Life Offices Association
of Zimbabwe

Demystifying Insurance Part 26

Welcome to part Twenty Six 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 some insurance companies tried to shield policyholders from the full impact of hyperinflation.

From previous articles we know that insurers took care in selecting growth-type assets such as shares and property, which delivered some value to our clients. With the exception of the prescribed assets, the assets held tended to be a good hedge against inflation. Against hyperinflation though, no asset can survive.

Pension increases
Pension annuity products require payments on a monthly, quarterly or annual basis. These pensions can be augmented by annual bonuses, based on how the investment markets performed.

We know that inflation erodes the value of money. In other words, inflation means that if you are paid the same wage or pension amount over some time, in the future you will not be able to buy the same basket of goods. During Zimbabwe's hyperinflation, employees began to receive monthly salary increases. Although these increases could not eliminate the devastating effects of inflation, they smoothed the impact.

Interim increases
Salaried workers were getting salary increases on a regular basis. As income earners, pensioners also needed some form of continuous inflation-linked income increase. Insurance companies realised that pensioners would suffer immense loss in value if they continued receiving bonus increases to their pensions at the end of each year. This led to the introduction of interim monthly bonus increases, where insurance companies calculated returns and declared bonuses on a monthly basis.

Investment returns were, however, not matched to inflation. The value of investments grew but not necessarily purchasing power. When pensioners received bonus increases, while not necessarily able to buy more goods they could at least buy some of the basics, so the value was not totally wiped out.This move by insurance companies could not eliminate inflation completely, but it somehow cushioned pensioners from the full impact.

Updates and increases
The concept behind the various types of updates or increases (such as Cover Update Facilities and Automatic Cover Increases) was that cover and premiums needed to grow in line with inflation if some value was to be derived from the policies that people had bought.

This meant that premiums needed to increase, as well as sum assured, on a voluntary and mandatory basis. However, because the effects of inflation were far reaching, even if policyholders understood the rationale behind the need to volunteer for cover increases and premium updates, they could not afford to.

Prices of basic household goods were going up daily. People were anxious about where their next meal was coming from and insurance became the last thing on anyone's mind. Without the premium and cover updates, the policies eventually suffered loss in value as hyperinflation continued on its destructive course.

Special surrender values
As the policies lost value, some insurance companies decided to offer policyholders special surrender values, which were much higher in value than the actual amount due to them. The offers were made through the press but many policyholders did not respond.

Waiver of premiums
As early as 2005, it became increasingly clear that life assurance policies were becoming unviable in that the costs of collecting premiums were actually now higher than the premiums from policyholders. Some insurance companies stopped collecting premiums and actually began to pay the due premiums of policies on behalf of the policyholders.

Conversion of products to cash accumulations
When the economy first re-denominated in the year 2006 (slashing off 3 zeros), the insurance industry crystallised the value of policies into an accumulation. At this point policyholders were offered the opportunity to cash in their policies. (It is important to note that ordinarily, the policies should have been worth nothing for the policyholder due to non-payment of premiums since the benefits are dependent on meeting the premium obligations.)

Realising the abnormal nature of hyperinflation, insurance companies waived their rights and converted the policies into cash accumulations. Some insurance companies, through their shareholders, increased the value of the policies to a certain minimum level as some policies had very low values. Not all policyholders cashed in their policies and those policies which were not cashed out were accumulated with interest.

At currency conversion, some policies were worth insignificant amounts. Some insurance companies, through their shareholders, increased the value of the policies to a certain minimum level. Policyholders that have never claimed should contact their insurance companies to find out the status of their policies taken prior to dollarization since a sizeable number of them are still unclaimed.

Commutation of pensions
At conversion, because of hyperinflation, some pensioners could only set up a very low pension. The Insurance and Pensions Commission in consultation with stakeholders in the insurance industry set a threshold of $10 per month as being the minimum pension that should be paid on a monthly basis. The threshold of $10 was arrived at in recognition of the fact that the underlying values of the capital supporting pensions would increase, with improvements in economic fundamentals. All pensioners whose capital could not meet this threshold had to be paid their capital values as a cash lump sum.

As a result of this, all capitals which could not support a monthly pension of $10 were paid in cash. Some of the capital values were so low that the insurers, by use of shareholder funds, paid a minimum lump sum commutation of $150, thereby giving those pensioners more than they would have obtained based on their capital values only.

Conclusion
As Zimbabweans, we watched our investments ravaged by hyperinflation, but we also did our best to limit the loss, salvaging some value from policies and pensions and learning key lessons along the way.

Join us next week as focus on frequently asked questions and also explore what the future holds.

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