Executive Summary

Background

Previous studies undertaken over a long period of years have identified the weaknesses of existing social security schemes in Zambia. An important aspect of this failure, which has developed progressively and in large part because of the prevailing inflationary environment, is the inability of the major institution, the National Provident Fund (ZNPF), to adequately meet the needs of workers at the time at which they retire from formal employment. Studies initiated with the participation of both n.-O and the World Bank in 1994 and continuing in 1995 developed proposals for the replacement of the National Provident Fund by a National Pension Scheme, which was envisaged as providing a modest level of pension benefits, payable in circumstances of old age, invalidity or (to surviving dependants) death. The system of income protection for workers (in the short-term at least, those employed in the formal sector) should encourage continuing participation of occupational schemes organized through individual companies, on a basis complementary to the national scheme.

A number of steps have already been taken towards such a reform of the major national social security institution, and are described in Chapter 2 of this report. These steps include the drafting and enactment of 2 statutes, 1 of which (The National Pension Scheme Act of 1996) provides the basis for the creation of the proposed national pension scheme, and the other of which (The Pension Scheme Regulation Act of 1996) provides for the regulation and supervision in the occupational pension schemes which will complement the national scheme. These 2 basic statutes are to be supplemented by regulations which must be drafted and approved through the normal legal processes before taking effect. Preparatory work to this end has been carried out within the framework of the project by the Consultant on Planning and Legislation, whose recommendations will be based on accepted international practice, together with the outcome of thorough discussions conducted with the various interested parties in Zambia.

An analysis of the recent financial history of the National Provident Fund, also to be found in Chapter 2, shows the extent to which the capacity of the institution to provide protection against loss of employment income for the formal sector workforce has been undermined by severe levels of price inflation and high costs of administration, which have been inadequately offset by the Fund's investment returns. In addition, the current economic conditions in the country are leading to stagnation, and perhaps a reduction, in the numbers employed in formal sector jobs. The closure of a number of large parastatals, and the need for government to cut its own costs and so to restrict the numbers employed in the public sector, has not as yet been offset by growth in private sector jobs. A major objective of government policy is to provide an economic environment in which such growth may be expected in the future.

The proposed National Pension Scheme

Responding to the recognized weaknesses of the National Provident Fund, the National Pension Scheme Act of 1996 calls for the future needs of workers for protection against loss of income due to the contingencies of old age, disablement or death to be met by a new institution. Existing members of the ZNPF are to be offered the opportunity to exchange their rights under the provident fund for additional pension credits in the new scheme.

Following the initial ILO/World Bank studies, discussions were held amongst the various groups concerned -several departments of government, the employers (as represented by the Zambia
Federation of Employers, ZFE) and the workers (represented by the Zambia Congress of Trade Unions, ZCTU) - in order to establish the most appropriate outline of a scheme design suitable for the current situation in Zambia. A variety of views exist concerning many aspects, not least the scope of the scheme (including the general level of benefits to be provided), the form of the benefits and the level of contributions which can be afforded. These discussions make clear, moreover, that the new scheme must command a level of public confidence which has, over recent years, been lost to ZNPF. In addition, several International Labour Conventions, notably Number 102 of 1952, provide guidance as to the levels of social security provisions which are regarded amongst the international community as representing appropriate targets. Having taken account of these discussions and considerations, this analysis holds that the design of a new scheme appropriate to current conditions in Zambia should offer pensions calculated on a defined-benefit basis and should be financed on a partially funded basis. Detailed discussion of this recommendation is provided in Chapter 3.

The actual parameters of the benefit formula, and recommendations as to the initial contribution rate needed to meet the cost, remain to be decided (together with some subsidiary matters) in the light of the results of the actuarial valuation to which this report relates. These matters are covered in Chapter 4.

**Actuarial assessment**

The actuarial assessment comprises a series of projections of the financial progress of the proposed National Pension Scheme into the future, to enable the year by year costs of benefits and administration to be measured against the available income from contributions and investment returns. The projections depend on data representing the membership and other features of the scheme at the outset, together with an actuarial basis comprising a set of mathematical development factors representing estimates of future economic and demographic conditions. A variety of different, or "variant", possible scenarios for the future development are examined. This is done for 2 reasons. Firstly, it is necessary to consider several possible, different benefit formulae, in order to reach a recommendation (and to indicate the basis for this) as to which formula should be chosen. Secondly, it is highly desirable to carry out some "sensitivity tests" to examine the significance for the results of the valuation of variations in the estimates of future parameters such as interest and inflation rates. The results of all of these analyses are set out in Chapter 5 of this report.

**Conclusions and recommendations**

Chapter 6 sets out the conclusions which are drawn from the actuarial calculations and offers further comments based on the consultant's observations during the study. The main conclusions and recommendations are as follows:

* **Benefit and contribution levels** - As a benchmark against which to evaluate a range of options regarding levels of benefits and contributions, an estimate is set out firstly on the basis that the rate of contributions at the outset will conform broadly with the existing rate paid to ZNPF. The total rate of contributions would thus be 7 percent of earnings, although the earnings taken into account would be subject to less stringent limits than under ZNPF. The scale of benefits affordable on the basis of such contributions would represent a pension accrual rate of 1 percent of pensionable earnings per year of contributory service. It would nevertheless be desirable to strengthen the funding of the scheme by making a modest increase in the contribution rate at the earliest time which conditions prevail.
The immediate objective of the scheme is to provide a basic level of income support, within the
general framework discussed by the social partners in several fora (including, in particular, the
National Social Security Reform Implementation Steering Committee) over a considerable period
of time. It is also necessary to take account of the affordability of any scheme in the prevailing
economic climate in the country. The scale of benefits represented in the "benchmark" estimate
does not meet the requirements of International Labour Convention 102, Social Security (Minimum
Standards), and being very modest, will not alone provide an adequate standard of living for retired
members. The actuarial estimates therefore include a number of variants based on alternative
benefit formulae which would be sufficient to meet or exceed the requirements of this Convention.
It is recommended that benefits be increased to meet the Minimum Standard at the earliest time
when national economic conditions permit.

* Buy-in option for NPF members - A contributing member of the National Provident Fund who
becomes a contributing member of the National Pension Scheme from the outset should be granted
an option at the date of retirement to exchange his or her rights in the National Provident Fund,
represented by the accumulated balance of the individual member's account, for additional credits
of pensionable service in the new scheme. It is recommended that the rate at which such credits are
granted be 3 months of credited service for each full year of contributions paid to the National
Provident Fund before the inception of the new scheme.

* Credits for "lost" work years - In calculating the pension benefits to be paid to a member of the
new scheme who becomes entitled by reason of disablement, or to the surviving dependants of a
deceased member, it is recommended that partial credit be granted for the member's potential,"lost" years of future service. It is recommended that the rate at which such service should be
credited be one half of the outstanding period until the member reaches, or would have reached,
pensionable age.

* Pensionable and covered earnings - It is proposed that both pensionable earnings (the earnings
to be taken into account in calculating benefits) and covered earnings (the earnings on which
contributions will be assessed) should include (i) basic pay and (ii) all allowances included in
regular employment income. Pensionable earnings should be the average of aggregate covered
earnings over the worker's period of membership in the scheme. Covered earnings should be
subject to a ceiling set at 2 times National Average Earnings.

* Investment of assets - It is of the highest importance that the investments of the new scheme be
managed effectively, on a basis which is accountable only to the requirements of the Board, but
publicized to the members. It is strongly recommended that the scheme seek to utilize the best
available skills in the selection and management of investments. It is probable that this would be
best achieved by delegating these functions on a fixed-term contractual basis to external managers.

* Administrative expenses - It is an absolute pre-requisite for the viability of the scheme that it be
managed with much greater efficiency than has been the case for ZNPF. The cost of administration,
in current Kwacha, must be reduced to a level significantly below that which now prevails. To
achieve this reduction, it is recommended that a mandatory limit be placed on administrative
expenses. After an initial phase-in period, this limit should equal] percent of pensionable earnings.
(If the initial rate of contribution is set at 7 percent, this would mean that no more than 1/7 , or 14
percent, of contribution income could be used for administration.) As contribution rates increase
gradually over time, the limit should be kept in place, resulting in further reductions in the scheme's
rate of administrative expenses compared to contribution income.
A phase-in is necessary because the start-up costs of a new scheme are normally higher than in later years (and in order to allow a reasonable period for the phasing down of NPS operations). Thus, the limit should be set at 3 percent in the first 3 years of the new scheme's operation, 2 percent in the second 2 years, and 1 percent thereafter.

* Indexing of contributions and benefits - An important feature of the scheme design is that the benefits, contribution limits and the assessable earnings entered in each member's contribution record will be adjusted each year by reference to an Index of National Average Earnings. It has become evident recently that the publication by the Central Statistics Office of the tables which should underlie the construction of the index has fallen behind schedule. It is recommended, therefore, that the new scheme should maintain statistics of the average earnings declared in respect of its own members which may be used as a proxy in the event that the CSO figures are not forthcoming as required.