

Managing Pension Funds in Zimbabwe: Ethical Issues and Challenges

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This article is motivated by the predicament that hit pensioners in Zimbabwe following the introduction of the multi-currency system. Zimbabwe experienced economic woes which rendered the Zimbabwean dollar worthless and consequently necessitating a switch to stable currencies. The pension assets and liabilities were invested in the local currency before the currency reform, and the result of the multi-currency system was a mismatch of the assets and liabilities of the pension funds financial position which led to paltry pension benefits. The nature of pension funds places a great responsibility on the stakeholders who are involved in running these schemes and therefore ensuring that reasonable expectation by beneficiaries is met. The article focuses on the core aspects surrounding the structure and managing of pension funds in Zimbabwe. The researcher investigated the roles of important stakeholders in the Zimbabwean pension industry, namely, government, trustees, investment managers, and actuaries. The article further delves into the ethical issues and challenges faced by those managing Zimbabwean pension funds. The researcher conducted a total of 30 personal interviews to collect primary data from professionals in the Zimbabwean pension industry which were split as follows: 10 trustees, 10 investment managers, and 10 actuarial consultants. Secondary data were also used in this study and it comprised of journals, newspaper articles, investment reports, and textbooks. The researcher recommends that pension funds develop sound corporate governance mechanisms that will encourage the best ethical practices among all of their stakeholders. The findings provide evidence for a need to empower pension fund trustees through training and introduction of a pension protection scheme. In addition, the current regulatory system needs to be reviewed to capture the changing economic environment upon which pensions funds operate.

Keywords: pension fund ethics, stakeholders' roles, administering pension funds

Introduction

A pension fund encompasses a collection of investment assets which comprises of financial assets (such as money-market securities, bonds, loans, equities, and collective investment vehicles), real assets, derivatives, and alternative investments (Blake, 2006). Employers set up pension funds because they offer significant tax advantages, assist employees in saving for their retirement, aid employers hiring the type of employees they want, increase productivity, and they can be used as a severance pay to help restructure the workforce by promoting younger employees to positions of greater responsibility occupied by older employees whom the

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employers want retired (Baker, Logue, & Rader, 2005).

The main types of pension funds which are available to members include defined benefit and the defined contribution funds. The defined benefit fund promises a guaranteed income to the retiree which is determined by a formula devised by actuaries. The formula is found in the pension rule book which governs how the defined benefit fund is managed and each pension fund has a unique formula. The guaranteed income can be a fixed monetary value for example US\$10,000 per year given to the retiree as long as he/she is alive, and it can also be a percentage of the ultimate salary before retirement. In contrast, a defined contribution fund operates as a collection of individual investment accounts which depends on contributions (employer and individual) to the account during the career lifetime and the investment returns earned from investing the contributions. On retirement, the income would be the amount which an individual has accumulated in the individual investment accounts.

The quest of providing retirement income is affected by the risks spelt out in Dodge, Laurin, and Busby's (2010) work. Five risks were identified, namely, political risk, longevity risk, investment risk, inflation risk, and low replacement ratio. Political risk refers to the risk that retirement income will be cut as a result of changes in the governing system before an individual reaches retirement age. Longevity risk is the possibility that the retiree will outlive the amount reserved for retirement income. Investment risk emanates from a mismatch between actual and expected investment returns, particularly when actual investment returns are lower than expected investment returns used in the provision or valuation, the retirement income will consequently be lower. Inflation risk is defined as the erosion of the purchasing power of retirement income due to the continuous rise in the general price levels. A low replacement ratio is a result of income received after retirement being insufficient to secure the same standard of living enjoyed from the income in the pre-retirement period.

By the end of 2008, Zimbabwe introduced a multi-currency system which enabled foreign currencies to be used as a medium of exchange. This was a result of the hyper inflationary environment that rendered the Zimbabwean dollar useless. Unfortunately and regrettably, the pension industry has not been insulated from woes of currency collapse. The primary objective of any pension fund is to provide financial security to members and beneficiaries in the event of retirement. However, pension funds in Zimbabwe have become unable to meet the pensioner's reasonable expectations in recent years and have resulted in an outcry from pensioners.

In terms of Zimbabwean dollars, payments for retirement income and the total accumulated amount were so large running into quadrillions. After the currency conversion most value came to as low as nothing (Mphambela, 2012). The economy of Zimbabwe was plagued by immense hyperinflation, for instance in July 2008 the official annual inflation rate was 231 million percent (McGreal, 2008). This made the adoption of a foreign currency as the medium of exchange inevitable. It no longer made sense to trade and invest in the local currency as prices were escalating rapidly. The impact of hyperinflation was evidenced by the destruction of the formal economy which consequently led to severe poverty. Wages, salaries, and pension payments were unable to meet basic living costs of the country's citizens. Savings including pension accumulated over an individual entire career were reduced to zero (Newsday, 2010).

As a way of dealing away with hyperinflation and bringing stability in the economy, the Minister of Finance introduced the multi-currency system in his 2008 National Budget proposal. The announcement made it possible for companies to remunerate their employees in foreign currency and enabled the Zimbabwe Stock

Exchange (ZSE) to start trading equities in United States Dollars (USD). The multi-currency regime meant that members of pension funds would now be able to make contributions in foreign currency in USD. Due to the total collapse of the Zimbabwean dollar, no suitable exchange rate existed and a way of converting accumulated member credit and pension payment had to be found. After the conversion, the pension payments were so low that beneficiaries complained about their values and queried where their lifetime savings had gone (Newsday, 2010).

In 2011, two years after the currency conversion, pension funds continued to have low accumulated values as evidenced by low pension fund assets (Madera, 2011). This situation has not been helped by the continued poor performance of the stock market, the ZSE as elucidated in a report entitled *Zimbabwe Investment Outlook 2011 and Beyond*, in which it was reported that the industrial index declined by 0.47% whereas the mining index rose by 8.03% for the year ended 31 December, 2011 (MMC Capital, 2011).

The minimum pension that was being paid by the National Social Security Authority (NSSA) was US\$25 (Muzondo & Diura, 2011), whilst the minimum pension for pension funds governed by the *Pension and Provident Funds Act* of 1976 chapter 24:09 was set at US\$10 (Mphambela, 2012). The minimum pension figures are below the poverty datum line of US\$500 per month. One of the pension funds issued a notice that it would be unable to meet pensioners obligations every month (Herald, 2011a). Whilst as a result of low pension values, some pension funds had to resort to paying full commutations which is a process of converting the entire annuity pension payments into a once-off payment, while others had to inject money to boost retirement income. It is the case of the aforementioned that pension funds are failing to meet pensioners' reasonable expectations and consequently making old age poverty a reality for the greater populace.

Globally, the issue of ethical behavior has gained attention, especially after the Enron scandal where senior management as a result of corporate greed, were involved in fraudulent activities despite the presence of legislation. Existing legislation at the time failed to control the behavior of market players resulting in the American government enacting the *Sarbanes-Oxley Act* of 2002 (H. Rockness & J. Rockness, 2005). The Enron saga highlighted the challenges pension fund members face in saving for their retirement, particularly lack of disclosure of critical information by trustees, the importance of regulation in protecting members and the impact investor education in managing pension funds (Walker, 2002). Pension funds account for more than 50% of the investments on the Zimbabwe Stock Exchange (Herald, 2011b); as such trustees being the directors of pension funds ought to possess ethical leadership qualities to represent the interests of members (Petrache, 2009). Corporate fraud has been on the increase, where those in the position of fiduciary trust act dishonestly and deceive the public resulting in financial gain by perpetrators (Gore & Murthy, 2011). This calls for pension fund regulations to be instituted to deter such unethical behavior. Drawing from international lessons, Zimbabwe corporations and investors should realise that they are not immune to unethical behavior. The failures of pension fund trustees to meet the requirements of members have tainted the confidence, efficiency, and effectiveness of pension funds which is a requirement for good ethical governance.

The aforementioned body of evidence illustrated how unethical behavior by individuals and entities threaten the survival of pension funds. It is on the premise of the mentioned facts that the researcher investigated the Zimbabwean pension fund management system to unearth the challenges and ethical issues involved.

Research Objectives

In light of the above and based on the researcher's experience as of an actuarial consultant in the Zimbabwe pension industry. The objective of this article was to identify and discuss the ethical issues and challenges present in the provision of pension fund management in Zimbabwe. The findings of this study will contribute to the body of knowledge on ethical issues in the Zimbabwean pension industry and will provide recommendations to stakeholders in the industry.

The next sections of the article will focus on the research design and methodology adopted in this study as well as a brief literature overview. Conclusions and recommendations will be provided in the final section of the article.

Research Design and Methodology

The researcher analysed both secondary data and primary data. With regard to the former the researcher consulted various secondary literature sources, namely, academic journals, newspaper articles, investment reports, and textbooks. With regard to the collection of primary data the researcher carried out in-depth interviews with different stakeholders in the industry including trustees, investment managers, and actuarial consultants. The interviews carried out were both telephonic and personal.

An interview schedule was prepared to facilitate the interviews. The schedule was in the form of closed questions. A total of 30 interviews were done. An equal number of stakeholders were interviewed that is 10 for trustees, 10 for investment managers and 10 for actuarial consultants.

Literature Review

The next sections provide a brief literature overview on the roles of the stakeholders involved in pension fund administration and contextualising the theory to the Zimbabwean context.

The Role of Government

The primary role of the government is to regulate the provision of pension funds. Regulation impacts pension funds through requiring certain benefits to be provided, certain proportions of assets to be held, and restrictions on the type of assets to be held (Sweeting, 2011). In Zimbabwe the statutes governing pension funds are *Pension and Provident Funds Act* Chapter 24:09 of 1976, Insurance and Pensions Commission Act Chapter 24:21 of 2000, and the NSSA Act Chapter 17:04 of 1989 upon which NSSA is established. The acts overlook the risk nature of the pension funds and hence this makes it difficult to achieve effective protection of members and beneficiaries. The regulatory aspects of the acts must target to achieve a sufficient and stable pension funding level to ensure that the members and beneficiaries benefits are secure. Although the Pension and Provident Funds Act Section 19 looks on how to deal with unsound funds, it does not create conditions for encouraging ethical pension fund management.

Retirement system reforms are one of the highest priority policy issues of the developing world (Mitchell, 1997). In her article she argues that a country's ability to construct a market and regulatory environment supportive of its pension system powerfully influences the chances of pension system success. She also states that an effective retirement system reform plan should seek to better protect participants against risks by firstly understanding the source of the risk, secondly, establishing how to avoid and reduce the risks, and thirdly where possible insuring against these risks. Each country faces old age problems specific to its own history and

institutions, but effective reform depends on reducing or insuring against the risks faced by participants in the system. It is argued that while there are many paths to reforming retirement systems, what matters in the end is whether reforms lead to improvement of system solvency, increase adequacy, efficiency and equity, and enhance national saving (Mitchell, 1997).

The two key features for regulating pensions are a consumer or investor protection and macroeconomic considerations (Dickinson, 2001). Individuals through pensions, accumulate sizable savings which deem it necessary for the government to put in place regulatory bodies to monitor enterprises supplying these financial services. This is to ensure that these companies are able to meet their long term promises to customers which otherwise they may not be able to meet for some reasons that include incompetence or dishonesty of management.

The Role of Trustees

The role of the trustees in a pension fund includes controlling the pension funds assets through use of prudent investment and safe custody of the assets (Mureriwa, 2011). They also act as custodians of members records and accounts for schemes and ensuring that benefits are paid in line with the fund rules. They also have discretionary powers enabling them to declare bonuses and grant additional benefits. There are two types of trustees: the member elected trustee and the independent trustee. The difference lies in choice, member elected trustee have an option to be or is not a trustee whereas the independent trustee has taken up a trustee as a professional career. According to the respondents, a majority of pension funds in Zimbabwe has member elected trustees who happen to be employees of the sponsoring company. Being a trustee is a noble and responsible position (Latchman, 2012). The trustees have a duty to simplify, they do not tempt and encourage the wrong behaviour, and they appreciate and embrace the diverse cultures and differences. They have a role to be sincere without compromising on business, fiduciary, and member imperatives. The boards of trustees are the directors of the pension funds, and as such, they have the power to ensure good ethical and governance practices in the same manner as with directors for companies.

The Role of Investment Managers

The main determinants of the investment performance of the pension fund industry can be grouped into three categories investment regulations, investment practices, and the ability of investment managers to diversify their portfolios abroad (Chan-Lau, 2004).

An investment manager is an individual who, or company which manages the assets in a pension fund on behalf of the trustees of a pension fund. The investment manager can be employed directly by the pension fund or can be an independent organisation under contract to the fund. The roles of the investment manager are: portfolio structuring and analysis by using the trustees objectives and constraints to structure an optimal portfolio, and then analyse the portfolios expected return and risk; portfolio adjustment through selecting the set of asset purchases and sales as circumstances change; portfolio performance measurement and attribution by ensuring the actual performance of the portfolio, identifying the sources of performance, and comparing the performance against that of a predetermined benchmark portfolio; risk management using hedging instruments such as futures, options, and swap contracts to hedge the interest rate, stock market, and currency risks involved in both domestic and international investment so as to manage the investment risk budget set by the trustee (Blake, 2006).

Although investment managers perform the aforementioned functions, they charge a levy which is a fixed

percentage of pension fund assets without specifying or giving a breakdown of the services rendered. The charging structure affects the capability of the pension fund assets to meet its liabilities (retirement benefits to members and their beneficiaries). This creates unethical practices and there is a possibility of a mismatch between the amount paid for and the services provided resulting in the pension fund being overcharged.

The Role of Actuaries

The pension industry in Zimbabwe is serviced by less than 10 firms which offer actuarial services according to the responses by the actuarial consultants. The role of a pension actuary is to advise the pension fund trustees and companies. The pension actuary typically provides advice on; scheme funding by establishing the funds needed to be held in respect of scheme benefits now as well as the funds needed to be paid in the future, investment strategies for selecting the most suitable assets for the funds held in the scheme, scheme designing by deciding the level and form of benefits to be provided to the members, accounting for pensions to determine the impact the pension scheme has on the company's accounts, formulating strategies for managing and mitigating the risks associated with providing pension benefits, affecting the trustees, company and members, corporate transactions by providing advice on the pension aspects of sales or mergers which can have a significant impact and advising trustees, companies and often individual members on complicated options relating to individuals pension benefits (Actuarial Profession, 2012). The Actuaries Code has a significant role to play in promoting best ethical practices. The actuaries and those who employ them have a duty to raise and report unlawful, unethical or improper course of action (Actuarial Profession, 2011).

Findings of Ethical Issues and Challenges Facing Stakeholders in the Zimbabwean Pension Fund Industry

The next sections discuss the ethical issues in pension funds and challenges faced in managing pension funds in Zimbabwe.

Regulatory Reforms

The current regulation framework in Zimbabwe has not been flexible enough to take into account the ever changing trends in management of pension funds. The Pension and Provident Funds Act of 1976 is now outdated despite the amendments that have been made to it. Regulation plays a critical role in reinvigorating the provision of pension environment. There has been a lack of adequate monitoring body or laid down the penalty for flouting. This is particularly important in the protection of pensioners. The opinion poll of 5 December, 2012, indicated that 62.9% rated the services of Insurance and Pensions Commission as poor. According to the interviews data analysed, 63% of the respondents blamed the regulatory environment for the erosion in the value of their pension values and 70% indicated that the regulatory authorities lacked the expertise to monitor the regulations.

Investment Consideration

The Pension and Provident Funds Act Chapter 24:09 states that a registered fund shall at all time hold its assets in Zimbabwe in investments which are realisable in Zimbabwe. Furthermore, Section 18 of the Act allows 10% of the aggregate cost value of all the fund assets to be invested in prescribed assets. The prescribed assets are defined to be in the form of local registered securities which are issued or guaranteed by the state or which are issued by a local authority or statutory body, they could be also in the form of loans approved by the commissioner to a local authority or statutory body.

The implications of the Act are that a pension fund which cannot invest in foreign markets, and also it has to disinvest in higher yield investments so as to meet the statutory requirements with regard to prescribed assets. The challenge with prescribed assets is that there are difficulties to access, even if to be found that are not competitive. The problem is amplified by a shallow financial market; the equities and the property market are the main markets for pension funds, accounting for 75% and more than 50% of total investments respectively (Chitambara, 2010). The bond market and treasury bills are virtually non-existent. The money market is characterized by liquidity challenges.

Evidence from previous studies carried out suggests that holding a portfolio of foreign assets would minimise systematic risk arising from economic performance as compared to holding assets solely in a domestic market (Solnik, 1988, 1998). Furthermore, it is argued that financial markets in developing countries may be poorly developed calling for the need of international investment to access a range of financial instruments; the existence of an active financial market in developing countries may be highly susceptible to policy changes and external economic shocks thereby leading to high inflation that depreciates the values of domestic assets, and if the local currency depreciates as a result of inflation, the real returns of foreign assets will temporarily be boosted (Davis, 2002; Kotlikoff, 1998).

The adoption of prudent man rules is preferred over quantitative restrictions (Dickinson, 2001). Quantitative investment restrictions usually impose a maximum on asset classes or holding in individual investments and are concerned solely with risk characteristics of the investment themselves. They cannot capture the risks associated with mismatching of assets and liabilities, in particular, the risks embedded in the liabilities due to contractual guarantees. Prudent man rules are generally guidelines within which an investment policy should take place. They are less constraining on financial asset choice, therefore allowing investment policy to change with changing liabilities and capital market conditions. Prudent man guidelines are favoured because the quantitative investment restrictions affects the way of optimisation of the asset allocation and securities selection processes leading to sub-optimal return and risk taking (Franzen, 2010).

Shareholder Activism

The responsibility of trustees is to undertake investment decisions in a manner that ensure that pension funds assets meet the liabilities. The trustees can influence the performance of their investments and enhance returns through shareholder activism by monitoring the investment managers, taking part in negotiating directors remuneration. The empirical study revealed that about 7% of the pension funds engage in shareholder activism. This is consistent with existing literature which purports that pension funds should play a crucial role in monitoring management in the companies in which they invest in as this helps to increase returns and where investments are pooled, pension funds have no direct access to the proxy nor do they have right as shareholders in the funds (Lynn & Mulgrew, 2008). The rights are exercised at the discretion of the investment manager thereby taking away the significant shareholder right of the pension fund.

Educating Trustees

The board of trustees for a majority of pension funds is composed elected member trustees who are not aware of the dynamics of pension funds management in particular investment principles (Chituku, 2011). This study has revealed that trustees lack investment expertise to manage pension funds, and this has impacted negatively on the pension funds (60% of the respondents blamed the behaviour of trustees for low levels of retirement income). In addition, the pension funds have no education and training policy to support the skills of

the trustees. This has resulted in the trustees failing to fulfill their mandate of protecting and advancing the rights and interests of members. The finding is similar to documented evidence which highlights that trustees were lacking the necessary investment expertise to appreciate and be discerning clients of actuaries, investment consultants, and fund managers that provide services to them (Crown, 2004).

Lack of Effective Communication

Communication is defined as a transactional process of sharing meaning with others (Rothwell, 1998). This study revealed that information has not been communicated effectively to members of the pension funds. For instance, some pension funds converted their schemes from defined benefits to defined contributions without having consulted their members. In addition, the method used for currency conversion was not communicated to the pension fund members. Most pensioners are not aware what actually happened to their money that they saved during their careers and this is consistency with documented evidence of low financial literacy in developing countries (Miller, Godfrey, Levesque, & Stark, 2009). This creates a moral obligation for trustees to explain the member's investment principles, so that they understand pension fund management. However, the challenge is that trustees lack of the knowledge of the investment issues. Pension funds have tended to be secretive lacking transparency and effective communication with fund members. This has exposed pension fund members and in some cases their rights have been violated. Furthermore, fund members are faced with financial constraints as well as inadequate legal skills to challenge violations. Financial regulators in South Africa, asserts that poor communication by the pension fund may not have a financial consequence but may impair the credibility of the provision of the benefits by the fund and administration of the fund (Financial Services Board, 2007).

Lack of Sound Corporate Governance

About 78% of the respondents attributed the failure of pension funds to deliver on their promise due to a lack of sound corporate governance structures. One of the respondents was of the opinion that the pension funds board must have independent trustees as member trustees seem to be overloaded by work to be answerable to the employer as well as the pension fund. Empirical studies provide evidence that better governance and management structures improve returns on a pension fund (Kim & Stewart, 2011). This notion is relevant because governance policies influence the asset allocation when investing pension funds (Useem & Mitchell, 2000). Trustees in Zimbabwe take trustee business as commitments that can be avoided leaving the management with unlimited powers to make decisions. Pension funds are facing challenges in providing good governance (Pupurai, 2012). This problem is not only in Zimbabwe but also in other countries as well. Most studies carried out have highlighted that good governance benefit pension funds in a number of ways. Good governance minimise the conflict of interests that can arise between fund members and trustees and it creates trust amongst all stakeholders and it also avoids over-regulation and facilitates supervision thereby securing benefits of members (Stewart & Yermo, 2008).

Conclusions and Recommendations

Based on the research findings the paper concluded the following. The current regulatory system is restrictive in that it prohibits pension funds to invest abroad thereby diversifying and hedging risks involved in managing pension funds. Trustees lack of competencies to manage pension funds. Most pension funds do not have a code of conduct to upheld best ethical practices, they are lack of a statement of investment principles to

guide their investment decisions and monitor their investment managers. In addition, they are lack of education and training policy to extend the skills of trustees and a communication policy to transmit information to the members they represent.

Therefore the following recommendations are made:

(1) Review of the current regulatory system regarding pension funds by the Insurance and Pension Commission in liaison with the stakeholders in the pension industry so as to ensure efficient management of pension funds;

(2) The regulatory reforms must make it mandatory for pension funds to have a code of conduct, statement of sound investment principles, and a communication policy. This would promote good governance of pension funds and ethical practices;

(3) Introducing a pension protection fund so as to protect the members' retirement benefits and this assist in guarding against the risk that the pension scheme becomes insolvent;

(4) Empower pension fund trustees through training and educating them on pension fund management. This will equip trustees with knowledge to understand the fundamental regarding the operation of pension funds in this ever-changing and complex financial system.

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