Executive summary

Introduction

This report concerns, in the main, the results of an actuarial assessment of the financial condition of the Zambia Public Service Pensions Fund, which will supersede the Civil Service (Local Conditions) Pensions Fund. This assessment is one of several components of the ongoing project, ZAM/96/002, funded by the United Nations Development Programme and executed on behalf of the Government of the Republic of Zambia by the Ministry of Labour and Social Security, to strengthen social security systems in Zambia. The project as a whole focuses on the needs for training and capacity building at the institutional level, including the formal social security institutions, but also provides for several analytical components. The International Labour Office (ILO) is contracted to provide many of the specialist technical inputs to the project, which include actuarial analysis of several social security schemes.

The financial record of the Fund

The Civil Service Pensions Fund has existed in some form since Zambia gained independence, having developed from even earlier arrangements to provide retirement benefits for government employees. The main features of the Fund were formalised in the Civil Service (Local Conditions) Pensions Fund Act of 1968, which laid the responsibility for administration with the Ministry of Finance. Under amendments passed in 1986 but brought into force only in late 1992, the scheme gained a large measure of administrative and financial autonomy, and the Fund has since existed as a separate entity maintaining its own accounts. Under the Public Service Pensions Act of 1996, the scheme will consolidate the arrangements for several groups of government employees, in addition to the central Civil Service, and will be renamed the Public Service Pensions Fund. It will be supervised by an autonomous Board, the Public Service Pensions Fund Board. (At the time of this assignment, these changes had not yet been brought into force.) The basic structure of the scheme has not been changed greatly by the 1996 Act, although that Act did repeal provisions introduced a decade earlier allowing officers to retire voluntarily after 20 years of service with full pension benefits; and this change has already been applied.

In principle, the scheme is financed by equal contributions from members and the Government as employer, each paying at the rate of 7.25 per cent of pensionable emoluments. However, the Government has not paid the employer's contributions since the separate fund was established in 1992, and although payment has been promised, this will be subject to the findings of an independent assessment of the liability to be carried out on mutually agreed terms. In round terms, the outstanding sum has accumulated to some K.25 billion at book value. Yet if the Fund had been able to invest this money on comparable terms with its other assets, a conservative estimate is that the amount would have risen to at least K.44 billion. The Fund has other assets, comprising equities, real estate, deposits and government securities amounting in value to about K.13.5 billion. The total Fund should therefore amount to nearly K. 60 billion, although the assets available to invest at present are less than one quarter of this sum.

In addition, the legislation specifies that the Treasury should meet a large part of the cost of benefits to those officers who retired early under the special provisions of the 1986 Act. These payments are also in arrears, to an estimated extent of around K.31 billion (including both lump sum and pension liabilities) and have resulted in a long backlog of payments to these pensioners, which the Fund administration considers should not be met from its own current cash flow; these liabilities are not reflected directly in Fund accounts. The scheme will require further modification to conform to the Government's policy that future entrants to the Civil Service should become
members of the proposed National Pension Scheme. The basis for such changes has not yet been decided, and so the present valuation has been based on the existing scheme provisions.

The actuarial assessment: data and basis

The actuarial valuation comprises a series of projections of the financial progress of the scheme into the future. In principle, the financial system applied by the Fund is one of full funding, and the appropriate measure of costs is the long term contribution rate estimated by comparing the discounted values of the yearly flows of contributions and benefits. This procedure also enables estimates to be made of the capital values of the Fund's outstanding liabilities.

The economic basis factors used for the actuarial valuation have been chosen to reflect current and prospective financial conditions in Zambia, while the demographic factors are derived from various relevant external sources. The analytical basis is described in Chapter 3 and details of the technical basis, in Annex B to the report.

The starting point for the valuation projections is the existing membership of the scheme. In theory, a detailed analysis of the demographic profile and earnings distribution can be derived from the Government computer payroll database. In practice, this is far from possible, as a large proportion of the individual members' records are incomplete, lacking correct entries even for items such as the sex of the official. It has therefore been necessary to make this valuation on the basis of data derived from other sources and a series of broad estimates of the distributional factors. The Fund administration itself is able to provide a certain amount of summary information, mainly relating to pensioners, but is awaiting its acquisition of computer equipment to enable it to develop a fully independent record-keeping system.

Results and conclusions

Chapter 4 sets out the results and conclusions of the valuation. The main conclusions arising from the calculations are as follows:

- The valuation estimates show clearly that the cost of benefits to Civil Servants according to the current formula, even after the repeal by the 1996 Act of the extraordinarily generous benefits previously available on voluntary early retirement, is very much higher than can be met in the long term by contributions at the current statutory rates. The total rate of contributions needed is estimated to be about 38 per cent of pensionable emoluments, net of administrative costs, although this figure may be reduced by as much as 10 per cent if a more favourable economic scenario is assumed.

- Similar total costs will be incurred if the provision of benefits continues at current levels, even if this is achieved in the future through simultaneous membership by government employees of both the public service scheme and the proposed national pension scheme.

- The estimates of the value of outstanding liabilities are very substantial. The estimate of the sum required to meet the obligations attributed to the Treasury in relation to voluntary early retirement pensions now amounts to about K.31 billion, and the arrears of contributions owed by the Government to the Fund amount to a further sum which (subject to the conclusions of the separately-commissioned independent review) may be assessed at a minimum amount of K.44 billion.

- Beyond these sums, the Fund bears liabilities, not met by the current rates of contribution, now estimated at over K.500 billion. Successive improvements in the scheme provisions have increased the long-term cost to a very significant degree whilst no corresponding strengthening has been made in the financing arrangements. If the cost is to be amortised through regular contributions, the necessary addition to the joint, long-term contribution
rate paid by the members and employers together is estimated to be in excess of 10 per cent of pensionable emoluments.

- These costs reflect the fact that the CSPF provides benefits at scales which, in relation to the earnings on which contributions are assessed, are extremely generous by comparison with private sector schemes in general and public sector schemes in other countries.\(^1\)

Some further observations of a non-numerical nature which have arisen from this study include the following:

- The pensions paid represent a poor standard of living in absolute terms; the average pension paid from the scheme according to the data supplied is about K. 13,000 per month, or rather less than US$10 per month at the prevailing rate of currency exchange. This reflects the fact that although the scheme benefit scales are "generous" in proportion to earnings, the general level of wages and salaries in Zambia is very low. However, this problem cannot be solved in any very satisfactory way by granting ever higher levels of salary-related benefits in the pension scheme.

- In view, especially, of the imbalance which has developed over many years in the finances of the scheme as a result of improvements to the benefit structure without corresponding financing adjustments, it is of great importance to establish a regular sequence of (triennial) actuarial valuations, the recommendations arising from which must be applied to restore the financial balance.

- In order that future actuarial valuations can be carried out on the basis of reliable information, the CSPF should proceed (as planned) without delay to create a reliable, computerised record-keeping system, independent of the government payroll.

- The record of the Fund in investing its assets since gaining autonomy in late 1992 appears to have been reasonably successful, but it has been severely handicapped in this regard by the large sums due in respect of the employer's share of contributions which have not been transferred from the Treasury. It is recommended that a plan of action be negotiated between the Treasury and the Fund, in order to enable the Fund managers to plan the investment programme on a firmer basis than hitherto.

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\(^1\) Whereas the Zambia Civil Service Scheme provides a pension payable at age 55 accruing at the rate of 1.82 per cent of pensionable earnings per year of service, two-thirds of which is commutable to a cash lump sum, few schemes elsewhere provide a pension accruing at a yearly rate greater than 1.67 per cent of pensionable earnings, which is not generally payable before age 60 or even 65, and few allow more than one quarter of the pension to be commuted to cash.