act clearly states who a “complainant” is, which includes a broad spectrum of ‘persons’ with locus standi in this regard. The definition includes a member or former member of a fund, a beneficiary of a fund, an employer who participates in a fund, a board of a fund or member thereof or any person who has an interest in a complaint. Furthermore, “complaint” means a complaint over the administration of a fund concerning, the investment of its funds or the interpretation and application of its rules, and alleging that:

- “(a) a decision of the fund or any person purportedly taken in terms of the rules was in excess of the powers of that fund or person, or an improper exercise of power;*
- (b) the complainant has sustained or may sustain prejudice in consequence of the mal administration of the fund by the fund, or any person, whether by act or omission;*
- (c) a dispute of fact or law has arisen in relation to a fund between the fund or any person and the complainant;*

⁸⁶ Act 24 of 1956 of the Laws of South Africa

(d) an employer who participates in a fund has not fulfilled its duties in terms of the rules of the fund.”

These provisions give a broad spectrum of the grounds under which one may seek redress. This definition even provides for prospective actions or omissions likely to prejudice the complainant. Thus a problem can be dealt with before it actually occurs and adversely affects the rights of a pensioner, member of a fund or indeed a beneficiary of a fund.

Section 7D clearly stipulates the duties of a pension fund board. These duties include inter alia that the board shall: *“(b) ensure that proper control systems are employed by or on behalf of the board, (c) ensure that adequate and appropriate information is communicated to the members of the fund informing them of their rights, benefits and duties in terms of the rules of the fund.”* These provisions are aimed at protecting the stakeholders’ welfare. Section 14A provides for the minimum benefits which a registered fund shall provide to a member, which include in sub-section (b) that the benefits paid to a member if the fund is liquidated must not be less than the minimum individual reserve. The Act tends to uphold the best interest of the pensioner as evidenced in section 15B that deals with the apportionment of existing surplus. This section takes into consideration issues of liquidation and conversion from one fund type to another⁸⁷. While sub-section 3 provides that the board shall appoint a person to represent the interests of former members in the development of the scheme and such person shall *“(a) assist the board in identifying former members, communicating proposals to former members and to the fund to which former members transferred to the board; and collating any objections to the scheme from former members and the funds to which they transferred”*. Sub-section 4 goes further to mandate the Board to enable the apportionment of actuarial surplus⁸⁸ to former members even if their records are insufficient, by obtaining records from the administrator, employer or even through advertisements, before any such member can be excluded from the additional benefits. There is also established a contingency reserve account to satisfy any future claims of former members.

These provisions are aimed at creating an interactive atmosphere between members and the fund managers. They have taken into consideration the proposals and objections coming from the

⁸⁷ Sub-section 1 (b) (ii) and (iii)

⁸⁸ This is the fair value of the assets of the fund less any credit balances to the members.

members in so far as the way in which the fund is managed and developed. Thus, the contributors have an active role to determine the status and growth of their funds as they are kept abreast with the management of their funds.

Chapter VA is dedicated to the contribution and adjudication of complaints. Section 30B establishes the office of the Pension Funds Adjudicator (PFA) whose main object is to dispose of all complaints lodged, in a “procedurally fair, economical and expeditious manner⁸⁹”. Section 30 G further provides for a wide spectrum of persons that can become parties to a complaint. These persons include; the complainant, a fund or person against whom the complaint is directed and any person with a sufficient interest in the matter. An advantage of having a PFA is that it works to reduce costs that could otherwise have been incurred by the complainant in a court action in paying for his legal representation; there is here no need for legal representation⁹⁰. Another advantage of this system is that according to section 30O, the decision of the PFA is as binding as a court decision. This means that the complainant can have such a judgment enforced so as to realize his rights or benefits, while still reserving his right to bring a civil action or appeal in the courts of law⁹¹. The Adjudicator enjoys a level of independence in that he is funded by the Financial Service Board in pursuance to section 30U. This is progressive in that the Adjudicator is more likely to discharge of his functions in a transparent, and fair manner to the extent that there is the absence of undue influence. The specific allocation of funds to the work of the Adjudicator will enable the Adjudicator to work independently without fear or favour. Furthermore, the Adjudicator is required to submit annual financial reports to the Minister, which is an effort to the furtherance of accountability.

The Pension Act of the United Kingdom (UK)⁹²

The UK Pension Act provides various progressive clauses that are designed to enhance the efficiency and profitability of pension schemes in the UK. Some of these provisions include; the power of the Regulator to recover unpaid contributions⁹³, the Investment of funds⁹⁴ and the

⁸⁹ Section 30 D

⁹⁰ Section 30K

⁹¹ Section 30P

⁹² CAP 35 of the Laws of the United Kingdom

⁹³ Section 17

⁹⁴ Section 113

Investment principles⁹⁵, reviews, appeals and mal administration review by the Pension Board⁹⁶, and the establishment of the Pension Protection Fund Ombudsman (PPFO) whose mandate is to look into complaints of mal administration⁹⁷ of the pension funds.

Section 17 provides for the powers of the Regulator of pensions to recover unpaid contributions;

“(1) Where any employer contribution payable towards an occupational or personal pension scheme is not paid on or before its due date, the Regulator may, on behalf of the trustees or managers of the scheme, exercise such powers as the trustees or managers have to recover that contribution”.

This provision ensures that the employer adheres to his duty to remit his pension contributions to the scheme. The essence of this section is to avoid a situation of letting employers have backlogs in paying these contributions, such that even in an event of the employers’ business becoming bankrupt, the pension benefits will still be available to the members as this money will already be in the scheme fund. Furthermore, failure by the employer to make his contribution would mean that members’ funds are not placed into investment ventures aimed at increasing the value of his pension assets, thus prejudicing the member.

Section 90 of the Act provides for Codes of practice by which the managers and trustees of pension schemes must abide by. Subsection (1) provides that the Regulator may issue codes of practice, *“(a) containing practical guidance in relation to the exercise of functions under the pensions legislation, and (b) regarding the standards of conduct and practice expected from those who exercise such functions.”* This is a way by which the Regulator may monitor the activities of managers and thus ensure that the pension schemes are managed effectively. The success of such an objective is to ensure that there are regular checks and that the Regulator has sufficient enforcement powers. Section 74 provides for the inspection of premises in respect of employers’ obligations to ensure that the employers carry out their duty of facilitating access to stakeholder pension schemes. Premises are liable to inspection if the inspector has reasonable grounds to believe that employees of the employer are employed there, documents relevant to the administration of the employer’s business are being kept there, or the administration of the

⁹⁵ Section 114

⁹⁶ Chapter 6

⁹⁷ Section 214

employer's business, or work connected with that administration, is being carried out there⁹⁸. This provision is meant to ensure that employers do in fact facilitate pension schemes for their employees, but this will only work if there is also a strong enforcement provision in this vain.

The Act provides in Section 114 for Investment principles that must cover inter alia, the trustee's policy for securing compliance with the Act, the kinds of investments to be held, the balance between different kinds of investments, risk, the expected returns on investments, and the realisation of investments. These principles or guidelines reflect the areas in which investment ventures must take place. The issue of investment has not been restricted to listing the areas where funds can be invested and as such gives more flexibility to managers and trustees of pension schemes to enter into economic sectors that may be very viable. This flexibility is progressive in the sense that in consultation with an actuarial evaluation, a fund manager may invest in economic sectors that will yield the highest returns on the investment, and this may even include overseas investment.

The establishment of the Pension Protection Fund Ombudsman in Chapter six is an essential provision for the effective regulation of pension schemes. It is a body established to investigate cases of mal administration of the schemes, thus the PPFO ensures that the funds of the members are protected. It ensures that pension schemes are run efficiently and for the benefit of its members. Also the 1995 Act provides that trustees of occupational pension schemes have to adopt internal dispute resolution procedures (IDR), which must cover disagreement between the trustees and members, prospective members, widows, widowers and dependants.

The Retirement Benefit Act of Kenya⁹⁹

The retirement benefit Act of Kenya provides for a clear and broad definition of a retirement benefit scheme. The Act defines retirement benefit scheme as, "any scheme or arrangement (other than a contract for life assurance) whether established by a written law for the time being in force or by any other instrument, under which persons are entitled to benefits in the form of payments, determined by age, length of service, amount of earnings or otherwise and payment primarily upon retirement, or upon death, termination of service, or upon the occurrence of such

⁹⁸ Subsection 2 (a-c)

⁹⁹ Act No. 3 of 1997 of the Laws of Kenya

other event as may be specified in such written law or other instrument.” Also in aiming to protect the benefits under such a scheme the Act provides in Section 36 for the protection against attachment of scheme funds:

“Notwithstanding anything to the contrary contained in any other written law, where a judgement or order against a member of a scheme is made, no execution or attachment or process of any nature shall be issued in respect of the contributions or funds of the member or his employer except in accordance with the scheme rules and such contributions shall not form part of the assets of the member or of his employer in the event of bankruptcy”.

This provision aims at insulating the retirement benefits from any tampering in an event that the employer’s business becomes insolvent. The employer is thus treated as if he was a guaranteed creditor whose funds are secured from claim by other creditors. In the same vain, Section 38 places restrictions on the use of pension scheme funds to the extent that no scheme funds shall be used to make direct or indirect loans to anyone, or invested with the view to secure loans¹⁰⁰. While subsection (2) empowers the Retirements Benefits Authority to disqualify any person in contravention of these provisions from participating in the management, custody and administration of any scheme fund. This is a practical and adequate sanction that is likely to encourage adherence to the provisions of the Act.

With regards to the investment of scheme funds the Act in Section 37 requires that every scheme must have a prudent investment policy on the investment of funds of the scheme. Subsection (2) provides that the investment policy of a scheme shall be implemented subject to any regulations the Minister may, in consultation with the Authority, make for that purpose. These regulations have been listed in Table G that provides for categories of assets against the maximum percentage of aggregate market value of total assets of the scheme or pooled fund. Some of the categories of assets include; offshore investments in bank deposits, government securities, quoted equities and rated Corporate Bonds and offshore collective investment schemes, which have a maximum allowed percentage of 15%; another category of assets includes Guaranteed Funds at 100%; and a maximum percentage of 70% allowance is reserved for investment in Kenyan Government Securities and preferential shares and ordinary shares of companies quoted in a

¹⁰⁰ Subsection (1)

stock exchange in Kenya, Uganda or Tanzania. The essence of giving guidelines is to ensure that the types of investments embarked on are economically viable and to ensure higher returns. These guidelines however are not restrictive in that they do not limit the investment opportunities but rather leave it open to a scheme to be able to undertake a combination of investment options.

The Retirement Benefit Act of Kenya also details the contents of an actuarial review report as provided in Table AR. For example, Section 9 provides a description of the basis employed in calculating the actuarial value of the accrued liabilities together with adequate particulars to this end. In particular this inter alia includes¹⁰¹:

“A statement of how member’s individual liabilities have been determined”, and “the appropriateness of the methods used to distribute investment returns to individual members’ accounts and the various reserves of the scheme. Comments on the equity of the distribution where this differs between category of members”.

While Section 13 states that the actuarial report must include comments on the appropriateness of the investment policy being followed, and the quality of the investments, in relation to the scheme’s liabilities, taking particular account of the method used to accrue investment returns to individual member accounts and the communication of the investment risk to the member. These provisions are very beneficial to the administration of a scheme in that the actuarial evaluation of a scheme will be specific and focused on the needs and constraints within that particular economy. These sections take into account the need of determining the individual’s and not an aggregate level of liability which is likely to show the pensioner’s financial position with respect to the level of his benefits. Furthermore there is here an emphasis on the education or communication to a member of his investment risk, which would place him in a position to determine how much he is likely to acquire or lose from the investment.

It is clear from the analysis of the pension legislations of the UK, South Africa and Kenya that these countries have encompassed provisions that operate as safeguards for the funds held by pension managers. The idea is to ensure efficient operation and management of the schemes, while providing for the necessary checks and balances through effective enforcement provisions.

¹⁰¹ Subsections (a) and (d) respectively.

CHAPTER FIVE

RECOMMENDATIONS AND CONCLUSION

Introduction

From the preceding chapters on the examination of the pension industry in Zambia it is clear that the performance of pension schemes as effective financial service providers has been disappointing. This situation has been occasioned by numerous problems that pose serious threats to the sustainability, growth and efficiency of pension schemes. Unfortunately there are no easy solutions to the problems of the huge deficits of the PSPF and the LASF, and of the complacent behaviour exhibited by government in making their contributions to these funds. Furthermore, the availability of limited investment outlets and consequent poor investment returns have weakened the efficiency of the pension schemes. The sustainability of the pension schemes and the NPS in particular are in doubt as this is dependent on a substantial increase in the contribution base in the years to come, which may be severely hampered by the adverse effects of HIV/AIDS. A shrinking formal sector is worrying in this regard. The growth of the pension industry is contingent upon adequate legislative provisions, a deliberate government policy to ensure pension growth, an effective regulatory and enforcement agency and the inculcation of the importance of pension participation in the minds of ordinary Zambians.

Recommendations for reform of the Pension Industry in Zambia

The bedrock of any meaningful improvements to the pension industry is to ensure that the legislative provisions that give effect to the pension schemes are adequate, clear and largely harmonized. Thus, to this end, it is recommended that the amendments hereunder be effected to the various statutes concerning pension schemes.

The Pension Scheme Regulation Act (PSRA) as well as the Amendment Act must be strengthened and less ambiguous. For instance the amended Act must address issues of the Pensions and Insurance Authority's (PIA) regulatory powers over all pension schemes without any exceptions. In this regard the PIA should be an independent body reporting to Parliament and not to the Ministry of Finance especially when at present the responsibility of NAPSA falls under

the Ministry of Labour. If the PIA becomes answerable to Parliament this would ensure independent allocation of resources in the Parliamentary budget. However since budget allocation is the duty of the Ministry of Finance, it may be advisable to reserve some managerial positions in the PIA to a delegate of the Ministry of Finance. It is not necessary to encompass the Ministry of Labour provided that there is adequate protection in the PSPR ensuring mandatory pension provision to be effected by an employer either privately or under the compulsory NPS. “A clear and transparent regulatory process would lead to greater demands on all pension schemes¹⁰²” and consequently enhance general understanding of pension schemes among contributors and the general public.

The PIA must be deployed with the tax collection department of the Zambia Revenue Authority (ZRA) so that it takes up the duty of pension contributions collection, for and on behalf of the PIA. This would result in substantial savings in administrative costs of the PIA because the enforcement function would be passed on to the ZRA. This is for example the process followed in the UK and the USA where the Inland Revenue is responsible for collecting national insurance contributions along with taxes. In addition, the PAYE¹⁰³ taxpayers are by definition employees who should be NPS contributors. Such information at the disposal of the PIA would enable it to ensure that all these employees are contributors to NPS¹⁰⁴. Another progressive step would be to have a legislative provision requiring all pension schemes to be run at efficiency levels much like those of bank financial services. To this end the Bank of Zambia (BOZ) should act as a ‘checking’ agency on the pension fund assets, and management techniques to ensure that they operate at economically viable standards. Thus the BoZ in consultation with the PIA can set guidelines on the standard and level of operation needed in line with those of other financial services, while accommodating the special characteristics of the pension industry.

Dispute settlement and deciding appeals must be via an office created within the PIA, i.e. there must be provision for an internal tribunal under the auspices of the PIA to make provision for a cheaper channel for dispute settlement, as opposed to the court system. Also, establishing a

¹⁰² This would enhance accountability and efficiency of the pension scheme as it would place the duty on pension schemes to provide annual reports to all members, provide statements etc.

¹⁰³ Pay As You Earn, the process by which taxes are deducted at source from wages.

¹⁰⁴ In 2002, according to the World Bank Financial Sector Assessment Program, it was observed that there were 500,000 PAYE taxpayers, but only 334,000 NPS members.

pensions' ombudsman much like the one in the UK, or the Adjudicator much like the South African one would be very instrumental in ensuring that mal administration of pension schemes is curtailed.

A common problem in the pension industry has been inadequate investment outlets and returns. Thus, all pension laws must be amended to provide for the development of investment guidelines for pension schemes. The sole objective of pension fund investment should be guided by the fiduciary responsibility to serve the interests of pensioners. Thus investment managers must be allowed to invest in the asset class that offers the most secure real return. The guidelines should provide for broad provisions that may be altered from time to time taking into account changing economic factors and considering actuarial evaluation of risk in certain market sectors. For example the curtailment of overseas investment must be justifiable on real economic grounds. Thus as is the case in Kenya and the UK, the PIA must improve current guidelines (which must be regularly evaluated as the market fluctuates) by which pension scheme managers may invest the scheme' assets for the purpose of increasing the value of a members' benefits. This will ensure that investment strategies are in line with economically viable projects. This will also help to make the pension industry more competitive and thus more efficient.

The issue of tax and its effect on pension schemes must be dealt with by amending the Income Tax Act¹⁰⁵. The Act should make special provision for collective investment schemes and investment companies. These derive substantially all of their income from distributions received from other companies on which tax has been paid, and thus no additional tax is payable by the ultimate beneficiary when the investment company itself makes a distribution. This is typically achieved by treating certain types of companies as tax exempt or by treating investment income received by a company as income on which tax has already been paid. This would ensure that investment schemes such as pension schemes (especially the occupational ones) are not subjected to a 'double' tax¹⁰⁶. Zambia can adopt the South African position by which the Financial Service Board imposes various levies on the fund management activities and not on the scheme assets. Alternatively the VAT¹⁰⁷ regime should introduce some selective treatment on pension activities.

¹⁰⁵ CAP 383 of the Laws of Zambia

¹⁰⁶ I.e. tax deducted from employer on contribution money, and tax deducted when paying out the pension benefits.

¹⁰⁷ Value Added Tax

Pension schemes must be zero rated to reduce the cost of management. Furthermore, it has been suggested that for the occupational schemes to benefit from the maximum tax deductibility, the individual contributions must be increased. The maximum tax allowability for individuals' contributions should be increased substantially, i.e. to the actual 15% of pay per month, if government is to encourage savings in the form of pension contributions at the individual level and in the form of pension funds at a macro level.

As an essential human right it would be progressive to make legislative provisions that support the spirit of a guaranteed pension or gratuity and ensures priority payment of benefits in the event of bankruptcy or winding up of an employer's business. In this regard the provision of pension schemes should not only be the reserve of formal sector employees but should also be available for the informal sector. There should be compulsory membership to a pension scheme for all income earners. Such participation it is suggested can be monitored through the ZESCO accounts. This of course should be a starting point only, as there is a greater need to educate people on the benefits of maintaining a pension fund, so that people will freely and willingly join such schemes. Also incorporating the Kenyan provision on establishing the requirement of an actuarial review report would be most helpful in that specific details of pension schemes can be looked into especially in view of the fact that many of the actuaries contracted to evaluate pension schemes in Zambia are foreign firms. There is also need for the PIA to ensure that adequate and appropriate information is communicated to the members of the fund informing them of their rights, benefits and duties in terms of the rules of the fund.

Conclusion

Firstly, the paper gave a general overview of the pension industry in Zambia, giving a historical background of the development of pension schemes in Zambia bringing it up to date with the current position of pensions in Zambia. The paper went on to analyse the importance and rational of providing for pension schemes, giving both an international and national perspective.

Furthermore, paper made an assessment of the issues and constraints undermining the efficiency of the pension schemes, with the view of ascertaining how these issues have adversely impacted on the performance of pension schemes. There was an identification of which problems have

been a recurring phenomenon and how these constraints can be dealt with to promote the growth and efficiency of the pension industry. An important observation was made over the fact that government pension schemes have been crippled by the failure of government to make substantial contributions to these schemes. The paper highlighted the need to have stronger legislative provision to ensure that the government adheres to its duty to make such contributions. The other issues that must be dealt with included the broadening of investment opportunities open to pension schemes as a way of encouraging greater returns on invested funds.

In order to upgrade the efficiency of the pension industry, it was observed that there are various reforms that need to be undertaken in this regard, and in this vain the paper undertook an assessment of the legislative provisions of the pension industry in Zambia as this forms the basis and foundation upon which the growth and development of the pensions industry may be achieved. An observation was made to the effect that all the laws pertaining to pension schemes needed to be amended and harmonised so as to create a unified pension industry, under the regulation of one regulatory body. And that such a body must be sufficiently provided with enforcement mechanisms to ensure strict regulation and observance of the pension legislation on the part of pension scheme managers as well as on the employers to fulfil their obligation to make contributions to these schemes. In making these reforms to the pension legislation in Zambia, it was determined that assessing the legislative provisions of other countries' pension schemes would be most beneficial to the extent that the Zambian legislators could import some of the more progressive provision while, specifically tailoring them to suit the economic condition in Zambia. The rational for this is that such reforms would ensure greater efficiency in the pension schemes by making them as competitive as the pension schemes of other countries, while providing sustainable financial services for the people of Zambia.

In addition the paper has also acknowledged the role of the judiciary in promoting and protecting the benefits available from the pension schemes to a member. Generally the Courts have tended to uphold the rights of the member by ensuring that his pension benefits are not unjustifiably taken away from him. Finally the paper provided for recommendations on the reforms to be adopted in order to make the pension industry in Zambia less open to risk and more inclined to growth and sustainability.

The general outlook of the paper has been to assess how pension schemes as a financial service, may be reformed to improve their effectiveness and to ensure sustainability. Also the purpose of the paper has been to highlight the importance of providing for pensions in a developing country like Zambia. There has been a strong emphasis on the need to recognise such provision as a basic human right that must be among the priority policies of the government. In this regard it has been recommended that the PIA as a regulatory body must be specifically funded by Parliament and must report to parliament, while the ZRA must take up the job of collecting pension contributions in the same manner as it does with other taxes. Also the paper has recognised the need to improve the level of education of the local Zambian on the importance of maintaining a pension scheme as a tool of empowering oneself for the less productive years of one's life.

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