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Paradigm Shift in the Namibian Pension Fund Industry: A Model to Deal with Legislative Change

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Abstract

Legislative reform triggers environmental shock and pension funds are required to develop strategies to deal with such change. This research seeks to answer the main question whether pension funds are ready to embrace the major compliance requirements proposed under the Financial Institutions and Markets Bill (FIM Bill). Therefore, the research objective is to develop a qualitative model to help pension funds prepare for the proposed legislative changes.

Keywords

Pension Funds, Change Management, Environmental Shock, Governance, Regulations, Compliance, Coverage

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1. Introduction

The relevant literature generally confirms the view that pension funds are very important for socio-economic development (World Bank, 1994). Globally, the concept of pension fund savings dates back to the 19th century (Roessler, 2009) and in Africa, South Africa was the first country to formalise pension fund savings under the Pension Funds Act 24 of 1956 (Ponting, 2000). Namibia was a colony of South Africa and hence subject to the same laws. According to the Bank of Namibia (2004), pension fund savings in Namibia account for more than 60% of GDP making it very important for socio-economic development (Stiglitz, 1999).

Namibia at independence in 1990 inherited a pension fund regime consisting of three pillars resembling the World Bank classification. The first pillar seeks to redress poverty and is usually universal and guarantees a degree of income in old age (World Bank, 1994) and promotes distributive equity (SA National Treasury, 2007). The first pillar pension is therefore a social security type of old-age pension guaranteed under Article 95 of the Namibian Constitution (1990) and administered under the Ministry of Health and Social Services from the State Revenue Fund (Basic State Grant Act, 2000). The social pensions in Namibia are universal and non-means tested and has over 80 000 beneficiaries. Namibia is one of the few countries in Africa with a non-means tested social pensions system (Schleberger & Devereux, 2002). The second pillar is employment based and codified under the Pension Funds Act of 1956. The third pillar of retirement funding was introduced in Namibia through mainly insurance companies as individual retirement annuities under the Long-Term Insurance Act of 1998 and the Income Tax Act of 1981. Under this arrangement, no employer and employee relationship is required and hence multiple memberships between the second and third pillar is possible and usually creates double counting in the overall membership data of pension fund members (SA NationalTreasury, 2013).

A critical review of the Namibian legislative environment in the pension fund industry reveals serious shortcomings which impacts on the ability of pension funds to be operationally efficient. Some of these major shortcomings are summarized as follows:

- the pension fund industry is fragmented since pension

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funds are regulated by multiple laws. Although the Pension Funds Act of 1959 is the primary source of regulation, several other legislations purports to regulate pension funds like the Income tax Act of 1981, Social Security Act of 1991 and Financial Institutions (Investment of funds) Act of 1984. This practice is undesirable and compromises the ability of pension funds to be efficient (World Bank, 1994).

- service providers like administrators are not regulated in terms of market conduct and fees. This has opened doors for abuse, lack of transparency and excessive charges for services (SA NationalTreasury, 2013).
- no governance structures aimed at efficiencies in the management of pension funds to avoid conflict of interests and enforce compliance. Proper governance structures and a code of conduct increases levels of efficiency in pension funds (OECD, 2009).
- benefit structures and contribution levels are not regulated and provision of benefits to members is at the mercy of market and product dynamics without due regard to consideration of efficiencies. In other jurisdictions like Australia and Germany, the statutory minimum levels are imposed on benefits and contributions to ensure better coverage, redistributive equity and cost efficiencies (OECD, 2011)
- despite several isolated initiatives for preservation of pension benefits, no substantive legal framework exists in Namibia for compulsory savings. Therefore, retirement savings is left to the employers and individuals to make voluntary arrangements.

In an effort to remedy the above shortcomings in the pension fund industry, NAMFISA has undertaken a review process to consolidate legislation under one omnibus law governing the financial services industry called the Financial Institutions and Markets Bill (FIM Bill).

This proposed legislation is aimed at a complete overhaul of the existing legal framework for pension funds in Namibia and hence create circumstances for environmental shock which requires pension funds to find ways and means to absorb this radical change. This study aims to explain the Namibian pension fund environment with reference to the legislative change imperatives in the FIM Bill and the development of a qualitative model to deal with the environmental shock created by the introduction of the proposed legislation in the management of pension funds. The outcome of the study will help stakeholders in the pension fund industry deal with environmental change in an effective manner whilst enhancing the objectives of socio-economic growth for Namibia as developing country.

The lay out of the study will be presented as follows: Chapter 1 deals with research background, objectives and analytical framework. Chapter 2 covers a review of relevant and current literature on the topic. Under this chapter various relevant theories are discussed and analysed to create a theoritical framework for the development of a model to deal with environmetal change. In chapter 3, research design is presented which covers the problem statement, research propositions and case study methodology. Chapter 4 deals with data analysis and presentation of results, whilst chapter 5 covers a discussion of implications of findings and recommendations for the pension fund industry.

2. Problem Statement

The literature review reveals the important role that pension funds play in Namibia as catalyst for savings and income protection. Therefore, the regulatory environment needs to be adaptive to evolutionary changes in population demographics and society in general. As we have seen from the literature review, the current legislation governing pension funds is flawed and archaic since it dates back to 1956 and does not adequately address current circumstances. This has prompted NAMFISA to introduce the FIM Bill which seeks to revolutionise the pension fund industry. Therefore, the pension fund industry in Namibia is faced with a challenge around an effective strategy to absorb this radical environmental change.

The above scenario underscores the research problem.

3. Research Propositions

The research proposition in qualitative studies refers to an expression of the expected outcome of the research and is not statistically tested, unlike hypothesis in quantitative studies (Saunders, Lewis, & Thornhill, 2009). Therefore, the research proposition of the study is that:

- change in organizations is driven by evolution;
- legislative repeal creates radical evolutionary change, which impacts organizations and
- organizational change induces uncertainty leading to shock requiring mitigating strategies.

4. Research Objectives

Given the research problem above, this primarily research aims to construct a model that pension funds can use as a guide to deal with the environmental shock emanating from the introduction of the proposed legislation. In order to achieve the research objectives the study will use the following questions:

1) How do pension funds describe the factors that led to the introduction of the proposed legislation?
2) How do pension funds in Namibia prepare for the implementation of the proposed legislation?
3) How do pension funds in Namibia describe the challenges around the implementation of the proposed legislation?

Answering the above questions will fill the research gap by developing a better understanding of the factors driving organisational change and the best strategies to deal with legislative environmental change. Therefore, the study will also contribute to the body of knowledge with the development of a model that will outline behavioural factors in the pension fund industry driving change, enhance further understanding of key concepts with theory application and underscore the relationships between research concepts.

5. Literature Review

The theoretical basis of the study emanates from the empirical literature review. The literature review provides informed and better clarity on the drivers of legislative change by grounding the discussion on proven and tested theoretical principles.

5.1. Theory of Organisational Evolution

The Pension funds Act 24 of 1956 defines a pension funds as an organisation created mainly for the purpose of providing retirement benefits to members. An organisation is defined as a unit of persons pursuing a common goal (Davis, 1977) and this view is shared by other authors who defines an organisation in terms of relationships or human associations aimed at achieving a common objective (Barnard, 1995).

Although the FIM Bill replaces reference to pension funds with retirement funds, it does not change the above characteristics as organisations and hence the theory of organisational evolution still applies (Zamuee, 2015).

The research will analyse the relevance of the Darwinist theory of evolution to explain organisational change and draw a contrast with modern theories on change management (Jones, 1999). This theory will position change as an integral part of human activty and explain the evolutions of pension schemes after the period of industrialisation which has given rise to the present day pension funds (Ponting, 2000).

5.2. Life Cycle Theory

In order to conceptualise pension fund legislative reform, it is important to understand the consumption smoothing objective of pension funds based on lifestaging profiles of members. This means that members of pension funds will accumulate enough throughout their working life based on prevalent consumption needs at a particular stage in life and decumulate at retirement or dissave enough in line with retirement consumption needs at that time (Munnell&Yohn, 1991).

The life cycle theory presupposes savings based on intergenerational transfers and this has been a major source of criticism for this approach. However, modern literature has favored this theory as a sound framework for decisions on pension savings. The study will use this theory to determine the impact of the proposed legislation on savings, especially in the context of investment regulations and asset decumulation strategies (Kotlikoff (1988), (Modigliani, 1988).

5.3. Agency Theory and Pension Funds

Pension funds are managed by a board of trustees consisting of equal representation by the sponsoring employer and members (Pension Funds Act, 1959). The board of trustees have the overall powers to devise benefit structures, receive and invest contributions and appoint service providers. Under the Namibian common law and the Financial Institutions and Markets Bill (2014), the relationship between the board of trustees and the members is fiduciary in nature and invokes duties of good faith and care in the administration of the affairs of the pension fund. The above description reveals a delegated authority by stakeholders (employer and members) to the board of trustees to take some investment decisions on their behalf with a view to receiving a maximised retirement benefit. This principle is consistent with the agency theory which suggests a relationship in which a person engages another to carry out some service on their behalf based on delegated authority (Jensen & Meckling, 1976). Hill and Jones (1992) also confirm this view. Given the fiduciary nature of the agency relationship, board of trustees are required to be prudent and efficient in making investment decisions since members also have legitimate expectations of maximised retirement benefits (Ferrier & Lovell, 1994).

5.4. Theory of Pension Funds as Organisational Systems

Pension funds are conceptualised as organisations under the Namibian Pension Funds Act of 1956 and the Income Tax Act 24 of 1981 and created with the primary purpose of providing retirement savings. In this regard, pension funds collect contributions for savings and investment with a view to providing retirement income to members.

According to the systems theory in management, organisations are regarded as open or closed systems depending on whether they are influenced by the external environment or not (Kast & Rosenzweig, 1972). Therefore, as a participant in the financial services universe, pension funds are influenced by the external environment and hence qualify as open systems as illustrated in figure 1 below. Therefore, similar to other open systems, pension funds have inputs (contributions) that are converted to outputs (retirement benefits) (Njuguna, 2010). This implies optimization of scarce resources (Kumbhakar & Asaftei, 2007). As indicated before, the above systems approach is conceptualised as follows in figure 1:

Fig. 1. Conceptualisation of pension funds as open systems. Source: Own construction by researcher.

The figure above shows how contributions as inputs are converted into retirement benefits as outputs, following a throughput or conversion process as measured by the opening and closing values of the fund. In other words, the theory measures the extent to which the scarce resources (in the form of contributions) have been converted into retirement benefits for the members.

5.5. Theory of Workforce Coverage of Pension Funds

Pension reform is a key component of global socio-economic development and the World Bank states “pension systems need to provide adequate, affordable, sustainable, and robust benefits” (Holzman & Hinz, 2005). By ‘adequate’ the World Bank intends that “all people regardless of their level or form of economic activity” have access to benefits “that are sufficient to prevent old-age poverty on a country-specific absolute level in addition to providing a reliable means to smooth lifetime consumption for the vast majority of the population”. Herein lies the theory of coverage, which intuitively implies membership density of pension funds or the capacity of pension funds to a retirement safety net for the majority of the workforce who are in dire need of adequate retirement benefits (Zamuee, 2015). The coverage theory will aid the analysis of whether the proposed FIM Bill embodies the social welfare ethos of contribution solidarity, risk-sharing and prudential foresight required to cover the majority of the Namibian workforce, including informal workers. The theoretical test is whether the proposed legislative environment will have the impact of increasing or decreasing the rate of workforce coverage in Namibia.

5.6. Theory on Governance of Pension Funds

A change in legislation affects the allocation of resources and hence it is important to analyse the regulatory environment from a governance and compliance perspective (Kumbhakar & Asaftei, 2007). Regulation is defined as the enforcement of compliance with laws dealing with pension fund management, whilst governance talks to structures created to enforce legislation (OECD, 2002).

The concept of governance has gained prominence in global literature over the last two decades and especially as a result of the global financial crisis (Antolin & Stewart, 2009). The OECD and World Bank define governance in terms of segregation of duties, risk management and operational efficiency (Carmichael & Palacious, 2003), (OECD, 2009).

The proposed FIM Bill introduces radical changes to the governance landscape of Namibian pension funds, including constitution of board of trustees, regulation of service providers and managing conflicts of interests. Therefore, despite the furor from critics of governance (Kwame & Chowdhury, 2012), an analysis of the concept provides a sound theoretical basis and context for a discussion on the impact of the FIM Bill on pension funds and the creation of a possible model to deal with this environmental change in the pension fund landscape.

5.7. Finance Theory and Market Efficiency

The finance theory will cover the overall resource and cost management aspect of pension funds and include a discussion on market efficiency using Potter’s five forces. This will provide a theoritical foundation for understanding the nature and structure of the pension fund industry market competitive dynamics.

The FIM Bill requires boards of trustees of retirement funds to “maximise administrative and operational efficiency”. Operational efficiency is defined in terms of the employment of a mix of resources or cost management strategies to achieve optimized value for members (Harris, 2006).

According to the World Bank, competition in the pension fund industry drives cost efficiency (World Bank, 1994). Namibia only has limited competition in the pension fund industry and makes it difficult to negotiate service fees on the free-market principle of elasticity of demand and supply (Treasury S. A., 2013). However, this view is contrasted in Chile where there are many private administrators, but competition in the industry has not yielded relatively lower cost structures (Barrientos & Boussofiane, 2005). Therefore, it is reasonable to conclude that competition in itself does not necessarily guarantee cost-efficiencies without an effective regulatory framework. Therefore, the theory of finance of pension funds will provide a useful academic framework to understand the requirements of cost management and market efficiency required under the FIM Bill and possible intervention strategies to achieve the objectives of retirement funds.

5.8. Prospect Theory

This theory was developed by Daniel Kahneman and Amos Tvesrsky and offer an alternative to the pervasive utility theory which has governed the decision-making sphere over the last decades. Prospect theory is behavioral-based and defines human behaviour in terms of the way people choose between alternatives based on perceived conflicting risks in an environment where outcomes are probable (Kahneman & Tvesrsky, 1979). This theory is relevant in understanding and predicting the behavioral outcomes of pension funds in relation to the probability of alternative outcomes around risk factors inherent in the implementation of the new legislative environment. This will position the possible decision weights pension funds attach to the probable and certain outcomes arising from the proposed FIM Bill. This analysis will enhance the discussion about effective strategies that can be deployed by pension funds to absorb environmental shock arising from the proposed FIM Bill.

5.9. Theory of Fund Size and Design

The theory of size and fund design seeks to explain whether size and design issues are impacted by legislative change and how pension funds should respond to these changed environment. Comparative empirical literature found that the efficiency of pension funds is influenced by size in terms of membership and assets under management (Bikker and Dreu, 2006). This view is contrasted by Tang and Mitchell (2008) who asserts that benefit design determines efficiency rather size. However, in Namibia it was found that size had no significant association to pension fund efficiency and that smaller schemes were financially more efficient than larger ones (Zamuee, 2016). A discussion of this theory will aid the analysis of whether the FIM Bill covers these aspects sufficiently and strategies to absorb potential consequences from implementation of the law. The discussion about size will assess the impact of economies and dis-economies of scale on legislative change (Viceira, 2007) and the emergence of a potential model to absorb environmental shock from the FIM Bill.

6. Research Design and Method

6.1. Research Design

Research design refers to the totality of the research process and covers the theoritical conceptual framework, data collection and analysis. Research methods can be divided into qualitative and quantitative approaches Creswell (Saunders, Lewis, & Thornhill, 2009).

The current study is qualitative in that it seeks to answer questions around the impact of legislative change on the pension fund industry in Namibia from the point of view of key stakeholders in their natural setting (Leedy, 1997).

According Yin (2003), a case study method is suitable when analysing contemporary or interesting events where manipulation of behaviour of participants is not possible. Therefore, in exploring the phenomena of legislative change, the researcher intends to use a case study method. A case study is defined as a phenomena manifesting in a "bounded context" (Creswell J., 2009) and hence provides context to the situation (Yin, 2003). The research intends to study the environmental change likely to happen due to the introduction of the proposed FIM Bill. Therefore, the case study will come from the phenomenon observed at pension fund industry level and sub-cases reflects the themes and issues emanating from the observed phenomemnon.

6.2. Population (Where Applicable)

According to (Saunders, Lewis, & Thornhill, 2009), the population of a study refers to the full set of cases from which a sample is drawn. Therefore, the population of this study will be all the 79 registered pension funds in Namibia registered with the Namibian Financial Supervisory Authority (NAMFISA). The results of the study will hence be generalised to this research population.

6.3. Sample

This study will use a collective case study approach based on purposive sampling. This method is suitable for case studies and will be used to select the research sample (Yin, 2003). The collective case studies will consist of the all 79 private pension funds registered with NAMFISA and will investigate the readiness strategies by funds to deal with environmental change and perceived consequences of introduction of the FIM Bill.

6.4. Research Instruments

In a qualitative study, data is collected in the form of words sourced from interviews or observation or documents (Miles & Huberman, 1994). This view is supported by Creswell (2009) who recommends interviews for this this type of research. Therefore, the study will conduct interviews with key industry participants and relevant industry documents to collect data in line with the research objectives.

6.5. Procedure

As part of theory buidling, the researcher intends to conduct initial informal interviews with industry participants to obtain their views on the proposed research framework. The outcome of this will contribute towards the final research design. The themes and issues emanating from these interviews will form part of the cases to be analysed in the research design.

As prescribed by Creswell (2009), the study will establish an interview protocol to ask research questions and recording of the same.

The researcher has adequate access to key participants in the Namibian pension fund industry and will conduct in-depth and semi-structured face-to-face interviews with industry participants using written notes and audio-visual recording. At the same time, the researcher intends to keep a journal during the research study and analyse public documents from Government Ministries, semi-State entities and any relevant archival materials. Documentary corroboration will be in the form of Acts of Parliament, regulations, minutes of meetings, policy documents, published articles, court judgements.

The use of multiple instruments serves to triangulate the findings and enhances validity and generalisability.

6.6. Data Analysis

According to Creswell (2009), data analysis involves the process of making sense of text data. Therefore, a data preparatory process is required to facilitate analysis of data. During the initial analytical process, the researcher intends to describe any specific issues arising from the data collected in the case study and will observe any themes emerging from the data. Within-case analysis will be used for any themes appearing from the data creating sub-cases to create an opportunity for individual analysis of the same leading to the emergence of possible relationships or further constructs or hypotheses, as the link between theory and data becomes closer (Creswell J., 2009).

Therefore, the analysis will be both vertical (issues and themes arising from the case study data) and horizontal (responses from industry experts in the interviews). This approach underscores cross-case analysis (Silverman, 1993).

7. Conclusion

It is expected that the research outcome will solve the research problem and provide a valid and credible theoretical foundation for the development of a model to absorb environmental shock from the introduction of the proposed FIM Bill. The research outcome will highlight the important factors driving organizational change and validate findings through observance of the major themes forming part of the case studies. In other words, the model will include all aspects of the findings based on research design and manifest generality and replicability across other sectors facing rapid environmental change. The research outcome will increase knowledge on change management strategies and offer pension funds with a tool to solve the challenges arising from the implementation of the FIM Bill.

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