

1.0 OVERVIEW OF LASF OPERATIONS

1.1 ESTABLISHMENT OF THE FUND

The Local Authorities Superannuation Fund (LASF) was created under Government Notice Number 314 of 1954. The Fund was initially for expatriate officers until the passing of the Local Authorities Superannuation Fund Act Cap 476 in May, 1963 when membership was extended to all permanent officers and employees who were in receipt of a salary or wage of not less than K500.00 per year and who were 18 years but not more than 50 years old. The LASF Act was renumbered Cap 284 of the Laws of Zambia in 1997.

1.2 MEMBERSHIP OF THE BOARD OF DIRECTORS

Statutory Instrument No. 66 of 1998 issued by the Minister of Local Government and Housing in pursuance of Section 41 of the LASF Act.

Cap 284 requires that the Board consists of:

- (i) The Permanent Secretary, Ministry of Local Government and Housing;
- (ii) One member appointed by the Minister from two representatives nominated by the Local Government Association of Zambia;
- (iii) One member appointed by the Minister from two representatives nominated by the Zambia United Local Authorities Workers Union;
- (iv) One member appointed by the Minister from two representatives nominated by the management of the National Housing Authority;
- (v) One member appointed by the Minister from two representatives nominated by the management of the ZESCO limited;
- (vi) One member appointed by the Minister from two representatives nominated by a trade union of the ZESCO limited; and
- (vii) Director, Local Government Administration of the Ministry responsible for Local Government;
- (viii) One member appointed by the Minister from two representatives nominated by the management of the National Pension Scheme Authority;
- (ix) The Chief Executive of the Local Authorities Superannuation Fund;
- (x) One member appointed by the Minister from two representatives nominated by the management of the Lusaka Water and Sewerage Company; and
- (xi) One member appointed by the Minister from amongst the members of the public.

Statutory Instrument No 66 of 1998 (May, 1998), changed the composition of the Fund's Board to include the Chief Executive of the Fund. It also deleted from the

Fund's Board, the four members from organisations external to those belonging to the Fund, who were appointed by the Minister of Local Government and Housing.

By Statutory Instrument No. 74 of 1998 (June, 1998), the Minister expanded membership of the Board to include one member appointed by the Minister from two representatives nominated by the management of the Lusaka Water & Sewerage Company; and one member appointed by the Minister from amongst the members of the public.

The Minister designates one member as Chairperson and one member as Vice Chairperson provided that the Permanent Secretary and Director of Local Government Administration shall not be appointed Chairperson or Vice Chairperson of the Board.

1.3 ADMINISTRATION OF THE FUND

The day to day administration of the Fund is under the responsibility of the Managing Director who is appointed by the Board in pursuance of Section 9(2) of Cap 284.

The Managing Director appoints Directors and Managers in the Fund. The two Divisions, Finance & Pensions Administration and Corporate Services are headed by the Directors while the Departments are headed by Managers. The Departments include Finance & Investments, Contributions & Benefits, Internal Audit, Information Technology, Legal Services, Public Relations and Human Resources & Administration.

Section 5 of the Local Authorities Superannuation Fund Act establishes the Board of the Local Authorities Superannuation Fund as a body corporate with perpetual succession, capable of suing and being sued in its corporate name and with powers to acquire, hold, charge and alienate property, real or personal and with power to do all such acts or things as are necessary for or incidental to the performance of the duties and the exercise of the powers imposed or conferred by the provisions of this Act.

The Fund is under the "sole management and control" of the Board by virtue of Section 4 of the LASF Act.

1.4 OPERATING HISTORY OF THE FUND

The Fund enjoyed a favourable operating history following Zambia's independence in 1964. Contributions from all Associated Authorities were regular and were paid on time resulting in the prompt payment of benefits to retirees and

to all persons who were separated from employment by an Associated Authority for one reason or another. The regular payment of contributions also resulted in the Fund having surplus assets. The surplus assets were invested largely in real estate as there were few investment outlets at that time.

In view of the above, LASF did not have a backlog of retirees in unpaid benefits. In addition, the debt on unremitted contributions did not reflect in the Fund's Financial Statements.

However, operational problems started when various amendments were made to the LASF Act. Details of the amendments are outlined in Section 1.5 below.

1.5 AMENDMENTS TO THE LASF ACT

From 1989, a series of amendments were made to the Principal LASF Act. These amendments greatly affected the operations of the Fund. Specific amendments, their dates and their implication towards the financial position of the Fund are outlined below –

• August 1989 – LASF Amendment Act No. 17 of 1989

This Amendment Act reduced the age for mandatory retirement from 60 to 55 years. It meant that persons who had reached the age of 55 and had worked for at least 10 years would be entitled to full retirement benefits. This resulted in unplanned payments of benefits due to early exit from the membership of the Fund, and in so doing adversely affected the Fund's liquidity position.

The amendment also adjusted the monthly contributions to the Fund from 14% of the individual member's monthly basic salary (7% contributed by the employee and 7% by the employer) to 33% of which the employee now contributed 10% and the employer 23%. This was meant to cushion the increased demands on benefits resulting from members who qualified for retirement due to the reduction in the retirement age.

• July 1990 – LASF Amendment Act No. 14 of 1990

This Amendment Act changed the definition of pensionable emoluments from average monthly contribution for the last 5 years to last annual salary at the time of retirement.

Essentially, a higher annual salary level was now used to calculate a retiree's Gross Annuity upon retirement. The passage of this Amendment Act also had an

effect on the liquidity position of the Fund in that benefits payable were now calculated at a high rate, hence affecting the financial position of the Fund.

• **December 1991 –LASF Amendment Act No. 27 of 1991**

This Amendment Act made it mandatory for all employees who had worked for 22 years to qualify for full retirement benefits regardless of their age.

As a result of the Amendment Act, over 1,200 contributing members retired. This brought immediate claims of Ki .8 billion on the Fund. By the time this Amendment Act was repealed in 1996, over 4,300 persons had filed retirement claims with the Fund and had made claims on the Fund amounting to K13.4 billion.

The Amendment Act completely crippled all investment plans of the Fund as all the funds in LASF Bank accounts and short-term cash deposits were used to offset part of the claims. In 1995, a decision was made to dispose off 50% of the Fund's housing units in an effort to reduce the claims and comply with the Government policy on home ownership.

• **December 1996 –LASF Amendment Act No. 30 of 1996**

This Amendment Act repealed Act No. 27 of 1991. This meant that the previous conditions of retirement at 55 years old and after 10 years of continuous service were brought back into effect.

However, after this Amendment Act was passed, some contributing members who were eligible for retirement on account of having completed 22 years of service had already given notice of retirement. To this effect, Statutory Instrument No. 84 of 1997 provided that any member who was in receipt of a notice of retirement prior to 12th December, 1996, could retire on the expiration of six months from 12th December, 1996. Effectively, members continued to retire until June 1997 on account of 22 years continuous service. This further affected the Fund's liquidity position.

1.6 MEMBERSHIP COVERAGE

The Local Authorities Superannuation Fund is a defined benefit scheme responsible for the pension cover of members in all the Local Authorities (Councils), Water and Sewerage Companies, the ZESCO and the National Housing Authority (NHA). Statutory provision exists for other members to be admitted on application and subject to a favourable actuarial recommendation.

Membership of the Fund is as follows:

Local Authorities 10,450
ZESCO limited 3,265
Water and Sewerage Companies 1,106
National Housing Authority 101

Local Authorities Superannuation Fund 44

Total Active Members 14,966

Pensioners 6,676

TOTAL MEMBERSHIP 21, 642

1.7 FUND OFFICES

The Fund has only one principal office –in Lusaka, Zambia. It has occupied this building since 1985 after having been previously housed at the Lusaka City Council offices. Having its own building has given the Fund a measure of independence in its daily operations.

However, LASF management found the current arrangement to be constraining in that pensioners can only collect their due payment from one place. This often required those pensioners who are located in places that are very distant from Lusaka to make long journeys to collect their lump-sum payments and monthly pension pay-outs. Given the relatively low level of economic activity in most areas outside Lusaka and the corresponding low-income levels, the travelling costs to and from Lusaka can consume a large portion of the pensioner's savings. This significantly lowers the quality of the pension product provided as the pensioner ends up with a very small pay out in absolute and real terms.

1.8 DECENTRALISATION OF THE ANNUITIES

In view of the centralized offices referred to in item 1.7 above, management in its Five Year Strategic Plan identified the decentralization of annuity payments as a goal to be achieved.

During the year 2002, Management concluded discussions with Zambia National Commercial Bank (ZANACO) and Finance Bank to enable the Fund use their branch network for payments of annuities. As a result of the successful conclusion of the discussions with the Banks, LASF has now decentralized the payments of annual pensions. With effect from January, 2003, pensioners have been getting their annuities at the nearest branch in their area. Pensioners do not have to travel

to Lusaka to collect their monthly pensions.

In addition, during the process of developing the decentralization of annuities, management embarked on a programme to update the details of retirees through the registration process where all pensioners were requested to register with ZANACO or Finance Bank in their respective towns. The programme was aimed at upgrading the integrity of the Fund's database maintained at LASF offices' in Lusaka.

1.9 FINANCING OF THE FUND'S OPERATIONS

The operations of the Fund are largely financed out of members' contributions. The contributions are currently at 10% of basic salary for employees and 23% of basic salary for the employers.

The other source of income is investment income. Part of the contributions received are invested in various investment instruments available on the Zambian financial markets. Section 12(i) of the LASF Act permits the Fund to invest in various investment portfolios. The Investment Policy which was formulated by the LASF management and approved by the Board of Directors in May, 2002, further provides the Fund's investment objectives and guidelines on the management of its investment portfolios aimed at achieving investment growth through maximizing returns and minimizing risks.

Lastly, the Government does from time to time give grants to LASF to assist in the paying of council retirees and meet other operations of the Fund.

1.10 COLLECTION OF CONTRIBUTIONS

In terms of Section 20 of the LASF Act, contributions are a first charge on the salary or wages payable to the members of the Fund and are required to be remitted to the Fund with the employer's contributions before the seventh day of every month. In other words, pension contributions are statutory and it is the responsibility of employers to remit such contributions to LASF.

Recovery of the pension contributions from employees without remitting to the Fund is regarded as "theft" and it is a criminal offence. This can result into serious legal proceedings where a pension scheme enforces legal proceedings on defaulting employers.

The current position is that Associated Authorities have continued to default in the remittance of members' contributions to LASF. The persistent and debilitating

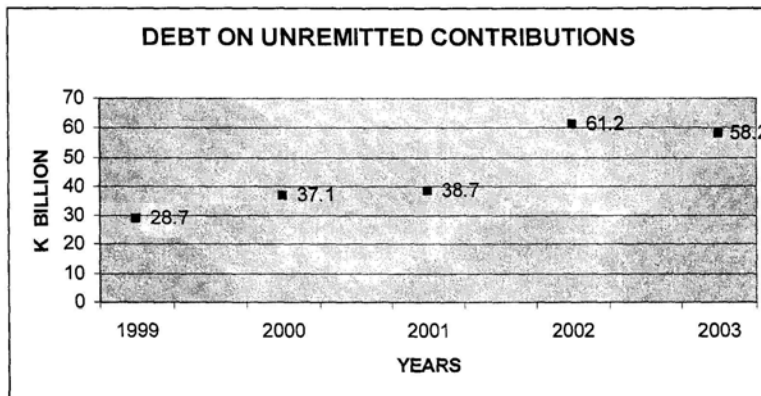
liquidity problems faced by the councils, particularly during the post decentralization era which commenced in 1980 has affected their ability to remit the contributions. Unfortunately, the defaulters list includes also ZESCO which is the biggest contributor.

Over the last five years, the trend as at 31st December each year on unremitted contributions to LASF was as follows:

The debt on unremitted contributions increased by 58% from 2001 to 2002 due to the fact that ZESCO, which is the Fund's biggest contributor had not remitted contributions from January to August, 2002 because it was affected by the change of ownership of the mines from Government to Konkola Copper Mine and Mopani Copper mine. Resumption of contributions commences in September, 2002 after the Government finalized that sale agreements with the new owners of the mines.

As at 31st December, 2004, the total outstanding contributions not remitted to the Fund was K72.3 billion broken down in segments of Associated Authorities is as follows:

1999	2000	2001	2002	2003	2004
K billion	K billion	K billion	K billion	K billion	K billion
28.7	37.1	38.7	61.2	58.2	72.3



Associated Authority
ZESCO
Councils

K Billions
36.9
31.9

Water Boards
TOTAL

3.5
72.3

The only member organization that is current in remitting contributions is the National Housing Authority (NHA). However, it is expected that with the payment plans that LASF has entered with ZESCO, Lusaka Water & Sewerage Company and Councils like Chipata, Chongwe, Ndola, Solwezi and Lusaka the amount of the debt on unremitted contributions is expected to be cleared. The proposal to enter into payment plans is been extended to other Councils. LASF management has also been closely working with the Board and Government to resolve the contribution arrears for the councils through various options such as the debt swaps.

Section 20 (3) of the LASF Act allows the Fund to charge the associated authority concerned 4% interest on the amount unpaid by the seventh day in any month.

1.10 EFFECTS OF NON REMITTANCE OF CONTRIBUTIONS

As indicated in item 1.8 above, the current position is that Associated Authorities have continued to default in the remittance of contributions. The consequence of this situation is that most of the Fund’s operations have been adversely affected in particular the following:

(i) Liquidity Position: The Fund’s actual performance has been below the projected income. This has resulted into LASF failing to meet its financial obligations as planned.

Over the last few years, the actual income against the budgeted income has been as follows:

	1999	2000	2001	2002	2003
2004					
	K billion	K billion	K billion	K billion	K billion
Budget	12.2	16.3	22.7	33.4	37.9
Actual	5.7	6.7	14.4	12.8	35.7
	46.7%	41.1%	63.4%	38.3%	94%
	45.5%				

However, 2003 was a successful year with the Fund collecting a total of K35.7 billion income against a budgeted amount of K37.9 billion representing a 94% performance. The favourable performance was as a result of ZESCO, N}IA and Lusaka Water & Sewerage Company (LWSC) resuming paying current on a monthly basis. In addition, ZESCO and NHA have been paying the contributions arrears on a monthly basis. Out of the K35.7 billion income, K28.2 billion came from current contributions and recovery of contribution arrears. The balance was from investment income, rental income, refundable annuities, grants from Government and other sundry income.

(ii) Settlement of Unpaid Benefits: The non remittance of contributions in particular the councils have resulted into the Fund not paying retirees their benefits on time. This has created a backlog of unpaid benefits. Members who have retired have to wait before they are paid their retirement benefits. By the time they get their benefits, the value would have reduced due to effects of inflation and price increases in the commodities.

Over the last five years, the trend as at 31st December each year on unpaid benefits has been as follows:

2000	2001	2002	2003	2004
K billions	K billions	K billions	K billions	K billion
7.3	10.4	16.0	12.0	22.4

The amount on unpaid benefits increased by 53.8% from 2001 to 2002 due to retrenchments and re-organization at ZESCO, City Councils and Municipal Councils. Most of the Directors and other senior staff in these member organizations were retired to serve on contracts.

(iii) Lack of Investment Growth and Diversification: In the past, the Fund has been unable to build up a diversified investment portfolio due to non remittance of contributions. Although LASF has been building up its investment portfolio commencing 2000, it could have performed much better in meeting its investment objectives set in the Investment Policy and the Five Year Strategic Plan if all contributions were remitted.

(iv) The Fund's Actuarial Position: As a result of non remittance of contributions, the last actuarial valuation conducted in 1997 by a South

African firm of Actuaries revealed that LASF had a deficit of K31.622 billion and the funding level was 29%.

(v) Deferment of Capital Projects: The Fund has deferred capital projects due to liquidity caused by non remittance of contributions. Some of the projects include the development of the commercial plots and acquiring a pension package from software suppliers to back up the in-house developed programmes written by the IT staff.

2.0 THE WAY FORWARD THE LASF FIVE YEAR STRATEGIC PLAN

2.1 THE FIVE YEAR STRATEGIC PLAN

In order to overcome the financial and operational problems that the Fund has been facing as a result of various legal changes, LASF management identified the need to review the operations of the Fund in order to meet the expectations of its stake holders.

In this regard, LASF developed a Five Year Strategic Plan that became effective on 01st January, 2001. The Five Year Strategic Plan identifies the Fund's strategic approach and options between 01st January 2001 and 31st December 2005.

The Five Year Strategic Plan is based on the following principles:

(i) Addressing the Fund's liquidity position: efforts to recover contribution arrears and to ensure Associated Authorities resume regular remittance of monthly contributions have begun and are on—going.

Since the implementation of the Strategic Plan, Management has entered into arrangements with ZESCO, Lusaka Water & Sewerage Company and National Housing Authority to clear the arrears on contributions and resume payments on contributions on a monthly basis. Other options such as debt swaps, negotiations with Government, payments in kind are also been pursued.

Management is also hopeful that the recent approved Decentralization Policy of the local government will improve the financial position of the councils.

(ii) Clearing outstanding benefit payments to retirees and other beneficiaries and improving the overall level of service delivery to beneficiaries: management has set the clearing on unpaid benefits to retirees as a priority.

As a result of measures so far taken in this direction, ZESCO, NHA and Lusaka Water & Sewerage Company have resumed the payments of contributions on a monthly basis and significant progress has been made to reduce the liability on unpaid benefits.

(iii) Improving internal operations: efforts in this area are wide ranging. These include:

- Upgrading the Fund's staff complement by bringing in new staff and sending existing members of staff for further training and development;
- Reviewing the Fund's organizational structure;
- Reviewing operational systems and procedures aimed at improving efficiency;
- Reviewing financial systems and procedures aimed at strengthening internal controls;
- Decentralization of the payments of annuities;
- Upgrading the Fund's information technology (IT) hardware and software to automate as many systems and procedures as possible;
- Improving the Fund's public image
- Review of the LASF Act, changing the name of the Fund, adopting a new logo and mission statement.
- Improving the quality of the annuities product

(iv) Investment diversification: this involves broadening the range of the Fund's investments. The objective is to spread the risk associated with any given investment as well as to increase the bases from which the Fund can draw investment income. Management has made significant strides in this direction via the development of an Investment Policy. The Policy document was approved in May, 2002 and will serve as the basis for the Fund to diversify its investments; and

(v) Intensification of long term survival measures: this will involve changing the Fund's legal framework, minimizing financial and operational risk, ensuring that contributions from Associated Authorities are paid on time and address issues relating to the NAPSA Act;

3.0 ADJUSTING OF THE ANNUITIES

3.1 BACKGROUND

The Local Authorities Superannuation Fund has over 6,500 pensioners who are in receipt of annuities. Members who qualify for an annuity are those who retired from employment and had either commuted 1/3 or 2/3 of the Gross Annuity for a lumpsum benefit. The balance is paid as an annuity until the death of the retiree.

Over the years, the annuities received by LASF pensioners have not been adjusted. This has resulted into the majority especially those who retired prior to 1990 having their annuity pension product lose value due to time value of money.

In this regard, LASF management put in a proposal to adjust the annuities upwards for the first time in the Fund's history.

3.2 RESEARCH ON EXISTING/ADJUSTMENT POLICIES IN THE PENSIONS INDUSTRY

To understand the indexation!adjustment position on annual pensions, the Management of LASF carried out a research at other similar pension schemes. These included statutory pension schemes –the National Pension Scheme Authority and Public Service Pension Fund and private pension schemes –Madison Insurance and Professional Insurance.

3.2 APPROVAL OF THE ADJUSTMENT

Management prepared the report to the LASF Board and the Ministry of Local Government and Housing. The recommendations by Management were approved by the Board and the Minister of Local Government and Housing during the year 2003.

3.3 EFFECTIVE DATE

With effect from 01st January, 2004, all annuities have been adjusted upwards. The new policy is that annuities will be adjusted upwards every three years depending on the financial performance and advice from actuaries.

The adjustment made was increasing annuities to Ki 00, 000.00 for all pensioners who were receiving **less than** K50, 000.00 and increasing annuities for pensioners receiving **more than** K50, 000.00 by K100, 000.00 across the board. The increase for those who were receiving less than K50, 000.00 represents an increase exceeding 100%.

Management is committed to provide a reasonable pension product especially with improved liquidity.

4.0 THE DEBT EQUITY SWAP TRANSACTION

In its Five Year Strategic Plan, the Fund set restructuring of the Council debt through various options such as debt swaps, factoring and other available options

as a strategic priority. In this regard, during the year 2002, LASF made a proposal to recover part of the contribution debt owed by the Councils through a debt equity swap arrangement.

4.1 APPROVAL AND CLEARANCE OF THE PROPOSAL BY THE LASF BOARD AND THE MINISTRY OF LOCAL GOVERNMENT AND HOUSING

At the Board meeting held on 23rd July, 2002, the LASF Board of Directors approved management's proposal to recover the contribution arrears of the Local Authorities through a debt equity swap arrangement. The Board had approved a maximum of **K10 billion** be available for the purpose of facilitating the debt swap.

On **16th** October, 2002, the Ministry of Local Government and Housing wrote to the Ministry of Finance and National Planning giving principle approval that it is in support of the Fund's proposal.

4.2 CONSULTATION WITH STAKEHOLDERS

The Fund made consultations with various stakeholders and regulatory bodies in the securities market in order to establish the procedures involved and legal position regarding the debt swap. The stakeholders and regulatory bodies consulted were the Bank of Zambia, Lusaka Stock Exchange, Securities and Exchange Commission, Zambia Privatization Trust Fund and Investrust Merchant Bank in their capacity as lead managers for the BP floatation.

4.3 RESEARCH ON THE PERFORMANCE OF COMPANIES THE FUNJ) IS IN WHICH LASF ACQUIRED SHARES

Management conducted a research on the performance of the companies in which the Fund was seeking to acquire shares. The report was submitted to the Board, Ministry of Local Government and Housing, Ministry of Finance and National Planning, the Bank of Zambia and other relevant stakeholders.

These companies are:

- BP Zambia Plc;
- National Breweries (Z) Plc;
- Pamodzi Hotels;
- Zambia Sugar Plc; and
- British American Tobacco Zambia.

4.4 JUSTIFICATION FOR INVESTMENT IN ZPTF HELD EQUITIES THROUGH A DEBT SWAP ARRANGEMENT

In making a proposal to acquire Government shares held by the Zambia Privatization Trust Fund (ZPTF) in exchange for the council debt on unremitted contributions, LASF management justified that a debt swap arrangement would be beneficial for the Government, the **Fund** and the Associated Authorities.

A debt swap would be beneficial for Government because it would entail that Government, the Fund's *de facto guarantor*, would not have to spend its limited cash resources to settle the contribution obligations of the Local Authorities and the limited cash resources could be directed towards other sectors of the economy.

The debt swap would also further provide an opportunity to relieve the burden of settling the contribution debt on the Local Authorities themselves. Most Local Authorities are currently not in a position to pay their debts as many are experiencing severe financial problems as a result of a reduction in their revenue bases. This position has been confirmed by recent tours of Local Authorities by officers of the Fund.

Finally, Management was also of the view that, the debt swap would go some way towards alleviating the Fund's own liquidity difficulties. This is because the shares acquired would provide the Fund with an alternative revenue stream through the payment of dividends in the long run and, on appropriate occasions, the disposal of equities on the Lusaka Stock Exchange (LuSE).

4.5 BENEFITS OF THE DEBT EQUITY SWAP

The following benefits were identified and expected to accrue to various stakeholders as a result of the debt swap:

(i) **Diversification of the Fund's investment portfolio:** in the Five Year Strategic Plan, the Fund committed itself to diversifying its investment portfolio so as to increase the bases from which it draws income and to improve its overall liquidity. In 2002, the Fund made significant headway towards achieving this objective via the formulation of a new Investment Policy document. The Investment Policy document was approved by the Investment Committee and the full Board on 16th and 24th May, 2002 respectively. The Fund saw the acquisition of shares through a debt swap as being a major step in diversifying its investment portfolio, a key cornerstone of the Investment Policy document.

(ii) Improving confidence in the Zambian capital market: despite recent signs of greater activity, the Zambian capital market still has significant room for growth. The Fund, by taking up the GRZ shares held with the ZPTF, felt that it would be playing a role in increasing financial market confidence as it is one of the largest pension schemes in the country.

(iii) Improvement of the Fund's investment asset quality: at the time of making the proposal, a large portion of the Fund's investment was in real estate. The property market in Zambia has been experiencing a long—term structural decline and this has somewhat reduced the value of holding property as an investment asset.

(iv) Enhancing Zambian ownership of strategic assets: the Fund was of **the view that it would be** enhancing and supporting Government's policy of empowerment of indigenous Zambians through share ownership, as well as increasing the level of Zambian ownership of major corporate enterprises in the country;

(v) Saving of liquid resources by Government: as previously mentioned, the debt swap would relieve Government, *the Fund's defacto guarantor*, of the burden of having to find liquid resources to settle the debt of the Local Authorities;

(vi) Learning curve for similar transactions in future: the Fund could use the knowledge gained through the debt equity swap to participate in similar debt swap transactions in future years.

(vii) Restructuring the Fund's balance sheet: The Fund's balance sheet will be restructured to a favourable position of increasing its investment assets and reducing the debtors on contribution. The latter has been a doubtful debt for a long time and External Auditors have been asking how realizable the debt was.

4.6 APPROVAL OF THE DEBT EQUITY SWAP BY THE MINISTER OF FINANCE AND NATIONAL PLANNING

On 20 August, 2003, the Minister of Finance and National Planning approved the debt equity transaction and further authorized ZPTF to transfer K7 billion worth of shares from ZPTF account to LASF.

In line with the authorization by the Minister of Finance and National Planning that shares be transferred at market value, LASF and ZPTF agreed to transfer the shares at prices prevailing on the LuSE on the dates of the

transactions.

The share prices on the date of transaction (September, 2003) and the number of shares acquired are as follows:

The acquisition of the Zambia Sugar shares involved **three (3)** different trades at three different prices. The first trade involved 50,000,000 shares and was transacted at a share price of K 33.90; the second trade involved *10,105,773* shares and was transacted at a share price of K 35.10 whilst the last trade of 1,729,512 shares was transacted at a share price of K 34.90.

LASF is now a shareholder in the five (5) companies. The acquisition of the shares will provide the Fund an alternative income stream through the receipt of dividends. In addition, it has provided an opportunity for LASF to start achieving its investment diversification objectives.

4.7 REDUCTION OF PART OF THE COUNCIL DEBT AFTER THE K7 BILLION DEBT EQUITY SWAP

Following the completion of the debt equity transaction, LASF was to reduce the Local Authority debt by K7 billion on the *pro rata* basis agreed upon. Each Local Authority was to be allocated an amount for the purpose of reducing the debt on unremitted contributions.

Since the shares were acquired during September, 2003, outstanding balances as at ^{31st} August, 2003 were used as the basis for reducing the contribution debt of the Local Authorities.

(1) Categories of the Councils

Company	Trade No.	Share Price (K)	No of Shares Acquired	Market Value (K)
BAT (Z) Plc	56/BT/8/3B	139.70	5,000,000	698,500,000.00
B P (Z) Plc	55/BP/8/3B	89.90	28,339,126	2,547,687,427.40
National Breweries Plc	57/NB/8/3B	208.20	700,000	145,740,000.00

Pamodzi Hotels Plc	58/PHI8/3B	149.80	10,000,000	1,498,000,000.00
Zambia Sugar Plc	54/ZS/8/3B	33.90	50,000,000	1,695,000,000.00
Zambia Sugar Plc	72/ZS/9/3B	34.90	1,729,512	60,359,968.80
Zambia Sugar Plc	65/ZS/8/3B	35.10	10,105,773	354,712,632.30
TOTALS	N/A	N/A	105,874,411	7,000,000,028.50

The basis of debt reduction adopted by the Fund was to group the Local Authorities into three (3) categories and allocate a portion of the K7 billion to each category.

The Local Authorities were grouped into three categories as follows:

- City Councils;
- Municipal Councils; and
- District Councils.

(ii) Amounts Allocated to Each Category

The allocation of the K7 billion was as follows:

- District Councils K3.5 billion
- Municipal Councils K2.5 billion
- City Councils Ki .0 billion

TOTAL K7.0 billion

4.8 BENEFITS RECORDED AFTER CONCLUSION OF THE DEBT EQUITY SWAP

Since the acquisition of the shares following the conclusion of the Debt Equity Swap, the following benefits have been recorded:

- (i) The Fund has so far received dividends over Ki billion. The dividend income has been applied towards the paying of benefits and pensions;
- (ii) The shares have recorded capital gains in excess of about K5.8 billion from the time the shares were acquired in September, 2003;
- (iii) The asset that was non performing in the Balance Sheet has been translated into a investment asset that is realizing value as a performing asset;
- (iv) The conclusion of the Debt Equity Swap transaction has created opportunity

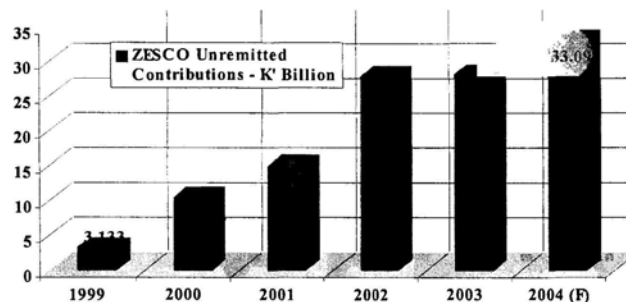
of being a successful pilot proposal and has opened the route to restructure the contributions debt through other strategic options. LASF has now proposed to ZESCO to convert K20 billion contributions debt into Corporate Bonds with maturity periods ranging from 18 –36 months. The LASF Board and the Ministry of Local Government & Housing have approved the proposal.

5.0 PROPOSAL TO RECOVER PART OF THE ZESCO DEBT

5.1 Background to the ZESCO Debt

Over the years, ZESCO’s debt on contributions has increased from K3.1 in 1999 to over K30 billion in 2004. This represents 89% increase in the debt over the last five (5) years. As at 30 November 2004, the contribution arrears owed to the Fund by the Zambia Electricity Supply Corporation (ZESCO) stood at some K 35.08 billion. In 2003, LASF and ZESCO had entered into some payment plans in order to reduce the debt on contributions owed to the Fund. Since the exercise started to recover contribution arrears and resume payments of current contributions from Associated Authorities, ZESCO has paid in excess of K 48.842 billion over the years to the Fund to keep up with current contributions and to settle contribution arrears. However, in 2004, the payments were not regular to clear the contribution arrears. There was a significant increase in ZESCO’s contribution arrears position in 2002 when contributions were not remitted for nine months. This was as a result of the technical and legal issues relating to the change of ownership of the mines. This, combined with the aforementioned inconsistent contributions has lead to the significant build up of ZESCO’s arrears position (see graph below).

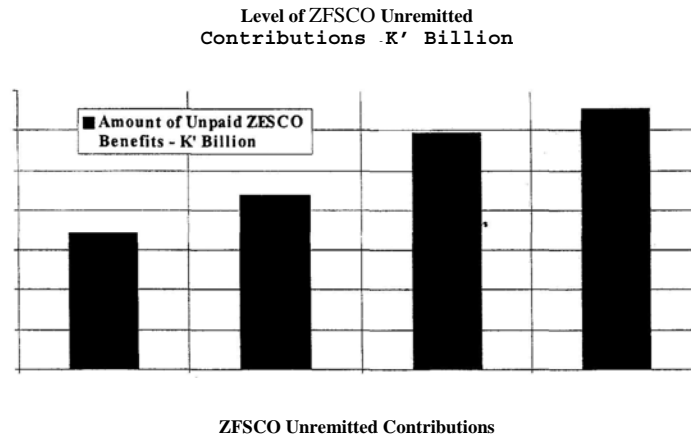
Level of ZESCO Unremitted Contributions to LASF 1999 -2004



Source: LASF Finance Department

5.2 Effects of Unpaid Contributions

As a result of non consistency in the remittance of contributions, ZESCO's unpaid contributions had risen to a level of K 35.08 as of 30th November, 2004. In addition, the other effect arising from the non regular remittance of contributions has been the Fund's inability to pay benefits to retired ZESCO employees on a timely basis. Unpaid benefits to ZESCO retirees only have doubled over the course of the year from K 6.851 billion to K 13.078 billion as of September 30, 2004 (see graph below).



As at the close of 30th November, 2004, the unpaid benefits to ZESCO retirees had further increased to K14.20 billion. The total unpaid benefits to retired members from all member organisations stood at K22.40 billion as at 30th November, 2004. This implies that ZESCO account for 63% of the total unpaid benefits and the balance of 37% relates to unpaid benefits for retirees from the Councils, NHA and Water & Sewerage Companies. This is clearly a situation that requires to be addressed as the Fund is under increasing pressure from its stakeholders to meet obligations of paying pensions and benefits to members on a timely basis.

5.3 Proposal Submitted to ZESCO

In January, 2005, the Fund proposed to convert K20 billion of ZESCO's current arrears into debt securities. The amount of ZESCO's arrears stood at around K 35.08 billion at the end of November, 2004. ZESCO has been straddling this level of arrears for the better part of the last few months. As such, it is indicative of an in-built structural level of arrears of ZESCO to the Fund. This notwithstanding, the Fund does understand that the amount could well accumulate by the time that any possible transaction to convert the arrears to debt securities is concluded. To accommodate this possibility, the Fund is willing to look at three options:

- (i) It can freeze an amount at K 35 billion on one schedule and create a new schedule to cater for arrears that may be accumulated after November, 2004. This will be done on the understanding that the K 35 billion amount will be converted to a debt security

at a future date and will enable both the Fund and ZESCO to precisely identify which arrears will be converted to debt securities; or

- (ii) ZESCO can commit itself to paying contributions at a sufficient enough level to keep the arrears at K 35 billion whilst processes to convert the historical arrears to debt securities are being finalised.
- (iii) Convert part of the pension contribution arrears into debt security instruments and the balance be paid at an agreed amount.

The Fund believes that the process of converting the ZESCO contribution arrears to debt securities will provide an excellent opportunity in restructuring the debt. The Fund is willing to further consider converting arrears that ZESCO may accumulate in future into debt securities because of cash commitments that ZESCO may face. The option of selling those debt securities on the secondary market may indeed be one way for the Fund to realise early cash flow streams from arrears that will accumulate in future.

5.4 EXPECTED BENEFITS OF TRANSACTION

The envisaged benefits of the transaction presented here for both the Fund and ZESCO are as follows:

1. The transaction could well result in considerable cash flow savings for ZESCO. This is particularly important at the present time when it is anticipated that ZESCO will have significant cash flow constraints on account of capital expenditure commitments in various parts of the country.
2. The income from interest payments on the debt securities is a predictable cash flow stream. The predictability of this cash flow stream may make it easier for the Fund to plan expenditures. Even though ZESCO has been by far the biggest contributor to the Fund historically, contribution income has been very haphazard and this has sometimes made it difficult to plan expenditures.
3. The possession of the debt securities may make it possible for the Fund to realise immediate cash by selling the debt securities on the secondary market. The reasons for holding this view are as follows:

- (i) The fact that the debt will be broken down into smaller units;
- (ii) The fact that ZESCO is a rated company whose recent performance has been quite sound;
- (iii) The fact that ZESCO will have had a history of making good on payments on debt securities *viz, a viz*, the CP instrument that it issued in 2003; and
- (iv) The fact that there are very few quality investments on the market with an inflation hedge at the present time.

All four facts above make it highly possible that the debt securities will be marketable should the Fund decide to sell some or all of them for cash in future.

LASF Management is awaiting the response from ZESCO on the proposal to convert K20 billion into Corporate Bonds with multiple maturity periods ranging from 18 to 36 months.

6.0 EFFECTS OF THE NAPSA ACT ON LASF OPERATIONS

The creation of NAPSA has brought various developments in the pensions industry. The challenge is the continued existence of statutory pensions schemes and other private occupational schemes since all new employees commencing employment on or after 01 February, 2000 are required to contribute to NAPSA on a compulsory basis.

The following implications have been identified:

(i) The Legal Position

Representations have been made regarding which Act (the LASF Act or the NAPSA Act) supercedes the other with respect to contributions to be made by new employees of Associated Authorities. Although the NAPSA Act requires all new employees of the Associated Authorities to join NAPSA before joining any other pension scheme with effect from **01st** February, 2000, the LASF Act has not been amended to address this particular issue. Indications from parties consulted so far seem to suggest that there is a legal basis for challenging the mandatory joining of NAPSA by new employees of Associated Authorities.

(ii) Declining Membership

The requirement that post—NAPSA employees of Associated Authorities not belonging to LASF on a mandatory basis will lead to declining membership over the longer term. This is because the amount of persons belonging to LASF is defined under the LASF Act and will not be augmented by any new members due to the NAPSA Act.

(iii) Declining Contributions

The fact that new employees are not required to contribute to LASF on a mandatory basis will cause shrinkage in the amount of money coming into the Fund. This is because the Fund will only be able to draw revenue via contributions from pre—NAPSA employees.

The effect of this will result in the Fund failing to meet its future liabilities as a result of declining contribution levels.

(iv) Government's Liability in the Long Run

Should the Fund run into financial difficulties as a result of declining membership and the consequent lower level of contributions, there is a likelihood that the requirement to cover up for any short—fall to assist the Fund to meet obligations to beneficiaries and retirees will fall on Central Government as it is the *dejure* guarantor of the Fund.

Since LASF is a statutory pension scheme created by an act of parliament, the collapse of LASF as a result of the NAPSA Act will in future put pressure on Government to resolve the issue of the members who would remain unpaid. Management believes that such future pressures on Government could be avoided by reviewing the position of the NAPSA Act.

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6.1 POSITION OF MANAGEMENT ON NAPSA ISSUES

Firstly, it must be emphasized that the Management of the Fund is completely in favour of the need for a national pension scheme to exist as it is the only assurance that workers will be able to draw on some sort of income upon retirement. The principal of NAPSA is therefore not something Management is necessarily against.

Management's major concerns about the coming into being of NAPSA are:

- (i) That it will affect future cash flows for LASF and other pension schemes as there will be no funds from contributions from new members;
- (ii) That there is an element of inequity both with respect to contributions and to the kind of separation product that employees will be entitled to. This specifically refers the fact that pre—NAPSA employees are paying their obligations at 10% employee contribution and 23% employer contribution. New employees of the Fund's Associated Authorities on the other hand pay the NAPSA contribution rate that generally comes to 5% employer contribution and 5% employee contribution. As a result, upon retirement, post—NAPSA employees of the Fund's Associated Authorities will not be entitled to the same kind of pension benefits as pre—NAPSA employees. Post—NAPSA employees will not be able to commute part of the gross annuity as lumpsum and the balance in form of monthly pension upon retirement as is the case at LASF at the moment;
- (iii) That there is need for guidance whether the NAPSA Act supercede the other principle Acts governing statutory pension schemes such as LASF and the Public Service Pension Fund given that both the LASF Act and NAPSA Act were created through an Act of Parliament;
- (iv) That implications and concerns raised by various stakeholders on the future of already existing statutory Pension Funds were not addressed; and

(v) That there has not been sufficient application of the provision which allows the Minister of Labour and Social Security exempt new employees of the Fund's Associated Authorities from contributing to the Fund. Section 13 (2) of the NAPSA Act gives the Minister of Labour and Social Security the power to do this via the signing of an appropriate Statutory Instrument.

6.2 MANAGEMENT'S PROPOSED WAY FORWARD ON ISSUES RELATED TO NAPSA

Management is of the view that first and foremost, the issue of the whole existence of NAPSA be addressed by all stakeholders who have been affected by its coming into being. As mentioned before, the issue is not one of doing away with a national scheme providing minimum coverage for all formal sector employees, but that doing so must be in a way that all parties benefit and which is not as damaging to the pensions industry. Management does recognize that apart from LASF, other pension schemes have also been affected by the existence of NAPSA. Quite a few business houses have alluded to the fact that NAPSA may prove to be a big drain on cash flow that they could use for investment purposes.

This means that there is need for a more holistic solution to be found to address the problems that have resulted from the advent of NAPSA.

Specific developments that LASF will like to see emerge from a review of the NAPSA position in the pensions industry are:

- (i) Exemption of LASF from NAPSA Act via the signing of an appropriate Statutory Instrument by the Minister of Labour Social Security;
- (ii) A situation where there is clarity from a legal standpoint. It is not known at the present time if there is a solid legal basis for requiring new employees of Associated Authorities to belong to NAPSA as the LASF principle law has not been amended; and
- (iii) That NAPSA come to parity with other pension schemes. The situation in the pensions industry at the present time is such that NAPSA tends to stand above all other pension schemes. This should certainly not be the case as a lot of occupational schemes have, for instance, tailored their benefits to fit a specific type of employment whereas NAPSA is a very general scheme regardless of occupation.
- (iv) If, however, there is an insistence that things remain as they are *viz. a viz.* NAPSA, then Management would like to see a situation where new employees of Associated Authorities would be required to pay 5% to the Fund and the employer 18% so that the total amount that is paid towards one's pension is the same as that paid by existing employees, i.e. 10% employee contribution and 23% employer

contribution. This is normally referred to as Top Up Schemes It would, subject to an actuarial review, give new employees a chance to access an additional and superior pension product to NAPSA upon retirement.

6.3 JUSTIFICATION FOR THE FUND'S EXEMPTION FROM NAPSA ACT

In addition to the issues stated in item 6.1 above, the Fund's justification for seeking an exemption from NAPSA are:

- Guaranteed long term survival for LASF because if LASF's member organizations were to obtain exemption from contributing to NAPSA, they will continue receiving new members;
- Avoidance of Government taking over huge liabilities in future. The liabilities likely to be avoided are payments of annuities to over 6,500 pensioners, payments to over 15,000 pensioners who are currently contributing to LASF and terminal benefits to members of staff at LASF. Government already has outstanding benefit obligations to employees of Zambia Airways, Lima Bank, Maamba Collieries etc;
- LASF has a better retirement package than the pension product offered by NAPSA upon retirement; members of the Fund are entitled to both a lumpsum and monthly pension paid for the rest of their life. Therefore, the payment of the lumpsum makes the retirement package of the Fund superior and attractive;
- The Fund enjoys the goodwill of being the oldest pension scheme in Zambia;
- Since the implementation of the Five-Year Strategic Plan which became effective on 01st January, 2001, the Fund is undergone various reforms aimed at meeting the expectations required by Government for a pension scheme. LASF can therefore compete favourably with other Statutory Pension Scheme.
- The Fund has adopted a policy to adjust the monthly pension product upward with effect from 01st January, 2004. This will make the monthly pension product offered by the Fund attractive to the pensioners as the amounts payable will be reviewed on a regular basis.

6.4 CURRENT POSITION ON NAPSA ISSUES

LASF has made a formal application to the application to the Ministry of Labour and Social Security to be exempted from the NAPSA Act. The Ministry of Local Government and Housing has supported LASF's application.

An evaluation report on the options available has been submitted to the Ministry of Labour & Social Security and the Ministry of Local Government & Housing

stating the legal position, advantages, disadvantages and general view of LASF Management on the three options. The three (3) options are:

- (i) Exempting LASF from NAPSA Act;
- (ii) Introducing LASF as a Top Up Scheme; and
- (iii) Merger of LASF and NAPSA.

The issue of exempting LASF from the NAPSA Act is being discussed between the Ministry of Labour & Social Security and the Ministry of Local Government & Housing. Once the discussions are finalized, the outcome will be communicated to the Fund's stakeholders.

7.0 CONCLUSION

LASF management is committed in ensuring that it operates at a level which meets the expectation of its stakeholders.

In a liberalized economy, LASF should be able to compete favourably with other statutory pension schemes such as NAPSA and PSPF. In order to achieve the competitive advantage, Management's approach has been to manage the scheme on a commercial basis.

With the current restructuring and reforms LASF is undergoing, the Fund has the potential to contribute to the Zambian economy.