Life Offices Association of Zimbabwe

Demystifying Insurance Part 24

Welcome to part Twenty Four of Demystifying Insurance, a continuation of the Life Offices Association (LOA)'s ongoing National drive to make insurance easily understood by all. Today's article examines how assets were converted to US Dollar values at the end of Zimbabwe's long battle against hyperinflation.

Previously we looked at partial dollarization in Zimbabwe. That is to say we examined how certain companies were licensed to trade in foreign currency and how values of certain commodities were arrived at.

Converting values

In this week's article we discuss how life insurance companies converted values from the Zimbabwean dollar to the United States dollar in 2009.

As many can remember, all businesses had to convert the values of each of their clients' investments from Zimbabwe dollars to US dollars. In addition, life insurers had benefit obligations to their policyholders, which constituted promises to them.

In order to cover these promises, life insurers at the time held assets in the form of policyholder funds. These assets, which included property, equity stocks, bonds and cash, belonged to the policyholders.

The greenback cometh

As there was no available trading exchange rate at the time of conversion, it was logical to first convert the value of total assets held into US dollars.

The value of the assets in foreign currency was then distributed to the policyholders, in proportion to the magnitude of each policyholder's fair Zimbabwe dollar share of assets.

The different asset classes were converted or valued differently depending on the nature of the asset class.

Assets and other fixed interest securities conversions

Prescribed assets mainly constituted bonds issued by the government. On conversion to foreign currencies in 2009, these bonds were not converted into foreign currency. The reason is because bonds represent borrowings done through the financial system, and hence they are paper-based money.

As we established in previous articles, paper-based money lost value because of its fixed nature. Moreover, as paper-based money is not supported by an asset, there is no easy way of determining its value, except for value attribution by authorities and the market.

Even if bonds had been converted they would have still had an insignificant value. This can be attributed to the fact that bonds were of a fixed amount in Zimbabwean dollars and hence their real value had been eroded by hyperinflation.

Other fixed interest securities (bank deposits for example) were also given a zero US dollar value, as there was no exchange rate to convert such bonds or cash because of the lack of an exchange rate. Companies, however, are still holding the Zimbabwe dollar balances, as the Zimbabwean dollar was not demonetized – as and when an exchange rate is made available they can be converted.

Conversion of share prices on the Zimbabwe Stock Exchange

Life insurance companies had also invested a significant portion of the assets in equities widely known as shares. This was an attractive investment option as it could track inflation better when compared to other investment options, such as fixed interest securities and cash.

When one invests on the stock exchange they get allocated a number of shares. At conversion to US dollars, the number of shares held did not change. When the stock market resumed trading in February 2009, the Zimbabwe Stock Exchange (ZSE) arrived at the value of shares in US dollars.

Simple calculation of value

The value of a company's share is fundamentally based upon the total current value of the expected stream of all future profits, which that company will make and pay out as dividends.

This total value was dependant upon the investors' perception of the company, such as the prices at which shareholders were willing to sell shares and the prices at which prospective buyers were willing to buy shares.

Calculating the total value of shares in US dollars for life insurance companies was therefore a relatively simple task, since there was a price determined by the market. The number of shares was simply multiplied by the price of those shares in US dollars on the stock exchange.

Conversion of property values

The last major asset type, held in significant proportion as an inflation hedge, which insurers had to convert, was property. Again the good news is that the land and buildings held in the Zimbabwean dollar era remained available after conversion in 2009. The only issue was what values they would have in US dollar terms.

Professional property valuators were engaged to determine these values. As mentioned in earlier articles, the value of property is derived from the rental income expected to be received throughout the property's lifetime, which in turn is used to pay out benefits. An inability of tenants to pay appropriate levels of rentals would, of course, result in low values.

The bottom line is that property values in 2009 were depressed due to the prevailing shortage of liquidity, which saw most of the properties being unoccupied.

There were few people able to buy property or pay rentals.

Conclusion

We have just outlined how assets, in which insurance companies were invested, were converted to US dollars.

Join us next week as we discover how the values of individual policies were determined.

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